

BRIEFING NOTE

Rolled-up holiday pay

The Working Time Regulations 1998 ("WTR") provide that both workers (individuals providing a personal service to an employer) and employees (referred to collectively as "workers"), are entitled to a minimum of four weeks' paid annual leave (pro rata for part-time workers). Mainly for administrative reasons, a practice of 'rolling up' holiday pay has developed whereby the employer makes an additional payment to a worker's basic rate which is expressed as holiday pay. This means that the employer does not have to pay the worker when he or she is actually on holiday, because payment for the worker's annual leave is spread throughout the rest of the year. This is a widely adopted practice for dealing with the holiday pay entitlement of people who do not work fixed hours.

This practice has recently been challenged by the European Court of Justice ("ECJ") who has held that this arrangement is unlawful and falls foul of the WTR, which govern the way in which holidays should be dealt with.

The purpose of this note is to explain how the WTR deals with holidays, what an employer is able to agree with workers concerning holidays and whether it is safe to continue the practice of rolled-up holiday pay in view of the ECJ's decision.

WTR Regime

The WTR sets out the minimum requirements for holidays to which workers are entitled. These include the following:

- The holiday leave year is the 12 month period from when the worker commences employment.
- A worker is entitled to four weeks' leave in any year. These four weeks include bank and public holidays. However, as of 1st October 2007, it is anticipated that the minimum entitlement will be four weeks plus bank and public holidays. As there are eight permanent bank and public holidays in Great Britain this will increase the statutory holiday entitlement to 28 working days.
- Holiday leave cannot be carried over from one year to another. These are Health & Safety regulations and the idea is that an employer must ensure that workers take sufficient time away from work and are financially provided for during those periods of absence. Giving workers money instead of time off, is unlawful if this would result in the worker taking less than four weeks holiday in any holiday year.
- During periods of holiday, workers are to be paid a week's pay in respect of each week of leave with a week's pay being calculated by reference to the average earnings of a worker in the 12 weeks which were worked prior to the holiday in question.

Contractual arrangements

Most contracts slightly embellish the default regime of the WTR setting out procedures for holiday leave requests, setting a company holiday year which is uniform to all workers and requiring workers to take holiday during their notice period or a period of garden leave.

The core elements of the WTR which are contained in the last three bullet points above, are easily satisfied in most cases where workers work regular hours and receive a regular income. Contracts normally stipulate that a worker is paid by reference to their basic salary rather than to any overtime or bonus payments.

Problems only arise when the working patterns of, or the remuneration paid to, workers vary. This applies to part-time workers and particularly to casual workers who may work a few days or even hours in one month but sometimes not at all. Industries such as the building trade and catering and seasonal businesses, such as agriculture, have these type of working patterns.

If one follows the WTR, each time the casual worker takes holiday leave, the employer has to work out:

- How much holiday the worker is entitled to take. An employer can deal with this by working out how much holiday a full-time worker is entitled to and then calculate the casual worker's entitlement on that basis.
- How much remuneration the worker will receive whilst on holiday. This is calculated as the worker's average earnings over the previous 12 weeks that he or she actually worked (which may have extended over a period of months) to come up with average weekly pay which is then used for the calculation of the week or part of a week that that casual worker takes off as holiday.

This places an enormous burden on employers and the solution found to this was rolled-up holiday pay: as part of a worker's package, they are not only paid their basic salary but a separate and distinct holiday supplement which is to be used when that worker goes on holiday. For example, if an employer's holiday regime is 20 days' holiday inclusive of bank and public holidays a supplement of 8.33% would be paid. If the holiday entitlement in a company is 28 days' holiday inclusive of bank and public holidays, which is soon to be the default arrangement, the holiday supplement will be 12%.

Domestic court and ECJ rulings

The courts have been concerned that rolled-up holiday pay goes against the spirit of the WTR legislation. As mentioned, these are essentially Health & Safety regulations and the idea is to ensure that workers take time off, not that they just get the right holiday pay.

There are other concerns with rolled-up holiday pay:

- Rolled-up holiday pay does not always give the correct amount of holiday pay for workers with irregular hours. This is because rolled-up holiday pay averages holiday pay over the course of a year but this means that if a worker takes holiday immediately after an unusually busy period, they would under the WTR regime be entitled to much higher holiday pay because the WTR calculates holiday pay by reference to the amount earned by a worker during the 12 weeks immediately prior to the holiday.

- If workers take leave early in the year, they may not be paid enough because by that point they will not have accrued enough rolled-up holiday pay to fund say, a two week holiday.
- There is a concern that employers will try and reclassify existing salary arrangements as inclusive of holiday pay. On this point, the courts have been quite clear, they say that any rolled-up holiday pay arrangement must be agreed in advance with workers and must be completely **transparent and comprehensible**. If there is any confusion, then workers will be entitled to not only the holiday supplement but also to periods of paid leave as well.

The latest decision of the ECJ in March 2006 clearly stated that as far as it is concerned, rolled-up holiday pay is unlawful because it does not ensure that workers are able to take time off for holiday. However, the judgment was qualified because the ECJ said that sums which had been paid under a rolled-up holiday pay scheme and were clearly identified as being that, could be set off against any claim for holiday pay. On the face of it, therefore, there are no teeth to this judgment because although employers can be sued for not providing holiday in accordance with WTR, those claims have no value because in almost all cases they will have received the correct amount of holiday pay using a rolled up holiday pay scheme.

Many employers are relying on this but this is not a safe view because the ECJ indicated that set off would not work beyond March 2006, when the decision was handed down. The Department of Trade & Industry has since given guidance and taken the view that sums paid under rolled-up holiday pay arrangements will continue to be set off until the employer puts a new system in place. However, it is a brave employer who decides not to modify their practices in the hope UK domestic courts will continue to allow the set off argument.

Suggested solution

On the basis that set off cannot be relied upon, employers should not continue with their existing rolled up holiday schemes. They therefore have two choices:

1. Ensure part-time and casual workers take holiday and are paid using the WTR formula. Although this creates an administrative burden, that can be alleviated by payroll software which should be able to calculate the correct level of holiday pay at any given time.
2. Produce a more refined rolled up holiday scheme with the following ingredients to ensure it is transparent and comprehensible, and satisfies any health and safety concerns:
 - Ensure that all workers agree to contracts which separate basic salary from holiday pay.
 - Ensure that payslips separate holiday pay from basic pay.
 - Pay holiday pay into a separate fund which can be drawn against when the worker goes on holiday.
 - Provide an arrangement by which the employer can insist that the worker takes a period of time off, for example at the end of any fixed short term contract, so that it can be demonstrated that not only does the worker receive holiday pay which has accrued but that he or she actually takes holiday.

Both solutions are more complicated than existing rolled up holiday schemes, and although the only safe one is the first, it is unlikely that employers will move away from rolled up holiday scheme entirely in the immediate future, given that it is popular with both employers and workers.

For further advice on this subject, please contact one of the employment team at Solnick & Co. We look forward to being of assistance to you.

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