

What tax code should I be on? How UK tax codes work

UK tax codes tell contractors how much tax they will be paying each time they are paid via a Pay As You Earn (PAYE) payroll. Determined by HMRC, a tax code usually consists of a series of numbers and letters. If a taxpayer has more than one employer or pension provider, they may have more than one tax code.

Limited company contractors have much greater control over how and when they take remuneration from their business, adjusting for any tax underpayment or overpayment via their **self-assessment tax return**.

Umbrella company contractors are employees, so their tax code is generally fixed. However, if an umbrella company contractor changes service provider suddenly or frequently, they may find themselves on **emergency tax codes** while their paperwork catches up.

Why do I need a tax code?

In the UK, PAYE is used to deduct tax from earnings each time a worker is paid, hence the name Pay As You Earn. This means that a taxpayer spreads their annual tax bill over 12 months, and does not pay it all in one lump sum. A tax code is used to tell an employer how much tax they should deduct from an employee's salary every time they are paid via PAYE.

Limited company contractors are employed by their own company, and their contractor accountant runs a PAYE scheme on their behalf, so they need a tax code even if they don't pay any tax because they take a salary that is below the personal allowance.

Umbrella company contractors are also employed, but by their service provider. The umbrella company will run the PAYE scheme and deduct the correct amount of tax from the contractor's salary.

How do I find out my tax code?

A limited company contractor who takes a **low salary** and outsources their payroll to a contractor accountant will find their tax code on their monthly or weekly payslip. Their accountant will liaise directly with HMRC to find the contractor's correct tax code.

If a contractor registers with HMRC to set up their own PAYE payroll scheme, they will be told their tax code via a PAYE Coding Notice. Umbrella company contractors are employees of their service provider that will be responsible for obtaining their tax code from HMRC, and it will be on their umbrella company payslips.

Generally, when a contractor leaves their last job to go contracting they will be given a P45 by their former employer that will include their tax code. And each year, via a limited company contractor's payroll or the umbrella company's payroll, a contractor will receive a P60 that includes the tax code.

What do the numbers and letters in a tax code mean?

Most limited company and umbrella company contractors with a single source of income will have a straightforward tax code made up of numbers and letters. The **numbers in a tax code** relate to a contractor's personal allowance and the **letters in the tax code** add further information. For example, the 1000L tax code means a contractor can earn up to the full personal allowance before they have to pay tax, and the 'L' means they are entitled to that full personal allowance.

But if a contractor has additional income that has not been taxed, such as rental income from a property, or if they have benefits such as a **company car**, then they will not qualify for the full tax free personal allowance, so may have numbers showing how much of the tax-free allowance remains and then the letter 'T'.

Changes in a contractor's personal circumstances related to earnings results in their tax code being adjusted and the number and letter will change. This then tells the employer – the contractor accountant or umbrella company – that the contractor's pay must be adjusted.

What are Emergency Tax codes?

Normally, an employee will leave one employer and be given a P45 as they leave which includes their tax code. They hand this to their new employer who then knows what tax code to use and deducts tax via PAYE accordingly.

However, umbrella company contractors who have suddenly changed umbrella company service provider or perhaps changed providers rapidly, may find that they do not have a P45 to hand to their new employer.

The umbrella company hiring the contractor uses as emergency tax code that automatically deducts 20% income from the contractor's salary. This is most likely too much tax for the contractor to be paying, but eventually HMRC will issue a new tax code which will be adjusted to allow for the overpayment.

Will Real Time Information (RTI) affect my tax code?

HMRC's Real Time Information (RTI) means that when an employer runs a payroll, HMRC is told how much each employee is paid and how much tax is deducted on or before the employee is actually physically paid.

One of the main objectives of RTI is to help employees with complex employments to avoid overpaying/underpaying their tax via PAYE. So, in theory employees should always be on more accurate tax codes and be paying the correct amount of tax even though they may have income from several employments and [pensions](#).

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