

Understanding Tax Codes

What is a tax code?

A tax code is used by your employer or pension provider to calculate the amount of tax to deduct from your pay or pension. If you have the wrong tax code you could end up paying too much or too little tax.

A tax code is usually made up of one letter and several numbers, for example 944L or K497.

If your tax code is a number followed by a letter, you can multiply the number in your tax code by 10, to get the total amount of income you can earn in a year before paying tax. The letter shows how the number should be adjusted following any changes to allowances announced by the Chancellor. Some of the most common tax code letters are explained below.

Common tax code letters and what they mean

- L** - used if you were born after 5 April 1948 and eligible for the basic Personal Allowance.
- P** - is used if you were born between 6 April 1938 and 5 April 1948 and eligible for the full Personal Allowance.
- Y** - is used if you were born before 6 April 1938 and are eligible for the full Personal Allowance.
- T** - used if there are items HMRC need to review in your tax code, for example the income-related reduction to the Personal Allowance.
- K** - is used when your total allowances are less than your total 'deductions'. If your tax code is a 'K' code, for example, K497 the number indicates how much must be added to your taxable income. Read more in this factsheet under 'How the K code works'.

Other tax codes

If your tax code has two letters but no number, or is the letter 'D' followed by a number, it is normally used where you have two or more sources of income and all of your allowances have been applied to the tax code and income from your main job or pension.

- BR** used when all your income is taxed at the basic rate - currently 20% and is most commonly used for a second job.
- OT** used when your allowances have been used up or reduced to zero and your income is taxed at the relevant tax rates. This may also be used if you've started a new job and don't have a P45 or have not completed a "Starter Checklist" before your first pay day.
- D0** is used when all your income is taxed at the higher rate of tax - currently 40% and is most commonly used for a second job or pension.
- D1** used when all your income is taxed at the additional rate of tax - currently 45% and is most commonly used for a second job or pension.
- NT** is used when no tax is to be taken from your income or pension.

If you have two jobs, it is likely that all of your second income will be taxed at the basic or higher rate - depending on how much you earn. This is because all of your allowances will have been used against the income from your main job.

Understanding Tax Codes - cont.

How tax codes are worked out

Step one

Your tax allowances are added up. In most cases this will just be your personal allowance and any blind person's allowance, in some cases it may include certain job expenses.

Step two

Income you've not paid tax on (for example untaxed interest or part-time earnings) and any taxable employment benefits are totalled.

Step three

The total amount of income you've not paid any tax on (called 'deductions') is taken away from the total amount of tax allowances. The amount you are left with is the total of tax-free income you are allowed in a tax year.

Step four

To arrive at your tax code the amount of tax-free income you are left with is divided by 10 and added to the letter which fits your circumstances.

Example

The tax code 944L means that you are entitled to a personal allowance of £9,440 therefore, any amounts earned above this threshold in the current tax year will be subject to income tax.

How the 'K code' works

If your deductions (untaxed income on which tax is still due) are more than your allowances you'll be given a K code. To ensure you pay tax on the excess, the excess tax due is divided by ten and added to the letter K. Whereas with other tax codes the number indicates the amount of income you can have tax-free, the number in a K code indicates how much must be added to your taxable income.

Example

K497 means: Your untaxed income was £4,970 greater than your tax-free allowances, as a result, £4,970 must be added to your total taxable income to ensure the right amount of tax is collected.

Changes that might affect your tax code

You must keep HMRC informed of any change in your circumstances, for example if:

- You get married, form a civil partnership or separate or either of you was born before 6 April 1935.
- You start to receive a second income.
- You become or cease being self-employed.
- You start receiving company benefits, for instance medical insurance.
- You start getting taxable benefits.

If you do not advise HMRC of any of these changes you could end up paying the wrong amount of tax.

Should HMRC change your tax code, you will receive a 'notice of coding' from your local tax office, they will send the same information to your employer and they can then update your tax code on their payroll systems. You should keep all notice of coding letters for reference in case you have any questions or need to check you are paying the right level of tax.