The certainty of uncertainty

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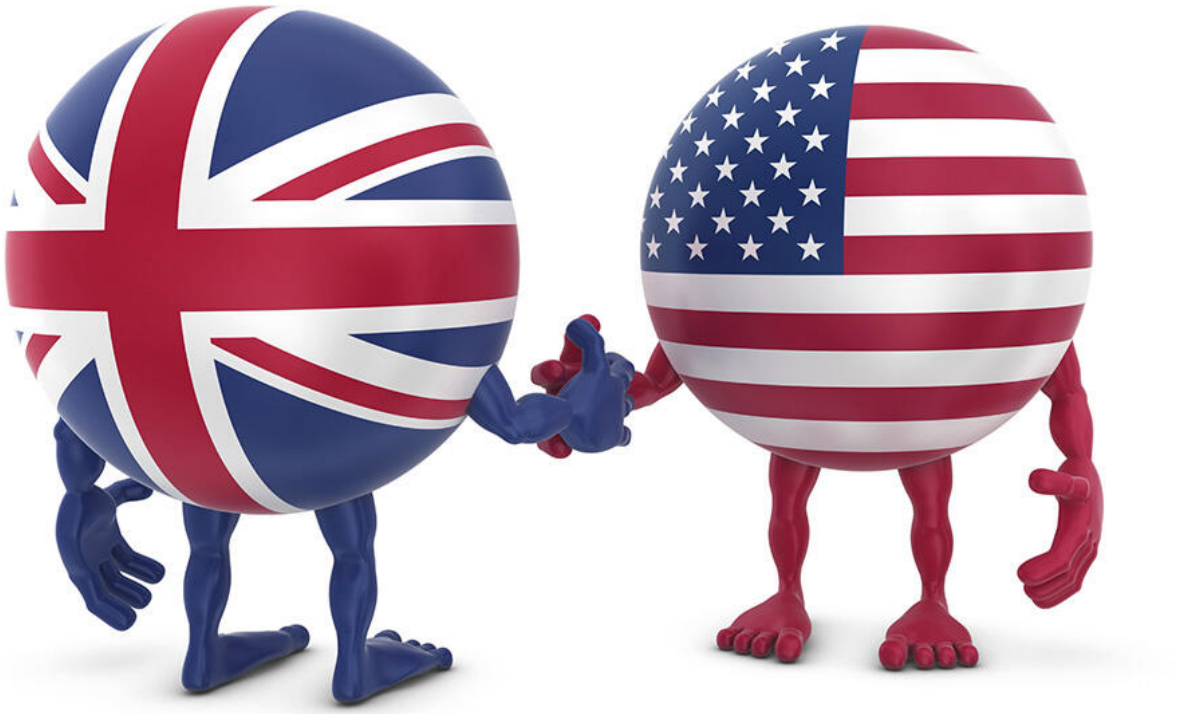

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David Treitel considers whether the *Anson* case makes the UK tax treatment of US LLCs any clearer

Key Points

What is the issue?

Many UK residents own interests in the US through LLCs. A Supreme Court decision offers double tax relief in the UK for some of them

What does it mean to me?

US LLCs are common structures, but UK practitioners will need to review each case to decide what to disclose to HMRC

What can I take away?

LLCs remain uncertain from a UK tax perspective and may be best avoided if simplicity is desired

Some of the long-held uncertainties over what income should be recognised from US limited liability companies (LLCs) for UK tax purposes, in addition with the amount of double tax relief individuals can claim in the UK for US tax paid on it, has been cleared up. Moreover, they have been resolved in the taxpayer's favour by the UK Supreme Court in *Anson v R & C Commrs* [2015] UKSC 44.

George Anson was a non-UK domiciled UK resident member of a Delaware LLC who paid US tax on his share of the entity's profits. The court decided that Mr Anson was entitled to claim credit against his UK tax for the US tax that he paid on the same profits that were subject to US tax. The ruling reversed the decisions of the Upper Tribunal and the Court of Appeal and upheld the original First-tier Tribunal decision.

In *Revenue & Customs Brief 15/15*, HMRC responded that the decision was 'specific to the facts found in the case'. Other individuals claiming double taxation relief based on this decision alone will find that any such claims will be 'considered on a case-by-case basis'.

HMRC's position is not surprising. They are having to accept that relief can be claimed in the UK in some, albeit limited, circumstances for US tax paid on an individual's share of income from a US LLC.

Mr Anson was a member of a US LLC and paid US tax on his allocated share of the profits. Before the Supreme Court decision, HMRC maintained that he should suffer not only this US tax – calculated under US rules – on his share of the income of the LLC, but also that he would be liable to pay additional UK tax on distributions as if they were dividends without any credit for US tax. In effect, HMRC stated that Mr Anson should suffer UK tax as well as US federal and state tax.

Anson’s circumstances

Mr Anson was a member in a Delaware LLC that carried out business in the US. For US tax purposes, this was classified as a partnership and therefore ‘transparent’ there. Mr Anson was liable to US federal and state taxes on his share of the profits of the entity, whether or not distributed. He was domiciled outside the UK and was taxable on non-UK income, and gains to the extent remitted to the UK. He remitted his income from the LLC to the UK.

HMRC sought to assess Mr Anson to tax on the basis that the income remitted from the LLC should have been treated in the same way as distributions from a company; akin to a dividend. HMRC argued, based on the *Memec* principle (*Memec plc v IRC* [1998] STC 754) that, under English law (unlike in the US), the LLC fell to be treated as ‘opaque’, so Mr Anson was not entitled to relief for any US tax that he paid personally on his share of the underlying profits. This would have resulted in potential double taxation because Mr Anson would have suffered a combination of US and UK tax on his share of the profits.

The Upper Tribunal and the Court of Appeal placed considerable emphasis on the concept of UK law established in *Memec* that one should determine whether an entity is transparent or opaque. Both courts found that Mr Anson did not have a right to the profits of the LLC as they arose but, instead, the right to receive distributions under the LLC agreement. Accordingly, the profits taxed in the UK were those derived from the right rather than the activities of the LLC. The Court of Appeal in particular focused on whether Mr Anson had a proprietary right to the underlying assets of the LLC ‘in any meaningful sense’ in reaching the conclusion that the entity was opaque, rather than the issue of whether the income taxed in the US was the same as that taxed in the UK.

Double tax relief

When the case reached the Supreme Court, HMRC continued to argue that ‘in the case of a partnership … the source of the taxpayer’s income is the business carried on by the firm … whereas in the present case the source of Mr Anson’s income is his rights under the LLC agreement’. This followed the logic that the LLC was, under Delaware law, a separate body from its members and was therefore opaque.

Lord Reed, however, stated that the key question here was not whether the LLC was opaque or transparent, but ‘whether the income on which Mr Anson paid tax in the US is the same as the income on which he is liable to tax in the UK’. The Supreme Court found in *Anson* that the profits belonged to the members of the LLC as they arose. It based this on a combination of Delaware law and the LLC members’ agreement. Consequently, to convince HMRC that any other taxpayer should be entitled to the same outcome one would need to show that both the laws of the state in which an LLC is incorporated and any specific LLC agreement provide an absolute entitlement to members of profits or income as they arise.

Article 23 of the 1975 UK/US Double Taxation Convention states that any US tax paid shall be credited against ‘any United Kingdom tax computed by reference to the same profits or income by reference to which the United States tax is computed’. An almost identical provision is in Article 24 of the 2001 UK/US treaty. UK domestic law provides for relief for tax paid ‘by reference to the same profits or income’. Did the UK and the US treat the tax imposed as being by reference to the same profits or income? The Supreme Court decision states that, to decide whether relief can be claimed for foreign tax, the profits or income in each case must be compared to determine whether they are the same.

Because the Supreme Court did not decide whether an LLC is opaque or transparent, it is unclear to the extent that this analysis is now relevant for ascertaining double tax relief. Will one simply need to consider whether an individual is entitled to the same share of profits that are taxable by the UK and US?

LLCs – practical issues

Although this case was decided in Mr Anson’s favour, it is so fact-specific that it leaves the UK tax position frustratingly uncertain. This case should serve as a wake-up call to all other UK resident individuals who own interests in US LLCs.

Neither *Anson* nor *Brief 15/15* states how much income is taxable. In Mr Anson’s case, the taxable amount is the same share of profits as is taxed by the US. If, alternatively, the income was taxed as a dividend, would HMRC seek to charge UK income tax on the gross amount distributed or the net amount after any US federal or state tax has been paid? For an individual claiming the remittance basis there may be an argument that the only amount capable of being remitted, and therefore taxable by the UK, should be what is left after US tax has been paid. Could the same

argument be used by an arising basis taxpayer?

Although *Anson* is not authority that LLCs are transparent, some LLCs that meet particular requirements can now be treated for UK double tax relief purposes as if they are. Consequently, if this treatment is desired, the documents would need to be drafted as closely as possible to the operating agreement in Anson.

Alternatively, and somewhat safer from a planning perspective, a US limited partnership will provide transparent treatment in the US and the UK while avoiding the remaining uncertainty over LLCs. If certainty is the desired outcome, perhaps HMRC’s message is that US LLCs should be completely avoided.