

Tax and the city

Client briefing

The Court of Appeal in *Burlington* considers the application of the treaty purpose test in the Ireland/UK double tax treaty in a judgment relevant to the principal purpose tests in other treaties and to purpose tests more generally. In *Gunfleet Sands*, the Supreme Court adopts HMRC's narrow interpretation of what is qualifying expenditure for the capital allowances legislation. The Court of Appeal in *MR Currell Ltd* agrees with the Upper Tribunal that a payment to an employee benefit trust subsequently loaned to a director did not constitute earnings of the director. The OECD's Taxing Wages 2026 report shows that the OECD average tax wedge reached its highest level since 2016 with the UK seeing the largest increase.

Burlington: application of purpose test in double tax treaty

In *HMRC v Burlington Loan Management DAC* [2026] EWCA Civ 461 the Court of Appeal delivered an important judgment on the scope of treaty purpose tests. Burlington Loan Management (BLM), an Irish-resident company, had claimed treaty relief from UK withholding tax (WHT) in respect of UK source interest. The interest arose on a debt claim assigned to it by an unconnected Cayman company, which would itself have suffered WHT in full had it continued to hold the debt claim. The price paid for the debt claim reflected BLM's expectation to be able to benefit from the UK/Ireland double tax treaty (the DTT). HMRC refused the refund of WHT arguing that the main purpose test in the interest article of the DTT prevented relief.

Article 12(5) provided: "The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment." HMRC argued that one of the main purposes of the assignment was for a person concerned with it to obtain the benefit of the interest article of the DTT. The taxpayer succeeded before the FTT, the Upper Tribunal and has now won again at the Court of Appeal. The treaty purpose test did not apply to prevent treaty relief. Consequently, the interest received by BLM could be taxed only in Ireland and BLM was entitled to a repayment of around £18m WHT.

The Court of Appeal rejected HMRC's contention that Article 12(5) was engaged simply because the assignment enabled BLM to obtain treaty relief. The phrase "to take advantage of", it held, means something more than merely securing the benefit of the treaty. Consistently with its earlier decision in *VietJet* which looked at a similar purpose test in the UK/Japan treaty, the Court concluded that Article 12(5) is concerned with abusive arrangements that run counter to the object and purpose of the treaty as it applies to the taxpayer. In this case, the outright assignment of the debt was not abusive, even though the availability of treaty relief was reflected in the pricing. As Lord Justice Snowden observed, Article 12 is not intended to protect HMRC's tax base, and Article 12(5) does not prohibit assignments simply because they result in less WHT being payable.

The Court of Appeal's decision is an important one for the following reasons. First, it is important for the smooth running of secondary markets that, in general, the treaty purpose test ought not to apply to an outright sale of a debt, by a person who is not entitled to treaty benefits, to an unconnected person who is so entitled even where that is reflected in the pricing of the sale.

Second, it is of interest from an international tax perspective. Although the relevant provision in the UK/Ireland double tax treaty has since been replaced by the principal purpose test in Article 7 of the OECD's Multilateral Instrument, the reasoning is equally applicable to the interpretation of the Article 7 test which has been widely imported in tax treaties worldwide. This case is a useful precedent for tax authorities and tax advisers when considering whether an arrangement or transaction might be considered to have a principal purpose of obtaining a treaty benefit.

Finally, this case has wider implications than for treaty purpose tests as it also builds on the Court of Appeal case law on the unallowable purpose test in the loan relationship rules that was the subject of dispute in *BlackRock* and *Kwik-Fit*. Lady Justice Falk took the opportunity to reiterate her point about the importance of the legislative context. Just as the unallowable purpose rules must be interpreted in the context of the legislation which confers tax relief for debt financing costs, so too must the relevant treaty test be interpreted in the context of the DTT. Where legislation is intended to confer a tax benefit, it cannot have been Parliament's intention that the benefit should be denied by a "main purpose rule", without something more, merely because the tax benefit is economically significant.

Gunfleet Sands: restrictive interpretation of qualifying expenditure

The Supreme Court in *Gunfleet Sands and others v HMRC* [2026] UKSC 12 considered whether pre-construction expenditure was incurred "on the provision of plant" for the purposes of Capital Allowances Act 2001, s 11. The Supreme Court unanimously agreed with HMRC that s 11 must be construed narrowly. On that basis, expenditure incurred by the taxpayers on environmental surveys and studies at the pre-construction stage of their offshore windfarm projects did not qualify for capital allowances, even though the surveys were a necessary precondition to obtaining the statutory consents required before the windfarms could be designed and built.

While the judgment is significant for taxpayers incurring pre-development costs in major infrastructure projects, it is also an important illustration of the court's approach to statutory construction. The taxpayers placed considerable weight on the purpose of capital allowances as an incentive to invest in plant and machinery. The Supreme Court rejected the suggestion that this broad purpose justified an expansive interpretation of s 11. As the Court put it, "one cannot rely on the broad purpose of a provision to define where the precise boundary lies between what is caught and what is not caught".

Instead, the Supreme Court approached s 11 as part of a detailed and internally balanced statutory scheme. It accepted HMRC's submission that reading s 11 too broadly would risk "scooping up" expenditure which rightfully falls within other parts of the legislation, thereby disturbing the careful balance struck by Parliament as to which types of expenditure qualify for relief and which do not. Particular emphasis was placed on the statutory language. Parliament chose to allow expenditure "on" the provision of plant, rather than expenditure

incurred “in connection with”, “relating to” or “with a view to” the provision of plant. Those broader formulations appear elsewhere in tax legislation but were not used here. The word “on” was taken to require a closer and more direct relationship between the expenditure and the plant itself. The Supreme Court declined to define a precise boundary between allowable and non-allowable expenditure, but it had little difficulty in concluding that the surveys and studies in issue lay well outside it. They were too remote from the plant itself to fall within s 11, notwithstanding their practical necessity to the wider project.

Although the Supreme Court was firm that the expenditure in issue did not qualify, it was careful not to close the door on all forms of pre-construction expenditure. In particular, no view was expressed on whether the cost of producing final technical drawings or specifications later “made real” by the manufacturer might qualify. That issue did not arise on the facts and HMRC expressly reserved its position. HMRC did accept, however, that certain surveys or studies undertaken during fabrication or installation could fall within s 11, where they form part of the production process or the installation of the plant. This shows that the case turns on statutory interpretation applied to specific facts, not on a categorical exclusion of all pre-development expenditure.

Consultation on tax treatment of pre-development costs

If tax relief is to be given for pre-development expenditure that falls outside the scope of s 11, this will have to be a policy decision leading to legislative change. Following the Upper Tribunal’s decision in *Gunfleet Sands*, which found in favour of HMRC that the pre-development expenditure in question did not qualify for relief, the October 2024 Corporate Tax Roadmap promised a consultation on the tax treatment of pre-development costs, particularly in the context of renewable energy and major infrastructure projects. That consultation was

expected in early 2025 but was subsequently delayed pending the outcome of the litigation.

MR Currell: distinction between why a payment is made and what the payment is

Although largely of historical interest now that a loan made via an employee benefit trust (EBT) to a director/employee would be squarely within Part 7A ITEPA (disguised remuneration), the case of *HMRC v M R Currell Ltd* [2026] EWCA Civ 445 has broader points of principle that remain relevant to non-Part 7A scenarios (and a good quote about trees). In brief, in November 2010 M R Currell Ltd (a family painting and decorating business) paid £800,000 to an EBT which immediately on-lent the same sum to Mr Mark Currell, a director and shareholder, under a five-year interest-free loan secured over shares, and HMRC assessed the payment as taxable earnings giving rise to PAYE and NICs, an approach upheld by the First-tier Tribunal but overturned by the Upper Tribunal.

The Court of Appeal provides a useful analysis of the distinction between what is a loan and the payment to fund the loan. HMRC had argued that as the loan was made because of Mr Currell’s work and as the function of the payment to the EBT was to fund the loan, the payment was in the nature of a reward for services. But the Court of Appeal determined that this was a non sequitur and that the nature of the payment to the EBT was a separate question: “the need to fund the Loan explains why the Payment was made but not what it was. It does not determine its nature.”

Another of HMRC’s arguments was that the loan itself comprised a payment of earnings, notwithstanding the obligation on Mr Currell to repay the loan on the basis that he had practical control over whether repayment would be required. The Court of Appeal concluded that the practical control was not made out on the facts (Mr Currell did

not have sole control) and, as a matter of law, the fact that the borrower controls the lender is not sufficient to alter the legal character of a loan. Otherwise, “the legal status of the entirely commonplace transaction of a loan to a parent company could be called into question”.

HMRC were not happy that Mr Currell accessed tax-free cash from the company and the legislation was changed to prevent this with the introduction of the disguised remuneration rules which were subsequently strengthened by the 2013 changes to the “loans to participators” rules. HMRC continued to argue, however, that under the pre-existing law at the relevant time Mr Currell’s arrangements failed. The Court of Appeal advised HMRC to exercise caution to avoid over-reach which would risk legal certainty. In Lady Justice Falk’s words “A close inspection of the trees can risk a failure to distinguish the overall wood. “A good reminder of the need the step back and look at the bigger picture!

OECD Taxing Wages Report 2026: UK moving in wrong direction for growth agenda

The OECD’s report *Taxing Wages 2026* uses the concept of a “labour tax wedge” as a basis for comparison, which measures total taxes on labour paid by employees and employers, minus cash benefits received by working families, as a percentage of labour costs. The report compares a number of distinct types of households across OECD jurisdictions.

Looking at a single earner on the average wage, the largest increase (of 2.45 percentage points) was observed in the UK, partly due to higher employer NICs and partly as a result of fiscal drag, as frozen tax thresholds pushed up effective tax rates. The UK’s wedge at 32.4% is still just below the 32.5% OECD average but the direction of travel is not great for the government’s growth agenda. As the report notes, a higher tax wedge reduces net pay and increases employers’ labour costs so reducing the incentives to work and hire.

What to look out for:

- Chancellor Rachel Reeves has promised that the Treasury will revisit the tax treatment of UK members of US LLPs to prevent double taxation. A consultation on the rules will be launched in due course.
- The consultation on taxation of pre-development costs is expected (hoped) to be forthcoming now that the *Gunfleet Sands* litigation is final.
- On 18-19 May, the Supreme Court is due to hear the appeal in the *ScottishPower* case on the deductibility for corporation tax purposes of customer redress payments.
- The consultation on extending the notification of uncertain tax treatment regime closes on 4 June.

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