K codes: collection of old debts

Personal tax



20 February 2023

LITRG reports on a recent spate of tax code adjustments to collect historic tax debt, some giving rise to K codes and severely reducing take home pay.

LITRG has recently heard about individuals who have had their tax code changed in-year – to a K code – to collect a tax return late filing penalty debt. TaxAid reported a number of callers to their helpline facing the same issue.

HMRC have the ability to collect historic debt through tax code adjustments (see the Debt Management and Banking (DMB) Manual page 618010ff) but, until recently, we had not seen this as common practice for late filing penalties. The contact from taxpayers on this matter suggests a change of approach from HMRC, and we have been in touch with them to understand more about this.

There are various safeguards built into tax code adjustments, for example:

- Tax deducted under a PAYE code cannot exceed 50% of relevant payments (essentially being PAYE income, less any pension contributions to net pay arrangements and/or payroll giving).

- Liabilities coded out are limited based on the taxpayer's expected PAYE income for the tax year for which the code is determined (SI 2003/2682, Reg 14D). For most taxpayers that LITRG comes into contact with, the relevant limit is £3,000 (where expected PAYE income is less than £30,000), but this can be up to as much as £17,000 for those on higher incomes. A full list of the coding out limits can be found in the DMB Manual page 618090.

We have seen an apparently fairly low income example where the £3,000 limit appears to have been exceeded, so we have asked HMRC for more information about how expected PAYE income is calculated for the purposes of determining the overall coding out limit set out in Reg 14D.

The DMB Manual page 618050 also suggests that HMRC can split any coded-out liability over more than one tax year. We are unclear if cases are being looked at on a case by case basis, as the codes we are hearing of (K codes on a W1/M1 basis) seem intended to collect the liabilities as quickly as possible. Again, this question is one we have put to HMRC.

Taxpayers should have received prior communication from HMRC about the debt and to let them know that there was a possibility of coding out action if the outstanding debt was not settled, as well as receiving a P2 coding notice. We are concerned that some taxpayers are reporting a change to their tax code without receiving any prior correspondence from HMRC and, indeed, some who say they were entirely unaware that there was a debt in the first place.

Finally, it is well understood among tax professionals that tax debt may be overstated or, in the case of late filing penalties, may be appealable. In some cases that TaxAid have dealt with, HMRC have agreed to cancel the late filing penalties after the taxpayer or TaxAid have contacted them – but not before the K code has had a considerable impact on the individual.

LITRG have produced an article aimed at letting taxpayers know what they can do if their tax code is changed, particularly if the amendment gives rise to a severe drop in net income that causes the taxpayer hardship, and drawing attention to certain situations where the late filing penalties might be challenged. The article can be read here: www.litrg.org.uk/K-code_PAYE.

We would be interested to hear if any members have been seeing a similar increase in tax code changes amongst their clients to collect late filing penalties, and in

particular, any instances where it is suspected that coding-out limits are being breached, or where the necessary prior contact from HMRC appears to be missing.

Antonia Stokes *astokes@litrg.org.uk*