SLAUGHTER AND MAY

September 2026

Tax and the City

Client briefing

The Upper Tribunal in *KDL* confirms that Article 6 of the UK/Isle of Man treaty extends to property development trading profits, giving the UK taxing rights over profits from UK land even where the developer has no UK permanent establishment. In *Elborne* the Court of Appeal reinforces that deeming provisions must be interpreted only to the extent necessary to achieve their statutory purpose and that the courts continue to place limits on HMRC's reliance on the *Rossendale* approach. *AXA Insurance* confirms that courts retain a discretion to disapply findings in a GLO test case where subsequent developments in the law undermine the legal basis of the earlier decision. HMRC's annual report and accounts reveal record tax receipts and compliance yield but also show a growing tax gap and increasing scrutiny of Large Business.

KDL: treaty interpretation

The Upper Tribunal (UT) in *Knights Developments Ltd v HMRC* [2026] UKUT 329 (TCC) had to determine whether trading profits derived by KDL, a property developer resident in the Isle of Man, from acquiring, developing and selling UK land, were taxable in the UK. This turned on the interpretation of the UK/Isle of Man double tax treaty. HMRC argued that the trading profits constituted 'income derived from immovable property' within Article 6, or alternatively, fell within Article 13 as 'gains derived from the alienation of immovable property'.

KDL had no UK permanent establishment (all strategic decisions were taken in the Isle of Man) and claimed its profits fell within the business profits article (Article 7) and were taxable only in the Isle of Man. Its appeal against assessments of around £5.4m was transferred directly to the UT as a complex case.

KDL's appeal is the lead appeal for a number of related companies within the same group as KDL whose appeals are stayed behind this one. HMRC estimate the broader revenue implications at up to £1bn of historic claims and £230m of annual future revenue. Against that backdrop, the UT's conclusion that Article 6 gave the UK taxing rights over the trading profits is a significant outcome for HMRC.

Scope of Article 6

Drawing on treaty interpretation principles from *Anson* [2015] UKSC 44, *Fowler* [2020] UKSC 22 and *Royal Bank of Canada* [2025] UKSC 48, the UT held that Article 6(1) is broadly expressed and not confined to a narrow class of income derived from the use or exploitation of land. The UT agreed with HMRC that Article 6(3) ('direct use, letting, or use in any other form') is clarificatory, rather than an exhaustive list. It does not exclude income from alienation of the property from falling within Article 6(1). The UT also agreed with HMRC that Article 6(4) reinforces the breadth of Article 6(1) by confirming that Article 6 income from immovable property remains within Article 6 even if it forms part of the profits of an enterprise and might otherwise be thought to fall within the business profits article. As obiter, the UT expressed the opinion that if Article 6(3) was, as the taxpayer argued, an exhaustive list, it would have concluded KDL's development activities fell within the 'use in any other form' wording and so the resulting profits would still fall within Article 6.

Relevance of academic materials

The UT confirmed that academic commentaries are persuasive rather than authoritative aids to treaty interpretation. Their weight depends on the cogency of the reasoning of the academic commentary and the extent to which they address the interpretive question before the court. The UT acknowledged that the respected commentaries of Vogel and Baker, which draw a clear distinction between 'use' and 'alienation' and would confine Article 6 to the former, provided support for the taxpayer's interpretation of Article 6. However, as neither academic commentary addressed the specific question of whether profits realised by a property developer from the acquisition, development and sale of land fall within Article 6, they did not persuade the UT to depart from the conclusion reached from interpretation of the language of the treaty itself.

Article 13

The UT also expressed its view, as obiter, but acknowledging the likely relevance on appeal or for the related appeals, that Article 13 is concerned with capital gains and does not extend to trading profits. HMRC had argued that since 'gains' was not defined in Article 13, a domestic law meaning was relevant and that in UK tax legislation 'gains' is not inherently confined to gains of a capital nature. Although the UT agreed HMRC's submission has some force if Article 13 is viewed in isolation, it must be considered in the context of the structure of the treaty as a whole. In that context, 'gains' does not extend to trading profits.

What next?

Given the sums involved and the implications for other taxpayers, an appeal is likely. The UT's broad interpretation of Article 6(1) may have implications well beyond the Isle of Man treaty and could affect any non-resident developer seeking treaty protection from UK tax on development profits derived from UK land. Indeed, it is noteworthy that the UT did not hear this case as the result of an appeal against a decision of the FTT but, rather, under a transfer under Rule 28 of the FTT Rules.

That said, there does seem to be something of the wanting to have your cake and eat it about the taxpayer's approach here. Taking a step back, the treaty does give the UK taxing rights over both income derived by an Isle of Man resident from UK land (Article 6) and gains derived from the disposal of UK land (Article 13). To be successful the taxpayer effectively had to persuade the UT both that profits derived from disposing of UK land in the course of a trade fell outside Article 13 because they were treated as income and not capital gains, which the UT did accept, and also that that income was not then income derived from UK land for the purposes of Article 6, which proved a bridge too far.

Elborne: limits of deeming provisions and the *Rossendale* approach

The Court of Appeal in *Elborne and others v HMRC* [2026] EWCA Civ 894 considered whether a 'home loan' or 'double trust' scheme to avoid inheritance tax worked. The arrangements, entered into in 2003, involved Mrs Elborne selling her £1.8 million home to a life interest trust in exchange for an interest-free promissory note, then gifting that note to a separate discretionary trust for her children, while continuing to occupy the property. HMRC had argued the statutory anti-avoidance provisions, including the gifts with reservation rules, brought the value of the home back into the estate, but the Court of Appeal held the legislation did not produce that result.

Although the arrangements pre-dated DOTAS and the GAAR and would not succeed today following subsequent legislative changes, the case is of wider interest as a further illustration of the principles governing deeming provisions and purposive construction.

Extent of deeming provision

HMRC had succeeded before the First-tier Tribunal (FTT) in arguing that the deeming provision in IHTA

1984 s49(1) was wide enough to deem the debt under the promissory note to be incurred by Mrs Elborne personally, rather than by the trustees of the life interest trust (with the effect that the anti-avoidance provision in s103 applied to prevent the liability under the promissory note being taken into account when valuing the estate). The UT and the Court of Appeal considered this aspect of the FTT's decision erroneous. Applying the principles of *Fowler* and the more recent Court of Appeal decision in *Muller* [2026] EWCA Civ 248, they looked at the purpose of the statutory fiction, concluding that the purpose is to bring the settled property into the estate and that the deeming could not be extended to treating the holder of the interest in possession as personally liable for the debts of the settlement. As the UT put it, in a passage endorsed by the Court of Appeal: 'Section 49(1) should not be construed in a way which forces it to answer a different question, which is one that there is no evidence that Parliament had intended it should answer.'

Limits of the Rossendale approach

HMRC argued that the liability under the promissory note did not reduce the value of the estate under either or both of IHTA 1984 s49(1) and s5(3) on the basis of purposive construction of those provisions, realistically applied to the facts. In *Rossendale* [2021] UKSC 16, the language of the statutory provision in question was given a wider meaning and application than it would normally bear to give proper effect to the intention of Parliament 'as ascertained from a close examination of the scheme as a whole'. The Court of Appeal emphasised that in order to give a provision a wider meaning and application than normal in reliance on *Rossendale*, it must be possible for the purpose of the statutory provision to be safely identified and for the wider meaning, when realistically applied to the facts, to be necessary to prevent frustration of Parliament's intention in enacting it. This is an important limitation on the *Rossendale* approach.

HMRC's recent attempts to rely on *Rossendale* to extend statutory language have attracted judicial criticism. In *HFFX* [2026] UKSC 18, Lord Sales described HMRC's approach as 'untethered from the language used by Parliament to impose the tax charge'. In *Elborne*, HMRC contended that Parliament could not have rationally intended the statutory provisions to be so construed as to enable an avoidance scheme aimed at escaping the very charge to IHT which the legislation seeks to impose. HMRC argued that, applying *Rossendale*, the liability under the promissory note should not reduce the value of the estate because it formed part of a composite avoidance scheme designed solely to remove value from the charge to IHT. The FTT and UT rejected that argument, while the Court of Appeal called it 'untenable' because it was framed too generally (at preventing IHT avoidance) and divorced from the statutory language.

Elborne is a further example of the reluctance of the courts to use purposive construction or deeming provisions as a licence to depart from statutory language merely because the outcome appears unattractive.

AXA Insurance: court has discretion not to apply test case to other taxpayers

The purpose of a group litigation order (GLO) is to 'facilitate the economic and efficient disposal of claims raising the same issues'. A judgment in a test case determining one or more common issues is binding on all GLO claimants at the time of the judgment unless the court 'orders otherwise' under Civil Procedure Rules Pt 19 rule 19.23(1)(a). The Supreme Court in *AXA Insurance UK PLC and another v HMRC* [2026] UKSC 24 has used its discretion under this rule to unanimously dismiss an appeal arising from the CFC and Dividend GLO, under which some 60 claims worth over £68m challenge the UK tax rules on foreign dividends that were found to be incompatible with EU law.

The taxpayers sought to rely on Henderson J's 2013 judgment in the *Prudential* test case on two issues: interest on ACT paid prematurely (the set-off issue) and the limitation start date for mistake-of-law claims. The difficulty was that the legal reasoning on both issues in the judgment has since been shown to be wrong. The Supreme Court held that the court's power to 'order otherwise' was properly exercised on set-off, and that Henderson J's limitation findings were fact-specific to the *Prudential* claims and had not determined the start date of the limitation period for any claims other than Prudential's.

The Supreme Court stressed that the discretion to 'order otherwise' should be used sparingly: a change in the law should not ordinarily suffice to reopen a settled GLO issue. The court must balance the need to protect the beneficial purpose of a GLO against the injustice that will be caused if a claim is determined otherwise than in accordance with the correct legal rules.

The decision reminds GLO parties that a favourable test-case ruling does not guarantee the same treatment for follower claims. Some issues determined in a test case may be specific to the test case rather than being binding as a determination of a common GLO issue and, even if determined as a common issue, if later legal developments undermine the ruling, the court may disapply it. Advisers should therefore continue monitoring the law and reflect this risk in provisions and reserves. The judgment also provides the Supreme Court's most detailed guidance on CPR Part 19 and the 'order otherwise' power, with relevance beyond tax.

HMRC report and accounts

HMRC annual report and accounts: 2025 to 2026, published in July, shows record tax revenues of £966.4bn. The compliance yield exceeded £50bn for the first time and over 2,100 new compliance officers have been recruited since Autumn Budget 2024 (the target is 5,500 by 2030). Despite record revenues and compliance yield, the provisional tax gap has increased to 6.4% (£59.2bn) for 2024-25, up from a revised 6.0% the previous year, highlighting the scale of the challenge ahead for HMRC to reduce the tax gap by 2030.

The Large Business compliance technical note shows that tax under consideration (an estimate of the maximum additional tax liability in cases under enquiry) in the Large Business directorate is now £73.8bn (up from £52.6bn the previous year). Some £14bn of this sum is tax under consideration for the banking sector. Enquiries into inaccuracies for the international category make up a big chunk of the total Large Business tax under consideration (£26.7bn, which is almost double the previous year). As we saw in the February 2026 NAO report, HMRC's approach to taxing Large Business is good value for money, bringing in £95 for every £1 spent based on the 2024-25 data they analysed. Large Business is therefore likely to remain a significant source of compliance yield.

HMRC continue to invest in artificial intelligence following the appointment in April 2026 of HMRC's first ever Chief AI Officer. AI-enabled analytics are credited with protecting and recovering £10bn of tax in 2025-26 (and are expected to recover an additional £10bn of tax each year to 2029-30). Upstream compliance yield (preventative measures) now accounts for 42% of the total compliance yield and AI-powered risk assessment tools are increasingly capable of linking data across taxes, entities and years. For taxpayers, greater upstream compliance activity and HMRC's growing reliance on data-driven methods heighten the importance of robust documentation, data governance and early identification of tax risk.

What to look out for:

- 14 September is the closing date for the consultation on modernising the distributions framework.
- 21 September is the closing date for the consultation on the tax treatment of predevelopment costs.
- Although the Budget is still some weeks away (28 October), speculation is rising about how the Chancellor can raise revenue without breaking manifesto promises. Recent media reports suggest the Treasury is considering further sector-specific taxes, including a possible bank windfall tax. Such a tax would harm the UK's financial sector competitiveness and would face strong industry opposition.

This article was first published in the 11 September 2026 edition of Tax Journal.

Contact

Mike Lane
Partner
T: +44 (0)20 7090 5358
E: mike.lane@slaughterandmay.com

Zoe Andrews
Head of Tax Knowledge
T: +44 (0)20 7090 5017
E: zoe.andrews@slaughterandmay.com