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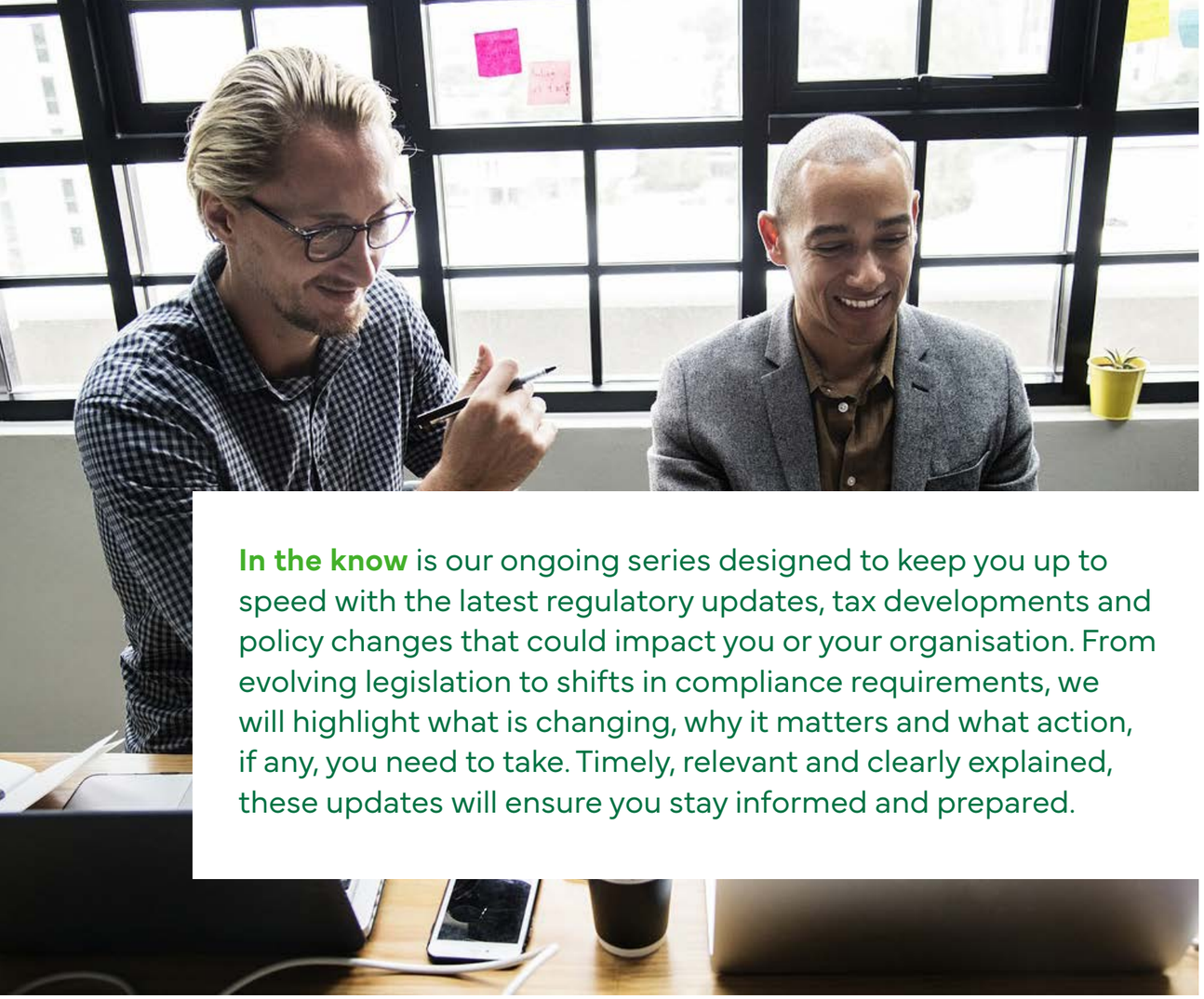
Chartered Accountants

In the know: tax edition

February 2026

Helping you prosper



In the know is our ongoing series designed to keep you up to speed with the latest regulatory updates, tax developments and policy changes that could impact you or your organisation. From evolving legislation to shifts in compliance requirements, we will highlight what is changing, why it matters and what action, if any, you need to take. Timely, relevant and clearly explained, these updates will ensure you stay informed and prepared.

Welcome to the February 2026 issue of **In the know: tax edition**, your regular update on the tax and regulatory changes shaping the business and personal finance landscape.

In this issue, we look at a range of developments that may affect you or your organisation, from whether you could be owed a tax refund and inheritance tax reliefs, to updates on Making Tax Digital and VAT compliance. Our aim is to help you stay informed, prepared and confident in your decision-making. Whether you want to optimise reliefs, stay ahead of reporting requirements or protect your personal finances, we highlight what has changed, why it matters and what action you may need to take.

In this edition, we cover:

Could you be owed a tax refund? HMRC overcharged workers by £3.5bn last year

Our research suggests that millions of UK workers may be overpaying income tax due to incorrect PAYE tax codes, often without realising it. As HMRC is under no obligation to proactively correct errors, it is essential you regularly check your tax codes and PAYE summaries to avoid losing out.

In the last tax year alone, HMRC overcharged workers £3.5bn in income tax, with an estimated 5.6 million Britons paying too much. These overpayments through the PAYE system largely stem from HMRC issuing incorrect tax codes. If a taxpayers' circumstances change and HMRC does not have the most up-to-date information, tax continues to be deducted based on HMRC's estimate of income rather than the actual position.

HMRC issues the incorrect tax codes due to:

- assuming that an employee is still receiving company benefits-in-kind such as company cars, healthcare and even gym memberships even though they may no longer be receiving that benefit
- incorrect assumptions about an employee's additional income, such as rental income, dividends or freelance work that they are no longer doing
- confusion over how many jobs an individual is currently working
- out-of-date or late employer payroll information.

Coding assumptions often go unchecked because paper tax code notices are no longer routinely issued. As a result, millions of people are paying the wrong amount of tax simply because HMRC is estimating their income. For too many people, this will go completely unnoticed.

HMRC now conducts fewer internal assessments to find errors and overpayments, and it will not always correct overcharging mistakes automatically. If you do not check your tax code or your PAYE calculation, you may never get your money back. We recommend regularly reviewing your tax codes and year-end PAYE summaries, particularly if you have any form of non-PAYE income or company benefits.

Making Tax Digital: what sole traders and landlords need to know

From April 2026, some sole traders and landlords will face a new obligation to report income and expenses to HMRC digitally every three months under Making Tax Digital for Income Tax (MTD IT). With implementation now only weeks away, it is important to understand whether the new rules apply to you and what action you need to take.

MTD IT is being phased in from 6 April 2026 for sole traders and landlords with qualifying income over particular thresholds. From that date, sole traders and landlords with qualifying income more than £50,000 for the 2024/25 tax year will have to join MTD IT. According to HMRC, this will affect around 864,000 taxpayers.

The rollout will continue in stages:

- from April 2027, sole traders and landlords with qualifying income over £30,000 in the 2025/26 tax year will be required to join
- from April 2028, the threshold will reduce further to £20,000 based on income in the 2026/27 tax year.

Under the new rules, taxpayers must keep digital records of income and expenses. MTD-compatible software is then used to send updates of income and expenses to HMRC every three months. In addition to these quarterly updates, there is an end-of-year tax return, also filed via MTD software.

If you are among those affected from 2026, you should already have received – or will shortly receive - a letter from HMRC notifying you that you must join MTD IT. The letter contains a QR code that can be scanned to get further information: though you can also find out more simply by searching 'Making Tax Digital for Income Tax for sole traders and landlords: step by step' on gov.uk. If you receive a letter from HMRC unexpectedly, please let us know and we can work with you to see what needs to be done.

MTD IT represents a major change in the way you interact with HMRC, moving record keeping and reporting much closer to real time. It is important that you have the right software in place and are confident using it. Alternatively, you may wish to appoint a competent third party to maintain digital records and make the submissions on your behalf. The requirement to submit quarterly updates means that timely and accurate record keeping will become more important than ever.

What should you do now?

If you think you may be affected by MTD IT:

- check whether your income exceeds the relevant thresholds
- ensure your records are suitable for digital reporting
- consider which MTD-compatible software will meet your needs
- seek advice if you are unsure how the new rules apply to you

We are here to help support you through your entry to MTD IT. Please do not hesitate to contact us if you have any questions or would like advice on how to prepare.

New online process for reporting VAT errors

Errors on the VAT return will now be notified online to HMRC in most cases. The old VAT652 form, previously used for this, has been withdrawn.

How to report errors

The online notification process is done via your Government Gateway log-in. The form needed can be found by searching 'Check how to tell HMRC about VAT Return errors' on gov.uk. You will need to have the net value of the error and total value of sales to hand.

Businesses exempt from MTD VAT will continue to notify in writing. Taxpayers can also choose to notify HMRC in writing, instead of using the online facility, if desired.

The rules you need to know

It's only the notification process that's changed. The rules on how to correct errors remain the same.

The correction process depends on the size of the error. For errors with a net value of up to £10,000 or errors between £10,000 and £50,000 and representing less than 1% of the box 6 (net outputs) in the return period in which you find the errors, you can simply correct the next VAT return. This is known as Method 1. Other errors should be notified to HMRC directly (Method 2). You can use Method 2 for errors of any size, if you prefer. Method 2 should always be used for deliberate errors.

There is a four-year time limit from the end of the accounting period to make corrections, though this does not apply to deliberate errors.

Why it matters

The importance of VAT compliance cannot be overstated. It's not just about good practice – important though that is – it can impact your business financially, too. Interest can be charged for underdeclared VAT and there can be penalties for errors in VAT returns that result in tax being underpaid, if HMRC considers that the error was careless or deliberate.

Careless errors can attract penalties of up to 30%. Deliberate errors can attract penalties of up to 70%. Penalties for deliberate and concealed errors can be as much as 100%. HMRC has considerable discretion over what is charged, and reductions can be made for errors disclosed without HMRC prompting; and also for the amount of cooperation given by the taxpayer when a disclosure is made.

For penalty reduction purposes, note that any error that HMRC considers careless or deliberate, regardless of size, must be formally notified to HMRC: in these circumstances, correction on the VAT return alone is not enough.

If you are in any doubt as to how HMRC would categorise an error, please get in touch with our specialist VAT team who can provide further details.

Tip: Best defence - taking reasonable care

If you make an error, but have taken what HMRC considers 'reasonable care', you should not be charged a penalty.

Reasonable care: What does taking reasonable care mean? HMRC defines it as taking the 'care and attention that could be expected from a reasonable person in the circumstances'. It's also worth noting that as far as HMRC is concerned, the opposite is also true: not taking reasonable care amounts to being 'careless'.

Taking reasonable care will look different for each taxpayer, depending on individual circumstances and abilities, but it includes basics like keeping sufficient records to form the basis of accurate tax returns; keeping your records safe; and taking advice if there's something you're not sure about

How we can help

Recent research by HMRC suggests that VAT can be particularly difficult for many businesses.

Our highly experienced VAT team can help with a VAT compliance health check to give you confidence that you are taking reasonable care, should HMRC ever come knocking. Please do not hesitate to get in touch.

High Income Child Benefit Charge: new option to pay through PAYE

HMRC now allows some taxpayers the option to pay High Income Child Benefit Charge (HICBC) through PAYE by adjusting their tax code, rather than filing a self assessment return.

If you only complete a self assessment return because of HICBC, this new option may be the simplest way to pay. To use PAYE for the charge, you must tell HMRC on or before 31 January in the tax year after the one to which the charge relates.

For example:

- If you need to pay HICBC for the tax year 6 April 2025 to 5 April 2026, you can choose to pay through PAYE up to 31 January 2027. After that date, you would need to file a selfbassessment return instead.

To start the process, you need to notify HMRC online that you want to pay through PAYE. Do this via the HMRC app, or by searching 'Child Benefit tax charge pay charge PAYE' on gov.uk. This takes you to your Government Gateway login.

The process is slightly different if you already file self assessment returns, but only do so in order to pay HICBC. Here you contact HMRC by phone, and ask to leave self assessment and then register to pay HICBC through PAYE. Both processes require you to provide specific information listed on the gov.uk page referenced above.

Welcome changes to inheritance tax

Changes to the availability of agricultural property relief (APR) and business property relief (BPR) are expected from 6 April 2026, as first announced at the Autumn Budget 2024. Earlier proposals would have significantly increased the inheritance tax (IHT) payable on the transfer of many farms and businesses. However, two recent developments have softened the impact.

Under the original proposals, the allowance for the 100% rate of relief was set at £1 million for qualifying business and agricultural assets, with 50% relief available for assets in excess of this. This was a per person limit, and not intended to be transferable between spouses and civil partners. But the position has now changed considerably.

The allowance for the 100% rate of relief will be increased to £2.5 million; and will, after all, be transferable between spouses and civil partners. Any unused £2.5 million allowance on the death of a spouse or civil partner will be transferable to a surviving spouse or civil partner. This means that overall, a couple will be able to pass on up to £5 million of qualifying agricultural or business assets between them, without paying IHT, on top of the existing allowances, such as the nil rate band.

Please get in touch with your usual UHY adviser if you would like help assessing what this will mean for you.

Why you should check AI output before you rely on it

The Upper Tribunal decision in HMRC v Marc Gunnarsson [2025] highlights the risks of relying on inaccurate information, including AI generated material. HMRC appealed the earlier First tier Tribunal decision, arguing that Mr Gunnarsson had claimed the wrong type of pandemic support.

Pandemic support claims remain a key area of government scrutiny, and HMRC was clearly unwilling to let the matter drop after the First tier Tribunal had partly found in his favour.The Upper Tribunal was asked to decide if Mr Gunnarsson had been eligible for the Self-Employment Income Support Scheme. It concluded that he was not as unfortunate timing meant previous self-employment had ceased, and he was trading as the sole director of a limited company. This meant he no longer met the qualifying criteria at the relevant time.

In a separate point, the Tribunal noted that some of the paperwork Mr Gunnarsson had prepared for the case relied on output from AI software. When HMRC checked the material, the Tribunal decisions quoted by the AI did not exist.

Although the Tribunal took a lenient view and did not hold Mr Gunnarsson to be 'highly culpable', it used the case to issue a reminder that anyone going to Tribunal is responsible for the accuracy of information provided. Presenting unreliable evidence is a serious matter, to which sanctions can apply.

Mr Gunnarsson represented himself without professional advice and support. As your advisers, we can help guide you through situations where judgement calls matter and ensure you have accurate, reliable information to support your position.

VAT: HMRC gets the last laugh

A recent Tax Tribunal decision concerning the supply of 8g nitrous oxide (N_2O) canisters for culinary use highlights how finely balanced VAT classification rules can be — and how costly it can be to get them wrong. The case provides a useful reminder that VAT treatment depends not on how a product is marketed or intended to be used, but on how it is classified under the legislation and interpreted by HMRC and the courts. N_2O - sometimes known as laughing gas - was supplied by taxpayer business, Telamara Limited. Telamara sold it to wholesalers and catering companies for use as cream chargers, to make whipped cream, foams and mousse.

A Tax Tribunal case hinged on whether or not it was right to classify the supply as being one of 'food of a kind used for human consumption'. Telamara said the N_2O was food. HMRC said it was not.

Far from being a theoretical exercise, this type of classification matters because of the VAT at stake. In this instance, Telamara faced VAT assessments of just over £1.4 million for zero rating supplies that HMRC said should have been standard-rated.

Rules for classification: two main groups and the odd ones out

The VAT rules specify that food of a kind used for human consumption is usually zero-rated. This is the first main group.

Then there is a list of exceptions: including ice cream, frozen yogurt and confectionery - but not cakes or biscuits, other than biscuits wholly or partly covered with chocolate. These exceptions are standard-rated, with VAT due at 20%.

There are items overriding the exceptions, like yogurt unsuitable for immediate consumption when frozen and herbal tea. These default to being zero-rated.

VAT and the average person

At the Tribunal, HMRC maintained that all this was 'uncomplicated'. It said that working out whether the N_2O in the charger was food of a kind used for human consumption was 'a short practical question calling for a short practical answer'.

In fact, HMRC's short, practical question is really anything but - and HMRC's own guidance on the meaning of 'food of a kind used for human consumption' proves the point. This says that a product qualifies as such food if the average person, knowing what it is and how it's used, would think it was food or drink: and it's fit for human consumption. The definition is then followed up by inclusions and exclusions. Products eaten as part of a meal or as a snack qualify as food, for example, but dietary supplements, food additives and 'similar products', which, though edible, are not food, do not. At least, not usually.

Why fairness doesn't determine VAT outcome

The problem is that the average person needs a mind like HMRC's to be confident that they're dealing with the rules correctly. Unfortunately, by the time that a case gets to the Tax Tribunal, the damage has often been done.

That was what happened in this case. Having digested over 1,000 pages of evidence, including previous decisions on the status of edible flowers; algae derivatives and linseed oil, the Tribunal ruled against Telamara. N_2O was held not to be a food, and the supply of canisters should therefore have been standard-rated.

It was an expensive mistake, and the taxpayer felt it was an unfair one. He had contacted HMRC when he started to supply the canisters, asking how they should be rated for VAT purposes and felt that other than referring him to its general guidance, HMRC had not been able to help. But while this was noted by the Tribunal, he was reminded that their remit is not about fairness: it's about applying the law.

Navigating the rules

The Telamara case makes sobering reading. The VAT rules can be a minefield and errors can be costly. If you would like support discussing and reviewing your VAT position, updating your policies or arranging a VAT health check, please get in touch.

What you should know about HMRC's use of algorithms

Imagine a system that can identify potential tax fraud, spot anomalies in transactions and uncover criminal networks - doing in minutes what once took days. HMRC already has such a system. Its Connect data platform has been expanding in scale and sophistication since its launch in 2010.

Connect combines data from across HMRC with information from banks, pension providers, online payment services, overseas tax authorities and government bodies such as Companies House, the Land Registry and DVLA. It also analyses data from third party sources including online marketplaces, flight and passenger records, social media activity and property letting agents. Working with organisations such as BAE Systems and Palantir, HMRC has been able to build one of the largest data sets in government use.

How Connect uses data

Connect is now one of the largest data sets in government use. It's key in HMRC investigations, and the bottom line speaks for itself. Connect has, on average, been bringing in an additional £3.4 billion in tax each year. In 2024/25, the extra tax take for HMRC hit £4.6 billion.

HMRC is understandably slow to talk about exactly what goes on under the bonnet. But what it has said is probably enough: Connect exists to identify '"hidden" relationships between people, organisations and data that could not previously be identified'. It turns the spotlight on anomalies between things like bank interest, property income and what HMRC calls 'other lifestyle indicators'. One expert put it like this: 'The algorithms that it uses allow HMRC to spot anomalies that would otherwise go unnoticed by the human eye'.

What it means for taxpayers

Essentially HMRC can, if it wants, see things it would never have been able to see before. While Connect often identifies genuine errors and evasion, it can also raise questions where no issue exists and answering unnecessary questions from HMRC is a position no one wants to find themselves in. The first line of defence is always to have the right records to back up any business and personal transactions. We can help you remain compliant with all your tax and accounting obligations. Please don't hesitate to contact us.

Charity tax: key compliance changes from April 2026

There are some new regulations that trustees and staff of charities and community amateur sports clubs (CASCs) need to be aware of.

Various changes to charity compliance measures are expected to take effect from April 2026. In outline, these include:

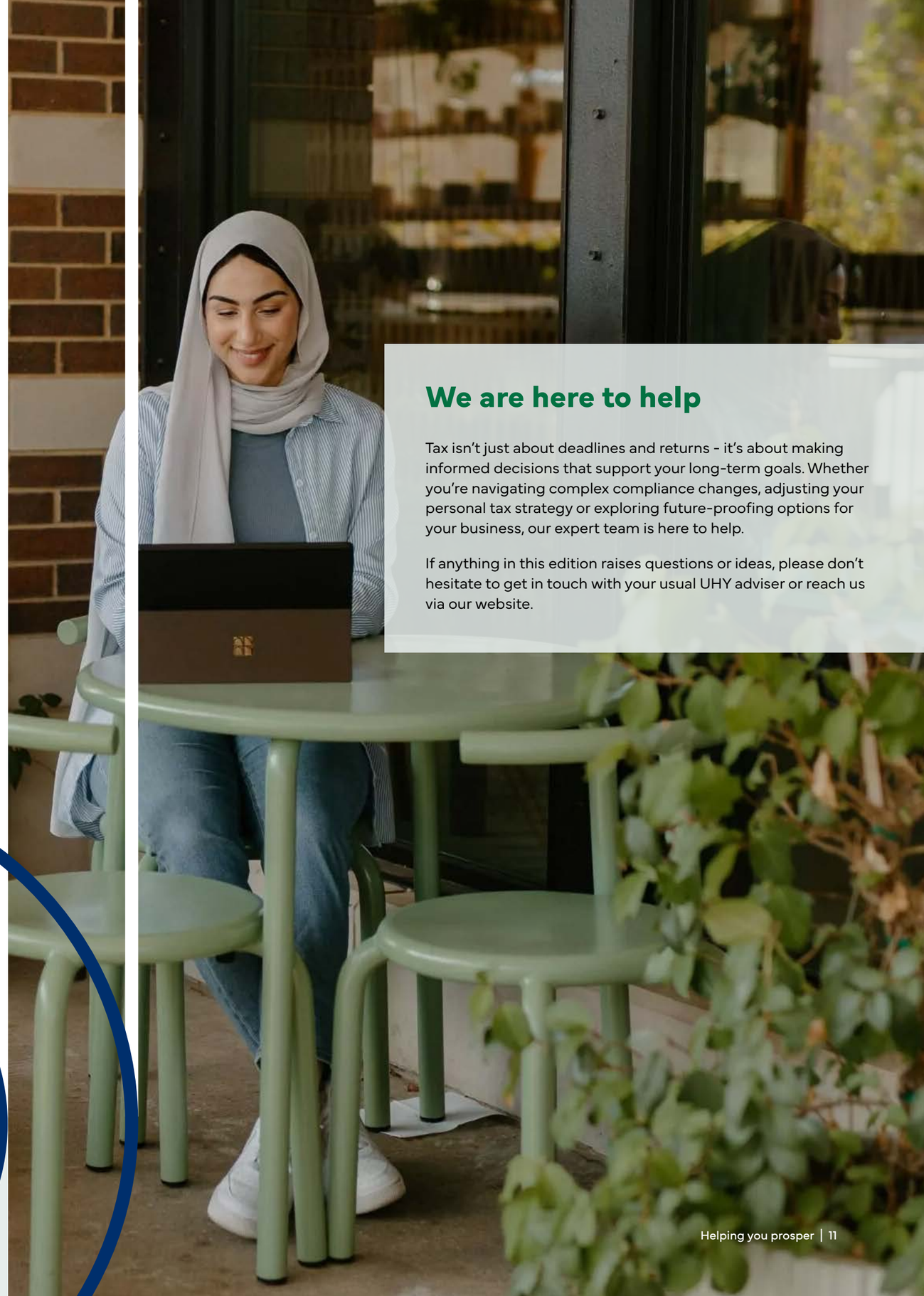
- a stricter test for what are known as tainted donations. The tainted donation rules seek to deny tax relief where a donor obtains a financial benefit from the charity or CASC in return for the donation, either for themselves or someone else involved in the arrangement
- approved charitable investments, so that all investments must be for the benefit of the charity and not for the avoidance of tax
- attributable income. The change here brings legacies within scope of the definition of attributable income, meaning they must be spent on the charity's charitable purpose, or be subject to a tax charge.

The changes come as part of the government's drive to close the tax gap, strengthen compliance powers and challenge abusive arrangements. This means that though technically, all UK charities and CASCs and their donors are subject to the changes, in practice, the impact will only be felt by a few.

The current emphasis is on a defaulting minority. In the government's words: 'The majority of charities meet their tax obligations, but a small minority persistently fail to comply and yet still claim tax reliefs such as Gift Aid.' To combat this, enhanced HMRC powers to compel tax compliance by sanctioning trustees and charity managers are in progress, and amended guidance on the Fit and Proper Persons test is expected imminently.

For the compliant majority, however, there is a more demanding compliance environment. The changes serve as a clear reminder of the need for timely filing of returns; accurate record keeping; and meticulous processes around Gift Aid.

With increased HMRC scrutiny and tougher compliance expectations on the horizon, now is a good time to review your charity's tax and governance arrangements. Our specialist charity team can help you understand the changes and ensure you are well prepared for April 2026.



We are here to help

Tax isn't just about deadlines and returns - it's about making informed decisions that support your long-term goals. Whether you're navigating complex compliance changes, adjusting your personal tax strategy or exploring future-proofing options for your business, our expert team is here to help.

If anything in this edition raises questions or ideas, please don't hesitate to get in touch with your usual UHY adviser or reach us via our website.

Combining national expertise with a tailored local service

Our UHY Hacker Young experts across our 22 offices nationwide provide the best advice because we understand both local needs and the national picture.

Whether you are looking for advice on your personal finances, or want support and guidance in navigating the future for your business, our team of experts are ready to help.

If you are looking for general audit, accounts or tax support, our advisers are always on hand to explain how we can provide assistance to you and your team in our commitment and dedication to **helping you prosper**.

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