

## UK CLIENT MEMORANDUM | ENGLISH LAW UPDATES

# The United Kingdom Supreme Court reverses the well-established UK tax treatment of Delaware LLCs

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## AUTHOR

**Judith Harger**

A decision published on 1 July 2015 by the UK Supreme Court (*Anson v HMRC* [2015] UKSC 44) upsets the UK tax authority's well-established practice of treating Delaware (and other United States) LLCs as "opaque" entities for UK tax purposes.

The Court decided that a UK resident individual member of a Delaware LLC was taxable on his share of the LLC profits as they arose (similar to a partnership profit share). This was a favourable outcome for the taxpayer because it meant that he was entitled to credit the U.S. tax paid on those profits against his UK tax liability. The UK tax authority (**HMRC**) had argued that the individual was only taxable if and when the profits were distributed (as with a dividend paid by an "opaque" company) with the result that there were two different income streams – the underlying profits of the LLC and the distributions by the LLC – and U.S. tax paid on the former could not be credited against UK tax payable on the latter.

Although the taxpayer won, the decision will not be welcome to all.

First, it creates uncertainty. The Supreme Court essentially restored the 2010 conclusions of the First Tier Tribunal. Following that decision, HMRC published a statement confirming that it had appealed the decision and intended, for the time being, to continue with its then current general practice in relation to U.S. LLCs. Thereafter, HMRC won in the Upper Tribunal and the Court of Appeal. However, the Supreme Court decision is final. We now await a response from

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HMRC as to what happens to existing structures and taxpayers who have relied on the longstanding (and contradictory) published practice of HMRC.

There may be scope for distinguishing the facts in *Anson* as the decision turned on a detailed examination of the constitution of the LLC in question. However, the basis for the key finding, that the profits of the LLC belonged to the members, is mainly derived from the Delaware LLC Act (in particular section 18-101(8)), which applies to all Delaware LLCs (and may not differ greatly from the corresponding provisions in the LLC legislation of other U.S. states), rather than the particular LLC agreement.

In the opposite factual scenario of a U.S. individual investing in a UK trading activity, one might previously have recommended a Delaware LLC, in the expectation that it would be taxed in the UK in the same way as an “opaque” company. This is a relatively attractive outcome, given the (low) UK corporation tax rate of 20% and the absence of any UK withholding tax on dividends. The general definition of a “company” for UK tax purposes includes “any body corporate . . . but does not include a partnership” (Section 1121(1) Corporation Tax Act 2010) and a Delaware LLC is a body corporate, incorporated under the Delaware LLC Act. Nevertheless, if, as the Supreme Court held, the profits do not belong to that body corporate, but rather to its members, then it appears that the U.S. individual would be subject to UK tax on the LLC profits themselves, on the basis that he is carrying on a trade in the UK through a branch or agency, attracting the much higher UK personal income tax rates of up to 45%.

Where a UK company invests in the U.S. via an LLC, it would previously have been taxed in the UK only on the distributions which, in many cases, would qualify for the exemption for corporate dividend income. This is no longer the case.

If, to solve that problem, an intermediate company, in a third jurisdiction, is interposed between the UK holding company and the LLC, the effect of *Anson* seems to be to attribute the underlying LLC profits to the intermediate company in analysing the UK CFC implications for the holding company.

The prior HMRC practice, as well as to treat Delaware LLCs (and other U.S. LLCs) as “opaque” companies for UK tax purposes, was also to accept that an LLC was capable of having “issued share capital” for UK tax purposes, provided that it issued membership certificates to evidence the LLC interests. This was important because many group relationships for UK tax purposes are defined by reference to percentage ownership of “issued share capital” in other entities. If an entity has no issued share capital, then it is not possible for it to be grouped, nor for a group relationship between two other entities to be traced via such an entity, for UK tax purposes. The Supreme Court did not directly comment on this point. However, the First Tier Tribunal decision back in 2010 cast doubt on the ability of any Delaware LLC to have “issued share capital”. This will affect the ability to consolidate tax profits and losses, and to transfer assets on a no gain/no loss basis, between certain affiliated entities.

Groups and other corporate structures that combine a UK element with a U.S. LLC will need to be reviewed.

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If you have any questions regarding this memorandum, please contact Judith Harger in London (+44 20 3580 4705, [jharger@willkie.com](mailto:jharger@willkie.com)) or the Willkie attorney with whom you regularly work.

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