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UK Supreme Court case of Anson v. HMRC [2015] UKSC 44

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Delaware LLC held to be UK tax transparent

The UK Supreme Court has handed down its judgment on the final appeal in the *Anson* case, in which it treated a taxpayer's interest in a Delaware LLC as transparent for UK tax purposes. This result is surprising as it had previously been HMRC's general practice to treat a Delaware LLC as opaque for UK tax purposes.

As a result of this judgment, it will be necessary to reconsider the position of specific Delaware LLCs from a UK tax perspective, particularly where the Delaware LLC was previously expected to be treated as opaque for UK tax purposes. While the judgment does not prevent Delaware LLCs from being treated as opaque, this treatment is potentially less likely than previously expected, and it will turn on whether the partners have an interest in the profits of the LLC as they arise under Delaware commercial law and the LLC agreement. The judgment may also present opportunities for UK taxpayers to claim credits for U.S. tax paid on profits from an LLC.

This judgment is contrary to HMRC's currently published general position on LLCs and so we expect them to issue some reaction or revised guidance over the coming weeks which may help to provide further clarity.

Case summary

The case concerns profits paid by a Delaware LLC to a member ("the Member") and the availability of UK tax credits in respect of the U.S. tax paid by the LLC on those profits under the U.S.-UK double taxation treaty (Article 23(2)(a)). Credits would be available if the UK tax was "*computed by reference to the same profits or income by reference to which the United States tax [was] computed*". However, HMRC denied the credits on the basis that the profits taxed in the U.S. were the profits generated by the LLC, whereas the profits taxed in the UK were the distributions made by the LLC to the Member. The key question was, therefore, as a matter of UK tax law, was the Member taxed on the profits of the LLC as they arose, or only on the distributions he received (i.e., was the LLC transparent or opaque for UK income tax purposes)?

The First Tier Tribunal ("**FTT**") held that, as a factual matter based on the Delaware LLC Act and provisions of the LLC agreement, it was the Member's share of the profits of the LLC which was subject to UK tax and so he was entitled to double tax relief. However, this was overturned in the Upper Tribunal ("**UT**"), which decision was subsequently followed by the Court of Appeal ("**CoA**"). The UT and CoA found that, as Mr. Anson did not have a proprietary right to the underlying assets of the Delaware LLC, he could not be entitled to a share of the profits of the LLC. As a result, the Member's income for UK tax purposes was not computed by reference to the same income taxed in the U.S., and so no relief was available.

The Supreme Court considered three matters: (1) the profits that were subject to tax in the U.S. (being a question of U.S. tax law); (2) the profits that were subject to tax in the UK (being a question of UK tax law); and (3) whether these were the same. Point (1) was not in dispute; as the Delaware LLC had not made any "check the box" election, it was treated as a transparent entity and the Member paid U.S. tax on his share of the income arising to the LLC. On point (2), the Supreme Court determined that the source of profits for UK tax purposes was also the Member's share of the income arising to the LLC in accordance with the specific terms of the LLC agreement and the application of the Delaware LLC Act (both of which are issues of fact that were determined by the FTT). As a result, the Supreme Court held that, on point (3), the profits taxed in the U.S. and the UK were the same. The CoA's decision was overturned and the Supreme Court found that the Member was entitled to relief from UK tax on his profits from the Delaware LLC.

This decision is important as it now casts doubt over the UK tax treatment of Delaware LLCs. In order to determine whether a Delaware LLC would be treated as opaque or transparent for UK tax purposes, taxpayers will need to review the underlying documents and also consider the impact of local law.

The consequences of a potential change of UK tax treatment from that which might have been assumed before this judgment could be significant. For example, UK corporation taxpayers may now be subject to tax on the underlying income arising to the LLC on a current basis, rather than being taxed (if at all) on distributions out of the LLC as dividend payments (in many cases those "dividends" would have been exempt from UK corporation tax). By contrast, a UK individual taxpayer may be able now to access credit against UK income tax for U.S. tax paid on the same underlying profits of the LLC on a current basis.

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