



MOORE

Payroll services

CALCULATING HOLIDAY PAY



BACKGROUND

The courts ruled that the calculation of an employee's holiday pay must be based on their "normal pay". The judgement focused on overtime, but it is clear from the reference to normal pay that other payments are potentially within the scope of what should be included in holiday pay calculations. This document is not intended to be an authoritative statement of the law, but is intended as general guidance to help employers with what needs to be included in the holiday pay calculation and how this can be calculated.

The EU required all member states to implement laws, which give all employees and workers the right to 4 weeks' paid annual leave per year. In the UK, this was implemented in 1998 by the Working Time Regulations. Anything that deters an employee or worker from exercising their right to this entitlement is unlawful. Note that the right does not extend to those who are genuinely self-employed.

Prior to this, the established practice for most employers was to pay holiday pay at the employee's basic rate of pay only. For salaried employees who receive nothing other than basic salary, this would make no difference. However, those whose salary is made up of basic salary plus enhanced payments, such as paid overtime, commission, bonus or travel allowances for travelling between work sites, would obviously find themselves worse off financially by receiving basic pay only when on annual leave. In practice this could mean that employees in this position are less inclined to take their annual leave, thereby potentially impacting their health and safety because of a lack of rest and recuperation from the workplace.

A number of recent court decisions have led us to the position where all elements of an employee's normal pay must be included in the calculation of an employee's holiday pay.

Employers only need to factor in these enhanced elements of an employee's normal pay for the 4 week entitlement to holiday provided for by the original Working Time Regulations. Whether they should be factored into the additional 8 days or 1.6 weeks introduced in 2009 under the UK's Working Time Regulations or any further enhanced holiday entitlement paid depends on the terms of the contract of employment, so employers should ensure that the contract terms are clear to reduce the risk of claims for breach of contract or unauthorised deduction from wages. It would be good practice to include all holiday entitlement and would be more administratively convenient, however employers can choose if they wish to do so.

WHAT DOES AND DOES NOT NEED TO BE INCLUDED IN HOLIDAY PAY?

OVERTIME

Compulsory but non-guaranteed overtime and overtime that cannot be unreasonably refused must be included. Voluntary overtime that is worked regularly so that it becomes a custom and practice or where it is not truly voluntary must also be included. That could be the case if the employee is treated less favourably if they do not accept overtime e.g. not being offered overtime in the future.



COMMISSION

Some types of commission must be included in the calculation of holiday pay.

Commission paid on the basis of each sale an employee makes must be included. Clearly the person needs to be at work to make a sale. The person is therefore disadvantaged if they take annual leave and are paid only at their basic rate. An example of this might be a sales assistant in a retail outlet.

Commission paid on reaching individual or team sales targets similarly should be included. The employee in this scenario would be discouraged from taking annual leave by the need to be at work in order to achieve their sales targets.

IRREGULAR, ANNUAL OR ONE-OFF PAYMENTS

These types of payments would include things like discretionary or annual bonuses and commission paid irregularly or on an annual basis.

It is not recommended that these irregular payments are factored into employers' holiday pay calculations at this point. There is a strong argument that employees receiving such payments are not disadvantaged in any way by taking annual leave as they will receive their commission/bonus regardless of whether they take their statutory time off or not.

SOME TYPES OF TRAVEL ALLOWANCE

Where an employer gives an employee a travel allowance to cover the cost of travelling from site to site, or pays an employee's travel expenses, these do not need to be included because they are simply reimbursing the employee's travel costs. Similarly travel expenses repayments do not need to be included.

If the employer makes regular payments to the employee to compensate the employee for time spent travelling from site to site it then does need to be included as this would be normal pay. However, it is not suggested that employers need to include payments for time spent travelling on an occasional or one-off basis.

FINAL NOTE ON WHAT TO INCLUDE IN THE CALCULATION

Although every effort has been made to identify payments that should be included in the calculation and those that do not need to be included, employer practices in calculating holiday pay have been particularly prone to legal challenge. Some commentators are suggesting that many payments made by employers to employees could be in scope (even annual or discretionary bonuses) and likely to be the subject of future legal challenge. These guidelines will be updated regularly to take into account any future legal decisions.

THE CALCULATIONS

Employers are obliged to use a 52 week reference period to calculate an employee's holiday pay.

Stage 1 - Collect the Basic Information:

- i. Gross annual salary = £15,000.00
- ii. Reference period = 31 December 2019 to 31 December 2020
- iii. Overtime worked between 31 December 2019 to 31 December 2020 = 200 hours at an overtime rate of £16.00 gross per hour = £3,200.00

Stage 2 - Work out the day rate, which will then be the rate of pay that the person will be entitled to for one day's annual leave over the next year. This assumes that the employee works a 5 day week and therefore that there are 260 working days in the year:

- i. Basic annual leave = $\text{£15,000} \div 260 \text{ days} = \text{£57.69}$
- ii. Overtime related holiday pay - $\text{£3,200} \div 260 \text{ days} = \text{£12.31}$
- iii. Total Holiday Pay = £70.00 per day

COMMUNICATION TO EMPLOYEES

Once the calculation has been done, the figures should then be communicated to employees and workers to ensure that they know what they will receive when they take any time off for that holiday year. As mentioned, the additional payment only needs to be included in the statutory holiday entitlement and not in the additional 1.6 weeks' leave allowed by UK law. However, employees may not aware that this is the case, so employers may find it helpful to inform employees of any additional statutory/bank holidays that will continue to be paid at the basic contractual rate.

Employers will also find it helpful to itemise the enhanced elements of holiday pay on each payslip, or to instruct any payroll company they use to do so. This will make for a longer and more complicated payslip, but the aim is that this, along with proper consultation before implementing the new calculation method, will help reduce the potential for disputes by making the system as transparent as possible so that employees can see exactly what they are getting in terms of holiday pay during any periods of annual leave. Then, if there is any dispute about whether things are being correctly calculated, everyone will have sufficient information to be able to iron these issues out without the need for litigation.

If you need further advice on any of the information contained in this factsheet, please contact your local Moore office.