

# Summary: Intervention & Options

<b>Department /Agency:</b> <b>BERR</b>	<b>Title:</b> <b>Final Impact Assessment of Amending the National Minimum Wage Regulations</b>
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<b>Stage:</b> Final	<b>Version:</b> Final	<b>Date:</b> 5 May 2009
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**Related Publications:** The National Minimum Wage Government response to consultation: Service Charges, Tips, Gratuities and Cover Charges May 2009

Available to view or download at:

<http://www.berr.gov.uk/files/file51166.pdf>

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## What is the problem under consideration? Why is government intervention necessary?

The National Minimum Wage is part of the Government's strategy to provide fair standards in the workplace and make work pay. Since the National Minimum Wage Act came into force in 1999 c39, regulation 31(1)(e) of the National Minimum Wage Regulations 1999 has permitted the use of service charges, tips, gratuities and cover charges to count towards the National Minimum Wage subject to certain conditions being met. Proposals in this Impact Assessment attempt to ensure tipping practices are made fairer ensuring all workers, whether they are paid tips or not, receive a fair wage in the form of at least the National Minimum Wage in basic pay and by providing greater transparency to consumers so that they can make a more informed choice when tipping.

## What are the policy objectives and the intended effects?

The National Minimum Wage sets a wage floor below which pay cannot fall. The aim of this policy is to provide access to the National Minimum Wage in basic pay for low paid workers and create an equitable wage floor for all workers irrespective of if they are paid tips as part of their wage or not. The amendment to regulation 31(1)(e) will ensure that all eligible workers will receive at least the National Minimum Wage in basic pay and any tips that may be paid are in addition to that. This will create a level wage playing field for all workers and business. We also seek to improve transparency for consumers who may not be aware of what happens to their tips.

## What policy options have been considered? Please justify any preferred option.

Two approaches have been considered: 1). all tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW, and consumer information and awareness is improved: 2). only discretionary tips and gratuities, and mandatory and discretionary service charges are excluded from counting towards the NMW and consumer information and awareness is improved. Policy options have been compared to a benchmark 'do-nothing' scenario. In November 2008, the Government consulted on this and in light of the responses will proceed with option 1, as it would create less ambiguity and we believe cover charges are used to limited extent.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The Low Pay Commission will assess the use of tips as part of their annual National Minimum Wage report to be published in 2010 and then annually thereafter. This policy amendment will be introduced in October 2009 and should have immediate effects.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:

Pat McFadden

..... Date:

# Summary: Analysis & Evidence

<b>Policy Option: 1</b>	<b>Description:</b> This summary sheet summarises option 1 – all tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' Potential increase in employers' labour costs resulting from higher pay (£82M) and employers' National Insurance Contributions (NICs) (£10.5M). An increase in workers' NICs payments towards pensions, contributory benefits and the NHS. Annual costs calculated are static and constant over time		
	<b>One-off (Transition)</b> Yrs			
	£ negligible	0		
	<b>Average Annual Cost (excluding one-off)</b>			
	£ 92.5M	10	<b>Total Cost (PV)</b>	<b>£796 million</b>
Other <b>key non-monetised costs</b> by 'main affected groups' one-off Small administrative and familiarisation costs for employers. Implementation and enforcement costs for HMRC. Associated policy costs in raising awareness amongst consumers. Firm may decide to increase prices				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' Potential increase in basic pay for workers (£73M) with tips in addition to that. Increase in NICs receipts (£19.5M). Annual benefits calculated are static and constant over time.		
	<b>One-off</b> Yrs			
	£ 0m	0		
	<b>Average Annual Benefit (excluding one-off)</b>			
	£ 92.5M	10	<b>Total Benefit (PV)</b>	<b>£796 million</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' Equalisation of NICs treatment across sectors and workers. Eligibility of workers for contributory benefits. Greater transparency for consumers.				

**Key Assumptions/Sensitivities/Risks** The analysis carried out is static and does not take into account the dynamics of the labour market. The costs equal the benefits because of transfers involving employers, workers and the exchequer.

Price Base Year 2008	Time Period Years 10	<b>Net Benefit Range (NPV)</b> <b>£ 0 million</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ 0 million</b>
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What is the geographic coverage of the policy/option?		UK		
On what date will the policy be implemented?		October 2009		
Which organisation(s) will enforce the policy?		HMRC / BERR		
What is the total annual cost of enforcement for these organisations?		£ negligible		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		N/A		
What is the value of the proposed offsetting measure per year?		£ N/A		
What is the value of changes in greenhouse gas emissions?		£ N/A		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt? No	This policy change will impose a cost for business, see page 9 for an illustrative example on average cost per employee.			

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of	£ negligible	Decrease of	£ negligible
<b>Net Impact</b>		£ negligible	

Key: **Annual costs and benefits: Constant Prices** (Net) Present Value

## Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

### A. Strategic overview

#### Existing Government initiatives

The National Minimum Wage Act 1998 c39 states that all workers qualifying for the National Minimum Wage (NMW) must be paid at least the NMW. Regulation 30 of the NMW Regulations 1999 specifies which monies paid to the worker by their employer counts towards NMW pay. Regulation 31(1)(e) allows employers to use service charges, tips, gratuities and cover charges to contribute towards the NMW, providing it's paid to the worker via the employer's payroll.

The use of service charges, tips, gratuities and cover charges for payment of the NMW is a complex area. There is a variety of ways in which employers distribute tips to workers.

#### Some definitions:

**Service charges** we take to mean those amounts that are added to the customer's bill before it is presented to the customer (typically between 10 percent to 12.5 percent). If it is made clear that the amount is purely discretionary then there is no obligation for the customer to pay and the payment is voluntary. Where this is not the case, the payment is a mandatory charge.

**Tips and gratuities** we take to mean uncalled for and spontaneous payments offered by the customer either as cash tips (eg left on the table or deposited in a box by the till or on a bar etc, or given to a taxi driver, hairdresser etc) or offered as part of a cheque, debit or credit card payment or detailed on a bill and added at the point of transaction (typically a discretionary amount added by the customer paying by credit, debit, charge card or cheque). It is optional and not a mandatory charge.

**Cover charges** we take to mean to be a mandatory fixed amount, often per head, that pays for entertainment and other services, (not necessarily waiting service in the case of restaurants), but that generally provide assistance towards other costs that might relate to expenditure that contributes to the experience (typically for items such as bread etc).

### B. The issue

Ten years after the introduction of the National Minimum Wage Act on 31 July 2008 the Government announced its intention to amend the Regulations so that tips can no longer count towards the payment of the NMW.

The changes will end the practice of employers using cover charges, service charges, tips and gratuities processed through the employer's payroll in payment or part payment of the NMW for all individuals on the 16-17, 18-21 and main rate of NMW.

The Governments strategy is to provide fair standards in pay for all workers across all sectors. This final Impact Assessment attempts to establish costs and benefits of the policy change detailed in the consultation. These are:

- 1) All tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW, and consumer transparency and awareness is improved;
- 2) Only discretionary tips and gratuities, and mandatory and discretionary service charges are excluded from counting towards the NMW and consumer information and awareness is improved.

The reforms will also enable a 'level playing field' amongst employers and workers. At present tips and gratuities that count towards payment of the NMW may be exempt from employer and worker National Insurance contributions (NICs) depending on how they are allocated to the employee. In terms of workers in tipping sectors, those who do receive tips and gratuities as part of their NMW pay may benefit from exemptions from NICs whereas all other workers must pay NICs on earnings above the 'earnings threshold' which is currently £110 per week for each employment for the 2009/10 tax year (this figure is subject to annual change).

### Consultation

#### *Within Government*

These proposals have been developed in consultation with the following Government departments: HM Revenue & Customs and HM Treasury.

#### *Public consultation*

Since the consultation was launched back in November 2008, there has been an intensive programme of stakeholder engagement, involving meetings with trade unions, business representatives and trade bodies. Our consultation on the issue closed on 16 February. We had 182 complete responses to the consultation, with a further 100 partially completed responses. The majority of the responses (roughly 75 per cent) support proposals to exclude tips from payment of the NMW. Of the total responses, half were from business. For more information please refer to the Government response on amending the NMW Regulations so that in future, tips are paid in addition to the NMW.

Following our consultation responses, this Impact Assessment (IA) reports a single point estimate as opposed to a range estimate presented in the consultation IA. It was felt that the lower range estimate did not adequately reflect the use of tips to top up pay to the NMW, as one of the variables that was used from ASHE (Annual Survey of Hours and Earnings) was 'other pay' which explicitly excludes 'bonus or incentive pay'. As a result, this lower range estimate has now been dropped from this IA.

## **C. Objectives**

The Government is intervening for three reasons:

1. To ensure that workers receive at least the NMW that is not made up from service charges, tips or gratuities and that any tips are paid in addition to the NMW.
2. To create a 'level playing field' amongst employers and workers regarding wages and NICs.
3. Increase consumer information and promote greater awareness

### Background

Under the current regulations, amounts paid by a customer as a service charge, tip, gratuity or cover charge can count towards NMW pay in certain circumstances.

Other sectors (i.e. non-tipping sectors) are compelled by law to pay their staff the NMW and both employer and employee pay NICs on all elements of pay above the earnings threshold (currently £110 per week).

ASHE shows that in 2008, average basic hourly pay actually exceeded the NMW in the tipping sectors – see table 1. It means that *on average*, people working in these sectors are paid a basic pay (without tips) above the NMW and that therefore the proposed amendments will have no impact on them.

The proposed change in legislation would affect people whose basic pay is less than the NMW and topped up by tips, thus potentially increasing employers and workers' NICs.

SIC code	Name	Mean basic hourly pay (£)
55	Hotels and restaurants	7.66
60.22	Taxi operations	7.41
92.71	Gambling and betting activities	9.00
93.02	Hairdressing and beauty treatments	6.51

Source: ASHE and BERR estimates

Table 2 below shows the mean hourly basic pay for workers earning less than the NMW in basic pay. We assume later on in the Impact Assessment that some workers earn less than the NMW in basic pay because their pay is being topped up by tips to reach the NMW. When analysing wage distributions the median is often preferred over the mean (as it is not affected by outliers). However, for the purpose of this Impact Assessment the use of the mean hourly wage is more appropriate when estimating the impact of legislative change because ultimately we are interested in the total difference between NMW and those earning below the NMW in basic pay for all workers, which can not be captured using the median hourly wage (as the median by definition does not provide any information on the total), .

SIC code	Name	16-17	18-21	22 and over
55	Hotels and restaurants	£3.23	£3.65	£4.72
60.22	Taxi operations	-	-	£5.47
92.71	Gambling and betting activities	-	-	£4.74
93.02	Hairdressing and beauty treatments	£2.29	£3.11	£4.29

Source: ASHE and BERR estimates. - Not possible to report a figure due to sample size

There are different levels of NMW, which depend on your age. The rates from 1 October 2008 are:

- adults (which means people aged 22 and over) receive the main rate of £5.73 an hour
- workers aged 18 to 21 inclusive, receive a rate of £4.77 an hour.
- young people receive £3.53 an hour (known as the youth rate)

A young worker is someone who is older than school leaving age and younger than 18. In England and Wales, you are under school leaving age until the last Friday in June of the school year in which you turn 16. (School leaving age is different in Scotland and NI).

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**3.a.** NMW rates (in £ per hour)

Employee's age	2006/07	2007/08	2008/09
22 and over	5.35	5.52	5.73
18 – 21	4.45	4.60	4.77
16 - 17	3.30	3.40	3.53

Source: LPC

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**3.b.** Mean wage and wage differential of those earning below the NMW

Sectors	16 - 17		18 - 21		22 and over	
	Mean pay	Wage differential	Mean pay	Wage differential	Mean pay	Wage differential
SIC 55	£3.23	£0.17	£3.65	£0.95	£4.72	£0.80
SIC 60.22	-	-	-	-	£5.47	£0.05
SIC 92.71	-	-	-	-	£4.74	£0.78
SIC 93.02	£2.29	£1.11	£3.11	£1.49	£4.29	£1.23

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

NB: due to small sample size some values are missing in the above table

Source: ASHE and BERR estimates

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In this Impact Assessment when analysing the difference between basic pay and the NMW the 2007/08 NMW rates have been used as these were the NMW rates at the time when the 2008 Annual Survey of Hours and Earnings was compiled.

## D. Options identification

### Option 1

All tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW and consumer information and awareness is improved.

### Option 2:

Only discretionary tips and gratuities, and mandatory and discretionary service charges are excluded from counting towards the NMW and consumer information and awareness is improved.

Both of the options above have been measured against a 'do-nothing' benchmark.

### Preferred option

There has been little interest shown on the issue of cover charges. Only the British Hospitality Association (BHA) has commented on this aspect of the Regulations substantially. Their view is to permit cover charges for use in payment of the NMW, however, the Government have decided that option 1 is the preferred option for following two reasons:

- If cover charges are not included at this time, this may create ambiguity in the law and could increase the chance of non-compliance.
- Cover charges already attract PAYE and NICs so there is little added benefit for business to use cover charges in the payment of NMW. Therefore, the removal of cover charges would have the least economic impact on business of all the tipping practices. It is also worth noting that the BHA suggests that cover charges are not well used in the UK, although we have no data to support this.

## **E. Analysis of options**

### **1. Business sectors affected**

When measuring the impact of the proposed amendments, we are considering the tipping sectors of the economy; these are principally the hospitality and gambling sectors:

- SIC 55: Hotels and restaurants
- SIC 60.22: Taxi operations
- SIC 92.71: Gambling and betting activities
- SIC 93.02: Hairdressing and other beauty treatments

### **2. Costs to the employers**

The proposed change to the legislation may cause an increase in some employers' labour costs. The increase in labour costs would concern employers who pay their staff less than the NMW and use tips in payment or part payment of the NMW. The increase would come from:

- the additional pay the employer would have to provide, and
- the increase in employers' NIC (12.8 percent) resulting from that.

These monetised costs would be similar under both options 1 and 2 as the impact of NIC payments in both instances will be the same.

Under option 2 (which permits cover charges counting towards payment or part payment of the NMW), cover charges already attract NICs. Although cover charges will form part of the business income we anticipate these payments to be small.

Under option 1 (all service charges, tips, gratuities and cover charges are excluded from the payment of NMW) employers concerned would have to top up basic pay with additional pay on which NICs will may also need to be paid (NICs are only due on earnings in excess of the earnings threshold currently £110 per week).

### **Increase in labour costs**

In order to calculate the increase in labour costs, the following methodology was followed:

- 1) Estimate the number of people who are earning a basic pay below the NMW (because the use of tips is used to top up to NMW pay), and
- 2) Differentiate between sectors and age group because NMW rates differ depending on age – see table 2.
- 3) Calculate the increase in labour costs.

#### *Estimating the number of people earning a basic pay below the NMW*

See Annex B for detailed calculation. Table 4 below gives a summary of the number of estimated workers that currently receive basic pay below the NMW and might be affected by the proposed amendment.

BERR estimates, based on Annual Survey of Hours and Earnings (ASHE) data, are that **60,500** workers could be effected by the change in legislation.

**4. Estimates of the population concerned by the proposed change to the legislation by age groups**

<b>Sectors</b>	<b>16 - 17</b>	<b>18 - 21</b>	<b>22 and over</b>	<b>Total</b>
SIC 55	200	6,800	41,500	48,500
SIC 60.22	0	0	300	300
SIC 92.71	0	0	700	700
SIC 93.02	4,100	4,100	2,800	11,000
<b>Total</b>	<b>4,400</b>	<b>10,900</b>	<b>45,300</b>	<b>60,500</b>

Source: ASHE and BERR estimates

<sup>1</sup>

**Calculating the increase in labour costs for employers:**

See Annex C for the details of the estimate in increased labour costs. Tables 5, 6 and 7 below show a summary of the additional labour costs due to the proposed change in the legislation.

The potential increase in extra pay could be **£82.0 million** and the increase in employers' NICs could be **£10.5 million**. Therefore the increase in labour costs could total **£92.5 million**

**5. Summary table for people aged between 16 and 17**

<b>Population</b>	<b>Total – extra pay (£m)</b>	<b>Employers' NICs (£m)</b>	<b>Total increase in labour costs (£m)</b>
4400	7.2	0.9	8.1

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

**6. Summary table for people aged between 18 and 21**

<b>Population</b>	<b>Total – extra pay (£m)</b>	<b>Employers' NICs (£m)</b>	<b>Total increase in labour costs (£m)</b>
10900	19.0	2.4	21.5

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

**7. Summary table for people aged 22 and over**

<b>Population</b>	<b>Total – extra pay (£m)</b>	<b>Employers' NICs (£m)</b>	<b>Total increase in labour costs (£m)</b>
45300	55.8	7.1	62.9

NB: Figures have been rounded

Source: ASHE

**8. Summary table for people aged 16 and over**

<b>Population</b>	<b>Total – extra pay (£m)</b>	<b>Employers' NICs (£m)</b>	<b>Total increase in labour costs (£m)</b>
60500	82.0	10.5	92.5

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

<sup>1</sup> We have assumed that some workers who earn less than the NMW in gross pay in the tipping sectors is because some employers are using tips to make up the NMW.



## Average cost per worker

Due to the nature of this policy change and the availability of evidence, it is difficult to estimate a meaningful estimate of the cost per business. For some businesses the cost will be zero, as they will be unaffected by this policy amendment, whereas some businesses could be more heavily affected. Hence for purely illustrative purposes we present an estimate of the average cost per worker of this policy amendment. From this estimate, the expected impact on individual businesses can be calculated e.g. if a business had three workers affected by this policy change, the cost to this business would be three multiplied by the average cost per worker. It should be noted that this average cost per worker is only an indicative number and the actual cost per worker may vary depending on the sector they are employed in, the number of hours they work and the gap between base pay and the NMW.

The average cost per worker per year of this policy amendment is **£1529**. This has been calculated by taking the total cost £92.5 million and dividing it through by the estimated number of workers affected 60,500.

## Administrative costs

The implementation costs may include: rewording of contracts and adjusting the payroll. Workers who don't have a written contract containing specified information and who are employed for one month or more have a statutory right to receive a written statement of employment particulars including 'the scale or rate of remuneration or the method of calculating remuneration', which may also imply the need for a change – depending on how the employer expresses the pay arrangements. It's a reasonable assumption that the relevant employers will also need to amend their payroll arrangements. Both of these costs are one-off costs, and are not on going costs, hence they will not add to the administrative burdens businesses face. BERR has looked at the cost involved in amending the payroll arrangements and as a result of that research it has concluded that the costs would be limited. For purely illustrative purposes it may take up to half an hour of a manager's time<sup>2</sup> to re-word contracts for some businesses this is equivalent to around £10.75. Further, this policy amendment will only affect a limited number of businesses, as most workers in the economy are receiving basic pay at or above the NMW rate, thus the administrative cost would be zero for these businesses. Thus, these costs have not been estimated and assumed to be negligible.

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<sup>2</sup> Source; Basic hourly pay Annual Survey of Hours and Earnings (ASHE) 2008, manager and senior officials basic hourly pay is £17.77 adding 21% for non-wage labour costs gives £21.50 (per hour) – half an hour is equivalent to £10.75 .

### 3. Costs/benefits to the workers

The proposed change to the legislation will affect workers, through an increase in their NICs and an increase in their *basic* pay.

#### Increase in NICs

See Annex D for details of the calculations.

The increase in workers' NICs could total **£9 million**.

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#### 9. Summary table for people aged between 16 and 17

Population	Total – extra pay (£m)	Employees' NICs (£m)
4400	7.2	0.8

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

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#### 10. Summary table for people aged between 18 and 21

Population	Total – extra pay (£m)	Employees' NICs (£m)
10900	19.0	2.1

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

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#### 11. Summary table for people aged 22 and over

Population	Total – extra pay (£m)	Employees' NICs (£m)
45300	55.8	6.1

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

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#### 12. Summary table for people aged 16 and over

Population	Total – extra pay (£m)	Employees' NICs (£m)
60500	82.0	9.0

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

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Again, the increase in NICs for workers would be the same under option 1 and option 2. We assume that tips that are currently used in payment or part payment of the NMW are not currently subject to NICs, but because employers would have to increase wages to at least the NMW, that extra amount would become subject to NICs under both options 1 and 2.

Workers could see their basic pay increase by **£82.0 million**.

## 4. Costs to the Government

### Implementation costs

BERR will have to raise awareness of this policy amendment and HMRC will have to inform employers and workers of the change to the law.

Enforcement costs are not expected to increase as a result of the amendment: HMRC investigates an employer when there is a complaint about possible non-payment of NMW and under their risk assessment programme. There is no evidence to suggest that the number of complaints will go up as a result of the changes. As is usual with NMW uprating, we would expect to see an increase in enquiries after commencement with stabilisation as employers and workers become accustomed to the new rules.

Implementation costs are assumed to be the same under option 1 and option 2 and to be small.

## 5. Benefits

- There may be increased retention of staff due to better pay for the worker and thus employers will retain skills.
- If employers pay tips on top of the NMW, there may be better quality of service because of greater incentivisation as tips become purely performance related.
- Equalisation of sectors and employers establishing a clear playing field across tipping and non-tipping sectors and amongst employers within the tipping sectors.
- Of the workers affected by the change in the legislation, some of them may become eligible for contributory benefits. A person builds entitlement to contributory benefits once his/her earnings become greater than the 'lower earnings limit', currently set at £95 per week. The lower earning limit is the point at which earnings count for benefit purposes however NICs only start to be paid at £110. However this benefit would be small and we do not attempt to quantify it.
- Greater Government revenues, which represent a transfer from employer and workers to the Exchequer: this is the sum of workers' and employers' NICs and would amount to **£19.5 million** under option 1.
- The time spent by employers calculating wage rates might lessen as the uncertainty over whether there will be enough tips to cover the difference between the basic pay and NMW will disappear.
- Increased consumer transparency may result in increased take-home pay for some workers as a result of fairer distribution of tips, and in customers making informed tipping decisions. The increase in take-home pay is estimated to be **£73 million**.
- Greater consumer confidence in tipping sectors.

## 6. Transparency

The consultation has shown that there is strong support for best practice guidance on transparency for the tipping sector from consumers, unions and business and we are working with these stakeholder groups to take this forward.

## F. Risks

The employers concerned by the amendments, and the data suggest that they are relatively few, may seek to offset the rise in their labour costs. The easiest way to do so would be to take a share or increase their existing share of the tips and discretionary service charges that they previously had not appropriated, thus possibly cancelling any increase in take-home pay for workers as a result of the increase in their basic pay. This could result in some workers receiving a lower take home pay.

There is a possibility that some workers could see their take home pay decrease as they find themselves paying higher employee NICs. This risk would increase if employers reduced the share of tips that went to workers.

Firms who previously offset the NMW through tips etc, will be faced with an increase in labour costs. As a result, they may decide to increase prices. The 'price elasticity of demand' will determine the extent to which prices could rise. Price increases would lead to the cost being transferred to the consumer. A final risk is that firms could decide to offset increased labour costs by employing fewer staff.

## G. Enforcement

The enforcement resulting from the change in regulations of the proposed amendments will be the responsibility of HMRC. HMRC do not expect this to be significantly costlier. Initially, there may be an increase in complaints as the new legislation beds in, but once a certain period of time has passed and business and workers become familiar with the changes, the number of NMW-related complaints may decrease.

The principles HMRC will use to enforce this policy change will be the same as they use for the NMW rates and have the aim to minimise administrative burden imposed on business. Further, there are no new measures in terms of enforcement that would add to the cost of business.

## H. Summary table of costs and benefits

Below is a table outlining the costs and benefits of the proposed change to the legislation. Option 1 and 2 have similar costs and benefits although option 2 provides more flexibility for employers as cover charges can be included in the NMW.

**13.** Summary table of costs and benefits

		One off / On going	Affected	Option 1 (£m)	Option 2 (£m)
Costs	Increase in employers' labour costs	On Going	Employers	£92.5	£92.5
	Increase in administrative costs	One Off	Employers	Small	Small
	Implementation costs	One Off	Employers	Small	Small
Benefits	Better quality of service, equalisation of NICs treatment across sectors, eligibility for statutory benefits and less administrative burden	On Going	Customers and employees	Small - Not quantified because the number of people concerned is small	
	Transfer to the Exchequer	On Going	Exchequer	£19.5	£19.5
	Increase in pay	On Going	Employees	£73.0	£73.0

## I. Implementation

BERR will work with HMRC to implement the new regulations during 2009 and it will come into force 1<sup>st</sup> October 2009.

## **J. Monitoring and evaluation**

Each year the Low Pay Commission (LPC) monitor, evaluate and review the NMW and going forward will be looking at the use of tips. The LPC pay particular reference to the effect on pay, employment and competitiveness in the low paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities and migrant workers and the effect on pay structures. The research they undertake is published, and will help inform future LPC recommendations. The next report will be published in 2010. BERR will also be monitoring data from the Annual Survey of Hours and Earnings to evaluate the use of tips and NMW pay.

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	No
Rural Proofing	No	No

## Annex A: Specific impact tests

### Small Firms Impact Test

The proposed amendment to the regulations would apply to firms of all sizes. The Federation of Small Business responded to our consultation and felt that the amendment to the NMW regulations would have 'little impact on small firms in this industry'. The table below presents the distribution of workers by firm size in tipping sectors and compares this to non-tipping sectors.

<b>A1. Distribution of employees by firm size in the tipping and non-tipping sectors</b>				
<b>Sector</b>	<b>1 to 49</b>	<b>50 to 249</b>	<b>250 and more</b>	<b>Total (m)</b>
SIC 55 (restaurants)	77%	20%	2%	1.1
SIC 60.22 (taxis)	67%	27%	4%	0.0
SIC 92.71 (gambling)	73%	22%	5%	0.1
SIC 93.02 (hairdressing)	97%	2%	0%	0.1
Total – tipping sectors	79%	19%	2%	1.4

Source: LFS Q4 2008

The table shows the general distribution of firm size in tipping sectors, but does not represent the firm size distribution of businesses that will be affected. We believe that although it may be more likely that larger businesses are currently benefiting from the NICs exemption and using tips and gratuities to pay part of the NMW, a significant proportion of small businesses will also be following this practice. We estimate that about **60,500** workers will be affected and we believe there will not be a disproportional impact on small business in terms of costs or benefits. If for instance this policy amendment did affect small firms disproportionately, exempting small firms would defeat the objectives of this policy change.

### Competition Assessment

The initial analysis of the competition filter test reveals that a detailed competition assessment is not considered necessary. The proposed legislation will apply to all firms and is a measure that will ensure a more level playing field between firms in the tipping sectors. At present some firms are using tips and gratuities to count towards the NMW and may be benefiting from the NICs exemption and others are not. The proposed legislation will change this so that all of the NMW will exclude tips from NMW pay for all firms. Table A2 below gives the results of the competition filter test.

<b>A.2. Results of the competition filter test – In any affected market, would the proposal:</b>	
Directly limit the number or range of suppliers?	No
Indirectly limit the number or range of suppliers?	No
Limit the ability of suppliers to compete?	No
Reduce suppliers' incentives to compete vigorously?	No

## Equality Assessment

In line with better regulation best practice and the Equalities Duties we have considered the impact of changing the law by gender and race.

### *Who will be affected?*

The Labour Force Survey indicates that around 40 percent of workers in the tipping sector are men and around 60 percent are women. We believe that there will be similar proportions of men and women who are directly affected by policy changes.

The table below shows that a higher proportion of ethnic minority workers work in tipping sectors than in all sectors:

<b>A.3. Distribution of people by ethnic minority</b>		
	<b>Total employees (%)</b>	<b>Employees in tipping sectors (%)</b>
White	90.7%	84.8%
Mixed	0.8%	1.2%
Asian or Asian British	4.4%	6.7%
Black or Black British	2.2%	2.1%
Chinese	0.5%	2.4%
Other	1.4%	2.9%

Source: LFS Q4 2008

We estimate that **60,500 workers** may receive tips to top up pay below the NMW. This represents a weighted figure and it would not be sensible to attempt to disaggregate this figure further by ethnicity or disability as the results may not be reliable.

### *Removal of barriers which hinder equality*

The proposed changes reflect a broad policy and are designed to have a positive impact on all workers in tipping sectors regardless of their gender, race or disability. Therefore the proposed changes are unlikely to create any barriers to equality in terms of gender, race and disability.



## Annex B: Estimating the number of people earning a basic pay below the NMW and receiving tips

**N.B.:** The available data does not differentiate between different categories of service charges so the calculation of the increase in labour costs will be the same under both option 1 and option 2, but it will be an overestimate in the case of option 2 as employers' NICs have always been due on cover charges used to pay part or all of a worker's wages.

Data on the number of people who earn a basic pay below the NMW and are paid tips to top up wages to the NMW is not collected. Therefore, we have used ASHE (Annual Survey of Hours and Earnings) to estimate the number of workers that could potentially be affected. The ASHE provides information about the levels, distribution and make-up of earnings and hours paid for employees within industries, occupations and regions and is regarded as the best survey on pay.

ASHE gives details on basic pay. For the three NMW rate groups, data could be obtained on the number of people earning less than their NMW band in basic pay (ASHE does not provide specific data on tips).

Following our consultation responses, this IA reports a single point estimate as opposed to a range estimate presented in the consultation IA. It was felt that the lower range estimate did not adequately reflect the use of tips to top up pay to the NMW and has now been dropped from this IA.

<b>B.1. Breakdown</b>				
	<b>16 - 17</b>	<b>18 - 21</b>	<b>22 and over</b>	<b>Total</b>
Total employed in the tipping sectors	83,126	283,065	970,107	1,336,298
Receiving basic salary below NMW <sup>#</sup>	4,357	10,874	45,295	60,527

Source: ASHE 2008. # This is an estimate. We have scaled down the number of employees receiving a salary less than the NMW by a factor of 0.8 to remove those who earn less than the NMW because of exemptions or non-compliance.

<sup>3</sup>

We are considering in our calculations only workers earning less than the NMW in basic pay. According to 2008 ASHE data, 5.6 percent (75,322) of workers in the tipping sector are on a basic pay below the NMW. The same database further indicates that 1.1 percent of workers in the whole economy are paid below the NMW due to either being exempted from the NMW or due to non-compliance. Assuming this percentage is the same in the tipping sector (exempted from NMW or non-compliance), 14,794 workers will be unaffected by this regulation, as non-compliant employers will not change behaviour and those exempted from the NMW will be unchanged. As a result, our estimate on the number of workers who earn less than the NMW in basic pay because of the use of tips to top up basic pay is 60,527 (75,322 – 14,794, difference due to rounding).

### **B.2. Estimate of number of employers affected by age groups and sectors – estimate for 2008**

<b>Sectors</b>	<b>16 - 17</b>	<b>18 - 21</b>	<b>22 and over</b>	<b>Total</b>
SIC 55	221	6785	41508	48514
SIC 60.22	0	0	324	324
SIC 92.71	0	0	692	692
SIC 93.02	4136	4089	2771	10997
Total	4357	10874	45295	<b>60527</b>

Source: ASHE and BERR estimates

<sup>3</sup> We assume that some employees who earn less than the NMW in basic pay in tipping sectors is because tips are being used to top up to the NMW.

## Annex C: Estimating the increase in labour costs

It has been assumed that all the workers are earning more than the earnings threshold of £110 a week (thus liable for NICs). Also, for ease of calculation, we have not adjusted for the NICs exemption on earnings below the earnings threshold, hence we will over estimate the additional employee and employer NICs from this policy amendment.

First, we estimate the differential between basic pay and the NMW, and then the increase in labour costs.

### Estimating the differential between basic pay and NMW

The 2008 ASHE survey provides figures about the wage differential, i.e. the difference between NMW and basic pay for the category of people earning less than NMW. We assume later that this differential does not change over time.

C.1. Mean wage and wage differential of those earning below the NMW						
Sectors	16 - 17		18 - 21		22 and over	
	Mean pay	Wage differential	Mean pay	Wage differential	Mean pay	Wage differential
SIC 55	£3.23	£0.17	£3.65	£0.95	£4.72	£0.80
SIC 60.22	-	-	-	-	£5.47	£0.05
SIC 92.71	-	-	-	-	£4.74	£0.78
SIC 93.02	£2.29	£1.11	£3.11	£1.49	£4.29	£1.23

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay  
 NB: due to sample size, we only estimate a central estimate.  
 Source: ASHE and BERR estimates

Another element to take into account before estimating the increase in labour costs is the amount of time worked by workers.

C.2. Hours worked	
Sectors	Mean basic paid hours per week
SIC 55	28.6
SIC 60.22	28.5
SIC 92.71	31.2
SIC 93.02	29.9

Source: ASHE and BERR estimates

### Increase in labour costs

C.3. For employees aged between 16 and 17						
Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
SIC 55	200	0.17	28.6	0.1	0.0	0.1
SIC 60.22	0	0.00	28.5	0.0	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0	0.0
SIC 93.02	4,100	1.11	29.9	7.1	0.9	8.0
Total	4,400	-	-	7.2	0.9	8.1

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay  
 NB: due to sample size, we only estimate a central estimate.  
 Source: ASHE and BERR estimates

**C.4.** For employees aged between 18 and 21

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
SIC 55	6,800	0.95	28.6	9.6	1.2	10.8
SIC 60.22	0	0.00	28.5	0.0	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0	0.0
SIC 93.02	4,100	1.49	29.9	9.5	1.2	10.7
Total	10,900	-	-	19.0	2.4	21.5

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

Source: ASHE and BERR estimates

**C.5.** For employees aged 22 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
SIC 55	41,500	0.80	28.6	49.5	6.3	55.9
SIC 60.22	300	0.05	28.5	0.0	0.0	0.0
SIC 92.71	700	0.78	31.2	0.9	0.1	1.0
SIC 93.02	2,800	1.23	29.9	5.3	0.7	6.0
Total	45,300	-	-	55.8	7.1	62.9

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

Source: ASHE and BERR estimates

**C.6.** For employees aged 16 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
SIC 55	48,500	2	28.6	59.2	7.5	66.7
SIC 60.22	300	0	28.5	0.0	0.0	0.0
SIC 92.71	700	1	31.2	0.9	0.1	1.0
SIC 93.02	11,000	4	29.9	21.9	2.8	24.7
Total	60,600	-	-	82.0	10.4	92.4

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

Source: ASHE and BERR estimates

## Annex D: Calculating the increase in NICs for workers

### D.1. Increase in NICs for employees aged between 16 and 17

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employees' NICs (£m)
SIC 55	200	0.17	28.6	0.1	0.0
SIC 60.22	0	0.00	28.5	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0
SIC 93.02	4100	1.11	29.9	7.1	0.8
Total	4400	-	-	7.2	0.8

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

NB: due to sample size, we only estimate a central estimate.

Source: ASHE and BERR estimates

### D.2. Increase in NICs for employees aged between 18 and 21

Sector	Population	Wage differential	Average hours	Total extra pay	Employees' NICs
SIC 55	6,800	0.95	28.6	9.6	1.1
SIC 60.22	0	0.00	28.5	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0
SIC 93.02	4,100	1.49	29.9	9.5	1.0
Total	10,900	-	-	19.0	2.1

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

Source: ASHE and BERR estimates

### D.3. Increase in NICs for employees aged 22 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employees' NICs (£m)
SIC 55	41,500	0.80	28.6	49.5	5.5
SIC 60.22	300	0.05	28.5	0.0	0.0
SIC 92.71	700	0.78	31.2	0.9	0.1
SIC 93.02	2,800	1.23	29.9	5.3	0.6
Total	45,300	-	-	55.8	6.1

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

Source: ASHE and BERR estimates

### D.4. Increase in NICs for employees aged 16 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employees' NICs (£m)
SIC 55	48,500	1.92	28.6	59.2	6.5
SIC 60.22	300	0.05	28.5	0.0	0.0
SIC 92.71	700	0.78	31.2	0.9	0.1
SIC 93.02	11,000	3.83	29.9	21.9	2.4
Total	60,600	-	-	82.0	9.0

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

Source: ASHE and BERR estimates