

UK Supreme Court Hands Down Decision in *Anson v. HM Revenue & Customs*

Members of a 'Transparent' Delaware LLC Entitled to Double Tax Relief in the UK

On July 1, 2015 the Supreme Court of England and Wales handed down its long awaited judgment in [Anson v. HM Revenue & Customs \(2015 UKSC 44\)](#).

The taxpayer, Mr. Anson, was a UK tax resident member of a Delaware LLC. He was claiming entitlement to double taxation relief against his UK income tax liability for US tax he had paid on his allocable share of the LLC's profits. The claim was made under applicable UK/US Double Tax Conventions (the "Treaty") and under certain domestic double tax relief rules, on the basis that the income taxed in the UK was the same as that taxed in the US. The Supreme Court upheld his claim by finding that the profits of the LLC in question belonged directly to the LLC members.

The unanimous decision, which reverses the February 2013 decision of the Court of Appeal¹ and reinstates the February 2010 decision by the First-Tier Tribunal (Tax) ("FTT")², is surprising since it runs contrary to HM Revenue & Customs' ("HMRC") historic practice of treating US LLCs as taxable entities and not as fiscally 'transparent' for UK tax purposes.

Background

Mr. Anson was a member of a Delaware LLC that carried on a business in Boston, Massachusetts of managing venture capital funds. Under the LLC agreement, the members were entitled to distributions in respect of their allocable share of the LLC's profits. But because the LLC was treated as fiscally transparent for US tax purposes, the members were subject to US federal and Massachusetts state tax on their allocable share of the profits regardless of whether those profits were actually distributed to the members or retained by the LLC.

At all relevant times, Mr. Anson was resident in the UK for UK tax purposes. He was not domiciled in the UK for UK tax purposes, so he was only subject to UK income tax on non-UK source income that was remitted to the UK. When Mr. Anson remitted his share of the LLC's profits (net of US tax) to the UK, HMRC sought to subject that remittance to UK income tax. Mr. Anson applied for double tax relief under the Treaty for the US federal tax paid on the LLC's profits and under UK domestic law for relief from the Massachusetts state tax.

The Treaty and the domestic UK law granted credit for the relevant US taxes only against UK tax computed by reference to the same income as that on which the US taxes were calculated.

¹ *HMRC v. Anson* [2013] EWCA Civ 63.

² *Swift v. Revenue & Customs* [2010] UKFTT 88 (TC).

HMRC contended that this requirement would not be met for Mr. Anson because the Delaware LLC was 'opaque' for UK tax purposes – this meant, said HMRC, that while the US tax was incurred on the profits of the LLC, the UK tax was incurred on something different, namely the distributions from the LLC. The Upper Tribunal and Court of Appeal agreed with HMRC, saying that while the LLC's members had rights to distributions under the LLC agreement, those rights were merely contractual and the members had no proprietary rights to the LLC's actual profits. Mr. Anson appealed to the Supreme Court.

Decision

The Supreme Court disagreed with the Court of Appeal's focus on the question of whether Mr. Anson had a *proprietary* right to the profits of the LLC. The Court considered that based on the ordinary meaning of the relevant words in the Treaty and the domestic UK law, the only question to be answered for the purposes of the appeal was whether the income taxed in the US was the same as the income taxed in the UK.

The FTT had found that, as a matter of Delaware law, the members of the LLC automatically became entitled to their share of the LLC's profits as they arose (prior to, and independent of, any subsequent distribution); and the Supreme Court considered this was a matter of fact upon which the FTT was entitled to conclude based upon the expert evidence provided as to the provisions of the Delaware LLC Act and the effect of the LLC agreement in question. The Court therefore rejected HMRC's argument that the profits generated by the LLC belonged to the LLC in the first instance and were then transferred by it to the members. An important distinction made by the Court was that between profits and assets. The Court considered that while the assets of the business belonged to the LLC, that did not prevent a finding that the members had, as a matter of Delaware law, an entitlement to profits as they arose.

The Supreme Court concluded that if Mr. Anson "*was entitled to the share of the profits allocated to him, rather than receiving a transfer of profits previously vested (in some sense) in the LLC, it follows that his 'income arising' in the US was his share of the profits*". Since it was this same income that was subject to tax under UK law (to the extent remitted to the UK), he was entitled to the double taxation relief.

Possible Implications

Implicit in the Supreme Court's decision is that Mr. Anson would be subject to UK tax on his share of the LLC's underlying profits, whether or not the profits were distributed to him. This is an important development and it directly contradicts the position historically taken by HMRC (and, correspondingly, many UK taxpayers) that UK members of an LLC are taxed on the distributions made to them, rather than on their allocated share of the underlying profits.

The decision may be welcomed by some individuals who, like Mr. Anson, hold interests in LLCs and wish to claim relief in respect of US taxes paid on their share of the profits.³ However, the decision also introduces some significant uncertainty:

- First, the case was decided on its own facts and it is unclear whether other LLCs (whether organized in other states,⁴ and/ or with different forms of LLC agreement), or indeed any other form of non-UK entity with similar attributes, would be treated the same way. The Supreme Court focused on provisions of the Delaware LLC Act and the drafting of the LLC agreement, therefore leaving open the question of whether it may be possible to pick an LLC jurisdiction, or to craft an LLC agreement, so as to establish an entity which is 'opaque' or 'transparent' for UK tax purposes, at the taxpayer's choosing.
- Second, the decision focuses on double tax relief and does not consider more generally whether Delaware LLCs are transparent or opaque, or whether they should be treated as partnerships for UK tax purposes. For example, the decision does not seem to address the treatment of capital gains accruing to LLCs or their investors (although the Court found that the assets of the LLC in question belonged to the LLC). Nor does it address the question of whether an LLC can form a member of a corporate tax group for UK tax purposes.
- Third, UK corporate investors in LLCs who have regarded the relevant LLC as opaque and have treated receipts from the LLC as exempt may have to reconsider their position. Pension funds and other tax exempt investors in LLCs may have particular concerns if the LLCs in which they invest are regarded as 'trading' for UK tax purposes.

In light of this uncertainty, there will need to be some clear guidance issued by HMRC about how they will deal in practice with the implications of the decision. In particular, clarification will be welcomed as to whether the decision will be applied retroactively to LLCs that have been relying on the long-standing HMRC practice to treat LLCs as opaque. A legislative solution for the future, perhaps along the lines of the US 'check the box' regime, would be a fundamental shift, but it cannot be ruled out.

In the meantime, investors in Delaware (and other) LLCs should carefully consider the impact of the case on the LLCs in question. In addition, funds that are LLCs, or make investments through LLCs, should carefully consider whether the change in treatment implicates any fund covenants (e.g., relating to structuring, information exchange, or cooperation in obtaining refunds) or requires changes in the structuring of existing investments.

³ If the LLC is treated as transparent for UK tax purposes, this may also allow UK residents receiving US dividends, royalties or other income subject to US withholding tax to benefit from reduced rates of withholding tax under the Treaty. To the extent the LLC was treated as opaque, section 894 of the US Internal Revenue Code would have prevented the benefit of reduced tax treaty rates.

⁴ Not all states in the US have the same provisions in their LLC Acts as those in the Delaware LLC Act that were considered in the Anson case. For example, the LLC Acts in California and Illinois do not describe a member's interest in the LLC as including a share in the profits and losses of the LLC.

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If you have any questions, please feel free to contact [Jason Factor](#), [Richard Sultman](#) or [Jennifer Marques](#) or any of your regular contacts at the firm. You may also contact our partners and counsel listed under "[Tax](#)" located in the "Practices" section of our website at <http://www.clearygottlieb.com>.

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