Analysis

Anson, transparency and Brief 15/2015

SPEED READ ***Revenue and Customs Brief 15/2015*** **sets out HMRC's policy in relation to US LLCs following the Supreme Court's decision in *Anson*. It dismisses *Anson* as 'specific to the facts found in the case'. The impact of the Brief is widely taken to be that members of an LLC will be taxed on distributions, and not exposed to tax on the underlying profits. This has been welcomed as sensible and practical. On close inspection, however, the Brief is very narrow. To avoid complex and fact sensitive analysis, taxpayers may need a specific HMRC ruling.**

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Are Delaware LLCs 'transparent' for UK tax purposes? No, yes, no, no, yes and no: this is what HMRC, the First-tier Tribunal, the Upper Tribunal, the Court of Appeal, the Supreme Court and HMRC have said during the passage of the *Anson* case *(Anson v HMRC* [2015] UKSC 44). Along the line some commentators – including '*Anson*: the latest in tax transparency' (Philip Harle), *Tax Journal*, 1 March 2013 – have pointed out that there is disagreement on what the question is in relation to 'transparency' and 'entity classification'; and, in any event, *Anson* cannot provide all the answers. Where do things stand now that this particular piece of music has stopped?

On 25 September, HMRC issued *Revenue and Customs Brief 15/2015* in response to *Anson*. It dismisses *Anson* as 'specific to the facts found in the case'. Its default policy remains to treat any US LLC 'as a company'. On close inspection, however, the Brief is very narrow. Taxpayers' rights to infer common sense from HMRC guidance are, of course, limited. This article draws together various strands to help assess the UK tax risk posed by LLCs in corporate structures.

Scope of *Anson*

The Brief must be read in light of the *Anson* decision. HMRC dismisses *Anson* as 'specific to the facts found in the case'. This is difficult to understand.

For the Supreme Court, the domestic aspect of *Anson* was not about generic transparency, but simply the application of the old Schedule D Case V. This taxed the profits of foreign trades and other foreign possessions. The question was whether the profits of the LLC's trade, as they were earned, were Mr Anson's 'income arising'.

The Supreme Court held that they were. The reasoning is not simply laid out. It appears to be as follows:

a) income arose as 'profits' were earned (see para 121);
b) 'profits' refers to an accounting measure (para 37);
c) whether those accounting profits were Mr Anson's required analysis of Delaware law (para 51);
d) the FTT had found, based on ss 18–101(8) and 18–503 of the Delaware LLC Act, coupled with s 4 of the LLC agreement, that as profits arose they were allocated to Mr Anson's capital account (para 18); and
e) this was sufficient for profits of the LLC's activity to be Mr Anson's income for UK income tax purposes.

The finding of fact at (d) seems uncontroversial and the same finding of fact is likely for many Delaware LLCs. The novel part of the decision is (e), but this is a ruling on UK tax law and so of general application. This was dealt with in four lines (para 116), which give little or no guidance as to why Mr Anson's member's interest in the profits of the LLC's activity was sufficient for those profits to be Case V income. They give no guidance on when such an interest would have been too 'thin' for the profits to be Case V income. And, of course, there is no comment on other UK charging provisions. This leads to the uncertainty which justifies the issue of a Brief.

Scope of the Brief

The Brief does three things. First, it gives confirmation that HMRC will treat (at least some) US LLCs as themselves carrying on a trade or business. However, this was not in issue in *Anson*. The Supreme Court found that the profits were Mr Anson's income even though the LLC carried on the trade.

The Brief confirms that HMRC will treat US LLCs 'as companies'. This is relevant to tax questions within a corporate group, such as whether loan relationships are between 'connected companies'. However, this was again not in issue in *Anson*; and, although the boundary between non-UK corporates and partnerships is not entirely clear, this does not seem to be controversial. CTA 2010 s 1121 provides broadly that a company is any body corporate or unincorporated association (in each case other than a partnership). The Partnership Act 1890 defines partnership as 'the relation which subsists between persons carrying on a business in common with a view of profit' (there is no tax definition). Where an overseas entity has separate legal personality, as does an LLC, and under local law carries on the business itself, the starting point must be that it is not a partnership, as it is not the partners who are carrying on the business. And so it is a company. There is nothing in *Anson* to displace this view.

Finally, the Brief gives confirmation that HMRC will not change its approach as to whether an LLC has

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issued share capital. This is relevant to reliefs, such as that for chargeable gains on sales of 'substantial shareholdings' and to corporate group structures, and was absolutely not in issue in *Anson*.

As has been pointed out before (see '*Anson*: entity classification revisited' (Charles Yorke), *Tax Journal*, 8 July 2015), *Anson* also calls into question HMRC's classification of entities as transparent or opaque at para INTM180030 of its *International Manual*. However, even on its own terms that list only deals with the characterisation of income received from such entities (not whether they are considered 'companies' or 'partnerships') and is not stated to be definitive on income classification. Taxpayers should continue to treat it with caution.

A common sense reading?

The legal position after *Anson* is clearly complex. Accordingly, we think it clear that HMRC had the power to say: 'We will treat US LLCs as opaque.' HMRC is able under its 'collection and management' discretion, especially in factually complex situations, to commit publicly to apply a treatment which is simpler than the underlying law (*R (Davies) v HMRC* [2011] UKSC 47, see para 26).

Although most are giving the Brief this common sense reading, HMRC's commitment is limited to a strict construction of the words it publishes. And a strict reading of the published words gives little comfort.

In addition to the points above, the Brief refers only to US LLCs, and arguably only preserves the existing tax treatment of US LLCs already in existence on 25 September. For other entities, the Brief may give commercial comfort, but no legal protection. Anyone relying on the Brief should also be aware that there is current experience in other areas of HMRC refusing to honour even very clear guidance, on the (mistaken) basis that it is prohibited by law from doing so.

It is likely that over time an understanding will grow of how HMRC applies the Brief, but that will again give commercial comfort only and no legal protection. The only route to securely avoiding *Anson* will be to obtain a specific ruling from HMRC.

Strict legal position

If *Anson* is applied strictly under current law (i.e. if US LLCs are 'transparent' in the sense considered in *Anson*), parent companies could be taxable on the income or gains of their LLC 'subsidiaries' as they arise. This could clearly lead to compliance burdens, if not to actual additional tax.

Schedule D Case V has now been abolished. Under the Supreme Court's approach, each charge would fall to be considered separately. For corporate members of an *Anson* LLC, obvious potential tax charges are on trading profits, or (especially for an investment holding LLC) on loan relationship credits and chargeable gains. None of them works simply. Dividends paid to the LLC should in any event retain their character as dividends and so generally be exempt.

It appears that a corporate member of an *Anson* LLC would be taxed on interest income of the LLC, but as miscellaneous income rather than under normal rules. Under current law, the loan would not be 'its' loan relationship (CTA 2009 s 307), and credits would likely not be recognised on its accounts (CTA 2009 s 308) as opposed to the LLC accounts. This appears to mean that interest income of an *Anson* LLC would (subject to the UK/US treaty) be taxed, but as miscellaneous income under CTA 2009 s 979 and not as loan relationship credit.

Trading profits of the LLC would be taxed as trading profits of the member. Under CTA 2009 s 35, corporation tax is charged on the profits of a trade. Under s 46, those profits must be calculated in accordance with GAAP. There is no restriction such as exists for loan relationships on whose accounts the profits must be recognised in. Therefore, the LLC's trading profits can be taxed in the hands of the member. This is a different approach than suggested by the cases leading to *Pertemps Recruitment Partnership Ltd v HMRC* [2011] UKUT 272 (TCC), which give some indication that profits can be treated as trading income only if the taxpayer beneficially owns the assets representing those profits. That creates uncertainty. The business profits article of the US treaty should eliminate any actual tax, but there is complexity even if the LLC is an 'enterprise of a contracting state' in the US, which would appear only to be the case if the LLC has elected to be treated as opaque for US tax purposes (and therefore a resident). If it has elected to be treated as transparent, there are highly fact sensitive questions as to whether the LLC is a permanent establishment of the parent.

For chargeable gains, the LLC appears opaque. It is the LLC, not the member, that makes any disposal, and a charge on the member under TCGA 1992 s 22 appears inappropriate as any capital sum is derived from the LLC's asset.

This mishmash of outcomes is in no one's interest. Certainty is critical.

Conclusion

On the face of it, HMRC's approach has the benefits of simplicity, stability and comprehensiveness, and of eliminating hybrid tendencies. In a week when the OECD published 455 pages on neutralising the effects of hybrid mismatch arrangements, that can only be a good thing.

The key difficulty is that the wording of the Brief is defective. Without a clarified Brief, taxpayers will need a specific ruling to avoid the need for item by item analysis.

In practical terms, if HMRC will honour the 'spirit' of the Brief as generally understood, we are perhaps back where we started. However, tax systems have difficulty in dealing with foreign entities which do not exactly replicate the characteristics of domestic entities; the courts cannot impose an overarching structure on piecemeal legislation; and guidance is as always a poor substitute for accurate legislation. Before the fundamentals of entity classification disappear under layers of OECD anti-avoidance, the UK and other jurisdictions should make a collective effort to grapple with and simplify them. ■

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