



ACTION POINTS

Check your code

Check that the right tax code is shown on your payslip – if it isn't, too much (or too little) tax may be deducted from your pay.

Keep things up to date

Tell your tax office when your circumstances change, so that it can update your code as soon as possible. That way, you'll pay the right tax.

Check your coding notice

Your coding notice shows the allowances and deductions to which you are entitled. If any are missing, you may be losing out on tax relief.

Correct any errors

Tell your tax office if any estimated figures shown on your coding notice are wrong. That way, you'll stop errors building up.

Your tax code

How tax is taken off your earnings or pension under PAYE, tax codes cracked, plus how to check a coding notice

The PAYE (pay as you earn) scheme applies mainly to income from a job but the same system is used for taxing most company and private pensions.

Under PAYE, tax is deducted directly from your earnings or pension. Revenue & Customs gives your employer (or pension company) a tax code that indicates how much tax-free pay you should get each pay-day. Tax is deducted from anything above this.

YOUR TAX CODE

Your tax code should be shown on the payslip accompanying your pay or pension. You may also get a coding notice from your tax office each year explaining how your code is worked out. Your tax code depends on your circumstances. Most codes consist of:

- a number that tells your employer how much tax-free pay you're allowed in each tax year
- a letter that gives more information – see p12 for what the letters mean.

Tax-free pay

Your tax-free pay is calculated by adding up all the allowances and reliefs to which you are entitled. But your tax code is also used to collect tax on fringe benefits (a company car, say), or on income from other sources that is taxable but paid with no tax taken off (such as the state pension), or tax outstanding from earlier years. Such amounts are deducted from your allowances to give you the amount of tax-free pay you are allowed in the tax year.

You can ask your tax office not to include in your tax code income that doesn't come from your job or private pension, such as interest and rental income – but this will mean that you get a tax return and have to pay the tax in a lump sum.

No tax-free pay

If the total of taxable amounts in your code, such as fringe benefits, comes to more than your total allowances and reliefs, you get no tax-free pay. Instead, the difference between the taxable amounts and

your allowances (shown by the number part of your code) is added to your pay.

To make this clear to your employer, your code begins with K. So if your taxable amounts exceed your allowances by £1,350, you are taxed as if you had £1,350 extra pay, giving a code of K134 (the last figure is knocked off and the remaining number is rounded down).

More than one code

You get a separate tax code for each job or pension but your allowances are given against what you or your tax office regard as your main job. Your gross pay from any other source of income will probably all be taxed at the basic rate (or 40 per cent for higher-rate taxpayers). If this means you pay too much, or too little, tax over the year, next year's tax code will be adjusted. ►

YOUR CODING NOTICE

We guide you through your coding notice and explain what your tax code means

A coding notice tells you how your tax code is worked out. Coding notices are normally sent out in January or February each year, so any tax changes can take effect at the start of the next tax year in April. You may receive one at other times if tax rules or your situation change.

You won't necessarily get a coding notice. For instance, if the letter in your code is L, P, V or Y, your employer may be able to alter your code number automatically, to take account of increases in allowances.

REVIEWING YOUR CODE

If you fill in a tax return, your tax office will use the information in it to adjust your code. If you don't get a return, your tax office may send you a tax review form (P810) from time to time to check your code – particularly if it includes taxable amounts above a certain value (such as untaxed interest) or some types



CHECK THE CODE

Having the wrong tax code cost Elspeth McCreadie almost £4,000 over three years.

When Elspeth changed jobs in 2002, she didn't give her new employer her P45. If you don't have a P45, you usually get the basic personal allowance until you get a new code. But Elspeth was put on code BR and did not get a new code. Her pay was taxed at the basic rate – she didn't get any tax-free pay.

Elspeth's tax office said her code was correct. It was only in 2005 she realised the problem and claimed. She's now on the right code and has had a refund.

TAX CODE LETTERS AT A GLANCE

BR or DO All your pay from this source is taxed at the basic (BR) or higher (DO) rate. Used if you have more than one source of PAYE income and all your allowances have been used up against another source of income.

K Your total deductions, such as fringe benefits, exceed your allowances.

L You get the basic personal allowance.

NT You pay no tax on this income.

OT No tax-free pay, but tax at starting rate first then basic rate then higher rate as applicable.

P You get the full age-related personal allowance for someone aged 65 to 74

T Used if your tax office needs to review your tax code. You can also ask your tax office to use it if you don't want your

employer to know personal details. It does not mean you are on a temporary tax code.

V You get full age-related personal allowance for someone aged 65 to 74, plus full married couple's allowance for couples aged under 75, and you are likely to pay basic-rate tax.

Y You get full age-related personal allowance for someone aged 75 or over.

of tax relief (for work expenses, say). If you don't get a tax return or a P810 and you're concerned about your code, contact your tax office.

Check allowances

If you are eligible for any of the following allowances or reliefs, check to see that they are included in your coding notice:

- blind person's allowance
- married couple's allowance
- a deduction for work expenses or essential professional subscriptions
- higher-rate tax relief on payments into a personal or stakeholder pension or gift-aid donations to charity (the basic-rate relief is given direct to your pension plan or to the charity).

Check taxable items that may apply

You need to look out for items that you have to pay tax on, including:

- company cars and other taxable fringe benefits
- earnings not taxed under PAYE, such as income from freelance work, commission or tips
- taxable state pensions and benefits; taxable rental income
- taxable savings income received with no tax taken off
- for higher-rate taxpayers, an adjustment for higher-rate tax owed on savings income.

UNPAID TAX

Your tax office may use your code to collect tax underpaid in a previous



TIP

Tell your tax office at once if things change – you get new untaxed income, say, that might reduce your tax-free pay or a new allowance. That way, you'll pay the right tax.

year that is not being collected in a lump sum. If so, the figure you see is not the tax itself but the figure that when multiplied by your top rate of tax, yields the right amount. Say you owe tax of £100 and your top rate of tax is 40 per cent; your code will show £250 because £250 x 40 per cent = £100.

PEOPLE AGED 65 OR OVER

If either you or your spouse (or civil partner) were born before 6 April 1935, you'll get married couple's allowance. Depending on your income, you may get a higher personal allowance and a higher married couple's allowance. The estimated income your tax office uses to work out your allowance is in the notes on the coding notice; contact your tax office if it is wrong.

MORE HELP

HMRC leaflets and helpsheets

- IR10 Paying the right tax on your earnings or pension
- IR121 Income tax and pensioners
- IR208 Payslips and coding notices

YOUR CODING NOTICE

Your coding notice shows all the allowances and deductions you are entitled to and it is this information that is used to work out your tax code. It is crucial that you check that the details are correct and that you notify your tax office straightaway of any discrepancies – otherwise you may pay the wrong amount of tax.

A new-style coding notice is being introduced this year but it follows the same principles as the coding notices you may have had in the past.

Here we show an example of the new-style notice that June Budd received in February 2006.

HM Revenue & Customs

PAYE Coding Notice

Tax code for tax year **2006 - 2007**

Please keep all your coding notices. You may need to refer to them if you have to fill in a tax return. Please also quote your tax reference and National Insurance number if you contact us.

010000:00000080:001 A91/1

MS J BUDD
100 ACACIA AVENUE
ANYTOWN
ANYSHIRE ANY TWN

H M INSPECTOR OF TAXES
NORTH WEST MU1
5 ABBEY FOREGATE
SHREWSBURY
SALOP
SY2 6AD

Inland Revenue office phone
01567 3456789

Date of issue
13 FEB 2006

Tax reference
491/G7070/HD

National Insurance number
CE 00 00 30 A

Dear MS J BUDD

Your tax code for the year 6th April 2006 to 5th April 2007 is 153L

You need a tax code so Giveus Abreak can work out how much tax to take off the payments they make to you from 6th April 2006. We have worked out your tax code but need you to check that our information about you is correct. The wrong tax code could mean you pay too much, or too little tax. Please keep your coding notices, you may need them if we send you a tax return.

Here is how we worked it out

your personal allowance	£5035 (see Note 1 below)
car benefit (new rules)	- £1500 (see Note 2 below)
car fuel benefit	- £1500 (see Note 3 below)
interest without tax taken off (gross interest)	- £500 (see Note 4 below)
a tax free amount of	£1535 (see Note 5 below)

If we have got this wrong, or if your circumstances have changed and you think it could affect the tax you pay, please tell us. Our telephone number and address are above. We turn £1535 into tax code 153L to send to Giveus Abreak. They should use this code with the tables they receive from the Inland Revenue to take off the right amount of tax each time they pay you from 6th April 2006. Giveus Abreak do not know the details of 153L or how it is worked out – that is confidential between us.

Notes

- The law allows everyone who lives in the UK to receive some income before tax has to be paid – a "tax free amount" of income. That tax free amount starts from a "personal allowance" that depends on your circumstances. Our records tell us you are entitled to £5035 for this tax year, the standard personal allowance for people who will be under 65 at 5th April 2007.
- We have to see if anything should reduce your tax free amount. We understand you have a company car from Giveus Abreak. You have to pay tax on the benefit of using that car for your private motoring. By taking into account the
 - car's cost,

P2(New) Page 1 Please turn over

Tax code

Your tax-free amount is converted to your tax code by removing the last digit and adding the relevant code letter. See 'Tax code letters at a glance', opposite, to check your letter is correct. As June is entitled to only the basic personal allowance, she gets an L. Her code is 153L.

Allowances

June's allowances are shown at the top of this box. She gets a personal allowance (the amount that she can receive in income before paying tax) of £5,035, but no other allowances or reliefs.

Taxable amounts

These are amounts on which your tax office wants to collect tax. In June's case, they are:

- her company car and car fuel (each with a taxable value of £1,500)
- interest from a National Savings & Investments account paid with no tax taken off.

Your tax office may need to adjust the amount entered, so that, when multiplied by your top rate of tax, it produces the right amount. For example, June received £550 interest, but only £500 is shown. This is because her interest is taxable at a lower rate (20 per cent) than her earnings (22 per cent). $£500 \times 22\%$ produces the same amount (£110) as $£550 \times 20\%$.

Tax-free amount

Taxable amounts are taken away from your allowances and the result is the tax-free income you can have in the tax year – £1,535 in June's case. June can earn one twelfth of this (£128) free of tax each month.