



Delaware LLCs: The Implications of *Anson*

Contacts

James Anderson

44.20.7519.7060

james.anderson@skadden.com

Alex Jupp

44.20.7519.7224

alex.jupp@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

40 Bank Street
Canary Wharf
London, E14 5DS

Four Times Square
New York, NY 10036
212.735.3000

Skadden held a webinar on September 14, 2015, to discuss certain key aspects of the U.K. Supreme Court decision in *Anson v. HMRC*, with a focus on potential ramifications for multinational groups including Delaware LLCs (and other similar entities), and on the U.K. tax authority's (HMRC) anticipated response to the decision. Speakers from Skadden's international tax practice were partner James Anderson and counsel Alex Jupp. Guest speaker Thomas Chacko, junior counsel to the Crown and a member of Pump Court Tax Chambers, appeared for HMRC on treaty aspects of the Supreme Court hearing in *Anson*.

Summary of *Anson* and Case History

In *Anson*, a U.K. resident and nondomiciled executive held interests in a management fee-earning Delaware LLC and later remitted some distributions from HarbourVest to the U.K. The principal issue before the courts was whether George Anson was entitled to a credit under the double tax treaty between the U.K. and the U.S. for U.S. taxes paid on his share of the profits of the LLC. HMRC's case was that no credit was allowed, leaving Anson with an effective tax rate of 67 percent on his remittances.

The First-Tier Tribunal had determined that credit should be given to Anson for U.S. taxes paid on his share of the profits. The Upper-Tier Tribunal and Court of Appeal both determined that such credit should not be given. The Supreme Court, however, restored the First-Tier decision, and Anson was granted credit relief.

The First-Tier Tribunal was the primary fact-finding tribunal. Non-U.K. laws are a matter of fact in English courts, so the findings of the First-Tier Tribunal on Delaware law were fundamental to the case. The tribunal found that Anson was entitled under the terms of the LLC agreement to: (a) a share of the LLC's profits as they arose, and (b) automatic distributions of those shares of profits (despite the managing member having some discretion over distributions). Despite the assets representing the profits belonging to the LLC until a distribution was made, the profits themselves belonged to its members.

The Supreme Court considered the key question to be whether the U.K. taxes that Anson was liable to pay were computed by reference to the same profits or income as the profits or income by reference to which U.S. taxes had been computed. The answer to that question was "yes."

Delaware LLCs: The Implications of *Anson*

Key Takeaways

HMRC's Reaction

On September 25, 2015, HMRC published a formal reaction to *Anson* in Business Brief 15 (2015). In essence, HMRC's view is that the conclusions of the Supreme Court are specific, and limited, to the facts of *Anson*. The approach appears to favor preserving the status quo, emphasizing that HMRC would follow its existing published practice in the main areas on which doubt was cast in *Anson*: entity classification and ordinary share capital.

Takeaways for UK Taxpayers

What to make of HMRC's response? Although a helpful indicator of HMRC's likely approach in practice, Business Brief guidance does not have force of law. It is rare to be able to rely on guidance against HMRC in court. Business Brief 15 (2015) appears to give taxpayers some comfort that prior years and existing structures will not be reconsidered in light of *Anson*. However, taxpayers with facts close to those in *Anson* and those wishing to ensure that a Delaware LLC, or any other non-U.K. entity, is transparent or opaque may wish to consider the factors described in the judgments as well (or instead) in considering their next steps.

Entitlement to profits (rather than entitlement to distributions). The key drafting point in light of *Anson* is that to ensure transparency for income tax purposes, at the very least the members of the LLC need absolute entitlement to profits as they arise (even if distributions are restricted), without an intervening step.

Nature of the income. The Supreme Court did not comment on whether the income received by *Anson* would be trading income if the LLC had been found to be trading for U.K. tax purposes. U.K. taxpayers finding themselves now with taxability on income from an LLC's underlying business would need to consider if tax credits (Section 18(2) TIOPA 2010) or trading losses are available. This applies on a retrospective basis as well as a prospective basis, so protective filings should be considered. Attention also needs to be paid to whether the U.K. taxpayer constitutes a permanent establishment of a "trading" LLC if that person is an active member of the LLC — although any U.K. tax on "trading income" could now be offset with the U.S. credits. If the LLC is receiving dividend income other than in the course of a trade, the credit and loss utilization position might be different.

Don't rely on Memec. *Memec plc v. Inland Revenue Commissioners* could be argued as more closely tied to its own facts as a result of *Anson*. Certainly, the principles extracted by HMRC from Memec will need revision, given the factual and thus legal and tax conclusions in *Anson* — for example, the irrelevance of legal personality and the restrictions on distribution.

Ordinary share capital should be carefully considered in light of the First-Tier Tribunal's comments that the capital of LLCs is closer to the partnership capital of a Scottish partnership than to share capital of an English company. In light of HMRC's formal response to *Anson* (see above), HMRC's stated practice of accepting that a Delaware LLC with issued certificated membership interests has ordinary share capital (Business Brief 54/07) appears to have been preserved. Ordinary share capital is of course a significant consideration in certain key features of U.K. corporation tax, notably many reliefs premised on the existence of a "group" and the substantial shareholding exemption.

LLCs with U.K. corporate members who rely on the dividend exemption in respect of distributions from the LLC should consider whether previously claimed dividend exemptions applied.

Direct investment into the U.S. may be an issue for pension funds that now could be considered "trading" (or at least receiving trading income).

Foreign permanent establishments. One of the questions that remains unresolved is on foreign permanent establishments. If the income of an LLC belongs to its U.K. member and the LLC is engaged in a trade (other than in the U.K.), can the U.K. member elect to exempt those profits under the exemption for profits of foreign permanent establishments?

CFCs. For LLCs whose members are controlled foreign corporations (CFCs) of a U.K. company, U.K. taxpayers may now need to revisit whether there is a CFC inclusion if the income is that of the members.

All in all, it is clear that the judgment in *Anson* has opened up several issues for U.K. taxpayers, which will take a good deal of time to resolve despite, or perhaps because of, HMRC's response to the case.