



Post-*Anson* Guidance Needed on U.K. Treatment of U.S. LLCs

By

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While many practitioners welcomed the U.K. Supreme Court's recent decision that a U.K. investor in a Delaware limited liability company is entitled to double tax relief, they say the decision has created some uncertainty about the U.K. tax treatment of LLCs.

The Court's July 1 decision in *Anson v. HM Revenue & Customs* (2015 UKSC 44)  surprised many in the tax community because it rejected HMRC's long-standing position that a U.S. LLC should be considered an opaque entity for U.K. tax purposes -- that is, the entity's profits should be treated as accruing to the entity itself and not to its members. The Court found that based on Delaware's LLC Act and the provisions of the LLC agreement in the *Anson* case, the LLC's members automatically became entitled to their share of the LLC's profits as they arose. The Court therefore concluded that because the U.K. and U.S. were taxing the same income, the taxpayer (a U.K. resident who was a member of a Delaware LLC) was entitled to a U.K. tax credit under the U.K.-U.S. tax treaty. (Prior coverage )

Practitioners who spoke with Tax Analysts said the decision was a mix of good and bad news. For U.K. investors who previously opted to use more cumbersome vehicles (such as a limited liability partnership) to avoid double taxation, the *Anson* decision gives them the ability to use a Delaware LLC, which offers more flexibility. However, practitioners noted that in some circumstances, investing through a Delaware LLC could now be less attractive.

For U.K. corporate investors in LLCs, distributions previously were treated as tax-exempt dividend income, said Judith Harger of the London office of Wilkie Farr & Gallagher LLP. "But now, the *Anson* decision is saying the U.K. corporate investor is itself earning its share of the LLC profits, so the investor will have to pay U.K. tax on that," she said.

Likewise, for U.S. individuals, investing in a U.K. trading activity through a Delaware LLC was an attractive option because the LLC was taxed in the U.K. as an opaque company, and the profits were therefore subject to the U.K.'s relatively low corporate tax rate. "However, if we apply the *Anson* decision's reasoning, the profits don't belong to the LLC but to its members," Harger said. "So it appears that the U.S. individual would be subject to U.K. tax on the LLC's profits himself, which would attract the much higher U.K. personal income tax rates of up to 45 percent."

Practitioners said there are also questions about the scope of the *Anson* decision.

Richard L. Winston, a Miami-based practitioner, noted that the Court didn't rule that all U.K. investors in Delaware LLCs will be able to claim a U.K. tax credit on the grounds that they are always subject to direct U.S. tax on their allocable share of the LLC's income. Rather, the Court

clarified that U.K. investors in a Delaware LLC may avoid double taxation when the LLC operating agreement makes it clear that the LLC's profits belong to the LLC's members and not to the LLC itself, he said.

The Court's decision didn't analyze the tax effects of a single-member Delaware LLC or a Delaware LLC that has elected to be treated as a corporation for U.S. tax purposes, Winston said.

Douglas S. Stransky of Sullivan and Worcester LLP in Boston noted that U.S. citizens who are resident in the U.K. and who invest in S corporations will continue to face double taxation because until HMRC provides further guidance, the *Anson* decision cannot be extended to S corporations. "I think, though, that *Anson* at least provides some glimmer of hope that HMRC might eventually take the view that an S corporation should also receive the same treatment in the U.K. as an LLC," Stransky said.

Whether the *Anson* decision applies to LLCs in other U.S. states is another unanswered question, said Nick Thornton of the London office of Fried Frank. "The problem with applying this decision more broadly is that it was based specifically on the LLC in this case," he said. "It's not clear from the public transcripts how much weight was given to the Delaware statute, as opposed to the specific provisions of the LLC operating agreement in *Anson*. So it's difficult to say whether this would apply to LLCs in other states or even to all Delaware LLCs."

Thornton said that because the *Anson* decision is limited to the finding that the LLC's profits belong to the members for U.K. source purposes, one can't say that the LLC is transparent for all U.K. tax purposes. The decision doesn't address, for example, whether an LLC is transparent for capital gains purposes, or whether an LLC can form a member of a corporate tax group, he said.

The *Anson* case highlights the need for more clarity on the entity classification rules, Thornton said. He noted that HMRC has a list (INTM180030) on its website in which it designates whether a particular foreign entity is considered opaque or transparent. That guidance was based on a 1998 Court of Appeal case, *Memec plc v. IRC* (70 TC 77), which until *Anson* was considered the leading authority for determining whether a foreign entity is transparent or opaque for U.K. tax purposes.

HMRC may need to revisit that list, Thornton said. "It seems from *Anson* that there is more complexity to the entity classification question than was recognized in *Memec*," he said. "I don't think it's possible anymore to say that an entity is opaque or transparent full-stop. The question has to be asked in a specific U.K. tax context, which means there's more granularity than we'd thought."

Thornton said he hopes the Parliament will enact legislation to provide simpler rules regarding entity classification. "Whether that means listing specific criteria to deem entities to be opaque or transparent for all U.K. tax purposes, or creating a list of foreign entities that are commonly used and deeming them to be companies, partnerships, etc.," he said, "having that in legislation would be very helpful. At present, we're left with chaos because entities can potentially have different classifications for different U.K. tax purposes."

In a July 23 statement to Tax Analysts, an HMRC spokesperson said HMRC "continues to

consider the details of the judgment and will therefore not be making any comment at present."

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