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## HOLIDAY PAY

### Introduction

The right for workers to take paid annual leave is well established across Europe. However, the way in which holiday pay is calculated was for many years largely unregulated at a European level, with each Member State left to formulate its own rules. In recent years a spate of European cases have begun to lay down some core principles for the calculation of holiday pay. Despite these cases, many of the practical details for calculating holiday pay are still left to Member States, and this creates scope for some interesting variations.

This briefing examines the European rules on holiday pay, and the way in which those principles are implemented in France, Germany and the UK. We have set out below an executive summary of the key differences in each jurisdiction, which is followed by more detail on the position under European law and in each of the three countries.

### Executive summary

- **Calculating holiday pay:** In **the UK**, the process varies depending on the working pattern, but essentially workers are entitled to a week's pay for each week of holiday, in some cases using a 12 week reference period. In **Germany**, holiday pay is based on a worker's daily or hourly rate, calculated over a 13 week reference period. In **France** there is a dual calculation method; workers receive the higher of (i) what they would have earned if they had worked during their holiday; or (ii) an amount calculated over a one year reference period.
  - **Amounts to include in holiday pay:** In all three countries, holiday pay should include not just basic salary, but also allowances which are 'intrinsically linked' to the performance of the worker's duties. This would typically include for example commission and some overtime payments. There are some variations however, for example in the way salary increases/ reductions are treated in **Germany**, and the inclusion of discretionary bonuses in **France**.
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- **Different rules for different types of holiday:** In **Germany** and **the UK**, different rules may apply to holiday in excess of the four weeks minimum leave under the Working Time Directive (the **Directive**), whereas in **France** the same rules must apply. In **the UK** there are no separate rules for bank holidays, whereas there are differences in **France** and **Germany**.
- **Effect of sickness absence:** In **the UK**, workers can take holiday during sickness absence whereas this is not the case in **Germany** or **France**. The rate of holiday pay may also be affected by sickness absence in **the UK** and **Germany**, although this would not typically be the case in France.
- **Termination of employment:** In all three countries workers are entitled to compensation for untaken holidays on termination, although in **Germany** the worker may instead choose for this to be carried over to the new employer. If a worker has taken more than their pro-rata entitlement on termination, in **France** they will be required to make a payment to the former employer for the excess holiday, whereas in **the UK** this only applies if the employer has expressly imposed such a requirement. In **Germany** such a payment cannot be claimed by the former employer, although the worker's entitlement to holiday with the new employer is reduced by the amount which was overtaken.

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## European law

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Under the Directive, every worker is entitled to paid annual leave of at least four weeks. The conditions for entitlement to, and granting of, such leave are expressly left to national legislation and/or practice. The only further provision made by the Directive is that the minimum period of paid annual leave may not be replaced by an allowance in lieu, except on termination of employment.

The Directive therefore lays down no requirements about the amount of holiday pay, or how it should be calculated. However, the European Court of Justice (**ECJ**) has handed down a number

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of judgments which have expanded on the Directive, and have established the following key principles:

- The purpose of paid leave under the Directive is to ensure that, for the duration of such leave, workers are put in a position which is comparable to periods of work with regards to their remuneration. Therefore, remuneration payments must be continued during the period of leave, and cannot be incorporated into workers' regular remuneration throughout the year (so-called "**rolled-up holiday pay**") (*Robinson Steele*).
- Holiday pay must reflect workers' "**normal remuneration**". This means that holiday pay should include not just basic salary, but also allowances which are 'intrinsically linked' to the performance of the workers' contractual duties, as well as payments relating to their professional and personal status. It need not however include allowances which are intended exclusively to cover occasional or ancillary costs arising in the course of employment (*Williams v British Airways plc*).
- Holiday pay must be calculated by reference to the **commission payments** that the worker would have earned during that period, had he not taken leave, where the commission is directly linked to his work and therefore forms part of his "normal remuneration" (*Lock v British Gas Trading Limited*).
- Holiday pay must be based on an average of the relevant remuneration earned "over a **reference period** which is considered to be **representative**" (*Williams, Lock*).
- Workers absent on **long-term sick leave** are entitled to benefit from paid annual leave under the Directive. The worker can either take holiday during sick leave or on his return to work, and may carry leave forward into the next holiday year if necessary for this purpose (*Stringer v Revenue and Customs Commissioners; Schultz-Hoff v Deutsche Rentenversicherung Bund*).
- Any **payment in lieu** of unused leave **on termination** of employment must be calculated on the basis of a sick worker's normal remuneration (*Stringer*).

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**National law****1. How is holiday pay calculated?**

In **the UK**, holiday pay has traditionally been calculated on the basis of “a week’s pay” for each week of leave (Regulation 16 of the Working Time Regulations 1998 (**WTR**)). “A week’s pay” is calculated in accordance with the complex provisions in sections 221 to 224 of the Employment Rights Act 1996 (**ERA**). The effect is typically that:

- Workers with normal working hours have their holiday pay calculated by reference to their contractual remuneration (typically basic salary only).
- Workers without normal working hours, or whose remuneration varies either according to the amount of work done, or the time at which that work is done, have their holiday pay calculated by using a reference period prior to the holiday. These rules will sometimes, but not always, require that holiday pay includes payments on top of basic salary (such as overtime and commission, depending on the nature of the payments) which have been earned during the reference period.

Under **German law**, the calculation of holiday pay is regulated by sec. 11 German Federal Holiday Act (*Bundesurlaubsgesetz* – **BUrlG**). Sec. 11 BUrlG provides that holiday pay is determined on the basis of the compensation payable to a worker prior to his annual leave. The first step is to divide the worker’s pay into a daily or hourly rate, depending on whether the worker’s daily working time is fixed or variable. The second step is to multiply this rate by the number of days or hours of work which the worker would have actually worked, had he not taken leave. However, modifications to these rules may and commonly will be agreed in collective bargaining agreements and other collective or individual instruments. This is provided they are no less beneficial to workers than the statutory rule in so far as the statutory minimum holiday is concerned.

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In **France**, there is a dual calculation method. Workers must be paid the higher of:

- (A) 1/10<sup>th</sup> of the remuneration paid during the reference period for the acquisition of holiday rights (usually the previous year). This gives the amount for the full annual holiday entitlement, which is then pro-rated for the amount of holiday taken at any one time; or
- (B) what the workers would have earned if they had worked during their holiday.

Holiday rights are calculated in workable days, which includes Saturdays and bank holidays (except 1 May). This means that:

- A worker taking a week's holiday (typically from Monday to Friday) will be treated as having taken six workable days.
- 1/10<sup>th</sup> of the remuneration during the reference period therefore corresponds to the holiday pay for 30 workable days, *i.e.* five weeks.
- If the worker is entitled to less holiday rights, the holiday pay is pro-rated. Similarly, for a worker having a higher holiday entitlement (*e.g.* six weeks, for instance as a result of a collective bargaining agreement more generous than the legal minimum), the aggregate holiday pay will increase accordingly.

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## 2. What amounts must be included within holiday pay?

In the UK, this is a hot topic due to a number of recent cases, in particular *Bear Scotland Ltd v Fulton and related appeals*, which held that holiday pay must include **compulsory overtime** payments (*i.e.* overtime which the worker is required to work if asked, regardless of whether the employer is required to offer it), if it is so regularly required for it to be part of "normal remuneration". In **Germany** and **France**, this is not usually such an issue.

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The current position across all three countries regarding amounts that have to be included may be summarised as follows:

Payment	France	Germany	UK
Base salary	Yes	Yes	Yes
Salary increases during reference period	Yes	Yes, except temporary increases. May also include salary increases during the period of leave.	Yes
Salary reductions during reference period	Yes	Not if caused by "events not falling in the sphere of the worker" (including short time work ( <i>Kurzarbeit</i> ) and strikes that the worker does not participate in).	Yes
Commission	Yes	Yes	Yes
Overtime	Yes	Regular payments: yes Supplemental payments: no	Compulsory overtime: yes Voluntary overtime: potentially
Standby and emergency call-out payments	Yes	Yes	Yes
Bonuses related wholly or partly to individual productivity/performance	Yes	Yes	Yes
Bonuses/profit sharing related exclusively to company productivity/performance	Not if paid for the whole year	No	Probably not
Bonuses - discretionary	Yes	No	Probably not

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Payment	France	Germany	UK
Allowances (e.g. shift and travel) which count as taxable remuneration	Yes	Yes	Yes
Other amounts which are 'intrinsically linked' to the performance of the worker's contractual duties	Yes	Yes	Yes
Other payments relating to the professional and personal status of the worker	Yes	Yes	Yes
Allowances (e.g. expenses) which are intended exclusively to cover occasional or ancillary costs arising in the course of employment.	No	No	No
Benefits in kind	Only if they do not continue during the period of leave	Only if they do not continue during the period of leave	No
Tips and gratuities	Yes	No	Potentially

**3. What reference period is used?**

In **the UK** under the ERA rules, no reference period is used for workers with normal working hours. Their holiday pay is calculated based on their contractual remuneration at the point when holiday is taken. In contrast, a 12 week reference period is used for workers without normal working hours, or whose remuneration varies either according to the amount of work done, or the time at which that work is done. Weeks in which no work is done are discounted from the 12 week reference period. There is no mechanism to deal with workers whose employment terminates after less than 12 weeks service, but in practice, employers will use an amount which fairly represents a week's pay (using the weeks which have been worked).

These rules have now been called into question by recent cases which have determined what amounts need to be included within holiday pay (see section 2 above). As yet, no UK cases have determined what the correct reference period should be following these cases.

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In **Germany**, sec. 11 BUrlG provides that holiday pay is calculated based on a worker's average remuneration payments during the 13 weeks preceding his leave. If a worker has not yet been employed for 13 weeks, the average remuneration paid to date will be used as the basis for the calculation of holiday pay.

In **France**, holiday pay is either calculated based in on the worker's remuneration at the time when holiday is taken, or on the basis of the remuneration paid during the reference period of accrual of the holiday rights, *i.e.* from 1<sup>st</sup> June of the previous year to 31 May of the current year. The calculation is pro-rated if the reference period is incomplete.

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**4. Are there different rules for different types of holiday?**

The principles of European law for calculating holiday pay (as noted above) only apply to the four weeks' leave required by the Directive. In **the UK**, the WTR provide for an additional 1.6 weeks' leave. It is also possible (and not uncommon in practice) that an employer may also give workers extra holiday above and beyond the requirements of the WTR. There is no separate right to time off for the eight UK public/bank holidays each year; if workers take holiday on these dates, it comes out of their 5.6 weeks' leave under the WTR.

It is possible for UK employers to adopt two different rates of holiday pay:

- (A) a higher rate for the four weeks' holiday under the Directive, which includes commission and overtime, etc., and
- (B) a lower rate for the additional 1.6 weeks' holiday under the WTR and any other holiday given by the employer.

Under **German law**, the requirements of sec. 11 BUrlG are mandatory for the four-week statutory minimum leave. Modifications may and often will be agreed in collective bargaining agreements (*Tarifverträge*) and may also be contained in other collective or individual instruments. These modifications must be equal or more generous for workers in respect of the statutory minimum leave. For any leave granted in excess of the minimum, other rules (including rules less beneficial for the employee than those of sec. 11 BUrlG) can be agreed individually or in collective instruments.

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The four weeks' minimum statutory leave does not include the typically ten or eleven public/bank holidays (the actual number depends on the place of work) each year. Workers have a separate right to paid time off on those dates, unless their employer requires them to work (in which case they will typically be entitled to supplemental payments).

In **France**, the calculation method provided for by the Labour Code also applies to any additional holidays granted to the worker under a collective bargaining agreement. However specific calculation methods apply for work on bank holidays, and for days off granted in consideration of the 35-hour week (workers working more than 35 hours a week may be granted extra time off so that their annual duration of work is on average at 35 hours per week).

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**5. When should holiday pay be paid?**

In **the UK**, the prohibition on rolled-up holiday pay has the effect that holiday pay must be paid at the time when the holiday is taken. The usual approach is to include holiday pay within the next salary payment following the holiday. The same is true in **France**.

In **Germany**, sec. 11 para. 2 BUrlG provides that holiday pay shall be paid before a worker goes on leave. However, this is rarely observed in practice although it is mandatory; most German employers will pay holiday pay in the usual salary run after the period of leave to which it relates.

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**6. What about workers on sickness absence?**

In **the UK**, a worker is entitled to holiday pay in the usual way for any holiday accrued or taken during sickness absence. Workers on long-term sickness absence may be receiving benefits under the employers permanent health insurance (**PHI**) policy, rather than their normal remuneration. In those circumstances, it may be possible to argue that the worker is only entitled to sick pay at the reduced rate of his PHI benefits, rather than based on his normal remuneration.

In **Germany**, a worker is also entitled to holiday pay in the usual way for any holiday accrued during sickness absence. Unlike the UK, holiday cannot be taken during sickness absence. If a worker falls sick during his holiday and provides a doctor's certificate to evidence this, his sick days do not count towards his holiday entitlement. As a rule, workers have to take their holiday entitlement in full during the ongoing calendar year, and may only roll it over until 31 March of the following

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year if they could not take it in full for personal or operational reasons. Thereafter, entitlements are forfeited, unless the worker could not take his holiday during such time because he was on long-term sickness absence.

For workers who go on holiday immediately following sickness, one judgment of a higher labour court suggests that their holiday pay must be calculated on the basis of the compensation payable before the employer stopped paying remuneration and the worker received sick pay from a health insurance policy instead. However, this is not yet a binding precedent and other courts may take a different approach, possibly basing holiday pay on sick pay payable in the reference period including the sickness period (which may be lower than the worker's regular pay).

In **France** a worker who cannot take his holiday because of sickness leave at the date when he was to leave on holiday is entitled to have his holiday rights carried over. However, French courts consider that a worker falling sick during his holiday cannot claim such a roll-over. Further, workers do not accrue holiday rights during sick leave. The possible reduction of the remuneration during the period of sick leave is in practice of little consequence to the calculation of the holiday pay, since holiday pay is based on the remuneration that the worker would have earned during the holiday, if it is higher than the remuneration paid during the reference period.

### **7. What happens on termination of employment?**

In **the UK**, if a worker has taken a smaller proportion of his holiday entitlement than the proportion of the leave year that has expired on termination of employment, he is entitled to a payment in lieu to make up the difference. The amount of the payment in lieu is the same as the usual calculation for holiday pay, unless a different method is laid down in the worker's contract, the holiday policy or a collective agreement (known as a 'relevant agreement'). The amount in a relevant agreement cannot be a token amount such as £1 and, following *Stringer*, must be equivalent to pay the worker would have received had he taken the holiday during employment – at least as regards holiday under the Directive. There is some scope for a lower amount to be payable in lieu of the additional 1.6 weeks' holiday under the WTR and any other holiday given by the employer.

Conversely, if the worker has taken a greater proportion of his holiday entitlement than the proportion of the leave year that has expired on termination of employment, there is no automatic

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right under the WTR for the employer to receive a repayment from the worker. Such a requirement can however be imposed by a relevant agreement, and almost always is imposed in practice.

In **Germany**, workers who have taken a smaller portion of their holiday entitlement than the proportion of the leave year that has expired on termination of their employment can choose between carrying their remaining holiday entitlement over to the next employer and receiving compensation for untaken holiday. If they choose the latter, the compensation is calculated in accordance with the rules for holiday pay (either sec. 11 BUrlG (described above) or as otherwise agreed for additional holiday).

For workers who have taken a greater portion of their holiday entitlement than the proportion of the leave year that has expired on termination of their employment, the holiday claim vis-à-vis the next employer is reduced by the excess amount. The former employer cannot ask for repayment of holiday pay that he has paid for such greater portion of holiday taken.

In **France**, workers who have taken a smaller portion of their holiday entitlement than the proportion of the leave year that has expired on termination of their employment are entitled to receive compensation for untaken holiday, calculated in the same way as the holiday pay. As an exception however, workers dismissed for wilful misconduct forfeit their right to untaken holidays.

Since workers are supposed to take their holiday only after it has accrued, the situation that a worker would have taken a larger amount of holiday than has accrued is very unusual in France. In such a situation, the worker would be liable for repayment of the excess holiday to the former employer, unless he could show that the employer intended to increase his holiday entitlement.

### **8. What remedies/enforcement options apply for non-compliance?**

In the UK, a worker can claim for unpaid (or underpaid) holiday pay, or for a payment in lieu on termination, under the WTR. Any such claim must be brought within three months of when the payment should have been made.

Alternatively, claims can be brought as unlawful deduction from wages under ERA. This allows claims based on a “series of deductions”, provided that the claim is brought within three months of

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the last in the series. This created significant concern amongst UK employers about the scope for significant historic liabilities for holiday pay stretching back many years. However, there are now two important caveats to this:

- (A) There cannot be a “series of deductions” for these purposes unless each underpayment is separated by no more than three months. Any gap of more than three months will mean that the worker cannot bring a claim in respect of any earlier underpayments (*Bear Scotland*).
- (B) The UK Government has implemented new regulations to impose a two year limit on unlawful deductions claims. This means that holiday pay claims cannot extend back further than two years, even if a “series of deductions” can be shown. The regulations will only apply to claims presented on or after 1<sup>st</sup> July 2015.

In **Germany**, workers can bring claims for unpaid or underpaid holiday pay or payment in lieu on termination before a labour court. The regular exclusion period of three years, counting from the end of the calendar year in which the claims have arisen, applies. However, it may and often will be curtailed by provisions contained in individual employment agreements or in collective instruments.

In **France**, the rules are very similar to Germany. Workers can bring claims for unpaid or underpaid holiday pay or payment in lieu on termination before a labour court. The statute of limitation is the same as for the regular remuneration, *i.e.* three years from the time the worker knew or should have known he had a claim, or, as regards payment in lieu on termination, from the termination of the contract of employment.

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## Conclusion

Despite being derived from European law, the rules on holiday pay vary significantly between each of the three jurisdictions. In the UK in particular, the rules are still developing, and further differences may yet emerge.

Employers who operate in one or all of these jurisdictions need to be aware of the variations and ensure that the correct rules are followed in each case. There may be some scope for a global approach that satisfies all three sets of rules, although this would need to be carefully considered. Some of the practical points which employers should think about include:

- Which elements of remuneration need to be included within holiday pay – and whether this should lead to any changes in the way certain elements of remuneration are structured in each country (particularly the most costly ones, such as commission, overtime and bonuses).
- To what extent different rates of holiday pay can (and should) attach to different types of holiday. A cost-benefit analysis may be needed to determine whether the potential savings associated with operating different rates of holiday pay would outweigh the cost and administrative burden of operating different rates.
- Dealing with holiday entitlements on termination of employment – for example in the UK, making sure you have the right to require repayment of a sum representing overtaken holiday.

This is an area in which specialist advice will be invaluable.

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## NEWS

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*This material is for general information only and is not intended to provide legal advice.*

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### Further information

If you would like to find out more about any of the issues raised in this briefing, or require advice in relation to a specific matter, please contact:

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