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Anson v HMRC – Case Summary

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Member of Delaware LLC eligible for double taxation relief on profit share.

The Supreme Court has unanimously held in favor of the taxpayer, allowing his claim for double taxation relief for income from his profit share of an LLC that was remitted to the UK. [1]

The case concerned a taxpayer who was a resident, but not domiciled in the UK, for UK tax purposes. He was liable to UK income tax on UK sourced income and on foreign income remitted to the UK and liable for US federal and state taxes on his US sourced income.

The taxpayer was a member of a Delaware LLC that carried on the management of a number of venture capital funds. Under the terms of the LLC agreement between the members, profits were attributed to each member's capital account and distributions of profits were made on a quarterly basis.

As the Delaware LLC was treated as a partnership for US tax purposes, the taxpayer was personally liable to US federal and state income tax on his share of the profits of the LLC. On remittance of the profits to the UK, the taxpayer was also liable to UK income tax subject to any double tax treaty relief.

The question before the court was whether a taxpayer was entitled to claim double taxation treaty relief on income remitted to the UK from the profits of a Delaware LLC to which he had already been subject to US tax.

The US/UK Double Tax Convention entitles the taxpayer to tax credits in the UK for any tax paid in the US which is "computed by reference to the same profits or income". The court therefore had to consider whether the income on which the taxpayer paid US tax was the same income to which he was liable to UK tax. This was the critical issue.

The court took a three-step approach in its judgment, firstly identifying the profits which were subject to US tax (as a matter of US law), secondly identifying the profits that were subject to UK tax (as a matter of UK law) and finally considering whether these were the same. On the first point it was undisputed that the Delaware LLC was transparent for US tax purposes and each member was therefore liable to tax on his share of the profits. In relation to the income subject to UK tax it was established that the source of the profits was also the taxpayer's share in the profits of the LLC as determined by the Delaware LLC Act and the LLC agreement between the members. As a result of this contractual right to the profits, the taxpayer was entitled to the profits as they arose, regardless of when the profits were actually distributed. The court therefore held that the taxpayer's liability to UK income tax was computed with reference to the "same" profits that he had already been taxed on in the US and he was entitled to double taxation relief.

Practical Considerations

This decision runs contrary to HMRC's established treatment of LLCs being treated as opaque for tax purposes with income belonging to the entity until it is distributed to its members. This will undoubtedly raise questions as to how HMRC will treat these entities going forward and may impact upon a number of UK taxpayers.

Whilst we await HMRC's response to the decision, it should be noted that the court in this case relied heavily upon the specific terms of the LLC agreement and the Delaware LLC Act. HMRC may, therefore, attempt to limit this decision applying more widely to other US LLC's/similar foreign entities.

[1] See our prior alerts dated December 2011 and June 2010 for the full history to the case.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Lawyers:

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