EXPLANATORY MEMORANDUM TO

THE NATIONAL MINIMUM WAGE REGULATIONS 1999 (AMENDMENT) REGULATIONS 2009

2009 No. 1902

1. This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The National Minimum Wage Regulations 1999 (Amendment) Regulations 2009 ("the Regulations"), which come into force on 1 October 2009, amend the National Minimum Wage Regulations 1999.

2.2 The Regulations increase the hourly rate of the national minimum wage for adults (22 years and over), 18-21 year olds and 16-17 year olds. They also increase the maximum amount for living accommodation that is allowed to count towards pay for national minimum wage purposes (the "accommodation offset").

2.3 The Regulations clarify that workers who are participating in the European Community Erasmus Programme or Comenius Programme do not qualify for the national minimum wage in respect of work done as part of those schemes.

2.4 The Regulations also provide that service charges, tips, gratuities and cover charges paid to a worker through the employer's payroll do not count towards payment of the national minimum wage.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The Regulations increase the rates and the accommodation offset in response to recommendations contained in the 2009 report made by the Low Pay Commission ("the LPC"), the independent body which assisted with the introduction of the national minimum wage and which has the continuing function under the National Minimum Wage Act 1998 of reporting matter relating to the national minimum wage that are referred to it by the Secretary of State.

4.2 As a result of a public consultation, the Regulations exclude service charges, tips, gratuities and cover charges paid to a worker through the employer's payroll from counting towards the national minimum wage.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

Pat McFadden has made the following statement regarding Human Rights:

In my view the provisions of the draft National Minimum Wage Regulations 1999 (Amendment) Regulations 2009 are compatible with the Convention rights.

7. Policy background

7.1 The national minimum wage was introduced on 1 April 1999 and creates an obligatory threshold pay level. The intention is to protect workers from unacceptably low rates of pay.

7.2 Decisions on the rates of the national minimum wage and other related matters are usually based on recommendations made by the LPC. The LPC's 2009 report was published on 12 May 2009. Copies of the Government's written statement concerning the LPC's report and the report were placed in the Library of the House of Commons and the Library of the House of Lords on that date.

7.3 The increases in the hourly rates and the accommodation offset amount to be effected by these Regulations are those recommended by the LPC in its report.

7.4 The Government believes that this element of the Regulations will be of public interest – in part because it estimates that up to 1 million low paid workers stand to benefit from the national minimum wage rate increases.

7.5 The exemption for European Community Erasmus and Comenius Programmes was not a matter which the LPC reported on. These are work placements which come under the umbrella of the EU Lifelong Learning Programme. The Lifelong Learning Programme aims to support Member States' policies on employability, lifelong learning and social exclusion by providing opportunities for mobility between Member States, including work experience placements. An exemption from the national minimum wage has already been created for one of the Programmes under the Lifelong Learning Programme and the Regulations clarify that work placements under the Comenius and Erasmus Programmes are treated in the same way.

7.6 It is not expected that there will be wide public interest in exemption for the European Community Erasmus and Comenius Programmes as workers in these areas are unlikely to expect that they were due the national minimum wage.

7.7 The Government considers that providing that service charges, tips, gratuities and cover charges paid through the employer's payroll can no longer be used towards payment of the national minimum wage creates a level playing field

for employers, promotes clarity for consumers and ensures equity and fair wages for vulnerable low paid workers. Service charges, tips and gratuities paid in cash directly to the worker by a customer do not count towards payment of the national minimum wage.

7.9 It is not expected that there will be wide public interest in this exemption as we estimate that only around 60,000 workers could be affected by this amendment.

8. Consultation outcome

8.1 The LPC carries out a wide-ranging consultation and fact-finding exercise before arriving at its recommendations, including taking written and oral evidence and making a series of visits throughout the UK. Details of this consultation are referred to in its annual report.

8.2 Stakeholders were consulted on the Erasmus and Comenius exemptions, and expressed their support for the changes.

8.3 The Department conducted a twelve week public consultation on the use of service charges, tips, gratuities and cover charges, including workshops with stakeholders. Roughly three quarters of the respondents welcomed a change in legislation to prevent service charges, cover charges, tips and gratuities from being used in payment of the national minimum wage. The consultation response is published on the BIS website and is available in the libraries of the House.

9. Guidance

9.1 Changes to the national minimum wage regulations will be publicised as part of a £500 million awareness raising campaign. In addition, extensive guidance on national minimum wage rates and operation of regulations is provided on the DirectGov and Business Link websites. New guidance on service charges, tips, gratuities and cover charges is being developed with industry and trade union representatives.

10. Impact

10.1 The impact on business, charities or voluntary bodies of the upratings is estimated to be £0 million cost. This is because the national minimum wage is not rising faster than average earnings (excluding bonuses) in October 2009. The national minimum wage is now part of employment practices and implementation costs of administering the proposed increase will be minimal.

10.2 The impact on the public sector of the upratings is estimated to be £0 million cost. This is because the national minimum wage is not rising faster than average earnings (excluding bonuses) in October 2009. The national minimum wage is now part of employment practices and implementation costs of administering the proposed increase will be minimal.

10.3 The exemptions for EC Erasmus and Comenius Programmes will have no impact on business, and a positive impact on the public sector.

10.4 An Impact Assessment for the upratings and the Erasmus and Comenius programmes is attached to this memorandum.

10.5 The impact on business, charities or voluntary bodies of the regulations relating to service charges, tips, gratuities and cover charges is estimated to be £92.5 million. The impact on the public sector is estimated to be negligible. An impact assessment for the changes was published alongside the consultation response.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 To minimise the impact of the requirements on firms employing up to 20 people, the approach taken is to provide clear guidance.

The basis for the final decision on what action to take to assist small business was:

- for the upratings: LPC consideration of the impact on small firms. The LPC's remit required them to consider the impact of the national minimum wage on small firms. Their recommendations were based upon extensive analysis and gathering of evidence, including evidence received from, and discussion with, small businesses and their representatives.
- for the life-long learning exemptions: The exemptions will have no impact on small business.
- for the changes relating to service charges, tips, gratuities and cover charges: We conducted a "small firms" impact assessment on the proposed regulatory changes on service charges, tips, gratuities and cover charges. It was concluded that there would not be a disproportionate impact on small business in terms of cost or benefit. The Federation of Small Business reported that the amendment would have little impact on small firms in the related industries.

12. Monitoring & review

12.1 Each year the LPC is commissioned to: monitor, evaluate and review the national minimum wage and its impact, with particular reference to the effect on pay, employment and competitiveness in the low paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities and migrant workers and the effect on pay structures. The results of this work are published in its annual report. In addition, they will be commissioned to review the impact of the changes to regulations on service charges, tips, gratuities and cover charges once sufficient data is available.

13. Contact

Rob Cottam at the Department of Business, Innovation and Skills, Tel: 020 7215 0169 or e-mail: rob.cottam@berr.gsi.gov.uk can answer any queries regarding the instrument.

Summary: Intervention & Options

Department /Agency:	Title:	
BIS (formerly known as BERR, Department for Business, Enterprise and Regulatory Reform)	**Final impact Assessment of amendment to the National Minimum Wage regulations 2009**	
Stage: Final	**Version:** Final	**Date: 08 June 2009**
Related Publications:		

Available to view or download at:
http://www.berr.gov.uk/files/file51722.pdf

Contact for enquiries: Asad Ghani/Rob Cottam **Telephone:** 020 7215

What is the problem under consideration? Why is government intervention necessary?

The National Minimum Wage (NMW) is part of the government's strategy to provide fair standards in the workplace by avoiding potential exploitation of workers by employers who in the absence of a NMW would undercut competitors by paying unacceptably low wages. The NMW came into force in April 1999 and since then the NMW rates have been uprated annually. The government has accepted the Low Pay Commission's (LPC) recommendations on the new October 2009 rates for the NMW. This impact assessment also looks at amending exemptions of the NMW to cover Erasmus students and Comenius assistants.

What are the policy objectives and the intended effects?

The NMW sets a wage floor below which pay cannot fall ensuring fair standards in the workplace. The aim when setting the rates is to help the low paid through an increased minimum wage, while making sure that we do not damage their employment prospects by setting it too high. Extending the NMW exemption to Erasmus students and Comenius assistants will bring the treatment of these groups in line with others on the European Union Lifelong Learning programme.

What policy options have been considered? Please justify any preferred option.

The NMW policy targets an improvement in the wage rates of those earning low wages. The NMW rates are reviewed by the independent LPC annually. The LPC carries out a wide ranging consultation on the operation of the NMW and takes account of the economic position before recommending rates. DIUS and BERR have carefully considered amending exemptions to the NMW to cover Erasmus students and Comenius assistants.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The government has again asked the Low Pay Commission to monitor, evaluate and review the National Minimum Wage and its impact. The LPC will be producing an annual report as usual.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister:

Pat McFadden, Minister of State (Business)

..... Date: 08/06/2009

Summary: Analysis & Evidence

Policy Option:	Description:

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups'
One-off (Transition)	**Yrs**	Business - £0 million cost from proposed 2009 rates.
£ 0 million	1	
Average Annual Cost (excluding one-off)		
£ £0 million	1	**Total Cost** (PV) **£ 0 million**

Other **key non-monetised costs** by 'main affected groups'

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' Workers - £0 million benefit from the proposed 2009 rates.
One-off	**Yrs**	
£ 0 million	1	
Average Annual Benefit		
£ £0 million	1	**Total Benefit** (PV) **£ 0 million**

Other **key non-monetised benefits** by 'main affected groups'

Key Assumptions/Sensitivities/Risks

We assume that the NMW would have increased by average earnings, excluding bonuses (in the absence of any regulation) and this assumptions leads to a £0million impact on costs and benefits. The cost and benefits are transfers.

Price Base Year 2009	Time Period Years 1	**Net Benefit Range** (NPV) **£ 0**	**NET BENEFIT** (NPV Best estimate) **£ 0**

What is the geographic coverage of the policy/option?				UK
On what date will the policy be implemented?				1st Oct 2009
Which organisation(s) will enforce the policy?				HMRC
What is the total annual cost of enforcement for these				
Does enforcement comply with Hampton principles?				Yes
Will implementation go beyond minimum EU requirements?				No
What is the value of the proposed offsetting measure per year?				£
What is the value of changes in greenhouse gas emissions?				£ Neglible
Will the proposal have a significant impact on competition?				No
Annual cost (£-£) per organisation (excluding one-off) (n/Q = not quantifiable)	Micro NO	Small NO	Medium NO	Large NO

Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)				(Increase - Decrease)
Increase	£ 0	Decrease	£ 0	**Net**	**£** 0

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

A: Strategic overview

Existing Government initiatives

NMW uprating

The NMW was introduced in April 1999. The rates have increased in a number of steps annually, most recently in October 2008. The adult minimum wage rate has increased from £3.60 in April 1999 to £5.80 (to come into effect in October 2009). The development rate of the NMW has also increased from £3.00 in April 1999 to £4.83 (to come into effect in October 2009). The 16-17 year olds rate was only introduced in October 2004 and has increased from £3.00 to £3.57 (to come into force in October 2009).

Amending NMW exemptions

The European Union Lifelong learning programme (LLP) aims to support member states policies on employability, lifelong learning and social exclusion by providing opportunities for mobility between member states, including work experience placements.

Authors of the LLP took the decision to move higher education participants in vocational training from the Leonardo Da Vinci Programme into the Erasmus programme in order to keep all higher education activities together. An exemption was created in 2007 through the National Minimum Wage Regulations 1999 (Amendment) Regulations 2007 - for participants in Leonardo. It does not cover those taking part within Erasmus – although the intention was to include this group.

Comenius Assistants are one stream of the Comenius Programme, which is part of the LLP. They can come from all LLP countries (EU, EFTA-EEA, Turkey, Overseas Territories) and work as classroom assistants within UK schools for between 13 and 45 weeks, for up to 16 hours per week (spread across up to three UK schools). Comenius Assistants receive stipend support (intended to contribute towards travel and living costs) from the Comenius National Agency of their home country of up to 6,224 euros for the first 13 weeks, and up to 271 euros per week thereafter.

Comenius Assistants are selected by the Comenius National Agency of their home country. Their hosting schools in the UK are selected by the UK Comenius National Agency, the British Council. Hosting schools are not required to pay a wage to the Comenius Assistants.

Comenius Assistants are thus work placements in exactly the same way as are the work placements carried out under the EU's Leonardo da Vinci Programme. Hence Comenius assistants should also be subject to the same exemption as participants in Leonardo.

The scope of this policy change is relatively small and further details can be found in annex C.

B: The issue

NMW uprating

Decisions on the NMW rates are made by the government following consideration of recommendations by the independent LPC. The LPC reports contain a large body of evidence and analysis on the impact to date of the NMW. The evidence and data collected and produced by the LPC have been used to inform this IA[1].

Consultation

Within government

BERR has been working closely with DIUS and HM Treasury.

Public consultation

The LPC consulted a range of stakeholders including employee and employer organisations to recommend new uprated NMW rates. A full list of those consulted can be found in the LPC report[2].

C: Objectives

Background

NMW uprating

The purpose of the NMW is to create a minimum pay level and thus to protect workers from unacceptably low rates of pay. The NMW forms part of the government's policies to make work pay, alongside other measure particularly tax credits.

Decisions on the NMW rates are made by the government following consideration of recommendations by the independent LPC. This year the LPC were given a few months longer to prepare their report so that more recent economic data could be examined compared to previous years.

D: Options identification

Options

NMW uprating

The LPC in their latest report to the government have recommended the following NMW rates:

Adult rate (for workers aged 22+)	£5.80
Development rate (for workers aged 18-21)	£4.83
16-17 year olds rate	£3.57

[1] National Minimum Wage , Low Pay Commission report 2009 (http://www.lowpay.gov.uk/lowpay/report/pdf/7997-BERR-Low%20Pay%20Commission-WEB.pdf)
[2] National Minimum Wage , Low Pay Commission report 2009 (http://www.lowpay.gov.uk/lowpay/report/pdf/7997-BERR-Low%20Pay%20Commission-WEB.pdf)

The LPC has recommended this latest rate rise after a wide ranging consultation and careful consideration of economic evidence and the impact on the employment prospects of low paid workers. The government has accepted this recommendation and the new NMW rates will come into force in October 2009.

The government accepts the LPC's analysis, that these proposals represent an acceptable balance between maintaining and enhancing the value of the NMW and preserving employment prospects for many of the most vulnerable workers. The LPC's analysis is set out in their report.

E: Analysis of options

Costs and Benefits

NMW uprating

The NMW is now a recognised part of employment practices and implementation costs of administering the proposed increase will be minimal.

Business sectors affected

All sectors are affected by the NMW, although agriculture has its own minimum wage machinery. The agriculture minimum wage rate for grade 1 workers over the compulsory school age is £5.74 and the pay rates for Grade 2-6 workers is £6.26 per hour[3]. In practice, the impact of the NMW is most felt in a number of sectors: retail; hospitality; cleaning and security; social care; manufacture of textiles, clothing and footwear; and hairdressing. In their report, the LPC paid particular attention to these sectors.

Number of potential workers covered by the NMW uprating

The latest data relating to the low paid jobs in the UK relates to Spring 2008. The data shows that at that time:

- an estimated 1.4 million jobs held by those aged over 21 were paid below the proposed October 2009 NMW adult rate of £5.80.
- an estimated 0.14 million jobs held by those aged between 18 and 21 were paid below the proposed development rate of £4.83 for October 2009.
- an estimated around 36,000 16-17 year olds were earning less than £3.57 – the proposed rate for 16-17 year olds from October 2009.

The numbers of jobs that are actually covered by the proposed increases in October 2009 will depend upon what has happened, and is likely to happen, to the wages of workers in the period between Spring 2008 and October 2009.

The adult and development rates of the NMW were increased to £5.73 and £4.77, respectively, in October 2008, and it is assumed that these changes fed through into earnings for all workers earning

[3] Further details on the agricultural minimum wage can be found at http://www.defra.gov.uk/farm/working/agwages/pdf/awo08.pdf

below those levels. We are assuming full compliance with the NMW[4]. The vast majority of businesses are compliant with NMW.

Increase in NMW rates from October 2009

In this IA, our main assumption is that the hourly pay of all those earning less than the October 2009 rates increases in line with average earnings growth (measured by the Average Earnings Index excluding bonuses) between Spring 2008 and October 2009. This is based on an average increase using actual data for the period April 2008 to February 2009,[5] and a forecast rate of increase thereafter derived from the HM Treasury comparison of independent economic forecasts.[6]

On this assumption, around 950,000 workers will be covered by the proposed October 2009 NMW uprating. This comprises of around 30,000 16-17 year olds; around 100,000 18-21 year olds, and around 0.82 million workers aged 22 and over.[7] Of the around 1 million covered by the NMW uprating, around two-thirds will be women.

Impact on labour costs of uprating

The impact of the upratings on wage and labour costs also depends upon the assumptions made about the likely path of wage increases between October 2007 and October 2008.

The methodology for estimating the increase in wage costs for the uprating is as follows:

- We calculate the additional average hourly uplift in pay that is required to bring all those jobs paying less than the October 2009 proposed rates onto the minimum wage. The size of this average increase will depend on the assumption made about what happens to earnings in these low paid jobs between October 2008 and October 2009. It is assumed that there is full compliance with the October 2008 rate[8]. Multiply this average increase per hour by the average number of hours worked by those workers affected. The latest data[9] shows average hours worked per week excluding overtime was 26.0 hours for low paid 16-17 year olds; 24.7 hours for low-paid adults (22 and over) and 26.9 hours for low-paid 18 to 21 year olds[10];

- Multiply by 52 weeks per year.

- Multiply by the number of potential beneficiaries (see above).

To go from the total wage bill to total labour costs, we add 15 per cent to take account of the cost to employers of National Insurance and any other non-wage benefits (such as pension contributions) that are linked to wages. We use a figure of 15 per cent, which is less than the 21 per cent figure used in other IAs, because low-paying jobs are likely to be associated with smaller non-wage benefits.

It should be noted that the IA only considers the direct impact of the uprating. This means we have not accounted for additional costs to employers or benefits to workers (earning above the NMW) as a result of the uprating.

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[4] It is very difficult to measure the precise level of non-compliance using ASHE data as there are exemptions from paying the NMW. The Low Pay Commission include a chapter on this issue in their annual report http://www.lowpay.gov.uk/lowpay/report/pdf/7997-BERR-Low%20Pay%20Commission-WEB.pdf

[5] Average earnings (including bonuses) grew by 2.2% April 2007 -January 2008. ONS Average Earnings Index (LMNQ).

[6] Source: http://www.hm-treasury.gov.uk/d/200904forecomp.pdf
Independent average forecast for AEI growth in 2008 was 4.0 per cent in March 2008.

[7] This is calculated by deflating the October 2009 proposed rates by actual and forecast headline average earnings growth (excluding bonuses).

[8] Although full compliance with the October 2008 rates indicate presumed minimum rates of pay of £5.73/£4.77, we need to maintain a constant price base. So, we deflate these presumed minima to take account of 6 months of earnings growth between April and October 2008 under the AEI scenario.

[9] Source: April 2008 Annual Survey of Hours and Earnings.

[10] Low pay defined by hourly pay excluding overtime in April 2008 for all ages earning less than or equal to the October 2009 minimum wages, deflated by 18 months AEI growth to give equivalent April 2008 rates.

The size of the average hourly increase in pay that employers are required to pay to comply with the minimum wage policy depends on the assumption made about what happens to low-paid earnings between April 2008 and October 2009. We assume that in the absence of any uprating, earnings would have risen in line with average earnings (excluding bonuses).

Costs for a typical business

The proposed changes to the October 2009 rates represent an increase of 1.2 per cent on the current rate for adults; 1.3 per cent for 18 to 21 year olds and 1.1 per cent on the current rate for 16-17 year olds. Those employers with staff currently paid at or close to the minimum wage will therefore see the earnings of these workers increase by an amount less than the expected growth rate of average earnings (excluding bonuses). At the time of writing this IA HM treasury independent forecasts made in April 2009 forecasted a 2.2% growth rate in average earnings (including bonuses)[11]. However, most workplaces do not employ people at or near current NMW rates and therefore will be unaffected.

Under our assumption that low pay wages would have risen in line with average earnings (excluding bonuses) in the absence of an uprating the estimated **cost impact of the 2009 rates is assumed to be zero**.

BERR has conducted some sensitivity analysis of the counterfactual assumption used in this IA and concluded that if the adult NMW was increased by around 2.4% to £5.87 this would start to impose an additional cost on business.

Benefits

Increase in minimum wage rates in October 2009

The aggregate additional benefit for workers is expected to be neutral in the year commencing October 2009. This is because the minimum wage will rise less than the expected average earnings growth.[12]

F: Risks

The estimates of costs and benefits presented in this impact assessment are necessarily based upon a number of assumptions which are subject to uncertainty. If our counterfactual assumption that wages would have increased by average earnings (excluding bonuses) turns out to be incorrect and instead wages would have increased by an amount lower than the increase in the NMW this would place a cost on business.

G: Enforcement

The NMW is enforced by the HM Revenue and Customs. HMRC respond to complaints about situations where workers may not be being paid NMW. They also visit employers identified through risk assessment. Individuals may also make a complaint to an Employment Tribunal that their employer has not paid them the NMW. Employers found to have underpaid their workers NMW are required to pay arrears (at the current NMW rates) to their workers and may be subject to a penalty.

[11] Tp note independent forecasters only forecast average earnings including bonuses hence we assume in this IA that this forecast will be the same for average earnings excluding bonuses.

[12] IA calculations assume on average hours worked per week of 25.1 for adults, and 27.2 for 18-21 year olds and 31.3 for 16-17 year olds. ASHE 2008. We also assume that the NMW would have grown in-line with Average Earnings if there was no uprating.

H: Recommendation and summary table of costs and benefits

NMW uprating

Table 1 below, shows the effect on the aggregate wage bill and labour costs of the October 2009 uprating under the assumption that in the absence of any uprating, low-paid earnings would have risen in line with average earnings (excluding bonuses).

Table 1: Impact of the October 2009 uprating on aggregate wage and labour costs (assumes low-paid earnings rise in line with average earnings, (excluding bonuses)

Increase in wage bill for proposed 2009 rates	£0 million
Percentage increase in economy's total wage bill due to uprating	0.%
Increase in labour costs for proposed 2009 rates	£0 million

Source: BERR estimates, based on ONS sources.

Table 1 shows that employers face no additional cost (over and above what they would in any case have to pay their workers) because the NMW is not rising faster than average earnings (excluding bonuses) in October 2009.

Amending NMW exemptions

Exempt Erasmus students seeking work placements and Comenius assistants (classroom assistants within UK schools) from payment of the National Minimum Wage.

I: Implementation

The new NMW rates and amendments to the NMW exemptions will apply to pay reference periods beginning on or after 1 October 2009. HMRC investigate complaints about situations where workers may not be being paid the NMW and also investigate companies where HMRC believe there is a high risk of non-compliance.

J: Monitoring and evaluation

The government has asked the LPC to monitor, evaluate and review the NMW and its impact, with particular reference to the effect on pay, employment and competitiveness in the low paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities and migrant workers and the effect on pay structures. The report is due by the end of February 2010.

Information on enforcement is set out in the government's evidence to the LPC. The evidence is published on the BERR website and copies are placed in House Libraries.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	Yes/No	Yes/No
Small Firms Impact Test	Yes/No	Yes/No
Legal Aid	Yes/No	Yes/No
Sustainable Development	Yes/No	Yes/No
Carbon Assessment	Yes/No	Yes/No
Other Environment	Yes/No	Yes/No
Health Impact Assessment	Yes/No	Yes/No
Race Equality	Yes/No	Yes/No
Disability Equality	Yes/No	Yes/No
Gender Equality	Yes/No	Yes/No
Human Rights	Yes/No	Yes/No
Rural Proofing	Yes/No	Yes/No

Annexes

Annex A

Coverage estimates of the 2009 uprating by sex and Government Office region

BERR estimates that around 950,000 to a million workers are covered by the October 2009 uprating of the National Minimum Wage (NMW). The lower range of this estimate is based on 1p pay bands from the ONS' Annual Survey of Hours and Earnings (ASHE) 2008, and takes account of actual and forecast average earnings growth (excluding bonuses) between April 2008 and October 2009. The higher range reflects uncertainty. Of the workers estimated to be covered, around two thirds will be women.

Table A1. Number of workers that are covered by the October 2009 National Minimum Wage uprating by age and sex

	Male	Female	Total
16-17	20,000	10,000	30,000
18-21	60,000	40,000	100,000
22 and over	270,000	540,000	820,000
Total	350,000	600,000	950,000

Source: BERR estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2008

Note: These data are based on 1p pay bands from the ONS ASHE and take account of actual and forecast average earnings inflation between the period Spring 2008 and October 2009; ASHE 1p pay bands measure number of jobs; therefore coverage estimates assume workers do not hold more than one job at the NMW. Figures have been rounded to the nearest 10,000. Numbers may not sum to total due to rounding.

Coverage estimate by country and Government Office region are also provided (Table A2).

Table A2. Number of workers that are covered by the October 2009 National Minimum Wage uprating by country and government office region

Country or region	Coverage estimate
Wales	50,000
Scotland	80,000
Northern Ireland	40,000
England	770,000
North-East	60,000
North-West and Merseyside	110,000
Yorkshire & Humberside	100,000
East Midlands	80,000
West Midlands	110,000
Eastern	90,000
London	70,000
South East	100,000
South West	70,000
United Kingdom	950,000

Source: BERR estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2008

Note: These data are based on 1p pay bands from the ONS ASHE and take account of actual and forecast average earnings inflation between the period Spring 2008 and October 2009; ASHE 1p pay bands measure number of jobs; therefore coverage estimates assume workers do not hold more than one job at the NMW. Figures have been rounded to the nearest 10,000. Numbers may not sum to total due to rounding.

Annex B

SPECIFIC IMPACT TESTS

1. Competition Assessment

The NMW provides a floor for wages and therefore ensures that firms cannot compete against each other by driving down wages to unacceptable levels. Most of the sectors where the impact of the NMW is felt are characterised by large numbers of relatively small firms. To the extent that the NMW increases labour costs, these are borne by all employers in a sector. It is therefore unlikely that the NMW creates significant barriers to entry.

We have fully considered the questions posed in The Office of Fair Trading competition assessment test[13] and conclude that clarifying the exemptions for those participating in employment programmes, extending work trials or uprating the NMW is unlikely to hinder the number or range of suppliers or the ability and incentive for businesses to compete. Although the effects of extended work trials alone are expected to be small, it supports an increase in labour supply, increasing the efficiency of the supply side of the labour market.

Table A1. Competition assessment.

Question: *In any affected market, would the proposal..*	Answer
..directly limit the number or range of suppliers?	No
..indirectly limit the number or range of suppliers?	No
..limit the ability of suppliers to compete?	No
..reduce suppliers' incentives to compete vigorously?	No

Source: BERR

2. Small Firms Impact Test

The LPC's remit required them to consider the impact of the NMW on small firms. Their recommendations were based upon extensive analysis and gathering of evidence, including evidence received from, and discussion with, small businesses and their representatives.

3. Equality Impact Assessment

NMW uprating

In line with better regulation best practice and the Equalities Duties we have considered the impact of the NMW uprating on minority groups.

Who will be affected?

The Low Pay Commission has carefully monitored the position of women, ethnic minorities and people with work limiting disabilities in relation to the NMW uprating.

Gender

[13] http://www.oft.gov.uk/shared_oft/reports/comp_policy/oft876.pdf

There is a higher prevalence of women in part-time roles and low-paying sectors, which suggests that the National Minimum Wage upratings plays a more important role in raising women's wages than men's. Although, the NMW is still important for men on or around the NMW. The gender pay including and above the middle of the earnings distribution is largely independent of the NMW. However, towards the lower end of the distribution the reduction in the gender pay gap is most obvious, declining from 11.6 per cent in 1998 to 7.1 per cent in 2008 – lowest decile.

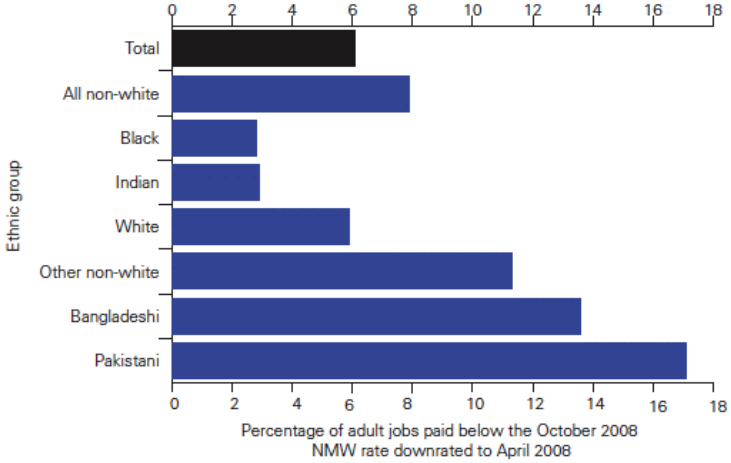
The general reduction in the gender pay gap since 1998 provides evidence that the minimum wage is having a greater impact on women's earnings than men's.

We estimate that around 600,000 women will be covered by the October 2009 upratings.

Ethnicity

Workers from the ethnic minorities are more likely to be employed in the low paying sectors as compared to their white counterparts. There is evidence that the minimum wage has significantly reduced the pay gap at the lowest decile. An estimate by the LPC suggests that the proportion of ethnic minority adults covered by the October 2008 minimum wage uprating was around 8 per cent which is 2 percentage points higher than for white adults.

Coverage of the minimum wage for ethnic minority groups UK, 2008



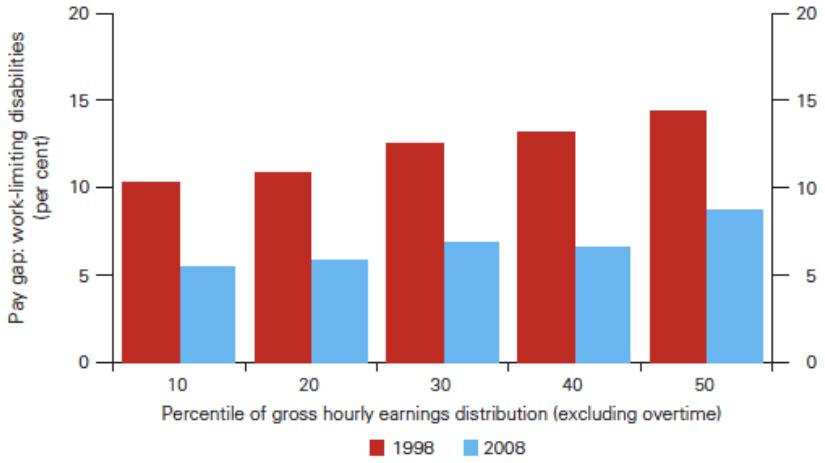
Source: ONS estimates based on LFS microdata, not seasonally adjusted, UK, Q2 2008.

Note: Covered employees defined as adults (aged 22 and over) earning less than £5.63 in April 2008

Work limiting Disability

The LPC have estimated that 4.3 per cent of people with a work-limiting disability were paid at minimum wage in the second quarter of 2008 compared with 3.1 per cent of all workers. The chart below shows that a pay gap exists, that is median hourly earnings for people with a work limiting disability are lower than for workers without a disability. There is evidence that the minimum wage has caused a reduction in the pay gap at each of the lowest five deciles.

Pay gap for people with work limiting disabilities compared with people without work-limiting disabilities, UK, 1998 and 2008.



Source: LPC estimates based on LFS microdata, not seasonally adjusted, UK, spring seasonal quarter 1998 and Q" calendar quarter 2008

Consultation with stakeholders in relation to the October 2009 uprating of the NMW

The LPC conducted a broad consultation when preparing their report. They consulted with individuals; businesses; groups representing each of the low-paying sectors and employer unions. The LPC carried out two formal written consultations and spent two days taking oral evidence from stakeholders. In addition, the LPC visited different parts of the UK to hear from those who are directly affected by the NMW. The increase in the NMW is unlikely to have any additional intentional specific impact in terms of race, gender and disability as it is a broad policy and is targeted at a broader group of people (paid at or below the NMW) rather than any specific minority group.

Removal of barriers which hinder equality

The NMW policy is a broad policy and is designed to have a positive impact on all workers in low paid sectors regardless of their gender, race or disability. Therefore the current NMW uprating is unlikely to create any barriers to equality in terms of gender, race and disability. The LPC[14] have concluded that women, ethnic minority groups and people with work-limiting disabilities have become more involved in the labour market over the last ten years and there is no evidence of an adverse impact on their employment due to the minimum wage.

[14] National Minimum Wage , Low Pay Commission report 2009 (http://www.lowpay.gov.uk/lowpay/report/pdf/7997-BERR-Low%20Pay%20Commission-WEB.pdf)

Annex C

Amending NMW exemptions

Government is seeking to exempt Erasmus students seeking work placements and Comenius assistants (classroom assistants within UK schools) from payment of the National Minimum Wage.

Exempting Erasmus students seeking work placements and Comenius assistants will bring the treatment of these groups in line with others on the EU's Leonardo da Vinci Programme. Their initial exclusion from the NMW exemptions was unintentional. Amending this 'loophole' will also reduce the risk of legal challenge in the European Court of Justice.

The option considered in this impact assessment is to amend Regulation 3(12) of the National Minimum Wage Regulations 1999 so that Eurasmus students seeking work placements and Comenius assistants are exempted from NMW pay. This was the original intention of the amendments to the NMW regulations that were made in 2007. This option will bring Erasmus students and Comenius assistants in line with the treatment of all those on the European Union Lifelong Learning Programme. The costs and benefits of this option have been considered against a 'do nothing' baseline.

Costs

There is no cost implication to the public or private sector to the exemption of higher education students participating in Erasmus work placements, and of Comenius assistants, from the NMW. Participants in these programmes, which are intended to offer students an opportunity of some work experience abroad, receive a grant from the European Commission. Employers providing work placements are not required to pay a wage but may, if they choose to, supplement this grant.

Benefits

Exempting Erasmus students seeking work placements and Comenius assistants will bring the treatment of these groups in line with others on the EU's Leonardo da Vinci Programme. Their initial exclusion from the NMW exemptions was unintentional. Amending this 'loophole' will also reduce the risk of legal challenge in the European Court of Justice.

These exemptions will allow providers of 'work placement schemes' for Erasmus students and Comenius assistants more flexibility in the pay rate offered and reduces the risk of these schemes being withdrawn on the grounds of cost. In total DIUS estimate that each year around 1,500 Erasmus students and 200 Comenius assistants will be covered by the exemptions.

Equality assessment

This policy change will affect all Erasmus students seeking work placements and Comenius assistants regardless of their gender, race or disability. Therefore we have concluded that it is unlikely to create any barriers to equality in terms of gender, race and disability.

Summary: Intervention & Options

Department /Agency:	Title:	
BERR	**Final Impact Assessment of Amending the National Minimum Wage Regulations**	
Stage: Final	**Version:** Final	**Date:** 5 May 2009
Related Publications: The National Minimum Wage Government response to consultation: Service Charges, Tips, Gratuities and Cover Charges May 2009		

Available to view or download at:

http://www.berr.gov.uk/files/file51166.pdf

Contact for enquiries: Amanda Lyne/Anthony Morris **Telephone:** 020 7215 1709/0972

What is the problem under consideration? Why is government intervention necessary?

The National Minimum Wage is part of the Government's strategy to provide fair standards in the workplace and make work pay. Since the National Minimum Wage Act came into force in 1999 c39, regulation 31(1)(e) of the National Minimum Wage Regulations 1999 has permitted the use of service charges, tips, gratuities and cover charges to count towards the National Minimum Wage subject to certain conditions being met. Proposals in this Impact Assessment attempt to ensure tipping practices are made fairer ensuring all workers, whether they are paid tips or not, receive a fair wage in the form of at least the National Minimum Wage in basic pay and by providing greater transparency to consumers so that they can make a more informed choice when tipping.

What are the policy objectives and the intended effects?

The National Minimum Wage sets a wage floor below which pay cannot fall. The aim of this policy is to provide access to the National Minimum Wage in basic pay for low paid workers and create an equitable wage floor for all workers irrespective of if they are paid tips as part of their wage or not. The amendment to regulation 31(1)(e) will ensure that all eligible workers will receive at least the National Minimum Wage in basic pay and any tips that may be paid are in addition to that. This will create a level wage playing field for all workers and business. We also seek to improve transparency for consumers who may not be aware of what happens to their tips.

What policy options have been considered? Please justify any preferred option.

Two approaches have been considered: 1). all tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW, and consumer information and awareness is improved: 2). only discretionary tips and gratuities, and mandatory and discretionary service charges are excluded from counting towards the NMW and consumer information and awareness is improved. Policy options have been compared to a benchmark 'do-nothing' scenario. In November 2008, the Government consulted on this and in light of the responses will proceed with option 1, as it would create less ambiguity and we believe cover charges are used to limited extent.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The Low Pay Commission will assess the use of tips as part of their annual National Minimum Wage report to be published in 2010 and then annually thereafter. This policy amendment will be introduced in October 2009 and should have immediate effects.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Pat McFadden

.....Date: 5 May 2009

Summary: Analysis & Evidence

Policy Option: 1	Description: **This summary sheet summarises option 1 – all tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW**

COSTS

ANNUAL COSTS		Description and scale of **key monetised costs** by 'main affected groups' Potential increase in employers' labour costs resulting from higher pay (£82M) and employers' National Insurance Contributions (NICs) (£10.5M). An increase in workers' NICs payments towards pensions, contributory benefits and the NHS. Annual costs calculated are static and constant over time
One-off (Transition)	**Yrs**	
£ negligible	0	
Average Annual Cost (excluding one-off)		
£ 92.5M	10	**Total Cost** (PV) **£796 million**

Other **key non-monetised costs** by 'main affected groups' one-off Small administrative and familiarisation costs for employers. Implementation and enforcement costs for HMRC. Associated policy costs in raising awareness amongst consumers. Firm may decide to increase prices

BENEFITS

ANNUAL BENEFITS		Description and scale of **key monetised benefits** by 'main affected groups' Potential increase in basic pay for workers (£73M) with tips in addition to that. Increase in NICs receipts (£19.5M). Annual benefits calculated are static and constant over time.
One-off	**Yrs**	
£ 0m	0	
Average Annual Benefit (excluding one-off)		
£ 92.5M	10	**Total Benefit** (PV) **£796 million**

Other **key non-monetised benefits** by 'main affected groups' Equalisation of NICs treatment across sectors and workers. Eligibility of workers for contributory benefits. Greater transparency for consumers.

Key Assumptions/Sensitivities/Risks The analysis carried out is static and does not take into account the dynamics of the labour market. The costs equal the benefits because of transfers involving employers, workers and the exchequer.

Price Base Year 2008	Time Period Years 10	**Net Benefit Range** (NPV) **£ 0 million**	**NET BENEFIT** (NPV Best estimate) **£ 0 million**

What is the geographic coverage of the policy/option?				UK
On what date will the policy be implemented?				October 2009
Which organisation(s) will enforce the policy?				HMRC / BERR
What is the total annual cost of enforcement for these organisations?				£ negligible
Does enforcement comply with Hampton principles?				Yes
Will implementation go beyond minimum EU requirements?				N/A
What is the value of the proposed offsetting measure per year?				£ N/A
What is the value of changes in greenhouse gas emissions?				£ N/A
Will the proposal have a significant impact on competition?				No
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt? No	This policy change will impose a cost for business, see page 9 for an illustrative example on average cost per employee.			

Impact on Admin Burdens Baseline (2005 Prices) (Increase - Decrease)

Increase of £ negligible Decrease of £ negligible **Net Impact** **£** negligible

Key: **Annual costs and benefits: Constant Prices** **(Net) Present Value**

Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

A. Strategic overview

Existing Government initiatives

The National Minimum Wage Act 1998 c39 states that all workers qualifying for the National Minimum Wage (NMW) must be paid at least the NMW. Regulation 30 of the NMW Regulations 1999 specifies which monies paid to the worker by their employer counts towards NMW pay. Regulation 31(1)(e) allows employers to use service charges, tips, gratuities and cover charges to contribute towards the NMW, providing it's paid to the worker via the employer's payroll.

The use of service charges, tips, gratuities and cover charges for payment of the NMW is a complex area. There is a variety of ways in which employers distribute tips to workers.

Some definitions:

Service charges we take to mean those amounts that are added to the customer's bill before it is presented to the customer (typically between 10 percent to 12.5 percent). If it is made clear that the amount is purely discretionary then there is no obligation for the customer to pay and the payment is voluntary. Where this is not the case, the payment is a mandatory charge.

Tips and gratuities we take to mean uncalled for and spontaneous payments offered by the customer either as cash tips (eg left on the table or deposited in a box by the till or on a bar etc, or given to a taxi driver, hairdresser etc) or offered as part of a cheque, debit or credit card payment or detailed on a bill and added at the point of transaction (typically a discretionary amount added by the customer paying by credit, debit, charge card or cheque). It is optional and not a mandatory charge.

Cover charges we take to mean to be a mandatory fixed amount, often per head, that pays for entertainment and other services, (not necessarily waiting service in the case of restaurants), but that generally provide assistance towards other costs that might relate to expenditure that contributes to the experience (typically for items such as bread etc).

B. The issue

Ten years after the introduction of the National Minimum Wage Act on 31 July 2008 the Government announced its intention to amend the Regulations so that tips can no longer count towards the payment of the NMW.

The changes will end the practice of employers using cover charges, service charges, tips and gratuities processed through the employer's payroll in payment or part payment of the NMW for all individuals on the 16-17, 18-21 and main rate of NMW.

The Governments strategy is to provide fair standards in pay for all workers across all sectors. This final Impact Assessment attempts to establish costs and benefits of the policy change detailed in the consultation. These are:

1) All tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW, and consumer transparency and awareness is improved;

2) Only discretionary tips and gratuities, and mandatory and discretionary service charges are excluded from counting towards the NMW and consumer information and awareness is improved.

The reforms will also enable a 'level playing field' amongst employers and workers. At present tips and gratuities that count towards payment of the NMW may be exempt from employer and worker National Insurance contributions (NICs) depending on how they are allocated to the employee. In terms of workers in tipping sectors, those who do receive tips and gratuities as part of their NMW pay may benefit from exemptions from NICs whereas all other workers must pay NICs on earnings above the 'earnings threshold' which is currently £110 per week for each employment for the 2009/10 tax year (this figure is subject to annual change).

Consultation

Within Government

These proposals have been developed in consultation with the following Government departments: HM Revenue & Customs and HM Treasury.

Public consultation

Since the consultation was launched back in November 2008, there has been an intensive programme of stakeholder engagement, involving meetings with trade unions, business representatives and trade bodies. Our consultation on the issue closed on 16 February. We had 182 complete responses to the consultation, with a further 100 partially completed responses. The majority of the responses (roughly 75 per cent) support proposals to exclude tips from payment of the NMW. Of the total responses, half were from business. For more information please refer to the Government response on amending the NMW Regulations so that in future, tips are paid in additional to the NMW.

Following our consultation responses, this Impact Assessment (IA) reports a single point estimate as opposed to a range estimate presented in the consultation IA. It was felt that the lower range estimate did not adequately reflect the use of tips to top up pay to the NMW, as one of the variables that was used from ASHE (Annual Survey of Hours and Earnings) was 'other pay' which explicitly excludes 'bonus or incentive pay'. As a result, this lower range estimate has now been dropped from this IA.

C. Objectives

The Government is intervening for three reasons:

1.To ensure that workers receive at least the NMW that is not made up from service charges, tips or gratuities and that any tips are paid in addition to the NMW.

2. To create a 'level playing field' amongst employers and workers regarding wages and NICs.

3. Increase consumer information and promote greater awareness

Background

Under the current regulations, amounts paid by a customer as a service charge, tip, gratuity or cover charge can count towards NMW pay in certain circumstances.

Other sectors (i.e. non-tipping sectors) are compelled by law to pay their staff the NMW and both employer and employee pay NICs on all elements of pay above the earnings threshold (currently £110 per week).

ASHE shows that in 2008, average basic hourly pay actually exceeded the NMW in the tipping sectors – see table 1. It means that *on average*, people working in these sectors are paid a basic pay (without tips) above the NMW and that therefore the proposed amendments will have no impact on them.

The proposed change in legislation would affect people whose basic pay is less than the NMW and topped up by tips, thus potentially increasing employers and workers' NICs.

1. Basic hourly pay per sectors – 2008

SIC code	Name	Mean basic hourly pay (£)
55	Hotels and restaurants	7.66
60.22	Taxi operations	7.41
92.71	Gambling and betting activities	9.00
93.02	Hairdressing and beauty treatments	6.51

Source: ASHE and BERR estimates

Table 2 below shows the mean hourly basic pay for workers earning less than the NMW in basic pay. We assume later on in the Impact Assessment that some workers earn less than the NMW in basic pay because their pay is being topped up by tips to reach the NMW. When analysing wage distributions the median is often preferred over the mean (as it is not affected by outliers). However, for the purpose of this Impact Assessment the use of the mean hourly wage is more appropriate when estimating the impact of legislative change because ultimately we are interested in the total difference between NMW and those earning below the NMW in basic pay for all workers, which can not be captured using the median hourly wage (as the median by definition does not provide any information on the total), .

2. Basic hourly pay for those earning less than the National minimum wage in basic pay - 2008 (£)

SIC code	Name	16-17	18-21	22 and over
55	Hotels and restaurants	£3.23	£3.65	£4.72
60.22	Taxi operations	-	-	£5.47
92.71	Gambling and betting activities	-	-	£4.74
93.02	Hairdressing and beauty treatments	£2.29	£3.11	£4.29

Source: ASHE and BERR estimates. - Not possible to report a figure due to sample size

There are different levels of NMW, which depend on your age. The rates from 1 October 2008 are:

- adults (which means people aged 22 and over) receive the main rate of £5.73 an hour
- workers aged 18 to 21 inclusive, receive a rate of £4.77 an hour.
- young people receive £3.53 an hour (known as the youth rate)

A young worker is someone who is older than school leaving age and younger than 18. In England and Wales, you are under school leaving age until the last Friday in June of the school year in which you turn 16. (School leaving age is different in Scotland and NI).

3.a. NMW rates (in £ per hour)

Employee's age	2006/07	2007/08	2008/09
22 and over	5.35	5.52	5.73
18 – 21	4.45	4.60	4.77
16 - 17	3.30	3.40	3.53

Source: LPC

3.b. Mean wage and wage differential of those earning below the NMW

Sectors	16 - 17		18 - 21		22 and over	
	Mean pay	Wage differential	Mean pay	Wage differential	Mean pay	Wage differential
SIC 55	£3.23	£0.17	£3.65	£0.95	£4.72	£0.80
SIC 60.22	-	-	-	-	£5.47	£0.05
SIC 92.71	-	-	-	-	£4.74	£0.78
SIC 93.02	£2.29	£1.11	£3.11	£1.49	£4.29	£1.23

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

NB: due to small sample size some values are missing in the above table

Source: ASHE and BERR estimates

In this Impact Assessment when analysing the difference between basic pay and the NMW the 2007/08 NMW rates have been used as these were the NMW rates at the time when the 2008 Annual Survey of Hours and Earnings was complied.

D. Options identification

Option 1
All tips, service charges, gratuities and cover charges, whether discretionary or mandatory, are excluded from counting towards the NMW and consumer information and awareness is improved.

Option 2:
Only discretionary tips and gratuities, and mandatory and discretionary service charges are excluded from counting towards the NMW and consumer information and awareness is improved.

Both of the options above have been measured against a 'do-nothing' benchmark.

Preferred option

There has been little interest shown on the issue of cover charges. Only the British Hospitality Association (BHA) has commented on this aspect of the Regulations substantially. Their view is to permit cover charges for use in payment of the NMW, however, the Government have decided that option 1 is the preferred option for following two reasons:

- If cover charges are not included at this time, this may create ambiguity in the law and could increase the chance of non-compliance.

- Cover charges already attract PAYE and NICs so there is little added benefit for business to use cover charges in the payment of NMW. Therefore, the removal of cover charges would have the least economic impact on business of all the tipping practices. It is also worth noting that the BHA suggests that cover charges are not well used in the UK, although we have no data to support this.

E. Analysis of options

1. Business sectors affected

When measuring the impact of the proposed amendments, we are considering the tipping sectors of the economy; these are principally the hospitality and gambling sectors:

- SIC 55: Hotels and restaurants
- SIC 60.22: Taxi operations
- SIC 92.71: Gambling and betting activities
- SIC 93.02: Hairdressing and other beauty treatments

2. Costs to the employers

The proposed change to the legislation may cause an increase in some employers' labour costs. The increase in labour costs would concern employers who pay their staff less than the NMW and use tips in payment or part payment of the NMW. The increase would come from:

- the additional pay the employer would have to provide, and
- the increase in employers' NIC (12.8 percent) resulting from that.

These monetised costs would be similar under both options 1 and 2 as the impact of NIC payments in both instances will be the same.

Under option 2 (which permits cover charges counting towards payment or part payment of the NMW), cover charges already attract NICs. Although cover charges will form part of the business income we anticipate these payments to be small.

Under option 1 (all service charges, tips, gratuities and cover charges are excluded from the payment of NMW) employers concerned would have to top up basic pay with additional pay on which NICs will may also need to be paid (NICs are only due on earnings in excess of the earnings threshold currently £110 per week).

Increase in labour costs

In order to calculate the increase in labour costs, the following methodology was followed:

1) Estimate the number of people who are earning a basic pay below the NMW (because the use of tips is used to top up to NMW pay), and
2) Differentiate between sectors and age group because NMW rates differ depending on age – see table 2.
3) Calculate the increase in labour costs.

Estimating the number of people earning a basic pay below the NMW

See Annex B for detailed calculation. Table 4 below gives a summary of the number of estimated workers that currently receive basic pay below the NMW and might be affected by the proposed amendment.

BERR estimates, based on Annual Survey of Hours and Earnings (ASHE) data, are that **60,500** workers could be effected by the change in legislation.

4. Estimates of the population concerned by the proposed change to the legislation by age groups

Sectors	16 - 17	18 - 21	22 and over	Total
SIC 55	200	6,800	41,500	48,500
SIC 60.22	0	0	300	300
SIC 92.71	0	0	700	700
SIC 93.02	4,100	4,100	2,800	11,000
Total	4,400	10,900	45,300	60,500

Source: ASHE and BERR estimates

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Calculating the increase in labour costs for employers:

See Annex C for the details of the estimate in increased labour costs. Tables 5, 6 and 7 below show a summary of the additional labour costs due to the proposed change in the legislation.

The potential increase in extra pay could be **£82.0 million** and the increase in employers' NICs could be **£10.5 million**. Therefore the increase in labour costs could total **£92.5 million**

5. Summary table for people aged between 16 and 17

Population	Total – extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
4400	7.2	0.9	8.1

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

6. Summary table for people aged between 18 and 21

Population	Total – extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
10900	19.0	2.4	21.5

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

7. Summary table for people aged 22 and over

Population	Total – extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
45300	55.8	7.1	62.9

NB: Figures have been rounded

Source: ASHE

8. Summary table for people aged 16 and over

Population	Total – extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
60500	82.0	10.5	92.5

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

[15] We have assumed that some workers who earn less than the NMW in gross pay in the tipping sectors is because some employers are using tips to make up the NMW.

Average cost per worker

Due to the nature of this policy change and the availability of evidence, it is difficult to estimate a meaningful estimate of the cost per business. For some businesses the cost will be zero, as they will be unaffected by this policy amendment, whereas some businesses could be more heavily affected. Hence for purely illustrative purposes we present an estimate of the average cost per worker of this policy amendment. From this estimate, the expected impact on individual businesses can be calculated e.g. if a business had three workers affected by this policy change, the cost to this business would be three multiplied by the average cost per worker. It should be noted that this average cost per worker is only an indicative number and the actual cost per worker may vary depending on the sector they are employed in, the number of hours they work and the gap between base pay and the NMW.

The average cost per worker per year of this policy amendment is **£1529**. This has been calculated by taking the total cost £92.5 million and dividing it through by the estimated number of workers affected 60,500.

Administrative costs

The implementation costs may include: rewording of contracts and adjusting the payroll. Workers who don't have a written contract containing specified information and who are employed for one month or more have a statutory right to receive a written statement of employment particulars including 'the scale or rate of remuneration or the method of calculating remuneration', which may also imply the need for a change – depending on how the employer expresses the pay arrangements. It's a reasonable assumption that the relevant employers will also need to amend their payroll arrangements. Both of these costs are one-off costs, and are not on going costs, hence they will not add to the administrative burdens businesses face. BERR has looked at the cost involved in amending the payroll arrangements and as a result of that research it has concluded that the costs would be limited. For purely illustrative purposes it may take up to half an hour of a manager's time[16] to re-word contracts for some businesses this is equivalent to around £10.75. Further, this policy amendment will only affect a limited number of businesses, as most workers in the economy are receiving basic pay at or above the NMW rate, thus the administrative cost would be zero for these businesses. Thus, these costs have not been estimated and assumed to be negligible.

[16] Source; Basic hourly pay Annual Survey of Hours and Earnings (ASHE) 2008, manager and senior officials basic hourly pay is £17.77 adding 21% for non-wage labour costs gives £21.50 (per hour) – half an hour is equivalent to £10.75 .

3. Costs/benefits to the workers

The proposed change to the legislation will affect workers, through an increase in their NICs and an increase in their ***basic*** pay.

Increase in NICs

See Annex D for details of the calculations.

The increase in workers' NICs could total **£9 million**.

9. Summary table for people aged between 16 and 17

Population	Total – extra pay (£m)	Employees' NICs (£m)
4400	7.2	0.8

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

10. Summary table for people aged between 18 and 21

Population	Total – extra pay (£m)	Employees' NICs (£m)
10900	19.0	2.1

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

11. Summary table for people aged 22 and over

Population	Total – extra pay (£m)	Employees' NICs (£m)
45300	55.8	6.1

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

12. Summary table for people aged 16 and over

Population	Total – extra pay (£m)	Employees' NICs (£m)
60500	82.0	9.0

NB: Figures have been rounded and totals may not sum to individual parts due to rounding

Source: ASHE

Again, the increase in NICs for workers would be the same under option 1 and option 2. We assume that tips that are currently used in payment or part payment of the NMW are not currently subject to NICs, but because employers would have to increase wages to at least the NMW, that extra amount would become subject to NICs under both options 1 and 2.

Workers could see their basic pay increase by **£82.0 million.**

4. Costs to the Government

Implementation costs

BERR will have to raise awareness of this policy amendment and HMRC will have to inform employers and workers of the change to the law.

Enforcement costs are not expected to increase as a result of the amendment: HMRC investigates an employer when there is a complaint about possible non-payment of NMW and under their risk assessment programme. There is no evidence to suggest that the number of complaints will go up as a result of the changes. As is usual with NMW uprating, we would expect to see an increase in enquiries after commencement with stabilisation as employers and workers become accustomed to the new rules.

Implementation costs are assumed to be the same under option 1 and option 2 and to be small.

5. Benefits

- There may be increased retention of staff due to better pay for the worker and thus employers will retain skills.
- If employers pay tips on top of the NMW, there may be better quality of service because of greater incentivisation as tips become purely performance related.
- Equalisation of sectors and employers establishing a clear playing field across tipping and non-tipping sectors and amongst employers within the tipping sectors.
- Of the workers affected by the change in the legislation, some of them may become eligible for contributory benefits. A person builds entitlement to contributory benefits once his/her earnings become greater than the 'lower earnings limit', currently set at £95 per week. The lower earning limit is the point at which earnings count for benefit purposes however NICs only start to be paid at £110. However this benefit would be small and we do not attempt to quantify it.
- Greater Government revenues, which represent a transfer from employer and workers to the Exchequer: this is the sum of workers' and employers' NICs and would amount to **£19.5 million** under option 1.
- The time spent by employers calculating wage rates might lessen as the uncertainty over whether there will be enough tips to cover the difference between the basic pay and NMW will disappear.
- Increased consumer transparency may result in increased take-home pay for some workers as a result of fairer distribution of tips, and in customers making informed tipping decisions. The increase in take-home pay is estimated to be **£73 million**.
- Greater consumer confidence in tipping sectors.

6. Transparency

The consultation has shown that there is strong support for best practice guidance on transparency for the tipping sector from consumers, unions and business and we are working with these stakeholder groups to take this forward.

F. Risks

The employers concerned by the amendments, and the data suggest that they are relatively few, may seek to offset the rise in their labour costs. The easiest way to do so would be to take a share or increase their existing share of the tips and discretionary service charges that they previously had not appropriated, thus possibly cancelling any increase in take-home pay for workers as a result of the increase in their basic pay. This could result in some workers receiving a lower take home pay.

There is a possibility that some workers could see there take home pay decrease as they find themselves paying higher employee NICs. This risk would increase if employers reduced the share of tips that went to workers.

Firms who previously offset the NMW through tips etc, will be faced with an increase in labour costs. As a result, they may decide to increase prices. The 'price elasticity of demand' will determine the extent to which prices could rise. Price increases would lead to the cost being transferred to the consumer. A final risk is that firms could decide to offset increased labour costs by employing fewer staff.

G. Enforcement

The enforcement resulting from the change in regulations of the proposed amendments will be the responsibility of HMRC. HMRC do not expect this to be significantly costlier. Initially, there may be an increase in complaints as the new legislation beds in, but once a certain period of time has passed and business and workers become familiar with the changes, the number of NMW-related complaints may decrease.

The principles HMRC will use to enforce this policy change will be the same as they use for the NMW rates and have the aim to minimise administrative burden imposed on business. Further, there are no new measures in terms of enforcement that would add to the cost of business.

H. Summary table of costs and benefits

Below is a table outlining the costs and benefits of the proposed change to the legislation. Option 1 and 2 have similar costs and benefits although option 2 provides more flexibility for employers as cover charges can be included in the NMW.

13. Summary table of costs and benefits

		One off / On going	Affected	Option 1 (£m)	Option 2 (£m)
Costs	Increase in employers' labour costs	On Going	Employers	£92.5	£92.5
Benefits	Increase in administrative costs	One Off	Employers	Small	Small
	Implementation costs	One Off	Employers	Small	Small
	Better quality of service, equalisation of NICs treatment across sectors, eligibility for statutory benefits and less administrative burden	On Going	Customers and employees	Small - Not quantified because the number of people concerned is small	
	Transfer to the Exchequer	On Going	Exchequer	£19.5	£19.5
	Increase in pay	On Going	Employees	£73.0	£73.0

I. Implementation

BERR will work with HMRC to implement the new regulations during 2009 and it will come into force 1st October 2009.

J. Monitoring and evaluation

Each year the Low Pay Commission (LPC) monitor, evaluate and review the NMW and going forward will be looking at the use of tips. The LPC pay particular reference to the effect on pay, employment and competitiveness in the low paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities and migrant workers and the effect on pay structures. The research they undertake is published, and will help inform future LPC recommendations. The next report will be published in 2010. BERR will also be monitoring data from the Annual Survey of Hours and Earnings to evaluate the use of tips and NMW pay.

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	***Results in Evidence Base?***	***Results annexed?***
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	No
Rural Proofing	No	No

Annexes

Annex A: Specific impact tests

Small Firms Impact Test

The proposed amendment to the regulations would apply to firms of all sizes. The Federation of Small Business responded to our consultation and felt that the amendment to the NMW regulations would have 'little impact on small firms in this industry'. The table below presents the distribution of workers by firm size in tipping sectors and compares this to non-tipping sectors.

A1. Distribution of employees by firm size in the tipping and non-tipping sectors

Sector	1 to 49	50 to 249	250 and more	Total (m)
SIC 55 (restaurants)	77%	20%	2%	1.1
SIC 60.22 (taxis)	67%	27%	4%	0.0
SIC 92.71 (gambling)	73%	22%	5%	0.1
SIC 93.02 (hairdressing)	97%	2%	0%	0.1
Total – tipping sectors	79%	19%	2%	1.4

Source: LFS Q4 2008

The table shows the general distribution of firm size in tipping sectors, but does not represent the firm size distribution of businesses that will be affected. We believe that although it may be more likely that larger businesses are currently benefiting from the NICs exemption and using tips and gratuities to pay part of the NMW, a significant proportion of small businesses will also be following this practice. We estimate that about **60,500** workers will be affected and we believe there will not be a disproportional impact on small business in terms of costs or benefits. If for instance this policy amendment did affect small firms disproportionally, exempting small firms would defeat the objectives of this policy change.

Competition Assessment

The initial analysis of the competition filter test reveals that a detailed competition assessment is not considered necessary. The proposed legislation will apply to all firms and is a measure that will ensure a more level playing field between firms in the tipping sectors. At present some firms are using tips and gratuities to count towards the NMW and may be benefiting from the NICs exemption and others are not. The proposed legislation will change this so that all of the NMW will exclude tips from NMW pay for all firms. Table A2 below gives the results of the competition filter test.

A.2. Results of the competition filter test – In any affected market, would the proposal:

Directly limit the number or range of suppliers?	No
Indirectly limit the number or range of suppliers?	No
Limit the ability of suppliers to compete?	No
Reduce suppliers' incentives to compete vigorously?	No

Equality Assessment

In line with better regulation best practice and the Equalities Duties we have considered the impact of changing the law by gender and race.

Who will be affected?

The Labour Force Survey indicates that around 40 percent of workers in the tipping sector are men and around 60 percent are women. We believe that there will be similar proportions of men and women who are directly affected by policy changes.

The table below shows that a higher proportion of ethnic minority workers work in tipping sectors than in all sectors:

A.3. Distribution of people by ethnic minority

	Total employees (%)	Employees in tipping sectors (%)
White	90.7%	84.8%
Mixed	0.8%	1.2%
Asian or Asian British	4.4%	6.7%
Black or Black British	2.2%	2.1%
Chinese	0.5%	2.4%
Other	1.4%	2.9%

Source: LFS Q4 2008

We estimate that **60,500 workers** may receive tips to top up pay below the NMW. This represents a weighted figure and it would not be sensible to attempt to disaggregate this figure further by ethnicity or disability as the results may not be reliable.

Removal of barriers which hinder equality

The proposed changes reflect a broad policy and are designed to have a positive impact on all workers in tipping sectors regardless of their gender, race or disability. Therefore the proposed changes are unlikely to create any barriers to equality in terms of gender, race and disability.

Annex B: Estimating the number of people earning a basic pay below the NMW and receiving tips

N.B.: The available data does not differentiate between different categories of service charges so the calculation of the increase in labour costs will be the same under both option 1 and option 2, but it will be an overestimate in the case of option 2 as employers' NICs have always been due on cover charges used to pay part or all of a worker's wages.

Data on the number of people who earn a basic pay below the NMW and are paid tips to top up wages to the NMW is not collected. Therefore, we have used ASHE (Annual Survey of Hours and Earnings) to estimate the number of workers that could potentially be affected. The ASHE provides information about the levels, distribution and make-up of earnings and hours paid for employees within industries, occupations and regions and is regarded as the best survey on pay.

ASHE gives details on basic pay. For the three NMW rate groups, data could be obtained on the number of people earning less than their NMW band in basic pay (ASHE does not provide specific data on tips).

Following our consultation responses, this IA reports a single point estimate as opposed to a range estimate presented in the consultation IA. It was felt that the lower range estimate did not adequately reflect the use of tips to top up pay to the NMW and has now been dropped from this IA.

B.1. Breakdown

	16 - 17	18 - 21	22 and over	Total
Total employed in the tipping sectors	83,126	283,065	970,107	1,336,298
Receiving basic salary below NMW#	4,357	10,874	45,295	60,527

Source: ASHE 2008. # This is an estimate. We have scaled down the number of employees receiving a salary less than the NMW by a factor of 0.8 to remove those who earn less than the NMW because of exemptions or non-compliance.

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We are considering in our calculations only workers earning less than the NMW in basic pay. According to 2008 ASHE data, 5.6 percent (75,322) of workers in the tipping sector are on a basic pay below the NMW. The same database further indicates that 1.1 percent of workers in the whole economy are paid below the NMW due to either being exempted from the NMW or due to non-compliance. Assuming this percentage is the same in the tipping sector (exempted from NMW or non-compliance), 14,794 workers will be unaffected by this regulation, as non-compliant employers will not change behaviour and those exempted from the NMW will be unchanged. As a result, our estimate on the number of workers who earn less than the NMW in basic pay because of the use of tips to top up basic pay is 60,527 (75,322 – 14,794, difference due to rounding).

B.2. Estimate of number of emloyers affected by age groups and sectors – estimate for 2008

Sectors	16 - 17	18 - 21	22 and over	Total
SIC 55	221	6785	41508	48514
SIC 60.22	0	0	324	324
SIC 92.71	0	0	692	692
SIC 93.02	4136	4089	2771	10997
Total	4357	10874	45295	60527

Source: ASHE and BERR estimates

[17] We assume that some employees who earn less than the NMW in basic pay in tipping sectors is because tips are being used to top up to the NMW.

Annex C: Estimating the increase in labour costs

It has been assumed that all the workers are earning more than the earnings threshold of £110 a week (thus liable for NICs). Also, for ease of calculation, we have not adjusted for the NICs exemption on earnings below the earnings threshold, hence we will over estimate the additional employee and employer NICs from this policy amendment.

First, we estimate the differential between basic pay and the NMW, and then the increase in labour costs.

Estimating the differential between basic pay and NMW

The 2008 ASHE survey provides figures about the wage differential, i.e. the difference between NMW and basic pay for the category of people earning less than NMW. We assume later that this differential does not change over time.

C.1. Mean wage and wage differential of those earning below the NMW

Sectors	16 - 17		18 - 21		22 and over	
	Mean pay	Wage differential	Mean pay	Wage differential	Mean pay	Wage differential
SIC 55	£3.23	£0.17	£3.65	£0.95	£4.72	£0.80
SIC 60.22	-	-	-	-	£5.47	£0.05
SIC 92.71	-	-	-	-	£4.74	£0.78
SIC 93.02	£2.29	£1.11	£3.11	£1.49	£4.29	£1.23

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

NB: due to sample size, we only estimate a central estimate.

Source: ASHE and BERR estimates

Another element to take into account before estimating the increase in labour costs is the amount of time worked by workers.

C.2. Hours worked

Sectors	Mean basic paid hours per week
SIC 55	28.6
SIC 60.22	28.5
SIC 92.71	31.2
SIC 93.02	29.9

Source: ASHE and BERR estimates

Increase in labour costs

C.3. For employees aged between 16 and 17

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
SIC 55	200	0.17	28.6	0.1	0.0	0.1
SIC 60.22	0	0.00	28.5	0.0	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0	0.0
SIC 93.02	4,100	1.11	29.9	7.1	0.9	8.0
Total	4,400	-	-	7.2	0.9	8.1

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

NB: due to sample size, we only estimate a central estimate.

Source: ASHE and BERR estimates

C.4. For employees aged between 18 and 21

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
SIC 55	6,800	0.95	28.6	9.6	1.2	10.8
SIC 60.22	0	0.00	28.5	0.0	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0	0.0
SIC 93.02	4,100	1.49	29.9	9.5	1.2	10.7
Total	10,900	-	-	19.0	2.4	21.5

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

Source: ASHE and BERR estimates

C.5. For employees aged 22 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increase in labour costs (£m)
SIC 55	41,500	0.80	28.6	49.5	6.3	55.9
SIC 60.22	300	0.05	28.5	0.0	0.0	0.0
SIC 92.71	700	0.78	31.2	0.9	0.1	1.0
SIC 93.02	2,800	1.23	29.9	5.3	0.7	6.0
Total	45,300	-	-	55.8	7.1	62.9

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

Source: ASHE and BERR estimates

C.6. For employees aged 16 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employers' NICs (£m)	Total increa labour co (£m)
SIC 55	48,500	2	28.6	59.2	7.5	66.8
SIC 60.22	300	0	28.5	0.0	0.0	0.0
SIC 92.71	700	1	31.2	0.9	0.1	1.0
SIC 93.02	11,000	4	29.9	21.9	2.8	24.7
Total	60,600			82.0	10.4	92.5

NB: wage differential = NMW – basic salary; Employers' NICs is set at 12.8% of total extra pay

Source: ASHE and BERR estimates

Annex D: Calculating the increase in NICs for workers

D.1. Increase in NICs for employees aged between 16 and 17

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employees' NICs (£m)
SIC 55	200	0.17	28.6	0.1	0.0
SIC 60.22	0	0.00	28.5	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0
SIC 93.02	4100	1.11	29.9	7.1	0.8
Total	4400	-	-	7.2	0.8

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

NB: due to sample size, we only estimate a central estimate.

Source: ASHE and BERR estimates

D.2. Increase in NICs for employees aged between 18 and 21

Sector	Population	Wage differential	Average hours	Total extra pay	Employees' NICs
SIC 55	6,800	0.95	28.6	9.6	1.1
SIC 60.22	0	0.00	28.5	0.0	0.0
SIC 92.71	0	0.00	31.2	0.0	0.0
SIC 93.02	4,100	1.49	29.9	9.5	1.0
Total	10,900	-	-	19.0	2.1

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

Source: ASHE and BERR estimates

D.3. Increase in NICs for employees aged 22 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employees' NICs (£m)
SIC 55	41,500	0.80	28.6	49.5	5.5
SIC 60.22	300	0.05	28.5	0.0	0.0
SIC 92.71	700	0.78	31.2	0.9	0.1
SIC 93.02	2,800	1.23	29.9	5.3	0.6
Total	45,300	-	-	55.8	6.1

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

Source: ASHE and BERR estimates

D.4. Increase in NICs for employees aged 16 and over

Sector	Population	Wage differential for 2008 (£)	Average hours worked per week	Total extra pay (£m)	Employees' NICs (£m)
SIC 55	48,500	1.92	28.6	59.2	6.5
SIC 60.22	300	0.05	28.5	0.0	0.0
SIC 92.71	700	0.78	31.2	0.9	0.1
SIC 93.02	11,000	3.83	29.9	21.9	2.4
Total	60,600			82.0	9.0

NB: wage differential = NMW – basic salary; Employees' NICs is set at 11% of total extra pay

Source: ASHE and BERR estimates