SQUIRE PATTON BOGGS

New Obligations on Employers When Allocating Tips

A Guide for Businesses in the Hospitality, Leisure and Services Sectors

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The Employment (Allocation of Tips) Act 2023 will come into force on 1 October 2024, placing new obligations on employers to ensure that any tips, gratuities and service charges paid by customers are allocated to workers on a "fair and transparent basis". The changes are expected to benefit more than two million workers across the hospitality, leisure and services sectors. The new rules will apply in England, Wales and Scotland.

Accompanying the legislation will be a new statutory Code of Practice, which provides guidance for employers on what is meant by the fair and transparent allocation of tips. Additional non-statutory guidance has also been promised to support employers. We shall see if this is any good, but bluntly, the legislation needs all the help it can get (see comment below).

In this guide, we set out our headline answers to the main questions employers may have about these new obligations. We appreciate that many businesses in the hospitality, leisure and services sectors will have already started reviewing and, where necessary, making changes to their current tipping practices, as the legislation itself was published last year. The Q&As in this guide should act as a useful checklist for employers to ensure that any proposed changes to their current practices align with the principles set out in the Code.

What Tips Are in Scope?

The new rules governing the fair and transparent allocation of tips will apply to "qualifying tips, gratuities and service charges" (referred to simply as "tips" in the rest of this guide) which are defined as:

- **"Employer-received tips"** – Tips paid by customers to the employer, an associated person or a third party under a payment arrangement. This would catch, for example, the standard practice where tips or service charges are paid by customers to an employer using a credit or debit card.
- **"Worker-received Tips"** – Tips paid by customers to workers that are subject to employer control (i.e. where the employer or an associated person exercises control or significant influence over the allocation of the tips). So if, for example, an employer directs its staff on how any tips received by them should be allocated, or collects or supports the collection of any cash tips from customers and then distributes them to staff, such practices would be caught by the new rules.

It does not matter what the sums in question are called – tip, service charge, gratuity, etc. – the key point is whether the employer receives them (in the case of employer-received tips) or exercises control or significant influence over them (in the case of worker-received tips). This does mean that if, for example, tips are paid in cash directly to workers by the customer and the employer has no control or influence over the allocation of them, they will not be caught by the new rules governing the fair and transparent allocation of tips.

Certain non-monetary tips will also be caught if they are paid in the form of vouchers, stamps or tokens that satisfy certain conditions. The Code of Practice gives the example of individuals working in a casino being given casino tokens. However, tips in non-transferable form ("And one for yourself, barman.") will not be covered.

How Must Employers Deal With Tips?

Employers will be obliged to ensure that the total amount of the tips paid at, or otherwise attributable to, a place of business are "allocated fairly" between workers of the employer at that place of business. A few points to flag:

- The whole amount paid by customers must be available for allocation to workers – no sums can be deducted first by way of bank, payroll, administrative charges, etc.
- The focus is on tips paid at, or otherwise attributable to, a particular place of business. So, for example, tips paid by customers at a particular restaurant should be available for allocation between those workers at that particular restaurant. They should not be shared with workers at a different restaurant in the same chain or ownership. Intriguingly, there are also provisions in the Act that give an employer the ability to allocate amounts paid at a non-public place of business (e.g. the company's headquarters) between workers at that place and workers at one or more of the employer's public places of business, although it is not immediately clear why people would leave tips at a non-public place of business.
- The rules apply to all workers, including eligible agency workers working at that particular place of business. For tipping purposes, agency workers should be treated as if they are workers of the employer and tips should be allocated on the same basis as for other workers. Tips may be paid by the employer to the agency instead of the agency worker directly (but no later than the end of the month following the month in which the tip was paid by the customers), and the agency must then pay them to the agency worker before the end of the month after the month in which the agency received the tip. Neither the agent nor the employer can make any deductions from these sums, e.g. in relation to administrative charges, etc.

The Act itself does not set out what is meant by allocating tips "fairly" to workers. Employers are referred to the new Code of Practice, although it must be said that the Code does not provide any particularly useful advice on this issue either. As it says itself, it simply sets out "overarching principles" on what fairness is for the purposes of the legislation. Employers therefore retain flexibility over how they allocate any tips between workers at a particular place of business. They are not obliged, for example, to allocate the same proportion of tips to all workers, or to maintain the same distribution each month.

The Code sets out the following factors that employers "may" wish to consider when deciding how to allocate and distribute tips:

- Type of role/work, e.g. distribution between front-of-house and backroom workers
- Basic pay (and how workers are engaged)
- Hours worked during the period when tips are received
- Individual and/or team performance
- Seniority/level of responsibility
- Length of time served with employer
- Customer intention, if known

Any factors considered by the employer should be set out in its written tipping policy (more on that below). The sensible approach would seem to be to reflect certain of those criteria with a fixed proportion (role, pay, seniority, etc.) where those will be broadly unchanging, and then to reserve a part of the "pot" to distribute on a discretionary basis to reflect varying contributions over the relevant period (hours, performance, known customer intention, etc.).

As the Code points out, employers should ensure that in distributing any tips they avoid any form of unlawful discrimination, including indirect discrimination, e.g. where an employer allocates fewer tips to a certain group of workers that includes a disproportionate number of workers with a particular protected characteristic, and it cannot justify such a course of action.

The Code says that employers should consult with workers to seek broad agreement in the workplace that the system of allocation of tips is fair, reasonable and clear. This is not a requirement under the Act but, as it is set out in the Code, it may be something that a Tribunal will consider when reviewing any tipping practices if they are alleged to be unfair. Tipping practices that have been discussed and agreed with workers are more likely to be found to be fair – and are also less likely to result in claims or grievances being brought in the first place.

Employers must ensure that all tips are distributed to workers by the end of the month following that in which the tips were paid by customers. For example, if a tip is left by a customer on 23 June, it must be distributed by 31 July at the latest.

What Do These Changes Mean for Employers That Operate a Tronc System?

Many businesses in the hospitality, leisure and services sectors use a tronc system to help with distributing tips. Under such a system, the employer delegates the collection, allocation and distribution of tips to a tronc operator – either employer-controlled or independently operated, e.g. by a payroll company.

Such an arrangement will be caught by the definition of an "employer-received tip" and will therefore have to comply with the new rules. The Act does, however, provide that where an employer uses an "independent tronc operator" and it is "fair" for the employer to do this, the employer will be treated as having complied with its obligation to allocate tips fairly and transparently. The Code of Practice says that if an employer chooses to appoint an independent tronc operator, the instructions or framework the employers sets for its operation must be in line with the principles of fairness. If they do so, and they have a reasonable belief that the tronc is operating independently and fairly, the employer will be regarded as having complied with the Code too.

The explanatory notes to the Act state that "the overall effect of these provisions is that the employer is responsible for the fairness of the allocation of an aggregate amount to a tronc, but not for the subsequent allocation of that aggregate amount between individual workers, which is a matter for the independent tronc operator. However, if it becomes apparent to the employer that the independent tronc operator was acting unfairly in allocating the aggregate amount, it is the responsibility of the employer to act to ensure that tips are allocated fairly."

And for those of you, like us, who have wondered where the word "tronc" derives from, it apparently comes from the French phrase *"tronc des pauvres"*, meaning collection-box or alms box.

Must Employers Have a Written Policy in Place?

Yes, if tips are paid on more than an occasional and exceptional basis.

A written policy must include the following information:

- Whether the employer requires or encourages customers to pay tips at the place of business
- How the employer ensures that all tips are dealt with in accordance with the new obligations (i.e. fairly and transparently), including how it allocates tips between workers at the place of business.

Such a policy must be made available to all workers at the place of business, and any updates or amendments notified to them.

If the employer is not caught by the new tipping rules (e.g. because only cash tips are given to workers and the employer does not have control or significant influence over them) this information must be made available so that workers are aware of this.

The Code of Practice says that employers are free to decide how to disseminate the policy to their staff, e.g. in electronic form, as a physical document, etc. They should ensure it is available to all workers, including agency workers.

We would recommend that such a policy, as with other HR policies, is stated to be non-contractual to give the employer greater scope to make changes to it, etc. Whether it is strictly contractual or not, however, it will be treated as such by workers and the burden to explain any departures from it will be squarely and heavily on the employer.

What, if Any, Records Must Be Kept?

The Act also introduces new recordkeeping obligations. Where tips are paid on more than an occasional or exceptional basis, employers must create records of how such tips have been dealt with and these must be kept for three years beginning with the date on which the tips were paid. Such records must include details of the amounts paid as well as how they were allocated to individual workers.

This is an important new obligation, not least because workers will have a new right to request access to their tipping records, including details of the sums paid to them by way of tips over a particular period, and the employer must provide this information within four weeks of receipt of the request. Workers cannot make more than one request for records in any three-month period. That right does not extend to seeing what others have been paid, but if the worker considers the allocation to have been unfair or discriminatory, that information may still have to be produced through the litigation disclosure process.

What Are the Potential Consequences of Non-compliance for Employers?

Under the Act, workers will be granted a number of new rights, including:

- The right to request certain tipping records from their employer – see above.
- The right to bring a claim that the employer has failed to comply with the requirement to have a written policy and/or keep records.
- The right to bring a claim if their employer has not allocated tips fairly or paid them within the relevant statutory timeframe. Note that workers will have up to 12 months after any such failure within which to bring a claim – this is much longer than the usual employment time limits. And, as with unlawful deduction from wages claims, if there has been a series of failures, the time limit will not start to run until the date of the last failure in the series. Employment Tribunals will have the power to require employers to revise any previous allocation of tips to a worker and make a payment of up to £5,000 to compensate the worker for any financial loss attributable to the employer's failure.

Agency workers will also have the right to bring claims, including against their agency if they fail to pass on any tips due. The Act does not contain any provision for claims to be brought directly against tronc operators.

A failure by an employer to comply with the new Code of Practice will not in itself give grounds for a complaint or any uplift in compensation payable, but Tribunals will be able to take an employer's failure to comply with the Code into account when dealing with any disputes relating to tipping practices.

If, when entering into a settlement agreement, an employer is concerned about any potential tipping claims, it should include a waiver of any such claims once the new rights come into force. As a statutory claim, a simple letter of agreement will not be sufficient to procure a binding waiver – a settlement agreement or COT3 will be necessary.

Key Takeaways

- The new rules will apply from 1 October 2024.
- 100% of tips must be allocated and paid to workers (and this includes agency workers working in the place of business).
- Tips must be "allocated fairly" – in line with the principles of fairness set out in the new statutory Code of Practice.
- Affected businesses must have a written tipping policy in place that is made available to all.
- Where tips are paid on more than an exceptional or occasional basis, employers must create records of how such tips have been dealt with, and these must be kept for three years beginning with the date on which the tips were paid.

Tips (Sorry!) for Employers

- Review your current tipping practices to see if you will be caught by the new rules.
- If so, consider whether any changes will be required to align your current practices with the new obligations set out in the Act and the new Code of Practice.
- If you don't currently have one, put in place a written tipping policy that contains all the required information.
- Think about how you are going to communicate any changes to your workforce and customers, clients, etc. Also ensure that, if you engage any agency workers, the agencies you work with are aware of the changes and their obligations.
- If you operate a tronc system, review it to ensure it will be compliant under the new rules. For example, not all current tronc arrangements cover agency workers in the distribution of tips, and some arrangements currently pool tips across multiple locations (which will no longer be permitted).

And Don't Forget That

- Tips cannot be used to meet an employer's obligations to pay the National Minimum Wage.
- This legislation does not interfere with the provisions around tax in relation to tipping.

Comment

While this new law is worthy in its objectives, it is in fact a recipe for dispute and litigation because of the vacuum at its heart, i.e. what amounts to "fairness". What seems fair to the employer may not to the worker, either in relative or absolute terms. Getting the same distribution as my peers sounds fair but not if I have gone above and beyond to serve my customers and they have not. I may think that I work harder and more effectively than my employer believes, or that my role is more valuable, or that the customer leaving the whopping tip did so wholly or mainly because of me. The legislation urgently needs some objectivity around the question, even if it is just to apply (in effect) the usual test of whether the distribution is "within the range of reasonable responses", so making it challengeable only if the worker can show that no reasonable employer would have divided up the tips in that way.

If you have any questions about the new rules and how they will apply to your business, please speak to your usual contact in the Labour & Employment team or one of the following partners:

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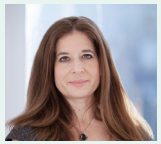

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