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# HR Briefing Note

## Holiday pay – are you getting it right?

Developments in recent years relating to the calculation of holiday pay have left many HR professionals confused about how to calculate holiday pay and the consequences of getting it wrong.

With the recent launch of a Government campaign designed to boost awareness of holiday rights, it is increasingly important for employers to approach holiday pay in the correct way.

### Do you need to take action?

In this briefing note, we explain the basic principles relating to the calculation of holiday pay and future developments that you ought to be aware of in relation to the calculation of holiday pay.

It is clear that both the Courts and the Government are keen to ensure that workers receive the holiday pay to which they are entitled. As this area develops, it is important for employers to ensure that they are calculating holiday pay correctly. Employers should consider whether they are calculating holiday pay on the correct basis and, if not, what changes should be made and how any such changes should be implemented.

### Background

#### Holiday entitlement

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

The WTR provides that workers are entitled to a minimum of 5.6 weeks paid holiday per year (inclusive of bank and public holidays). The first 4 weeks are a requirement of the Directive and the additional 1.6 weeks are an additional entitlement in the UK. Given that the current UK statutory holiday entitlement is more generous that the European minimum entitlement, it is highly unlikely that Brexit will affect minimum holiday entitlement in the UK.

**The rules on holiday pay in the UK – incompatible with the Directive**

Holiday pay in the UK is calculated by reference to the complicated provisions of the Employment Rights Act 1996 concerning a "week's pay". In essence, these provisions provide that in some cases, holiday pay is paid by reference to a worker's basic salary only.

In recent years, the tribunals and Courts have found that the rules on how to calculate a week's pay are not compatible with the requirements of the Directive. It is now a well-established principle that workers are entitled to receive "normal remuneration" during periods of holiday on the basis that there should be no financial disincentives for workers to take their holiday entitlement.

Case law suggests that holiday pay should be calculated by reference to the worker's normal remuneration over a representative reference period.

In practice, this means that if you are continuing to calculate holiday pay by reference to basic salary only, you may need to reconsider your approach.

However, these principles only apply to the first 4 weeks' of holiday provided for by the Directive. Employers can choose to pay the additional 1.6 weeks' holiday entitlement by reference to basic salary only if they wish to do so.

## What is normal remuneration?

Payments made to workers in addition to their basic salary will form part of normal remuneration where the payment has been made for a sufficient period of time and with sufficient regularity for it to qualify as "normal".

Whether a payment is paid with sufficient regularity to comprise normal remuneration is a question of fact and degree. In the case of Dudley Metropolitan BC v Willetts, the Employment Appeal Tribunal held that voluntary overtime which is worked one in every four or five weeks should be regarded as a payment which is part of normal remuneration.

The case law in this area demonstrates that the following elements of remuneration should be included in the calculation of holiday pay assuming that they are paid regularly or repeatedly so as to fall within the definition of "normal remuneration":

- Commission payments
- Bonus payment and other incentive payments
- Productivity or performance bonuses
- Overtime pay (whether compulsory or voluntary, guaranteed or non-guaranteed)
- Payments that relate to the personal and professional status of workers such as those based on seniority, length or service or professional qualifications
- Shift allowances and premiums
- Standby payments and payments for emergency call out duties

- Travel and allowances that are treated as taxable remuneration
- Any other regular payments

Benefits in kind, expenses and one off bonuses or occasional payments should not be taken into account for the purposes of calculating holiday pay.

## What is an appropriate reference period?

The Employment Rights Act 1996 uses a reference period of 12 weeks to calculate a week's pay. However, the recent case law suggests that the reference period must be representative. If additional payments such as commission or overtime fluctuate during the year, it is arguable that a 12 week reference period may not be appropriate.

To address this issue and to put a stop to the practice of some employers whereby they require workers to take holiday during or following a quiet period where their pay may have been lower than normal, the Government has announced changes in this area. From 6 April 2020, the reference period for determining a week's pay will increase from 12 weeks to 52 weeks. This change will be implemented by the Employment Rights (employment Particulars and Paid Annual Leave) (Amendment) Regulations 2018.

## Do these principles affect rolled up holiday pay?

Whilst rolled up holiday pay is technically unlawful, many employers continue to pay holiday pay on a rolled up basis to casual workers to avoid the practical difficulties associated with holiday entitlement for workers who have irregular hours.

However, rolled up holiday pay may not always provide workers with the correct amount of holiday pay. Rolled up holiday pay averages holiday pay out over the year (or the whole of the engagement if shorter) whilst the WTR calculate holiday pay for such workers on their average pay over the 12 weeks prior to the period of holiday. This means that if a worker takes holiday immediately after a period during which they have worked longer hours and earned more than usual, their holiday pay will be greater than if they take holiday after a quieter period. Rolled up holiday pay systems are not designed to take account of these fluctuations.

This issue has been demonstrated in practice in the Court of Appeal case of *Harpur Trust v Brazel*. Mrs Brazel, a visiting music teacher, sought to argue that a week's pay for the purposes of calculating her holiday pay should be calculated at the end of each term by reference to the previous 12 weeks of paid work (clearly the more beneficial method). The Harpur Trust argued that her holiday pay should be calculated by reference to 12.07% of her yearly earnings (the equivalent percentage holiday pay for a full time worker). The Court of Appeal held there was no requirement in the WTR to pro rate holiday entitlement of part-year workers to bring their entitlement in line with a full-time worker as long as the method of calculating holiday pay (and a "week's pay") was in accordance with the relevant provisions of the Employment Rights Act 1996 (s221-224) equating to 5.6 weeks' pay.

The change in the reference period from April 2020 will address this issue. However, in the meantime, employers who operate rolled up holiday pay ought to be aware that there is potential for there to be a shortfall in holiday pay.

## Consequences of calculating holiday pay incorrectly

Any shortfall in holiday pay can be claimed as a series of unlawful deductions. This means that workers can claim for any shortfall in holiday pay provided that their claim is submitted within three months of the final deductions and there has not been a period of more than 3 months between each deduction. Since 2015, workers can usually only claim shortfalls in holiday pay relating to the period of 2 years immediately prior to the claim. The value of such claims is the difference between the actual holiday pay paid to the worker and the amount that should have been paid to the worker.

Employers ought to be aware that the 2 year limit on holiday pay claims will not apply where the worker has been prevented by the employer from taking their holiday pay. In the recent case of ***King v the Sash Window Workshop Limited***, an employment tribunal found that a worker who had been effectively prevented from taking his holiday entitlement over a period of 13 years was entitled to be paid for all accrued but untaken holiday entitlement relating to his period of employment. The reasoning behind this decision was that an employer that does not allow a worker to exercise their right to paid holiday must bear the consequences.

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

## Future Developments

The Government published "The Good Work Plan" on 17 December 2018. It has been described by the Government as the biggest reform in employment law in the last 20 years and includes various proposals in relation to holiday rights. In particular:

- The Government has launched a campaign to boost awareness of holiday rights. In due course this will include new guidance produced in conjunction with ACAS with real life examples to support the interpretation of holiday pay rules.
- As mentioned above, from April 2020 the reference period for calculating holiday pay will increase from 12 weeks to 52 weeks. This ensures that workers who do not have regular working patterns are not disadvantaged by having to take their holiday at a quiet time of the year when their weekly pay might be lower.
- The Government will introduce state enforcement of holiday pay rights for vulnerable workers. Further details will be available in due course.

Taylor Walton's employment law team is happy to assist with any queries relating to holidays.

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