

Understanding Your Tax Code

What is a tax code?

Your Pay As You Earn (PAYE) tax code is an effective way of making sure you pay the right amount of tax during the tax year. Your tax code is unique to you and reflects your personal circumstances. It is your responsibility to make sure your tax code is correct and to contact HM Revenue & Customs (HMRC) if you believe it needs changing or you are unsure how your tax code has been calculated.

An incorrect tax code can result in too much or too little tax being paid

HMRC will often calculate any tax code adjustments based on your historical tax data. It is advisable to provide an up to date income estimate to HMRC.

Where can you find it?

You will find the PAYE tax code on your payslip. HMRC will also often send a "Notice of Coding", or form P2, which indicates a change in your tax code.

01 A N Other		Company Limited	
NI Letter & No : A EG123456B		Tax Code : 1185L	
Pay By : BACS		Date : 28 Apr 2019	
Period : 1			
Description	Rate	Units	This Period
Salary			2,000.00
Health Insurance (BIK)			74.15
Dental Insurance (BIK)			29.35
Total			2,103.50
Ers NIC TP : 239.43		Ers Pension TP : 72.45	
Ers NIC YTD : 239.43		Ers Pension YTD : 72.45	
Tax			305.00
National Insurance			208.20
Pension Contribs.			57.96
Health Insurance (BIK)			74.15
Dental Insurance (BIK)			29.35
Taxable Pay : This Period £2,103.50 To Date £2,103.50			674.66
Tax District : PAYE & SA			Tax Reference : 123/EG54321
			Net Pay 1,428.84

How does a tax code work?

In short, it tells payroll how to calculate the correct amount of tax.

What income is tax free?

The 'Personal Allowance' is the standard amount of tax free pay available each tax year. For the 2019/20 tax year, which runs from 6 April 9to 5 April 2020, the Personal Allowance is £12,500 for individuals with total income below £100,000. The amount was £11,850 for the period up to 5 April 2019.

If your tax affairs are straightforward and your taxable income is below £100,00 per annum (for example, you receive a salary with no taxable benefits or special reliefs) then your Personal Allowance will give you a tax code of **1250L**.

This notifies payroll that you are entitled to tax free pay of £12,500 for the 2019/20 year (or approximately £1,041 per month).

Why is there an extra letter in my tax code?

There are occasionally letters after the tax code, such as 'W1', 'M1', 'X' or similar. This indicates that HMRC has reduced your tax code during the tax year and estimated that you have potentially underpaid tax, but HMRC is waiting until the tax year has finished before checking.

Some employees have a letter K or S before their tax code. The letter K indicates negative allowances (see example below). A letter S at the start of your tax code will be included where you are UK resident for tax purposes, but you have your sole or main place of residence in Scotland for all or most of the tax year. Similarly, if you live in Wales your tax code will start with the letter C.

Why might my tax code change?

HMRC usually sends tax code notifications to individuals and employers in January and February in advance of the coming tax year. In some circumstances, your tax code will need to be adjusted from 1250L.

You receive taxable benefits from your employer...

The amount of tax free pay will be reduced by the estimated amount of the taxable benefit not reported on payroll.

For example, if you receive Private Medical Insurance (PMI) of £500 for the year, your tax free income would be reduced:

Personal Allowance	£11,850
Less PMI	(£500)
Tax Free Pay	£11,350
Tax Code	1135L

You are a higher rate taxpayer and have income from other sources...

The amount of tax free income will be reduced by the estimated higher rate tax that would be due on the other income.

For example, if you receive a gross amount of £1,000 of bank interest and you are a higher rate taxpayer, you will need to pay an additional amount of 40% on the amount in excess of your £500 annual savings allowance. Your tax free pay would be reduced:

Personal Allowance	£11,850
Less higher rate tax on investment income £500 at 40% = £200 x 100/40	(£500)
Tax free pay	£11,350
Tax Code	1135L

You are a higher rate taxpayer and you make pension contributions or charitable donations...

The amount of tax free pay will be increased by the estimated higher rate tax relief that would be due.

For example, if you pay pension contributions of £800 from your net pay, you receive basic rate (20%) tax relief via the pension plan so a "grossed up" total of £1,000 will be invested in your pension. As a higher rate taxpayer, you will be due an additional amount of 20% higher rate tax relief, making the net cost to you £600.

Personal Allowance	£12,500
Plus higher rate tax relief £200 x 100/40	£500
Tax free pay	£13,00
Tax Code	1300L

The above adjustment will not apply where your employer deducts the pension contributions from your gross salary, as full relief will be given at source.

You have an underpayment from a previous tax year...

The amount of tax free pay will be reduced to recoup the tax which has been underpaid. The adjustment takes into account your current rate of tax. For instance, if you are a higher rate taxpayer and you have a tax underpayment of £1,000 the tax code would be:

Personal Allowance	£12,500
Less tax underpayment £1,000 x 100/40	(£2,500)
Tax free pay	£10,000
Tax Code	1000L

Your total income exceeds £100,000 for the year...

Your Personal Allowance is reduced by £1 for every £2 of your income above £100,000. Your Personal Allowance will reduce to nil once your **income exceeds £125,000** in the 2019/20 tax year. For example, if your income for the year is expected to be £115,000 your tax code would be:

Personal Allowance	£12,500
Reduction (excess over £100,000) £15,000/2	(£7,500)
Tax free pay	£5,000
Tax Code	500L

You have deductions in your code exceeding the personal allowance...

This means that an additional amount of taxable pay needs to be factored into the payroll calculations to collect the excess deductions – the resulting code is known as a "K" code.

Personal Allowance	£12,500
Less company car benefit	(£6,850)
Less company car fuel benefit	(£5,900)
Less PMI Premium	(£1,100)
Tax free pay	(£1,350)
Tax Code	K135

There are provisions in place to prevent a very large K tax code from collecting more than 50% of taxable pay in any one pay period. If this is the case, then the underpayment is usually collected by completing a Self Assessment Tax Return and making a payment direct to HMRC.

What do I do if my tax code is wrong?

It is not possible for your employer or payroll provider to speak to HMRC to change your tax code. You are responsible for checking your tax code is correct and calling HMRC to request any amendments.

More information is available on the UK government website: www.gov.uk/tax-codes/overview.

If you have any questions, you should speak to HMRC (contact details below and can also be found on any notice of coding that is sent to you). You will need to have your National Insurance Number when you contact them.

Pay As You Earn, HM Revenue & Customs, BX9 1AS

Telephone: 0300 200 3300 / Outside UK: +44 1355 359022

Lines are open 8am to 8pm Monday to Friday and 8am to 4pm on Saturday (lines are closed Sundays and Bank Holidays).

This Information Sheet was produced in 2019 and is designed to provide general guidance only and covers the most common scenarios; however, there are other types of tax codes which may be applicable in special situations. Tax rates in Scotland and Wales differ to those in England.