

Changes to holiday pay what does it mean for your business?

A series of recent decisions has left many employers confused about how they should approach the calculation of holiday pay.

Background

The Working Time Regulations 1998 (WTR) implement the Working Time Directive (the Directive) in the UK. The WTR provides that:

- Workers are entitled to 5.6 weeks' paid holiday per year. The first 4 weeks are a requirement of the Directive and the additional 1.6 weeks are an additional entitlement provided for in the UK; and
- Holiday pay is calculated by reference to provisions of the Employment Rights Act 1996 (ERA) concerning "a week's pay." For workers with a settled pattern of work, "a week's pay" is generally calculated by reference to basic salary only. The effect of this is that significant elements of actual remuneration are not taken into account for the purposes of calculating holiday pay.

The Decisions

There has been various decisions concerning whether the provisions of the WTR relating to holiday pay are compatible with the requirements of the Directive.

In ***British Airways v Williams***, a case concerning flying and related allowances, and ***British Gas v Locke***, a case concerning commission payments for a salesperson, the Court of Justice of the European Union (CJEU) held that holiday pay should be calculated by reference to the worker's "normal remuneration over a representative reference period." Normal remuneration includes pay "intrinsically linked" to the tasks which a worker is required to carry out under their contract and payments relating to a worker's professional and personal status. In these cases, the employment tribunal read additional wording into the relevant provisions of the WTR in order to give effect to the principles of EU Law.

This principle was applied by the Employment Appeals Tribunal (EAT) in ***Bear Scotland vs Fulton***. The EAT stated that workers should receive their normal remuneration during holidays to ensure workers are not deterred from taking holidays for financial reasons. Payments have to be made for a sufficient period of time to justify the label "normal" although no detailed guidance was given about what period of time would be "sufficient". The EAT commented that in cases where there is a settled pattern of work (for example, a worker works 5 hours of overtime every week), normal remuneration will be easily identified as it is the pay normally received. Where there is no

settled pattern of work (for example, overtime requirements differ), normal remuneration should be calculated by reference to an appropriate reference period.

British Gas recently appealed against the employment tribunal's decision in the case brought by Mr Locke relating to commission payments. When considering the appeal, the EAT followed the approach taken in the Bear Scotland case. The EAT stated that the WTR can and should be interpreted to conform with the requirements of EU law to take into account commission payments when calculating holiday pay.

These principles only apply to the first 4 weeks' of holiday provided for by the Working Time Directive. In the Bear Scotland case the EAT stated that it is for employers to decide which type of leave an employee is taking and the recent EAT decision in British Gas v Locke did not consider this issue.

What payments should be included?

Employers are now required to calculate holiday pay by reference to a workers' normal remuneration. It is likely that the following types of payments will amount to "normal remuneration" and should be taken into account when calculating holiday pay:

- Overtime payments (including voluntary and non-guaranteed overtime if it is worked on a regular basis)
- Commission payments
- Payments or allowances made in relation to time spent travelling;
- On call and standby payments
- Acting up supplements
- Any other regular payments

One grey area is bonus payments. Many bonus payments will amount to "normal remuneration". Where workers receive a bonus based on company performance, it is arguable that the payment is not "intrinsicly linked" to their duties and does not fall within the definition of "normal remuneration". Where annual bonuses are paid, it may be the case that workers will receive the bonus regardless of holiday arrangements and that payments will not have any impact upon the calculation of holiday pay.

What is an appropriate reference period?

For workers who have no settled hours of work, the ERA uses a reference period of the last 12 working weeks to calculate a week's pay. It is not clear if that is the appropriate reference period to comply with the CJEU decisions referred to above which state that the reference period must be a representative normal period. It is arguable that if commission or overtime payments fluctuate widely during the year, a 12-week period may not be representative. Employers will need to consider when workers receive payments in addition to basic salary in order to justify any chosen reference period. The recent EAT decisions in the Bear Scotland and British Gas cases did not

provide any guidance on this issue and employer should consider taking advice.

Consequences of calculating holiday pay incorrectly

Underpaid holiday can be claimed as a series of unlawful deductions. This means that workers can claim backdated holiday provided that their claim is submitted within 3 months of the final deduction and there has not been a period of more than 3 months between each deduction. For claims brought on or after 1 July 2015, holiday pay can only be claimed for a period of 2 years. Where there are on-going deductions resulting from underpaid holiday, workers can submit further claims without being obliged to pay further employment tribunal fees.

Once an employer begins paying holiday at the correct rate and continues to do so, the series of deductions will be broken and workers will only have a limited period to lodge their claims.

What should you do now?

Employers should consider:

1. The payments workers receive in addition to basic salary to establish potential liability for underpaid holiday and whether any changes should be made to holiday pay calculations. For employees with settled working hours, consideration will need to be given to an appropriate reference period and differentiating between the first four weeks of holiday which must be paid by reference to “normal remuneration” and the additional 1.6 weeks which can be paid at basic rate.
2. If changes are needed, the nature of those changes and how those changes should be made. There are dangers associated with making changes to the way that holiday pay is calculated and businesses should consider taking legal advice on an appropriate strategy.
3. Whether contract of employment and employment polices require an update to reflect any changes.