HMRC - VATSC56400 - Gratuities, Tips And Service Charges

Additional payments by customers are variously referred to as gratuities, tips or service charges. They are a ‘bonus’ given by the customer in addition to the standard charge for meals, taxis, hairdressing etc and so, if freely given, they are outside the scope of VAT as they are not part of the consideration for the supply.

Service charges in restaurants

The main supply in a restaurant is the meal and compulsory service charges that are additional to the standard price are part of the consideration for the supply of the meal. Therefore they will follow the same liability as the meal and this applies even if they are passed on in full to staff as bonuses.

Optional service charges were originally also treated as part of the supply of the meal. This changed in May 1982 when we accepted they are not consideration if customers have a genuine option as to whether to make an additional payment.

This approach applies even if the amount appears on the bill. This is because it is the menu that sets the contract between the restaurant and the customer. Therefore, where a menu states that service charges are optional the bill comes too late to change this contract and so any additional charges are not part of the consideration for the meal. There are three Tribunal cases that are important in this policy area:

Potters Lodge Restaurant Limited (LON/79/286)

NDP Co Limited (LON/87/172)

James Dominic Joyce (LON/95/2747A)

Potters Lodge Restaurant

This restaurant charged a compulsory 10% service charge on all bills. The restaurant did not keep the charge, but passed it on to the waiters at the end of each day. Although the menu stated all charges were tax inclusive, no output tax was declared on the 10% given as the tip.

The Tribunal decided the additional 10% was part of the consideration that the customer paid for the meal and so was taxable. This could not be affected by any arrangement the restaurant had with its staff later.

NDP

This restaurant made a suggested service charge on both the menu and the bill given to customers although it was made clear on both that it was an optional payment. Customs assessed for output tax on these payments as they had been treated as outside the scope.

The Tribunal held that since the statement ‘service not included’ meant any service charge was voluntary, the customers were not obliged to pay it. Therefore, the service charge could not form part of the consideration for the meal and so was outside the scope of VAT.

James Dominic Joyce

The NDP decision was used as the basis for this case. It established that the contract between the restaurant and the customer was created by the terms of the menu. Since the bill comes later, after the contract has been made and the supply has been completed, it cannot change the terms of the previously agreed contract. Therefore if the menu states that service charges are optional - not part of the consideration for the meal - any charges added to the bill are also not part of the consideration and so are outside the scope of VAT.

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