Factsheet from
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Helping smaller businesses and their owners manage their accounting, business and taxation

A guide to PAYE tax codes

The basics

HMRC reviews your PAYE tax code from time to time, e.g. in the autumn after processing employer and pension company payrolls from the previous 5 April, after filing a Self Assessment Tax Return or starting a new job. New PAYE tax codes are normally issued in February each year ready for the new tax year.

A PAYE tax code indicates how much of your salary can be received before any tax is payable. The higher the tax code the more of your gross pay will be tax-free and the less tax you will pay.

Interpreting your tax code

Tax codes consist of numbers and a letter. The letters play no part in the tax calculation process. The letters make it easy to identify groups of similar people, e.g. those with codes ending in ‘L’, to make it easier for employers and pension companies to update codes ending in ‘L’ by a fixed annual amount.

If you have more than one job, or a job and a pension, you will have a tax code for each. Usually each code will be different. You can divide your full personal allowances between two or more jobs or pension companies. See Example 2 below. If your personal allowance was not shared between your employments and/or pension income, you may pay too much tax on one job or pension.

HMRC takes off the final digit from your allowance and adds an appropriate letter, usually at the end, but sometimes at the beginning e.g. a ‘K’ code, where tax code deductions exceed your allowances.

Checking the numbers

Your code is made up of tax allowances and reliefs. For example, every individual has at least £12,570 pa (for 2023-24) tax-free allowances, known as the personal allowance. There are very few other tax allowances. You will rarely see others in your tax code. A basic tax code for 2023-24 is therefore 1257L.

Common examples of tax reliefs (tax savings) are higher rate pension relief (for higher and additional rate taxpayers who pay into a personal pension plan), job related expenses (where you incur expenses in your job that are not reimbursed to you by your employer).

HMRC adds up your tax allowances and reliefs and then takes away any relevant deductions to arrive at your net tax-free allowances, which is then partly used to create a tax code.

Checking the deductions

This is where things usually go wrong, so check the deductions are correct. HMRC can deduct all sorts of things from your tax-free allowances. The list below gives the most common items:

- **Untaxed state and other pensions and other taxable state benefits.** Check that the amount included in the code ties up with the amount you expect to receive for the tax year.
- **Benefits-in-kind.** Check that the figures estimated by HMRC are reasonable and take account of known changes, e.g. your company car or employer provided medical insurance.
- **Untaxed investment income.** Check the estimate of income is reasonable. This could be rental income, bank interest or dividends. HMRC sometimes tries to be helpful and collect expected tax on your estimated untaxed income through your tax code each time you are paid through your employer or pension company. You do not have to pay tax on your untaxed income until after the tax year ends. Unless you want to pay your tax early, by spreading the extra estimated tax each week or month, you can tell HMRC to remove a coding adjustment.
- **Taxed investment income.** If you are liable to higher rate tax and receive investment income, e.g. bank interest that has only had basic rate tax (20%) deducted at source, HMRC may try to collect the extra tax by adjusting your code. Again, the principle for untaxed investment income applies i.e. you can have the adjustment removed from your code.
- **Tax underpayments.** If you owe tax from an earlier tax year, you can sometimes pay this weekly or monthly through your wages, salaries or pension income over the next tax year. Check that HMRC has included the correct amount of tax due in the code number. It is not uncommon to find the wrong amount of tax being collected.

Resultant tax code

The allowance left, if any, after taking off the various amounts, is used to work out your tax code.

Examples of working out tax codes

Example 1

If your personal allowance totals £12,570, your tax code number will be 1,257 followed by a letter, most usually 'L' i.e. 1257L. This tells your employer or pension company to treat £12,570 of your pay as tax-free. The tax-free amount is divided equally between each pay period. If you are paid monthly, a code of 1257L will mean that the first £1,048 pm of your gross pay will be tax-free.

Example 2

You are due a full personal allowance of £12,570 in 2023-24. You have a job that pays £2,000 pa and another that pays £8,000 and your also receive a state pension of £6,000 pa. You always receive your state pension gross of tax, though it is still fully taxable. You therefore have £6,570 (£12,570 less £6,000) of your personal allowance available. HMRC may allocate a tax code of 200L (worth £2,000) to your first job. This means that you pay no tax on that job. Your second job will therefore have a tax code of 457L (worth £4,570). You therefore only pay tax on the second job on your salary above £4,570 pa. You receive £12,570 tax free (i.e. £6,000 pension + £2,000 salary + £4,570 on your main job).

Cumulative tax codes

Most tax codes are cumulative. The tax code tells your employer or pension company how much tax-free pay to give to you each week or month before you start paying income tax. The tax code, i.e. tax-free pay, is normally allocated evenly over the tax year. If you are paid monthly and are being paid for the month of August (which is tax month 5, as the tax year starts in April each calendar year) then you are due to 5/12th of your tax code each month. In September, you will be due another 1/12th etc.

The income tax that you pay each month will normally be after receiving 1/12th of your tax code. However, if you have not fully used your allowances from previous months, e.g. you did not have a job or your income was too low, then you can use them against subsequent months' salary.

If your tax code increases, the effect will usually be backdated to the start of the tax year. This is known as the 'cumulative system' of receiving your tax code. The tax that you pay each month takes account of your gross pay to date and tax paid to date in previous months.

The tax that is due each month is calculated by comparing the tax that you should have paid to date, based on a proportion of your tax code, to the tax that you have paid to the end of the previous pay date. You will therefore pay more tax or receive a tax refund each month to keep you in line with the tax due to date. The idea is that when you reach the end of the tax year you have fully used your tax code and paid the correct income tax. National Insurance works differently, and is calculated on a month-by-month non-cumulative basis, unless you are a director of a company.

The effect of a change in tax code mid-year

HMRC may tell your employer to change your tax code at any time. However it will usually not do this in March because it's too near the end of the tax year and your employer might not be able to put the new code into use against your salary before the year ends.

The amount of the tax adjustment depends on how much your code changes. If halfway through the tax year your code increases by 100 points, you will receive an extra £1,000 of tax-free pay over the tax year. Because the new code applies half way through the tax year, you will only get the benefit of £500 extra tax free on your next payday. If you are a basic rate taxpayer, i.e. you pay at 20%, the amount of tax reduction will show in your net pay as £100 (£500 x 20%). The remaining extra tax-free allowance, in this example £500, will be spread evenly over the remaining months of the tax year.

If your tax code is reduced this will result in higher tax on your salary from your next pay period.

Non-cummulative tax code

Sometimes you will see W1 or M1 at the end of your tax code. This is not a tax code, but a method of applying a tax code. This stands for 'week 1 / month 1'. It means HMRC has asked your employer or pension company to operate your tax code on a non-cumulative basis. This means that income and tax deducted earlier in the tax year, as described above will not apply. Instead each time you are paid your employer or pension company must work out the tax for that week or month in isolation to all other tax periods i.e. as if you were being paid in the first week or month of the tax year in April. Therefore, the terminology of week 1 or month 1 is used.

List of tax code suffixes

HMRC use some the following letters at the end of tax code.

L you are entitled to the basic personal allowance of £12,570 for 2023-24 e.g. 1257L

M you have received a transfer of 10% of your spouse's personal allowance e.g. 1383M

N you have transferred 10% of your personal allowance to your spouse e.g. 1131M

T HMRC believes there are 'other items' that need to be considered as part of the calculation.

List of tax code prefixes

S HMRC believes that you are resident in Scotland for tax purposes and that your employer should use the Scottish tax rates to work out the PAYE tax payable on your salary.

C HMRC believes that you are resident in Wales for tax purposes and that your employer should use the Welsh tax rates to work out the PAYE tax payable on your salary.

K you have minus allowances, i.e. more deductions from your tax-free allowances e.g. you have untaxed state pension, benefits in kind from a job or tax to pay from a previous tax year.

Special tax codes

HMRC uses some special tax codes that are explained below.

BR this tells your employer or pension provider to deduct tax at the basic rate, currently 20%, on all your pay. This will normally apply to a second job or pension where you have already used the full £12,570 personal allowance in the tax year through a main job or pension.

0T this means you have zero tax allowances. It tells your employer not to allow any tax-free allowances, e.g. £12,570 pa, against your salary e.g. if you earn over £125,000.

NT this tells your employer or pension provider not to deduct any tax at all from your pay. It is most often used for foreigners who are working in the UK temporarily.

D0 tells your employer to deduct 40% higher rate tax from your pay.

D1 tells your employer to deduct 45% additional rate tax from your pay.

K if your code starts with a 'K' it means that instead of having some tax-free allowances, you have negative allowances. This means that instead of reducing your taxable pay, the 'K' code increases it. A code of K500 will mean that over the course of the tax year your employer will tax you as if received an extra £5,000 in pay i.e. you pay more tax then normal on what pay you do receive.

This guide deals with income tax payable through the PAYE scheme. National Insurance is dealt with under a separate set of rules. National Insurance is generally payable based solely on the salary in the pay period i.e. each week or month and does not take account of previous or future salary or National Insurance paid.