

## What happens if I work for someone else?

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### *For employees only*

If you work for someone else you are an employee. You may work for more than one employer as an employee. (If you are unsure if you are employed or self employed see the section [Employed or self-employed](#) in the Self-employment section).

If you are an employee (this includes company directors), and not a self-employed person, then your employer must operate PAYE. This stands for Pay As You Earn. It is a way of collecting your income tax and National Insurance as you go along. Tax is deducted each pay day from your wage or salary before you receive it. This means that at the year end the position should be about right. You should not normally owe income tax – or be due a refund- of more than a few pounds, so long as your PAYE code (see below) is correct.

It is important to realise that PAYE is only a method of collecting tax. If there are any errors and the wrong amount of tax is collected, you are usually liable to pay any arrears of tax. This is one reason for taking time to understand how PAYE works – you are more likely to spot errors and avoid underpaying or overpaying tax.

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### *PAYE – collecting tax as you go along*

Pay As You Earn works out the tax you owe as you go along. It means that you shouldn't have a large tax bill or a large refund of tax at the year end.

Your employer works out your income tax, takes it from your wage or salary, and then pays it over to the Tax Office. Your employer knows how much tax should be taken off because the Tax Office sends your employer a code number for you, and a set of tax tables to use with it. Many employers use an HM Revenue and Customs approved computer programme to work out the PAYE tax due.

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### *Your PAYE code number*

You will be sent a notice of coding by the Tax Office. The code that you are given usually consists of some numbers and a letter. Your employer is told your code number (but not how it has been calculated). With this, your employer knows how much tax-free pay you are entitled to.

For example, the code 647L means that you are entitled to the ordinary personal allowance for 2009-2010 of £6,475 (the code number always leaves out the final digit, so 647 means 6,475). L refers to the normal personal allowance for those under 65. For full details of personal allowances see the [Tax Rates and Allowances](#) section.

Other code numbers end in P, for the age allowance over 65; or Y, for the age allowance over 75.

#### *K codes*

K codes are different from all other codes. Other codes show an amount of tax free pay, whereas K codes show a amount of additional income. A 'K' code means that the source of earnings being taxed is being used to pay tax due on other income as well. HM Revenue and Customs uses K codes to collect tax due on, for example, State pension, taxable benefits and small amounts of rental income, by taxing your earnings or non-state pension at a higher rate. For instance, a K code may be applied to your occupational pension to allow HM Revenue and Customs to collect the tax due on your State pension at the same time. It is essential to check K codes individually.

#### *Adjustments to codes*

The number part of the code can be adjusted to collect the tax due on other income you have. This avoids a year end tax bill. This is frequently done with senior citizens where the state pension (which is taxable) is taken away from the tax free income. This means that the number part of your PAYE code may be lower than you might expect.

#### *Letter only codes*

There are some codes that are just letters. The code BR means that tax at the basic rate of 20% is to be taken from your pay. The code NT means that no tax should be deducted.

#### *Emergency codes*

Sometimes, people are given an emergency code. This might happen because you have started a new job and you haven't got a P45 form from a previous employer to give to your new employer. Your new employer may ask you to complete a P46 form, and if this is your only or main job, but you are part way through the tax year, your employer may use an emergency code until the tax office says what your PAYE code should be. You may also be on an emergency code if there has been a very large change to your code during the year. In this case, an emergency code is an advantage - it protects you from big changes in your take-home pay.

Emergency codes are sometimes called a 'week one' or 'month one' basis. The PAYE code looks like this: '647L Wk1' or 647L M1'. Emergency codes treat each week or month on its own. They give you an equal amount of tax free pay every payday. They do not take into account changes in

your income or coding which may have happened earlier in the year. This means that your tax position may not be exactly right at the end of the year.

#### *Checking your PAYE code*

You should check your code to see that it is reasonable. If it seems unusual, you should ask HM Revenue and Customs for an explanation of your coding. If the coding notice is wrong, you will pay the wrong amount of tax – and you are likely to have to pay back any underpayment of tax. (HM Revenue and Customs may give up tax due under Extra Statutory Concession A19, but only where there have been lengthy delays and you could reasonably have thought your tax position was correct – this includes checking your PAYE tax code. In practice, ‘long delay’ can be almost 2 years).

Notices of coding for the next tax year from 6 April are usually sent out in about February. Keep your notice of coding. It will help you check if your employer is deducting the right amount of tax.

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#### *PAYE month by month*

It is the code number before the letter that tells your employer how much tax-free pay you are entitled to.

For example, if your code number is 240, you are entitled to tax-free pay of £2,400. Therefore, you can earn £200 each month (£2,400 divided by 12 months) before any tax is deducted. Any pay above that will be taxed. Using the tax tables provided by HM Revenue and Customs, or an approved computer programme, your employer works out how much tax is due, takes it from your pay, and pays the rest to you. The tax is paid over to the Tax Office.

#### *PAYE with two jobs*

If you have more than one job as an employee, you need to check that your PAYE code is correct for each job. For example, if you are entitled to a basic personal allowance of 6,475, you can earn about £540 per month tax free.

#### *Earning less than your tax free personal allowance in your main job*

If you have more than one job, and earn less than 1/12 of your tax free pay per month (ie £540 per month if you are entitled to the basic personal allowance of £6,475 for 2009-2010), you may pay an incorrect amount of tax. This is because the PAYE system is designed to give the full monthly tax free pay to your main job, and tax any additional jobs at the basic rate of tax. If the pay from your main job is less than your tax free pay then some of your tax free personal allowance will be unused.

There are two possible solutions to this problem:

- 1) You may ask your tax office to divide your personal allowance between two jobs. Only do this if your income from each job is predictable and stable. You also need to review the position regularly to ensure that the split continues to be appropriate.
- 2) You may wait until the end of the tax year and ask your tax office for a refund. Send in the P60 forms from all your jobs with a letter asking for a refund. (Take copies of the P60s for your records).

#### *Earning more than your tax free personal allowance in your main job*

If you earn up to the level of your personal allowance in one job, and top your earnings up with a second job (or have both a job and a pension), the most common error is for you to under pay tax – and so be accruing a tax liability. Make sure the tax office and your employer know about the second job (or pension). Check that you have not been given your tax free pay in the PAYE code for both jobs. The main job should have the personal allowance; the other should be taxed at basic rate (BR). If this isn't happening you could face an unexpected tax bill later on.

The best way to avoid a problem is to check your notice of coding carefully, and to contact HM Revenue and Customs or a tax adviser if you are unsure about anything.

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#### *National Insurance contributions*

Your employer will also deduct National Insurance contributions (NIC) from your pay, as well as income tax. National Insurance is not due on all your earnings. You are allowed to earn some money without paying National Insurance as an employee. National Insurance contributions entitle you to certain benefits (like a non-means tested level of Jobseekers allowance). They also count towards the state retirement pension.

If your earnings are between £95 and £110 per week for 2009-2010, you are treated as if you had made National Insurance contributions, but you don't actually have to pay National Insurance. At higher levels of earnings, (above £110 but less than £844 for 2009-2010), you pay National insurance at a fixed percentage on your earnings (11% for 2009-2010). For earnings above this level, you pay a small National Insurance charge (1% for 2009-2010) on the additional earnings.

#### *Married women's reduced rate election*

Some married women and widows pay a reduced rate of National Insurance of 4.85%. (It was necessary to make an election to pay reduced rate National Insurance and the last date to make the election was 11 May 1977). The position is of current relevance for a number of reasons:

1. The reduced rate of National Insurance gives a right to only a 60% basic retirement pension based on the husband's contributions. It does not give a right to contributory benefits or a state pension in one's own right. As the election was made so long ago some women may have forgotten about the election or these long-term consequences.

The result can be an unpleasant surprise on retirement, or if the need arises to claim a contributory benefit.

2. The right to pay reduced rate contributions is lost on divorce, annulment or if, for two consecutive tax years an individual is neither self-employed or pays / is treated as paying class 1 contributions. In these circumstances there is a duty to contact the tax office and cancel the election. However, if this is not done, the individual could start to accrue a liability for underpaid National Insurance.

The election is also effective for self-employment – exempting the holder from class 2 National Insurance liability. In this case, failure to notify HMRC within 3 months of loss of entitlement to claim the exemption could render the individual liable to a late notification penalty of £100 in addition to any unpaid class 2 contributions.

More detailed guidance on the married women's reduced rate is available at [http://www.hmrc.gov.uk/faqs/women\\_reduced\\_rate.htm](http://www.hmrc.gov.uk/faqs/women_reduced_rate.htm)

Check the [Rates and Allowances](#) section for more details of National Insurance rates

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*Some basic forms, the P45 and P60*

Your employer should give you a written payslip each pay-day, showing your gross pay, tax and National Insurance deductions, and the net amount you receive. This is your 'receipt' for the tax your employer has deducted.

At the end of each tax year, your employer must give you a form P60. This is a summary of your payslips for the year. It shows your total pay, and the total tax and National Insurance taken from it. The P60 must be given to you by 31 May after the tax year, so that you can complete a tax return or claim a repayment of tax. You should keep the form P60 – it is your record of the tax you have paid. You will need it if you have to complete a tax return. It is worth keeping the document safe as queries about your tax can arise many years later.

When you leave an employer, he must give you a form P45. You are entitled by law to this record of your pay and tax deductions. This normally shows your name, your Tax Office and reference number, and the code number used to work out your tax. It also shows when you were last paid, the gross pay you have received in the tax year, and the tax deducted from it. It is a four-part form. The employer sends one part of the P45 to the Tax Office and gives you three parts. If you start a new job, give two parts to your new employer, so that your new employer can work out the tax on your pay correctly. The sheet called Part 1A is your personal copy which you should keep. It is evidence of the tax you have paid and will help you if there is a mistake with your tax or tax code.

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