



January 2021

## **Tax code time!**

Here we go again, it is tax code time. In the weeks before the new tax year beginning on the 6th April, HMRC will be busy sending out tax codes with the bulk of them being issued during February and March.

Tax codes apply to everyone who is employed full-time or part-time, or receiving a private pension and everyone who is in receipt of a tax code has a responsibility to check that the tax code is correct. Do not assume that responsibility for getting it right rests with employers, pension providers and HMRC. Whilst they have their part to play, it is ultimately up to everyone to make sure that their tax codes are right and also working correctly.

Nowadays, coding notices are computer generated within HMRC and transmitted directly to employers' or pension providers' computer systems without any human intervention. This sometimes means that errors can go undetected for a whole year or even longer, so it's important that you check the details. If there is an error and the wrong amount of tax is collected, HMRC will follow this up and you could face a tax bill after the end of the tax year. However if you check your code and spot the error you can let HMRC know and avoid an unexpected bill later.

## **Checking a tax code**

A tax code is a combination of numbers and letters and is used by employers and pension providers to work out how much income tax should be deducted.

Most people can earn £12,500 between 6<sup>th</sup> April 2020 and 5<sup>th</sup> April 2021 before paying tax. This is known as the tax-free allowance and it amounts to £1041 per month or £240 a week.

HMRC drop the last digit of the tax-free amount and then add on a letter. For example, in 2020/21, where the tax-free amount is just the personal allowance of £12,500 the tax code will be **1250L**.

This may be the case for 2021/22 as at the time of writing we have not been made aware of an increase in the personal allowance from 6<sup>th</sup> April 2021.

There are items included in the tax code calculation that will reduce the tax-free amount and increase the amount of tax that is taken from wages or pension. For example, the state pension. The state pension is taxable but the Department for Work and Pensions (DWP), who pay it, do not operate the PAYE system. The tax



due is therefore collected by reducing the tax-free amount by the total amount of state pension paid during the year.

Contribution based Employment Support Allowance is another taxable benefit.

Benefits from your employment, such as medical insurance should be included in your tax code and can therefore increase the tax you pay.

Allowances, such as the blind person's allowance, marriage allowance or flat rate job expenses increase the amount of tax-free pay and reduce the amount of income on which tax is paid. This means less tax is paid when relief is given 'through the tax code'.

The inclusion of savings interest in the code reduces the personal allowance so you should check the amount of the savings interest included in your tax code. It is an estimate that HMRC are making of the interest you will receive usually based on the amount received in previous years, so if there have been changes, HMRC will not know unless you let them know. The tax-free amount is reduced or increased as necessary and this forms the basis of a tax code.

The final letter in the tax code is there for HMRC or your employer (or pension provider) to refer to. The most frequently used letters are as follows:

L is the most common letter on tax codes

M denotes 10% of your spouse's personal allowance has been transferred to you

N you have transferred 10% of your personal allowance to your spouse

T allowances are split between 2 or more incomes and HMRC will review the code

X HMRC will review the tax paid at the end of the tax year

BR income taxed at basic rate, 20%

## **K codes**



There is one other type of tax code that you may receive, which is a K code. This code applies when items that reduce the tax-free allowances, for example a large state pension, exceeds those allowances, resulting in 'minus allowances'. HMRC treat these minus allowances as extra income on which tax is due, and they use a special code number, beginning with the letter K.

For the K code, HMRC drop the last digit of the minus allowance, and deduct one. For example, if you have minus allowances of £2,970, your tax code will be K296.

K codes are designed to collect extra tax, but cannot take tax of more than 50% of that period's pay (or pension). So while they are designed to collect the extra tax due, it might not be possible to do so and you may still have additional tax to pay at the end of the year.

If you think any of the items on your tax code are wrong or you have any questions about your tax codes, either contact HMRC on 0300 200 3300 or if on a low income, call Tax Help for Older People on 01308 488066.

This article is by Tax Help for Older People Registered Charity no 1102276 (Scotland no SC045819), offering free tax advice to older people on a low income who cannot afford professional help.