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**Deductions from pay:
could you be getting it wrong?**

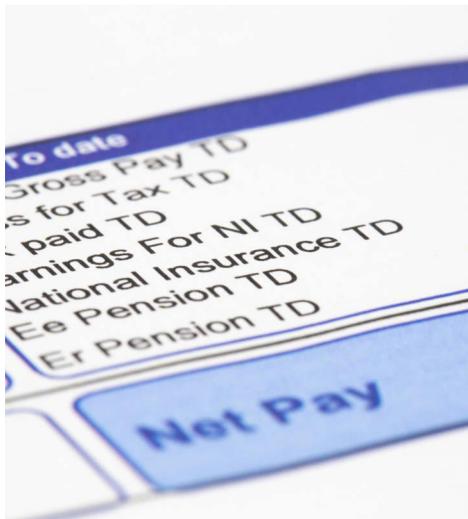
It's the employer's responsibility to make sure that their workforce is paid correctly. So how well do you know the rules?

Getting the basics right

As an employer, you are only allowed to make deductions from staff pay in certain circumstances set out by legislation. You are also required by law to give itemised payslips to all employees and workers, a category including staff on zero-hours contracts and agency workers. These must be provided on or before their payday.

Easy mistake: it's a statutory entitlement

The legal requirement to issue payslips stands even if there's no need to make PAYE deductions from someone's pay. All employees and workers have the statutory right to a payslip.



What must go on the payslip?

Payslips must provide certain specific information, as detailed in the Employment Rights Act 1996:

- the gross amount (total pay before deductions)
- the net amount (total pay after deductions)

- any variable deductions (such as tax; National Insurance contributions; student loan repayments; pension contributions) where deductions depend on the amount of pay
- any fixed deductions, such as a subscription to a trade union. Note that these can be detailed separately, in what is known as a standing statement of fixed deductions. If provided separately, it must be reissued annually (or earlier, if fixed deductions change)
- method of payment, if wages are paid by more than one method of payment, such as cash and bank transfer
- for someone on a variable hours contract, the variable hours worked
- for someone working variable hours and getting different rates of pay for different types of work, a breakdown of hours showing hours worked at each rate of pay.

Rules since 2024 mean that if you use rolled-up holiday pay for part-year or irregular hours workers, this must also be itemised separately.

What else can be shown on the payslip?

You can use the payslip to provide additional information, such as: the tax code; National Insurance number; employer PAYE reference number; time period covered by the payslip; and year to date figures. You may also want to split out payments such as bonuses, commission and overtime, as well as statutory payments like Statutory Sick Pay or Statutory Maternity Pay.

Handling deductions correctly

Look at the contract

Before making any deduction, check the employment contract to make sure the deduction is permitted.

It's important to understand that a contract of employment can extend beyond something written down and labelled 'contract'. It can

include verbal agreements, as well as written terms and conditions. It can be what's decided in a conversation at interview with an employee; emails about the role; or a formal job offer set out in a letter. It can also include things that haven't necessarily been put in writing, or expressed verbally. Thus, the reality of everyday working arrangements can be held to form part of an agreement between you and your workers. Any of these may constitute part of a legally binding contract of employment.

Know when deductions can lawfully be made

Deductions are permitted where:

- they are required by law: this covers, for example, deductions for PAYE
- they are specifically allowed in the contract of employment
- there is a salary sacrifice arrangement agreed between you and your worker (below)
- the employee has been accidentally overpaid
- the employee has given prior written consent for a deduction, such as a trade union subscription, to be made
- the employee has been on strike, or taken industrial action, resulting in their missing work
- there is a court order requiring you to repay a debt to a third party from employee wages
- there is a court order requiring an employee to make a payment to you as employer, and the employee has given written consent to the deduction being made.

Deductions outside these areas are unlawful.

Which payments can deductions be made from?

Deductions can be made from monthly, weekly or hourly pay; holiday pay; statutory payments such as Statutory Sick Pay or Statutory Maternity Pay; bonuses and commission. They cannot be made from loans, such as a pay advance for a season ticket; expenses; pension payments or redundancy pay.

Easy mistake: communicate to avoid escalation

Ensure procedures exist to resolve any staff queries arising. Ultimately, disputes over provision of payslips, or claims for unlawful deductions from wages can be taken to the Employment Tribunal - and this can be expensive. The Tribunal can order repayment of unnotified deductions made in the 13 weeks prior to the claim to the Tribunal - even if the employer was otherwise entitled to make them.



Special cases

Salary sacrifice arrangements

Salary sacrifice arrangements for non-cash benefits can form part of a tax efficient remuneration package. Employer workplace pension contributions are one of the most useful examples. Others include cycle to work schemes, gym membership, and car hire or lease schemes.

But it's important to get salary sacrifice arrangements right. They must be set out in the employment contract, and if there is a new arrangement, the terms of the employment contract should be changed. You and your employee must both agree any variation in terms. Interaction with the minimum wage

rules also needs careful attention, and is an area where mistakes are often made.

As these arrangements involve an employee giving up – sacrificing – part of their contractual entitlement to salary in return for a specified benefit, the danger is that cash earnings then dip below the appropriate minimum wage. You may need to cap salary sacrifice deductions to ensure minimum wage compliance.

Easy mistake: check pay after salary sacrifice

The figure to watch is the figure for pay after the salary sacrifice. It's when this is less than the appropriate minimum wage that you can breach your obligations under the minimum wage rules.

Particular areas of risk include:

- workers who have more than one salary sacrifice arrangement in place. Each additional arrangement further reduces pay for minimum wage purposes
- salary sacrifice arrangements for lower paid workers.

Tips, service charges and gratuities

New rules here took effect under the Employment (Allocation of Tips) Act 2023. Tips, service charges and gratuities over which an employer has control or significant influence must now be passed on to workers without deductions (other than tax and National Insurance). The rules on distributing tips can be complex, and the new Act is accompanied by a Code of Practice on fair and transparent distribution, making the area one where considerable care is needed.



Working in retail

You can only make deductions for stock shortfalls or till shortages if someone's contract of employment specifically permits it. Any deductions must not exceed 10% of gross weekly or monthly pay. The limit does not apply to final wages where someone is leaving their job.

If you make such deductions, you must notify your staff member in writing and give details of how the money will be recovered. Time limits apply, and you must reclaim the money within 12 months of finding the shortfall.

Deductions and minimum wage rules

Minimum wage is not an area to get wrong. HMRC continues to name and shame employers who underpay – even inadvertently. Year on year, employers struggle with deductions taking pay below minimum wage entitlement, and HMRC's most recent naming round showed more minimum wage underpayment arising from employer errors here than for any other reason.

The key point to grasp is that some deductions from pay reduce pay for minimum wage purposes, and others don't. The overarching rule is that deductions (and also payments to you by the worker) have repercussions for minimum wage pay if they are:

- in respect of a worker's expenditure in connection with the employment (such as uniforms, tools and training costs, unless reimbursed)
- made for what is technically known as 'the employer's own use and benefit', and are not a liability owed by the worker, and paid on their behalf to a third party. (For minimum wage purposes, a third party must be completely separate from the employer.)

What comprises a deduction for the employer's own use and benefit is not intuitive. It is defined as a deduction where the employer is free to use the money as they choose. For these purposes, it doesn't matter whether or not:

- the employer makes a profit from the transaction

- the deduction is from gross or net pay
- the worker agrees to the deduction
- the worker benefits from the arrangement.

Easy mistake: it's been agreed

Don't assume that staff agreement to, or request for a deduction makes it minimum wage compliant. It doesn't. Always check the rules, and remember they are not about common sense. Deductions for savings schemes, such as Christmas clubs, for example, need particular care to get right.

There are some deductions for the employer's own use and benefit that do not reduce minimum wage pay. These are:

- deductions permitted by the employment contract, relating to the employee's conduct or discipline
- repayment of an advance of wages, or an advance under an agreement for a loan
- recovery of an accidental overpayment of wages
- the purchase of shares, other securities or share option, or share in a partnership
- deductions for living accommodation, where this is not more than the accommodation offset.

Other deductions that do not reduce minimum wage pay are:

- Income Tax and National Insurance contributions
- student loans
- deductions not connected to the worker's employment or for the employer's own benefit, such as deductions to pay a third party which the worker asks the employer to make - trade union subscriptions and pension contributions, for example.

Common problem areas

Many of the mistakes that HMRC finds relate to deductions and payments for:

- food and meals
- parking permits and /or travel costs
- cost of, or lost work equipment, and/or personal protective equipment (PPE)
- stock or till shortages
- training costs
- Christmas savings schemes
- uniform
- childcare costs
- worker purchase of clothes to meet dress code.

Easy mistake: voluntary payment or deduction?

Take care how arrangements are structured. A voluntary payment by a worker for the purchase of goods and services from you, such as for payments for meals they have freely chosen to buy in the staff canteen, will not reduce minimum wage pay. But if you recover the money by making a deduction from pay, this will reduce minimum wage pay.

Here to help

No employer wants to get payroll wrong. We can help you check that deductions are being handled correctly, minimising both exposure to claims at the Employment Tribunal and unwanted minimum wage compliance activity. Do please contact us for more information.