
Lesson 8 – Advanced PAYE codes

Lesson outcomes

This lesson covers different PAYE codes and how to deal with these when using the various tables.

At the end of this lesson you will be able to:

- Understand why different tax codes such as Basic rate and K codes are used
- Calculate net pay for employees with BR and K codes
- Complete P11 forms for such employees
- Understand the reasons for having regulatory limits
- Calculate the amount of tax to be deducted when the regulatory limit is applied
- Understand when week 53 is used
- Recognise the forms used to record month end payments
- Understand the procedures involved in year end calculations
- Recognise the various forms used in year end procedures

BR Code

A person who is given the tax code BR (Basic Rate) will have tax deducted on ALL earnings at the rate of 20% i.e. Tables A should not be used.

A BR code indicates that no tax free allowances should be deducted, and there is no number associated with a BR tax code

When calculating the amount of tax due with a BR code, Table B is the only table used.

A BR tax code is normally applied when an employee has more than one job – tax free pay can only be applied to the first or main job, subsequent jobs will be taxed at basic rate as the personal allowance can only be applied once. An employee can therefore have more than one tax code at a time, one to allocate the personal allowance, and the BR tax code to deduct tax at 20% on all other earnings.

Example 8.1

An employee has a tax code BR applied. Given the following pay, tax will be deducted as follows:

Gross pay in week = £ 356.00 Tax due (from Tables B) £71.20
Gross pay in month = £2080.00 Tax due (from Tables B) £416.00

Practice Question 8.1

Using the correct deduction table calculate the tax to be deducted from employees with BR Tax Codes having earned the following amounts:

- a) £3766
- b) £427.60
- c) £2198.75
- d) £286.90

K Codes

If a tax code is a letter **K** followed by a number, it means that the person has been paid an amount of income, free of tax, which is greater than the personal allowance that they would normally be given. The tax on this additional amount must be recovered in some way from other earnings and the K Code will deal with this.

This code will often be applied to someone who is retired and receives a pension free of tax but it still working, or an employee (often a director) who has high amounts of benefits (income from such things as a company car) which do not form part of their basic salary.

It is a common thing for employees to be given rewards other than in money. The practice grew out of an endeavour to give staff a reward that would not be taxed. A "Perk" as the term became known.

However as fast as employers found ways to give perks, the Revenue brought them into the taxable income bracket. Today there is virtually no perk that is not liable, at least in part, to be taxed.

Prior to 1993 tax on perks was collected when an assessment had been completed sometime after the end of the tax year. This caused extra work for the Inland Revenue and presented employees with a bill they often could not pay.

In April 1993 K codes were introduced as a method of collecting tax on perks at the same time as tax on earned income, ie through the PAYE system.

Where an employee receives taxable benefits from his employer for example a motorcar, it is, like his/her salary, taxable. This tax is collected by **REDUCING** the code number by the taxable value of the car. Which in effect means that the employee pays more tax each week / month because the lower code number reduces the amount of free pay.

This adjustment to a code number can result in the benefits **EXCEEDING** the employees personal allowance.

For example say the basic allowance for a single person is £5435 and a car is given which is valued for tax purposes at £8000. There is a taxable benefit of £2565, or in other words, the taxable value of the benefit is more than the free pay allowance. In effect the employee has a "negative tax code."

Under the PAYE system the amount shown in the free pay tables for the negative tax code is **ADDED** to the taxable pay in order to arrive at Total Taxable Pay. The need to apply this principle is indicated by a K code.

Example 8.2

A retired person receives a car benefit of £6000 and other benefits worth £850 during the year. As the standard personal allowance is £5435, they have £1415 of income should have been taxed but which has not. The code that they will be given will be K141(ignore the last digit)

Make up of a K code.

	£	£
Personal allowance		5435
Car benefit	6000	
Other benefits	<u>850</u>	<u>6850</u>
Excess benefits not taxed		<u>1415</u>
PAYE Code		K141

As indicated there is an amount of £1415 to be collected in addition to the tax due on earned income. But as with earned income this is collected OVER THE TAX YEAR and not as a lump sum as was the case prior to 1993.

Practice Question 8.2

A person aged 55 has untaxed income of £8500. What tax code will be applied in this case?

Calculating taxable pay with a K code

The tax free pay tables are used in the same way as if the code was a normal one with the suffix L but instead of subtracting the amount of free pay from the gross pay to date it is added.

Example 8.3

James Dean is paid weekly and has a tax code of K250. Up to and including week 12 his total earnings have been £2880. His earnings in week 13 are £240. What is his Total Taxable Pay to date.

Answer:-

		£
Total taxable pay to week 12		2880.00
Earnings in week 13	240.00	
Code K250 addition (from table A)	<u>627.25</u>	<u>867.25</u>
Total taxable pay in week 13		<u>3747.25</u>

Practice Question 8.3

Tony has tax code K191. In the first month of the year he earns £2300. What will his taxable pay be?

Form P11 and K Codes

Where a K Code is in operation, the shaded columns 4b, 6a, 6b and 8 come into use replacing cols 4a and 6

This is done by using the Pay Adjustment Tables just as normal except that the K code indicates the additional pay (entered in col. 4b rather than as normal in col. 4a) which must be ADDED to the total pay to date (col.3) (rather than deducted as with other codes) to give total taxable pay to date (col. 5).

Column 4b replaces column 4a and the figure is added.
Column 6a replaces column 6 and is the tax due.

Note columns 4a and 6 will not be shown in the following examples.

Example 8.4

You are given the following details concerning 3 employees all with K codes.

Employee	Code No.	Week/Month No.	Total pay to date - £
A	K59	Week 12	3912
B	K10	Week 15	4260
C	K68	Month 3	6000

A and B are paid weekly, C monthly.

Show the entries for cols. 3, 4b and 5 for the week/month.

Answer

Employee A

Month no	Week no	2	3	4b	5	6a
2	8					
	9					
	10					
	11					
	12		3912 00	138 24	4050 24	
3	13					

Employee B

Month no	Week no	2	3	4b	5	6a
3	13					
	14					
	15		4260 00	138 24	4050 24	
	16					
	17					
3	18					

Employee C

Month no	Week no	2	3	4b	5	6a
2	8					
	9					
	10					
	11					
	12					
3	13		6000 00	172 26	6172 26	

Given the previous month's tax due to date, the current month's tax can be calculated in the normal way.

Practice Question 8.4

Mary Q is a monthly salaried employee whose PAYE code is K385.

At the end of month 6 her total pay to date was £7,500 with tax deducted £2035.17.

Her pay for month 7 was £1500 and for month 8 £2000.

Month	(2)	(3)	4(b)	5	6(a)	7
6						
7						
8						

What tax will be deducted in months 7 & 8?

Regulatory limit

The Revenue decided that, as a result of the use of K codes, some deductions may be excessive thus causing hardship. As a result they introduced what is known as **the regulatory limit**. This rule places a limit of tax that can be deducted in the week or month of 50% of the pay earned in that week or month. (The figure in col. 2).

Example: If the figure in col.2 is £360 then the maximum amount of tax that may be deducted is £180.

Unfortunately the employee does not escape the additional tax over the 50%, this will be collected in a later week/month or possibly by a demand at the end of the financial year.

Form P11 and the Regulatory Limit

When the regulatory limit comes into operation

Column 6b is used to indicate the regulatory limit

Column 8 is used to indicate the amount of tax owing as a result of applying the regulatory limit.

The figure for tax deducted or refunded (col.7) is the lower of the figures in columns 6a and 6b and is, as with non-K codes, the tax that will be deducted. If the figure in 6a is smaller than the figure in 6b there is no restriction. If the figure in 6b is smaller than 6a then the 50% restriction applies.

The figure unpaid as a result of applying the restriction is entered in col.8. This figure is then included in the figure of tax due in the next pay period.

This often occurs when a tax code is changed during the year.

Example 8.5

At the end of month 3, Clive has been paid £4500, and tax of £654.54 has been deducted using tax code 490L.

At the start of month 4 you are notified that a tax code of K350 must be applied.

The following tax deductions are calculated (note that the columns have changed in month 4 with the application of the K code:

Month	(2)	(3)	4(a)	4(b)	5	6(a)	6(b)	7
3		4500.00	1227.27		3272.73	654.40		
4	1500.00	6000.00		1169.68	7169.68		1433.80	779.40
5								

The tax that would normally be due is £779.40 – however the maximum tax that can be taken in any one month is 50% of the gross pay i.e. in this case £750.00

Hence the regulatory limit comes into play and the maximum tax entered in column 7 with the remainder entered into column 8

Month	(2)	(3)	4(a)	4(b)	5	6(a)	6(b)	7	8
3		4500.00	1227.27		3272.73	654.40			
4	1500.00	6000.00		1169.68	7169.68		1433.80	750.00	29.40
5									

At the end of 5 the table will look thus:

Month	(2)	(3)	4(a)	4(b)	5	6(a)	6(b)	7	8
3		4500.00	1227.27		3272.73	654.40			
4	1500.00	6000.00		1169.68	7169.68		1433.80	750.00	29.40
5	1500.00	7500.00		1462.10	8962.10		1792.40	388.00	

Note: the tax due in month 5 is £1792.80 - £1433.80 plus the remaining £29.40

If the amount of tax due is still over £750, then £750 is deducted in tax and the remainder carried forward in column 8.

The calculations continue until all the tax has been collected – if at the end of the year there is an outstanding amount this will either be collected in a lump sum or carried forward in a new tax code for the following year.

Practice Question 8.5

Jim J is another salaried employee whose pay code is K360. At the end of month 6 his total pay to date was £7,500 with tax deducted £1842. His pay for the month for month 7 was £1750 for month 8 £50 and for month 9 £1750.

Complete the necessary columns on Jim's P11 for the months 7, 8 and 9.

Month	(2)	(3)	4(b)	5	6(a)	7	8
6							
7							
8							
9							

K codes on a week 1 or month 1 basis

Where week1/month1 code is in operation any tax unpaid as a result of the regulatory limit is **NOT** collected on a future payday but is reconciled at the end of the financial year.

Week 53

You will see that Form P11 has a line below week 52 bearing a symbol. It is intended that it be used where the pay day falls on 4th or 5th April, or when a tax year has 53 weekly paydays, 27 fortnightly paydays or 14 four weekly paydays.

This extra payday is called week 53, week 54, or week 56 dependent on the pay period concerned.

When completing Form P14 at the end of the year there is a box headed "Payment in week 53" – into this should go :-

- ◆ "X" if there were 53 weekly payments in the tax year.
- ◆ "54" if there were 27 fortnightly payments in the tax year.
- ◆ "56" if there were 14 four weekly payments in the tax year.

Where an employee is on a cumulative code basis the following action should be taken:-

If the **total free pay** to date at week 52 is:-

The same as, or more than, the total pay for the year (this includes any payment made for week 52, 54 or 56) **no PAYE is due**.

Less than the total pay for the year **deduct PAYE** by reference to the pay for week 52, 54 or 56 less the amount of free pay shown in table A using the table for :-

- ◆ Week 1 where the employee is paid weekly.
- ◆ Week 2 where the employee is paid fortnightly.
- ◆ Week 4 where the employee is paid four weekly.

Where an employee is on week one basis the extra pay day is treated as another week 1 payment.