ICAEW
REPRESENTATION 47/26

CONSULTATION ON REFORM TO TAXATION OF UK-RESIDENT MEMBERS OF US LLCs

Issued 29 July 2026

ICAEW welcomes the opportunity to comment on the *consultation on reform to taxation of UK-resident members of US LLCs*, published by HMRC on 10 June 2026, a copy of which is available from this link.

ICAEW supports reform that aligns the UK treatment of US LLCs and other reverse hybrids with their treatment in the jurisdiction where they are established, provided the regime is clear, tax-neutral on entry and exit, proportionate for minority investors, and supported by practical safe harbours for reporting, foreign tax credits and transitional profit pools.

We welcome the aims of this consultation, which are to remove tax barriers that deter individuals from moving to, working in and investing in the UK. This is consistent with government's stated ambition for the UK to be the best place in the world to start and grow a business. The reform will be most effective if it addresses the underlying classification mismatch, rather than merely reducing the tax cost of that mismatch after it has arisen.

We believe that the simplest option is for the UK to mirror the tax opacity or transparency of the structure in the jurisdiction where it is established. Any other method creates an additional administrative burden on investors and advisers and prolongs HMRC enquiries. Investors with small holdings are often unable to obtain the underlying figures that are needed to convert their overseas profits or losses to a UK-acceptable basis.

Whether the Government chooses to implement this on a mandatory basis or by election, the rules should be clear on the process and deadlines that LLC members should adhere to. It must also be clear how profits, losses and foreign tax credits are to be calculated for UK purposes.

ICAEW would support an anti-avoidance measure for cases above a de minimis level, which would provide smaller taxpayers with finality of their position and would allow HMRC to focus its enquiry work on higher-value cases.

ICAEW also encourages the government to review other barriers that deter investors from coming to the UK, such as the lack of an investors visa, and to reduce the administrative burden of the foreign income and gain (FIG) regime.

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This response of 29 July 2026 has been prepared by ICAEW's Tax Faculty.

ICAEW notes that the consultation period is less than eight weeks and coincides with the summer holiday period. We encourage HMRC to allow sufficient time for consultation wherever possible, to ensure that stakeholders can provide comprehensive evidence and that robust conclusions can be drawn from the consultation process. ICAEW also notes that insufficient consultation periods are inconsistent with the Tax Faculty's Ten Tenets for a Better Tax System (Appendix 1).

Internationally recognised as a source of expertise, ICAEW's Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

Chartered accountants are talented, ethical and committed professionals. ICAEW represents more than 211,600 members and students around the world. 81 of the top 100 global brands employ ICAEW Chartered Accountants. 82% of FTSE 100 companies have an ICAEW member on their board. Founded in 1880, ICAEW has a long history of serving the public interest and we continue to work with governments, regulators and business leaders globally. And, as a world-leading improvement regulator, we supervise and monitor more than 11,500 firms, holding them, and all ICAEW members and students, to the highest standards of professional competency and conduct.

KEY POINTS

1. We welcome the aims of this consultation, of removing tax barriers that deter individuals from moving to, working and investing in the UK.
2. With regards to the UK tax treatment of LLCs and other foreign entities, we consider the key matters to address are as follows:
    a. The ability to elect to treat an entity as opaque or transparent (if not compulsory), where it is treated in that way for tax purposes in the jurisdiction in which the entity is tax resident.

    b. Transitional provisions should be clear that the entry into, or exit from, tax-transparent treatment does not constitute a cessation of a trade for income tax or a disposal for capital gains tax (CGT) purposes. The rules should also prevent underlying profits, income and gains that have already been taxed in the UK from being taxed again.

       ICAEW believes this can be achieved by maintaining separate statutory pools for profits accumulated during the opaque and transparent periods. Distributions of pre-transition opaque profits should retain their former treatment, while distributions of profits already attributed and taxed, or relieved under the foreign income and gains (FIG) regime, during the transparent period should not be taxed again. Clear ordering rules should also distinguish income distributions from returns of capital.

    c. Clear rules and guidance on how income/gains of foreign entities should be calculated and reported in the UK, including the calculation of tax credits. This should focus on achieving certainty for all, and simplicity where the tax at stake, particularly from investors with small holdings, does not warrant a more in-depth analysis. This would allow HMRC to focus its enquiry work on the higher-value cases.

    d. The above should apply to all UK resident investors in such entities, whether individuals, companies or trusts.
3. However, there are barriers beyond the double taxation of US LLC members that also deter individuals from coming to the UK, which we would urge the government to address.
4. First, the lack of an investor's visa.
5. Second, Second, the FIG regime is less competitive internationally because it is available for only four tax years and requires substantial calculations and disclosures to claim full relief. That compliance burden is a significant deterrent: many claimants must pay advisers to prepare detailed reporting even where the result is a full exemption and no additional UK tax. By contrast, other jurisdictions offer longer or simpler regimes, such as Turkey's recently-introduced 20-year regime and Italy's substitute-flat tax regime for qualifying new residents. ICAEW members, who are not only providing tax advice but running businesses, are telling us consistently that tax complexity is a barrier to growing business.

ANSWERS TO SPECIFIC QUESTIONS

IMPACT OF CURRENT TAX POSITION

Question 1: Have you or your clients faced a high effective tax rate (ETR) on income from reverse hybrids? If so, please provide details about the circumstances, including the ETR, the type of entity and income it related to, and what kind of member you or your clients were.

6. Clients of member firms have experienced high ETRs on income arising through reverse hybrid entities, principally US LLCs and US S-corporations. The affected clients have included individual minority and controlling members, and the issue has arisen across a range of underlying income, including trading and investment income. An ICAEW member has provided examples of some illustrative ETRs, which can be found in Appendix 2.

7. The high ETR principally arises because the US taxes the individual member on their share of the entity's underlying profits as the profits arise, whereas the UK generally treats the entity as opaque and taxes the individual on subsequent distributions. As the foreign and UK charges are imposed on legally different amounts, relief for the foreign tax may be unavailable, notwithstanding that both charges relate to the same underlying economic profit.
8. HMRC's published position, now reflected in DT19853, is that most US LLCs should be treated as opaque for UK tax purposes. Accordingly, distributions are generally taxed as foreign dividends, while US tax paid on the underlying LLC profits is regarded as underlying tax. Under Article 24(4)(b) of the UK-US Double Taxation Convention, relief for underlying tax is available only to a UK company meeting the relevant 10% voting-power condition. It is not available to an individual member.
9. Historically, the Special Tax Bulletin concerning the UK-US Convention, subsequently reflected in DT19853, formed the basis on which HMRC agreed with a number of firms that only the net amount of an LLC distribution should be subject to UK tax where US tax had been withheld and was not recoverable. A similar approach was accepted in some cases involving US citizens where no withholding tax arose but the individual was personally liable for, and paid, US tax on the underlying income. Revenue and Customs Brief 15 (2015) provides further detail on HMRC's approach following the Supreme Court's decision in Anson (2015 UKSC 44).
10. HMRC states in the consultation that applying Anson more widely, without analysing the particular LLC, could create uncertainty for taxpayers who rely on its existing position. In our member's experience, however, much of the uncertainty has resulted from the absence of a clear and consistently applied legislative framework following that decision. HMRC has continued to permit corporate taxpayers to rely on opaque treatment, while generally resisting transparent treatment for individuals even where the relevant facts and constitutional arrangements appeared comparable to those considered in Anson.
11. Following the Anson decision, several ICAEW member firms sought non-statutory clearances on the treatment of particular LLCs. Before that clearance route was withdrawn, the limited number of applications made by member firms were generally rejected, while related enquiries into filed returns could remain unresolved for extended periods. The absence of sufficiently detailed published reasoning, together with inconsistent treatment over time, has increased uncertainty, compliance costs and the risk of excessive taxation for individual members of LLCs.
12. The resulting high ETR is therefore not solely a consequence of the rates imposed in each jurisdiction. It arises principally from the classification mismatch and the resulting inability of individual members to obtain effective relief for foreign tax imposed on the same underlying economic profits.

Question 2: Have you ever taken steps to mitigate a high ETR related to a reverse hybrid? If so, please provide details. If you were not able to take steps to mitigate a high ETR, please explain what the barriers were.

13. The key factor in Anson was that the members had a right to profits as they arose, as noted at paragraph 12 of the Supreme Court decision. That feature may be widespread, but it will not be present in every Delaware LLC or in every other US LLC. A fact-specific analysis is therefore still required, unless legislation provides a clearer and more practical classification rule.
14. We are aware of cases where the UK-resident partners had sufficient influence and were able to effect a change in the LLC agreement or operating agreements to give that right.
15. We are also aware of other cases where the Anson position has been taken, where LLC members and their advisers thought there was such a right. Detailed white space disclosures were made on the UK tax returns. HMRC has largely challenged such cases and requires voluminous evidence on the relevant state law and the LLC agreement to be provided in each case. We are advised that some cases are still under dispute.

16. The principal barriers to effective mitigation have been the absence of clear statutory rules and changes in HMRC's approach over the last five to ten years without its legal basis being clearly or comprehensively published. These difficulties have been compounded by prolonged enquiries and the withdrawal of a practical clearance route. As a result, taxpayers have been unable to obtain timely certainty and have incurred substantial professional costs without assurance that a technically supportable position will be accepted.
17. Minority members face an additional practical barrier. They may have no ability to amend the entity's constitutional documents, influence its foreign tax classification, compel distributions or obtain the detailed information needed to support a separate UK analysis. In some cases, the only remaining options have been commercially disruptive restructuring, deferral of distributions or reconsideration of UK residence.

Question 3: Have you or your clients ever sought Double Taxation Relief from a foreign jurisdiction with respect to UK tax paid on income from a reverse hybrid entity? If you were granted relief, on what basis was this given? If you were not granted relief, why not?

18. We are aware of cases where double tax relief was available in the US in respect of tax paid in the UK; relief has principally been available where HMRC accepted an Anson-supportable analysis, so that the individual was treated as taxable in the UK on the same underlying income or gain as in the foreign jurisdiction, and the relevant treaty allocated primary taxing rights to the UK. In those circumstances, the foreign jurisdiction was able to give credit for the UK tax under the ordinary treaty rules.
19. Relief has also been available under the UK-US Double Taxation Convention where the UK charge arose under specified anti-avoidance provisions, including the transfer of assets abroad rules or the rules attributing gains of non-UK close companies. The Exchange of Notes to the Convention contains specific provisions enabling such UK charges to be treated as relating to the relevant underlying income or gain for treaty purposes. HMRC's guidance confirms that the Exchange of Notes addresses income, profits or gains charged on another person under specified UK anti-avoidance legislation.
20. In other cases, relief was limited to offsetting tax on non-US income and therefore was only possible because of the specific circumstances of the case.
21. The experience of the members who commented to us is that credit is unavailable in more cases than it is available. The principal difficulty is that the UK and foreign charges often relate to legally different amounts, even where both arise from the same underlying economic profit.

Question 4: Has the UK tax treatment of income from reverse hybrids affected your or your clients' personal decisions about where to live and work? If so, please give details.

22. An individual's decision to relocate to the UK, or to leave the UK, is not based on tax alone, but tax is a key factor and a marginal tax rate of 60% or more does make the UK unattractive. We understand that the issue regarding the double taxation of LLCs and similar investments is sometimes only identified after an individual moves to the UK.
23. ICAEW has been advised that clients of member firms have left the UK, or decided not to remain here, because the tax treatment of their interests in reverse hybrids exposed them to potentially significant double taxation.
24. Historically, this arose when individuals became deemed domiciled from 6 April 2017 or concluded that payment of the remittance basis charge was no longer cost effective. Previously, the remittance basis and protected trusts helped mitigate the impact. However, in their absence, we are aware of situations where individuals have left the UK due to the tax costs of losing these reliefs, or in advance of extracting profits from LLCs and similar structures. The abolition of the remittance basis from 6 April 2025 has increased the incentive for affected individuals to leave the UK, particularly once any entitlement to relief under the four-year FIG regime ends.

25. The classification mismatch has therefore directly influenced decisions about where clients of member firms live and work. It has also discouraged some individuals from relocating to the UK or remaining here for the longer term, even where the underlying business and investment arrangements were commercially established before UK residence began.
26. Offering perhaps a tapered relief after the end of the FIG relief period may attract individuals to stay longer in the UK, resulting in greater tax and investment overall.
27. We welcome the policy aims of this consultation. However, there are other factors beyond reverse hybrid taxation that are also deterrents to attracting individuals to the UK. If the government's policy aim is to attract people and investment to the UK then, in addition to the policy proposals in this consultation, the government should also review and improve the following areas which are also factors in relocation decisions:
    a. The lack of a visa for investors.
    b. Liability to inheritance tax (IHT) on worldwide assets once an individual becomes a long-term UK tax resident (10+ years of UK residency).
    c. The amount of work needed to convert an overseas profit/loss figure to comply with the UK rules on deductibility, and then convert that figure to a UK tax year basis.
    d. The amount of work needed to quantify FIG in the first four years of residency (plus associated adviser's fees plus the cost to HMRC in terms of enquiries into valid FIG claims where there can be no possible loss of tax) to claim what is a full exemption under the FIG regime.
    e. The 12-year time limit for assessing offshore matters, even where the taxpayer has taken reasonable care. This is at odds with the four-year time limit for assessing UK matters where reasonable care was taken. The gap is no longer justifiable in an age where HMRC is receiving considerable amounts of data from other tax authorities under the Common Reporting Standard (CRS).
    f. The restriction on sideways relief for losses from a non-UK trade (under s s95, Income Tax Act 2007) where losses in a foreign trade can only be used against foreign trading or foreign employment income.

Question 5: Has the UK tax treatment of income from reverse hybrids affected your or your clients' commercial decisions such as where to locate offices and staff, do business and make investments? If so, please give details.

28. ICAEW members tell us that the UK tax treatment of reverse hybrids has affected their clients' decisions about where to locate management functions, offices, staff and business activity.
29. In order to reduce the risk of adverse UK tax consequences arising from the entity-classification mismatch, some clients have ensured that the central management and control of the foreign entity remains outside the UK and have limited the activities and profits of UK subsidiaries.
30. The current treatment can therefore discourage the relocation of substantive business functions and investment to the UK, even where there are good commercial reasons for doing so.
31. Minority members of US-centred or US-controlled businesses face a particular difficulty. They may have little or no influence over the choice of entity, its foreign tax classification, its constitutional arrangements, or its distribution policy. Their practical options for mitigating the UK exposure may therefore be limited to restricting their own UK activities, restructuring their personal holding arrangements or reconsidering where they live and work.
32. Within Europe, the tax treatment of LLCs varies widely among the UK's closest competitors for inward investment. That variation makes it difficult for US citizens to obtain certainty before establishing or relocating a business. Providing clear UK rules for reverse hybrids would therefore improve the UK's competitiveness by reducing a tax uncertainty that can otherwise influence decisions about where to locate management, staff and investment.

Question 6: Do other jurisdictions offer more favourable treatment for your or your clients' income from reverse hybrids? If so, which jurisdictions are these? What makes the treatment more favourable than the UK?

33. The clearest example is the United States, where the "check-the-box" regime under Treasury Regulation 301.7701-3 allows an eligible entity to elect its classification for US federal tax purposes. An eligible multi-member entity may elect corporate or partnership treatment, while an eligible single-owner entity may elect corporate treatment or be disregarded from its owner. This elective approach provides greater certainty and flexibility and reduces the risk of classification mismatches arising under US domestic law.
34. Using the tax law of the state of residence to determine classification does not work in the case of a transparent US LLC which is not a resident of the US. See for example the 2025 Irish Court of Appeal case of Revenue Commissioners v Susquehanna International Group Ltd & Others ([2025] IECA 123).
35. ICAEW members have provided information on other jurisdictions which is set out in the paragraphs below.
36. We understand that the South African legislation allows South Africa to mirror the treatment in the country where the partnership is formed or registered. This appears to address the problem noted in the preceding paragraphs. We would be happy to provide more information if this would assist HMRC.
37. Israel considered how to address the issue of hybrid taxation some years ago. We are advised that their solution is a look-through election. With regards to reporting the underlying income/gains, we understand that it is possible for the taxpayer to report on the basis of the income/gains calculated in the other jurisdiction (eg, reporting figures included on a US K-1). However, there is an option for the Israeli tax authorities to require reporting on an Israeli tax basis where the tax at stake is at least 5m shekels (around £1.23m). This appears to be similar to the transfer pricing notice that HMRC can give to a medium-sized business under s167A, Taxation (International and Other Provisions) Act 2010. ICAEW would support adoption of a similar provision in the UK.
38. In France, SCIs are commonly used structures and taxpayers can elect to mirror the treatment where it is established, which allows treaty relief to be claimed.
39. Other jurisdictions may offer more favourable outcomes through their broader personal tax regimes, rather than through rules specifically directed at reverse hybrids. Some examples are set out below:
    a. The Republic of Ireland retains a remittance basis regime for qualifying non-domiciled residents, under which relevant foreign income and gains are generally taxed only when remitted to Ireland.
    b. Italy offers qualifying new residents an elective annual substitute-tax (flat tax) regime for foreign-source income of €300,000 per year.
    c. Switzerland permits certain qualifying foreign nationals who are not gainfully employed there to be assessed by reference to expenditure rather than their actual worldwide income and assets.
    d. Turkey has recently introduced a 20-year regime which exempts many sources of foreign income from Turkish tax for new tax residents.

    These regimes are not directly comparable with matched transparent treatment, as they do not necessarily resolve the legal classification mismatch or ensure corresponding foreign tax credits. They may nevertheless produce a lower or more predictable overall liability and can therefore be more attractive to internationally mobile individuals with interests in reverse hybrids.

PROPOSALS FOR CHANGES TO LEGISLATION

SCOPE

Question 7: Do you see any issues with defining the scope in the way stated above? Can you identify any potential boundary issues with any specific entity types?

40. The interaction with the rules in the jurisdiction where the entity is established or resident also needs to be considered. One possible solution would be to limit transparent treatment to entities established in jurisdictions with which the UK has a double tax agreement, although that condition should not exclude commercially ordinary cases where the classification mismatch and foreign tax charge can be evidenced in another way..
41. It may also be useful to consider the tax treatment of entities which are treated as opaque in other jurisdictions but look-through in the UK. For example, where a US LP has elected to be taxed as a corporate. The key would be to enable tax relief in the UK (if appropriate) for taxes paid in the other jurisdiction. Alternatively, the LP could be treated as a corporate in the UK and therefore tax would be payable on distributions as they would be taxable as dividends.
42. The scope may create boundary issues for entities whose foreign tax treatment is transparent or flow-through, but whose legal and commercial characteristics differ materially from those of a partnership. US S-corporations are a particular example. Although incorporated entities, their income, gains, losses and deductions generally pass through to shareholders for US federal tax purposes. They should therefore be expressly considered within the definition of an eligible reverse hybrid.
43. However, S-corporations can employ shareholder-employees and make employer contributions to retirement plans by reference to their employment compensation. Treating the entity simply as a partnership for all UK purposes could therefore re-characterise genuine salary, benefits and pension contributions as partnership profit allocations, producing outcomes inconsistent with the entity’s legal and commercial arrangements.
44. The legislation should consequently define eligibility by reference to the entity’s foreign tax treatment, rather than its legal form, while preserving genuine employment, benefit and retirement-plan arrangements. It should also clarify the treatment of single-member LLCs, entities that are transparent for only some categories of income, entities that elect to change their foreign classification, and tiered structures containing both transparent and opaque entities.

Question 8: Do you think that these conditions are reasonable? Do you see any potential issues with these conditions? Should further conditions be imposed to limit the holdings to which this treatment would apply?

45. The proposed conditions appear broadly reasonable and appropriately directed at holdings where a genuine classification mismatch arises. We do not consider that further conditions should generally be imposed by reference to the size of the holding, voting control or the member’s ability to influence the entity. Such limitations could exclude minority members, who may be most exposed to the mismatch because they cannot alter the entity’s structure, foreign tax classification or distribution policy.
46. ICAEW notes that the consultation does not extend to US LLCs which are deemed to be UK resident companies if central management and control are in the UK or where there is trade through a UK permanent establishment (as the consultation document outlines in the final paragraph of the summary of the existing UK tax position). This is a particular problem for single member LLCs, which are commonly used structures, if the member becomes UK resident and is a US citizen. The FIG rules also encourage non-resident British citizens to return, frequently after lengthy periods of absence. Many individuals of UK origin currently in the US have businesses operated as single member LLCs. There is some inconsistency in the FIG regime encouraging talent to return the UK, compared to those operating as single member LLCs who find the cost of the potential UK tax burden to be too great.

47. The conditions should, however, accommodate entities that are only partly transparent, changes in foreign classification and tiered structures containing both transparent and opaque entities. Eligibility should depend on whether the individual is taxed in the foreign jurisdiction on the entity's underlying income or gains, rather than solely on the entity's legal form. Any additional safeguards should be targeted at duplicated relief or artificial arrangements and should not restrict ordinary commercial holdings.
48. ICAEW members have told us that most taxpayers just want to get their tax right and have finality of position. If the UK wants to attract individuals to the UK, HMRC needs to make it easy for them to ascertain at the start what and how much they will be taxed on in the UK and when they will have finality of position.
49. ICAEW considers that members of LLCs and other hybrid entities should be able to assess their UK profits on the same fiscal period used by the country in which the entity is established. In many cases, investors with small holdings are simply unable to obtain detailed information from the overseas entity to prepare UK-compliant calculations. This treatment could be compulsory or by election. There will be winners and losers once calendar-year reporting is permitted, and we would suggest an adjustment mechanism to balance calculations up if they gain/lose by more than a certain percentage or amount of tax. For example, we would be in favour of a regime similar to that in Israel, as noted above, where the requirement to adjust figures in line with UK tax law is restricted to those where the tax at stake is high/the individual has a certain level of influence. In particular, Family LLCs are likely to be worse off.

Question 9: Do you see any advantages or disadvantages to transparent treatment applying automatically, rather than by irrevocable election?

50. We have considered whether the transparent treatment should be automatic rather than by election.
51. Automatic transparent treatment would provide consistency and remove the need for taxpayers to determine whether an election is beneficial. It would also reduce opportunities to select between opaque and transparent treatment according to the outcome in a particular period.
52. The problem with an election is that it gives scope for avoidance, for example where the individual has control over the timing of transactions when coming to, or leaving, the UK. An election also means that different members in the same LLC could have different tax treatments.
53. However, in large LLCs where each member has a very small holding, members cannot influence the timing of transactions. Therefore, any scope for avoidance would be limited to closely-held LLCs. Moreover, HMRC having the power to enforce reporting on a UK tax year basis and according to UK tax rules, where the tax at stake is high and there is control, would help prevent an election being used for avoidance.
54. Crucially, whether transparency applies automatically or by election, entry into the regime should not trigger a deemed disposal of the existing interest or its underlying assets (ie, it should be tax neutral). Any resulting dry tax charge would materially undermine the value of the reform, particularly for existing UK residents, and could mean that the changes principally benefit individuals becoming UK resident only after the new rules take effect.
55. Clear rules will also be required to establish the member's opening base cost in the underlying assets and to preserve historic acquisition costs, profits and losses. Member-level treatment, rather than an entity-wide election, would be sensible as the latter could affect corporate, exempt or non-UK members and may encourage the use of structures that are designed to keep management and control outside the UK or to interpose corporate members.
56. If an election is offered, the window for making it should be time-bound. One useful precedent is the non-domiciled capital losses election available up to the 2024/25 tax year under s16ZA TCGA 1992. A deadline of 31 January following the fourth tax year of residence, or the fourth tax year of holding the LLC interest, would align with individuals

moving to the UK and relying on the FIG regime. The election should take effect from when the interest was first held, to prevent profits from rolling up tax-free and then being extracted tax-free.

57. We consider that an individual-level election must also be irrevocable, or binding for a meaningful minimum period, and capable of taking effect from the beginning of the relevant period (where made in a timely filed return).
58. A limited late-election facility should also be available where the taxpayer could not reasonably have identified the entity's eligibility, or obtained the necessary foreign information, by the normal filing deadline.

UK TRANSPARENT TREATMENT

Question 10: Do you see any issues with deeming the trade or business of eligible foreign entities to be carried on in partnership (or as a sole trade), and profits/losses being computed in accordance with UK Income Tax rules? If so, what are they?

59. There are some key problems with this approach.
60. First, calculating a partnership's profits under UK rules and on a UK tax-year basis may be impractical for many members. Some US LLCs are large fund managers, and individual investors may have no power to obtain the records needed to convert the entity's figures into UK-compliant computations.
61. In other cases, investors, particularly with small holdings, are unable to obtain the accounting information that they would need to calculate their profit or loss on a UK basis. Many UK residents only receive Form K1 from their US LLCs, showing their entitlements under US rules (ie, in US dollars and on a calendar year basis). This inability to obtain accounting information also extends to structures where there are layers of LLCs or other partnerships (sometimes described as "tiered entities").
62. If the UK were to treat US LLCs as transparent, it would need to be clear:
    a. What method(s) should be used to calculate profits, losses and base costs;
    b. Whether there should be a de minimis of profits/gains, below which it is acceptable to use the figures calculated under US rules and on a calendar year basis;
    c. The basis of calculating the underlying US tax that is eligible for double tax relief.
63. In the cases that are of lower value, there is unlikely to be any significant loss of UK tax if calendar year figures, which are calculated on a US-basis, are declared in the UK.
64. The one exception to this is US LLCs which have significant real estate investments. In the US, they are able to claim significant deductions for depreciation, which would not be deductible in the UK. Such LLCs may need specific provisions for calculating (or converting) profits/ losses, and the underlying tax, on a UK basis.
65. The UK rules should ensure that a member is not taxed on profits they are not economically entitled to receive or cannot compel the entity to distribute.
66. The second problem is a wider issue which, as noted above, is the level of work needed to claim full relief (ie, a full exemption) on overseas income and gains, under the FIG regime effective from 6 April 2025. Taxpayers see no benefit from paying their agents for the volume of work required, which other countries do not impose, and which generates no additional UK tax receipts. This is a major deterrent for people considering coming to the UK. ICAEW urges the Government to reconsider and reduce the reporting requirements for those eligible to use the FIG regime.
67. Third, also noted above, the 12-year limit that HMRC has to assess offshore under-assessments (s36A, Taxes Management Act 1970), regardless of whether the taxpayer took reasonable care or not, deters people from coming to the UK. Since that legislation was introduced in Finance Act 2019, HMRC now receives large volumes of data from other tax authorities. For example, under automatic exchange of information agreements, with cryptoasset data under the cryptoasset reporting framework starting this year. If HMRC already has the data, the difference between onshore and offshore assessment time limits

can no longer be justified. If the government is keen to attract individuals to the UK, the s36A rules need to be changed to mirror the rules for assessing onshore matters.

Question 11: Do you see any issues with attributing investment income to members in line with their proportional membership interest, and tax liability being computed in accordance with UK Income Tax rules? If so, what are they?

68. Attributing investment income solely by reference to a member's proportional ownership interest may produce an outcome that differs from both the foreign tax allocation and the member's underlying economic entitlement. A single membership percentage may not accurately reflect different rights to income, capital or distributions, particularly where the entity has multiple classes of interests, preferred returns, distribution waterfalls or asset-specific allocations. In the US every Form K-1 shows three items based on the members agreement – each members' opening and closing percentage of profit, loss (which can be recourse or non-recourse), and capital. This question discusses the mechanism for attributing income – but does not specify which of these percentages HMRC has in mind.
69. The method of calculating the amounts that are reportable in the UK, and the equivalent overseas tax amount, will be crucial. As previously noted, we are in favour of straightforward reporting and accompanying guidance that provide taxpayers with certainty.
70. The UK rules should therefore permit reliance on the allocations used in the entity's foreign tax computations and member statements, provided that they are consistent with the constitutional arrangements and reasonably reflect the member's economic entitlement. A simple pro rata allocation should operate only as a fallback where no more appropriate allocation is available.
71. Further complexity arises in tiered structures, for example where an LLC holds interests in several underlying LLCs or where a general or limited partner holds interests through intermediate entities. Each tier may apply different allocation methods, accounting periods and entity classifications, making it difficult for a minority member to identify the character, source and amount of the income ultimately attributable to them. Published commentary has similarly identified tiered structures as a particular source of complexity under the proposed transparent treatment.
72. The legislation should include clear look-through rules for tiered structures, prevent duplication or omission of income, and allow reasonable reliance on foreign reporting information. Appropriate safe harbours should apply where the member cannot reasonably obtain complete information from lower-tier entities.

Question 12: Do you see any issues with applying Statement of Practice D12 to individual members, and capital gains/losses being computed in accordance with UK Capital Gains Tax rules? If so, what are they?

73. Applying Statement of Practice D12 (SP D12) and the UK CGT rules could create significant practical and computational difficulties, particularly for minority members who may not have access to the necessary entity-level information.
74. SP D12 treats members as holding fractional interests in each underlying asset. A disposal may therefore arise when the entity disposes of an asset or when a member's fractional interest is reduced, including following a change in sharing ratios or the admission or departure of another member. Applying this approach would require members to obtain and maintain asset-level information concerning acquisition costs, disposal proceeds, changes in fractional interests and relevant reliefs.
75. Specific difficulties would include:
    a. obtaining timely accounts and investment records;
    b. translating transactions to Sterling;
    c. applying UK share-identification and pooling rules;
    d. reconciling foreign and UK accounting periods; and

e. identifying foreign-exchange gains or losses.

These requirements would be particularly burdensome in entities holding numerous investments or operating through multiple tiers.

76. Further issues arise where a UK resident acquires an interest after the entity has accumulated gains in its underlying assets. In the US, an Internal Revenue Code s.754 election allows the basis of partnership property may be adjusted under IRC s.743(b), following certain transfers of partnership interests. The adjustment is specific to the incoming member and reflects the difference between that member's basis in the acquired interest and their proportionate share of the partnership's existing asset basis. The UK rules should recognise equivalent foreign member-specific basis adjustments to avoid taxing the incoming member on appreciation arising before they acquired their interest.
77. A requirement to prepare separate UK asset-by-asset computations would impose disproportionate cost and complexity and could make transparent treatment impracticable for minority members. The rules should therefore permit reasonable reliance on the entity's foreign accounts, tax computations, accounting period and member-specific basis schedules, provided that these reasonably reflect the member's economic entitlement.
78. ICAEW considers that the simplest option is to allow individuals to use the figures from the US Form K-1. It is the easiest way for taxpayers to comply and means that HMRC would not need to spend time on lower-yield enquiries.
79. HMRC could have the option to enforce UK CGT rules above a certain threshold, to ensure no loss of tax in cases where the tax differential is material.
80. Finally, SP D12 is a non-statutory statement of HMRC practice which can itself produce uncertainty and unexpected tax consequences. If it is to govern the treatment of foreign reverse hybrids, the relevant principles and any necessary modifications should be placed on a clear statutory footing, so taxpayers do not have to rely on guidance.

Question 13: Do you see any issues specifically with respect to establishing each member's fractional interest in the assets of the entity? If so, how could these problems be overcome?

81. In most cases, this will be straightforward because the rights of all individuals will be clear and the income/gains they are entitled to will be known (and potentially reported on Form K-1).
82. In other cases, a member's economic interest in a hybrid entity will not necessarily correspond to a single, fixed fractional interest in each of its underlying assets. Different rights may attach to capital, income, gains and liquidation proceeds, and those rights may be affected by preferred returns, distribution waterfalls, special or asset-specific allocations, changes in membership and member-specific basis adjustments. The information required to reconstruct these interests on a separate UK basis may not be available, particularly for minority members.
83. The rules should therefore permit reliance on the allocations used in the entity's local accounting and tax computations, provided that these are consistent with the entity's constitutional arrangements and reasonably reflect the member's economic entitlement. Where no fixed asset-level percentage exists, the member's interest could be determined by reference to their entitlement under a hypothetical realisation and liquidation of the entity, with asset-specific or class-specific ratios permitted where appropriate. A reasonable approximation or safe harbour should also be available where the member cannot obtain the information necessary for a more detailed computation.
84. This should be supported by a separate computation and tracking in Sterling of the member's external basis in the hybrid interest. That calculation would provide an overall reconciliation and ensure that the member's full economic gain or loss is brought into account on a disposal of the interest, without requiring minority members to reconstruct the entity's entire asset base under UK tax principles.

85. A targeted anti-avoidance rule may be sufficient, if not already covered by GAAR, to deal with cases where the rights of different members are manipulated to try to secure a more preferable tax position.

Question 14: Do you see any other issues with the transparent treatment outlined above in respect of the application of any other UK tax rules (or reliefs/exemptions)? If so, which UK tax rules (or reliefs/exemptions) are these? What are the issues that arise? How might these be mitigated?

86. Deeming an eligible hybrid entity as carrying on its business in partnership may affect a wide range of UK tax rules that were not designed with foreign limited-liability entities in mind. These include the foreign trade and partnership loss restrictions, capital allowances, business asset disposal relief, gift hold-over relief, roll-over and incorporation reliefs, the offshore funds regime, the FIG regime, foreign tax credit relief, business property relief for IHT, employment income, pension contributions, national insurance contributions and the offshore anti-avoidance provisions.
87. In relation to losses, s95, ITA 2007 would restrict losses of a trade carried on wholly outside the UK to narrowly defined qualifying foreign income and would prevent relief against capital gains. Further restrictions may apply if an LLC member is regarded as a limited or non-active partner. These rules may produce particularly restrictive outcomes where a member is attributed both trading and investment income from the same entity, or where the member has limited liability but does not otherwise correspond to a UK limited partner.
88. Transparent treatment may also make business CGT reliefs available, including business asset disposal relief and relief under ss152, 162, and 165, TCGA 1992. However, those reliefs often depend on the member's fractional interest in particular assets, continuity of ownership, the carrying on of a trade and the application of proceeds by the member. It should be made clear that entry into a transparent treatment regime does not interrupt ownership or constitute a disposal or cessation, and that actions taken by the entity in relation to its business and assets may be treated as taken proportionately by its members.
89. Further difficulty arises in preserving the character and source of each underlying item of income and gain. Local tax classifications will not always map directly onto UK trading income, property income, interest, dividends, offshore income gains or chargeable gains. The rules should permit reasonable reliance on the foreign member statement (eg, Form K-1 for US LLCs) and tax computation, subject to an anti-avoidance override, and should prevent duplicate attribution under the offshore funds or offshore anti-avoidance rules.
90. Protection is required for FIG-relieved or previously taxed profits. Statutory pools and ordering rules should ensure that later distributions of profits already taxed, or relieved under the FIG regime, are not taxed again. Similar matching rules are needed for foreign tax credits where tax years, allocations or final foreign liabilities differ.
91. Finally, transparency should be expressly limited to the taxes for which it is intended. It should not, without specific provision, re-characterise a genuine employment relationship, employer pension contribution or benefit-in-kind; impose national insurance contributions on a passive member; determine the availability of IHT business property relief; or disturb the treatment adopted by corporate or exempt members. A member-specific regime, continuity provisions, anti-duplication rules and reasonable information safe harbours would substantially mitigate these risks

TRANSITIONS

Question 15: Do you see any issues that might arise upon these transitions, in respect of tax rules (or reliefs/exemptions) applicable to a holding that begins or ceases to be treated on a transparent basis? What are the issues that arise? How might these be mitigated?

92. There are two key issues on transition. First, it must be clear whether income or gains arising during the opaque pre-commencement period should be taxed in the UK after the regime begins. For example, if a long-established US LLC becomes transparent in the UK on 6 April 2027 and makes a large distribution on 7 April 2027, the legislation should

specify whether the UK has taxing rights over profits that clearly arose before implementation and, if so, how much it is fair to tax

93. If the proposed transparent tax treatment in the UK takes effect automatically and firms have no warning of the commencement date, then it would seem very unfair to tax any of it.
94. If taxpayers can elect for transparent treatment in the UK, or they have advance notice of the commencement date, then it seems reasonable to have a window where firms can review their distribution plans.
95. Second, in the absence of transitional rules, the transition might be regarded as a cessation of trade for income purposes, or the disposal of the opaque entity interest and an acquisition of fractional interests in the underlying assets, or the reverse. This could crystallise capital gains without any legal transfer, change in economic ownership or receipt of cash. It would also require potentially difficult valuations of closely-held entities and their underlying assets.
96. The legislation should therefore provide expressly that entry into or exit from transparent treatment is not, of itself, a disposal or acquisition for income tax or CGT purposes and does not constitute the commencement or cessation of a trade. Ownership periods and other qualifying periods should continue uninterrupted.
97. Detailed rules will nevertheless be required to establish the member's opening and closing entitlements (or basis). On entry, the member's Sterling external basis in the entity interest should be allocated among the underlying assets, using the foreign tax computation and any member-specific basis adjustments, where reasonably available. On exit, the basis of the resulting opaque interest should be derived from the member's closing external basis, after taking account of profits, losses, contributions, distributions and basis adjustments during the transparent period. This should be supported by an overall reconciliation so that no economic gain is omitted or taxed twice.
98. Separate statutory pools should be maintained for profits accumulated during the opaque and transparent periods. Distributions of pre-transition opaque profits should retain their former treatment, while distributions of profits already attributed and taxed, or relieved under the FIG regime, during the transparent period should not be taxed again. Clear ordering rules should also distinguish income distributions from returns of capital.
99. Continuity should similarly apply to trading losses, capital allowance pools, deferred gains and qualifying periods for reliefs. A classification change should not generate terminal loss relief, early-years relief, balancing charges or recapture of rolled-over gains merely because transparent treatment begins or ends. Existing losses and deferred gains should follow the same underlying trade or asset, subject to safeguards preventing duplication.
100. Restricting the election to entities in jurisdictions with which the UK has a tax treaty may assist with this. If the taxpayer has already paid tax in the other jurisdiction on profits being distributed, then they will likely not have avoided any tax overall (when considering both UK and foreign taxes). Moreover, time limits may have run out for foreign tax credits to be claimed in the other jurisdiction if historic profits are now subject to UK tax. Any transitional rules should therefore focus on situations where no tax has been paid on the underlying profits.

EFFECT OF APPROACH

Question 16: Do you believe that the approach set out above would solve the issue of high effective tax rates for individual members of reverse hybrids? Please explain why/why not.

101. Yes, if enacted well, this approach would solve the issue for many taxpayers.
102. Transparent UK treatment should align the UK charge with the foreign charge by taxing the member on their share of the underlying profits, income and gains as they arise. Distributions of amounts already attributed to the member should then be ignored for UK tax purposes. This should enable foreign tax credit relief to apply to the same profits, income or gains and should generally limit the member's aggregate liability to the higher

of the applicable UK and foreign tax liabilities, rather than imposing the two liabilities cumulatively.

103. The proposal would therefore address both the effective double taxation and much of the present uncertainty surrounding the UK classification of US LLCs and similar entities. It should be particularly beneficial to individuals who have little or no ability to alter the entity through which the foreign business is conducted, including minority members and individuals relocating to the UK.

104. However, the proposal will not fully achieve its objective unless the detailed legislation preserves that alignment. In particular:

   a. the UK should accept the foreign accounting period, tax computation and member allocations where these reasonably reflect the member’s economic entitlement;
   b. foreign tax should be creditable against the corresponding UK liability notwithstanding reasonable differences in accounting periods, payment dates or subsequent foreign tax adjustments;
   c. federal, state and other qualifying foreign taxes imposed on the member’s allocated share should be capable of relief under the normal credit limits;
   d. distributions of profits already taxed, or relieved under the FIG regime, during the transparent period should not be taxed again;
   e. entry into or exit from transparent treatment should not trigger a deemed disposal, dry tax charge, commencement or cessation of a trade, or loss of qualifying periods for reliefs;
   f. historic opaque profits, transparent taxed profits, FIG-relieved profits and capital contributions should be separately tracked under clear statutory ordering rules;
   g. the regime should contain continuity and anti-duplication provisions for losses, capital allowances, deferred gains and existing anti-avoidance rules; and
   h. reasonable information safe harbours should be available to minority members who cannot obtain the information necessary to reconstruct the entity’s results under UK principles.

105. Some high ETRs may nevertheless remain. For example, foreign tax may exceed the UK tax attributable to the relevant item, foreign tax may not satisfy the ordinary conditions for credit, or the UK and foreign jurisdictions may characterise or allocate a particular receipt differently. These are ordinary limitations of double tax relief and are distinguishable from the structural double taxation that the proposal is intended to remove.

106. There may also be cases outside the scope of the proposed regime, including entities that are UK resident or trade through a UK permanent establishment, entities that cease to be transparent in their jurisdiction of establishment, and taxpayers or entity types that do not satisfy the final eligibility conditions. The treatment of US S-corporations also requires particular care because their shareholders may be employees, receive employment benefits and participate in employer retirement arrangements, despite the entity being fiscally transparent in the US.

107. Subject to these qualifications, transparent treatment is the solution most closely directed at the underlying problem. It aligns the UK charge with the foreign charge, improves the prospect of effective double tax relief and avoids taxing a later distribution of profits already attributed to the member. A deduction for foreign tax or a special credit against tax on distributions may reduce the ETR, but neither alternative would resolve the underlying differences in the character, timing and attribution of the income as comprehensively.

Question 17: Do you see any issues with this approach, including any unintended outcomes for individual or non-individual taxpayers? If so, what are these?

108. As noted above, it is crucial that taxpayers have certainty regarding the calculation of the income/gains they need to report along with clarity as to when and how to claim credit for US tax paid.

109. The proposed approach is capable of resolving the classification mismatch for individual members, but automatic and member-specific transparency could also accelerate tax on undistributed profits, impose disproportionate compliance obligations on minority members and result in the same entity being treated differently for individuals, companies, trusts and exempt investors.

110. Appropriate safeguards should include an election or limited opt out, recognition of reasonable foreign computations and accounting periods, and comprehensive rules for:

    a. continuity (so that it's clear that it's a change in tax classification and not a change in economic ownership).

    b. profit-pooling and ordering/matching of profits to distributions (to identify when profits arise and prevent distributions being taxed incorrectly simply because of a change in tax classification); and

    c. anti-duplication (to prevent the same economic amount being taxed twice and to prevent the same deduction, loss, credit or basis amount from being relieved twice).

111. It is essential that entry into transparent treatment does not trigger a deemed disposal of an existing interest, since any resulting dry tax charge would substantially undermine the purpose and practical value of the reform. An election should be effective from the beginning of the relevant accounting or tax period where it is made in a timely filed return, whether for the period in which the entity is established or the first period in which an existing entity is brought within the regime.

Question 18: Do you have any comments on the potential impacts of these changes on tax receipts or taxpayer behaviour? How might individuals and businesses respond to these changes? For instance, would these changes increase UK tax receipts overall? Conversely, are there specific tax planning techniques which these changes would incentivise or otherwise fail to capture?

112. The changes should make the UK a more attractive and workable location for members of US LLCs and other reverse hybrids. This may also encourage residents to remain in the UK beyond the end of the four-year FIG period.

113. By removing the additional UK tax charge on distributions of profits already attributed and taxed, the reforms may also encourage individuals to extract and use those funds for investment, expenditure and business activity in the UK, as they will not fear a high ETR. Moreover, they will have certainty on the position.

114. Although the direct effect may be a reduction in UK tax currently charged on distributions, this should be viewed as the removal of unintended double taxation. The wider Exchequer effect could be positive if the changes attract and retain internationally mobile individuals and increase UK investment and taxable economic activity.

115. Any planning risks, including selective use of an election, changes in foreign entity classification, the interposition of companies or trusts, manipulation of member allocations, artificial basis uplifts and duplication of losses or reliefs, should be addressed through targeted safeguards. These should include a minimum-term or irrevocable election, beneficial-ownership rules, tax-neutral basis continuity and consistent external-basis adjustments, without recreating the uncertainty and compliance burden that the reforms seek to remove.

116. For those where the changes do not change their behaviours, the changes would encourage consistent reporting on investments in affected entities across taxpayers. This will encourage more transparency with HMRC and enable enquiries to be dealt with more efficiently.

ALTERNATIVE FORMS OF RELIEF

Question 19: What are your views on the deduction for foreign tax and credit relief options outlined above? Do these approaches have advantages or disadvantages in comparison to UK matching of transparent treatment? Please give details.

117. We consider that these two alternatives will create more complexity than an election to treat entities in the same way as in the foreign jurisdiction. In particular, for taxpayers with otherwise simple affairs who hold small investments in LLCs or other similar structures, it is important that there is a solution which is simple, clear and straightforward.

118. Matching transparent treatment should be the primary (and preferred) approach as it is the most coherent and comprehensive solution and addresses the underlying classification mismatch. The individual would be taxed in the UK and the foreign jurisdiction on the same underlying profits, income or gains, improving access to ordinary double tax relief and ensuring that a subsequent distribution of profits already attributed to the member is not taxed again.

Deduction for foreign tax

119. Between the late 1990s and up to part of the 2010–2020 period, HMRC's policy position was to allow a deduction for foreign tax. It is only in recent years that HMRC has overturned this historic position, creating much of the current uncertainty in the HMRC tax treatment. A deduction for foreign tax would be simpler to administer because the entity could remain opaque and the individual would continue to be taxed by reference to distributions. It may therefore be useful where a minority member cannot obtain the information required for a UK partnership computation.

120. However, a deduction merely reduces the amount subject to UK tax and does not relieve the foreign tax 'pound for pound'. It would therefore reduce, but not eliminate, the excessive ETR. It would also preserve the difference between the underlying profits taxed abroad and the distribution taxed in the UK.

121. Deduction relief could be retained as a simplified fall-back. Any election should be subject to appropriate consistency requirements, but also be capable of taking effect from the beginning of the relevant period, where made in a timely filed return.

Credit for foreign tax

122. Credit relief would be more effective than a deduction because the foreign tax could be set directly against the UK liability on the distribution. It may provide a practical alternative where transparent treatment would impose disproportionate compliance costs.

123. However, it would not resolve differences in income character, source or timing, nor would it ensure that the UK tax on a distribution is creditable in the foreign jurisdiction. Detailed rules would also be required to match foreign tax to distributions, particularly where profits are accumulated over several years, membership changes, tax periods differ or foreign liabilities are subsequently adjusted.

124. Whichever approach is adopted, the legislation will require clear rules for foreign tax eligibility, currency conversion, timing differences, amended foreign liabilities, distributions from historic profit pools, and the prevention of duplicate relief. Those safeguards should be targeted and should not require minority members to obtain information beyond that which is reasonably available to them.

Question 20: Do you see any issues with either of these approaches, including any unintended outcomes for individual or non-individual taxpayers? If so, what are these?

125. We refer you to our answers for question 19.

126. The complexity of calculations and reporting is our key concern.

INTERNATIONAL COMPARISONS

Question 21: Do you have experience of the rules applied by other jurisdictions with respect to income from reverse hybrids? What jurisdictions are these, and what are the rules? What advantages and challenges have you encountered when applying these rules?

127. ICAEW member firms have experience of the US “check-the-box” regime, which was introduced through final regulations issued in 1996, and has applied since 1 January 1997. It permits eligible entities to elect their classification for US federal tax purposes, including treatment as a corporation, partnership or disregarded entity, as applicable.

128. The principal advantage is that it provides a clear and flexible method of determining an entity’s tax treatment, substantially reducing the uncertainty and hybrid mismatches that can otherwise arise. It is particularly effective for individual taxpayers moving between jurisdictions, although difficulties remain where the other jurisdiction does not recognise or match the US classification. In those circumstances, the taxpayer may face inconsistent treatment, additional compliance costs or double taxation.

GENERAL QUESTIONS

Question 22: Are there any other options or ideas for reforming the taxation of individual members of reverse hybrids that you believe the government should consider? This could include forms of treatment or relief not mentioned above.

129. The FIG regime is still in its infancy. To encourage internationally mobile individuals to remain in the UK and to deter talent from leaving, it may be worth exploring tapered rates of income tax, CGT and IHT after the end of the four-year and 10-year periods. One unintended effect of the current rules may be that internationally mobile families leave the UK at the four-year mark, reducing ordinary spending, school and university fee payments, and investment in the UK.

130. In addition to reforming the treatment of reverse hybrids, the government should consider wider measures to reduce comparable classification mismatches affecting internationally mobile individuals. One such area is the treatment of UK and US collective investment funds.

131. At present, a US mutual fund or exchange-traded fund must generally obtain UK reporting fund status if a UK-resident investor is to obtain capital gains treatment on disposal. A reporting offshore fund must apply to HMRC, maintain its status and report its income to HMRC and UK investors.

132. Conversely, UK unit trusts, open-ended investment companies (OEICs) and similar collective investment vehicles may fall within the US Passive Foreign Investment Company (PFIC) rules when held by a person subject to US tax, resulting in additional reporting obligations and potentially less favourable US tax treatment.

133. The government could consider granting deemed or simplified UK reporting fund treatment to appropriately regulated US mutual funds and exchange traded funds, provided that sufficient income information is available to prevent the ‘roll-up’ of income without taxation. It could also engage with the US authorities on reciprocal treatment for UK-authorised unit trusts and OEICs, including whether those funds could be excluded from, or given simplified treatment under, the US PFIC regime.

134. Such reciprocal recognition would not replace the proposed reverse-hybrid reforms, but it would address a related obstacle faced by individuals moving between the UK and the US. It could reduce compliance costs, limit the need to restructure otherwise conventional investment portfolios and make it easier for individuals to retain mainstream investments when changing residence. Any relaxation should be limited to appropriately regulated and transparent funds and should preserve the policy objective of taxing accumulated income.

Question 23: In relation to any of the proposals above, apart from change to UK liabilities, what would be the other impacts on you or your clients? For example, would there be impacts on time spent managing tax compliance, fees, cashflow, certainty, foreign tax expenses?

135. While any changes would inevitably result in an initial flurry of tax advice for affected taxpayers, a well-implemented regime should reduce the need for complex planning advice in the future. Clearer rules would give individuals and firms greater certainty about their tax treatment and should reduce the professional costs currently incurred in resolving classification issues.

136. In order to ensure this is not replaced by increased compliance costs, it is essential that the reporting required is as straightforward as possible, including clear legislation for what should be taxed in the UK and how UK-acceptable figures should be arrived at.

Question 24: How might any of the proposed changes to the tax treatment of income from reverse hybrids impact your or your clients' view of the UK as a place to live, work, do business and make investments?

137. Removing the current mismatch would make the UK a more workable jurisdiction for individuals with established interests in overseas businesses, particularly those who have little or no ability to alter the entity through which the business is conducted. The government's consultation expressly recognises that the current treatment may act as a barrier to individuals relocating to the UK.

138. ICAEW believes that the reforms should also reduce the incentive for existing residents to leave the UK when their four-year FIG period ends. Greater certainty over the treatment of LLC profits and distributions may encourage individuals to retain or expand their UK business activities, locate staff and decision-making functions in the UK, and distribute funds for expenditure or investment in the UK economy.

139. The benefit will, however, depend on the detailed design of the regime. A check-the-box style approach that permits reasonable reliance on the foreign accounting period, tax computation and member allocations should materially reduce administration and improve certainty for both taxpayers and HMRC. Conversely, requiring separate UK-basis computations, asset-by-asset reconstruction or a deemed disposal on entry could impose substantial costs and dry tax liabilities, particularly for minority members, and would materially reduce the attractiveness of the reform.

140. Overall, a clear, elective and tax-neutral regime would improve perceptions of the UK tax system by demonstrating that commercially established overseas structures will not produce punitive outcomes solely because of an entity-classification mismatch. That should support the UK's competitiveness as a place to live, work and invest. If, however, the new rules are complex, uncertain or expensive to apply, internationally mobile individuals may continue to restructure their affairs, restrict UK business activity or reconsider remaining in the UK beyond the FIG period.

OTHER COMMENTS

141. ICAEW would welcome continued engagement with HMRC on the detailed design of any legislation, particularly on transitional rules, safe harbours for minority investors, foreign tax credit mechanics and the interaction with the FIG regime. These details will determine whether the reform provides practical certainty, or simply replaces one form of complexity with another.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory.** Tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament. A clear statutory basis ensures legitimacy, accountability, and public trust in the tax system.
2. **Certain.** As far as possible, the application of tax rules and compliance processes should be certain. Taxpayers should not normally need to resort to the courts to understand how the rules apply to their affairs.
3. **Simple.** The tax system should be easy to understand for all taxpayers and advisers. Complexity undermines trust, creates unfairness, and discourages compliance.
4. **Easy to administer.** Tax liabilities should be straightforward to administer for HMRC, agents, and all taxpayers. Taxes should be designed to work effectively in a digital environment, while administration must remain accessible to those with limited digital capability.
5. **Properly targeted.** Anti-avoidance rules and other targeted measures should be proportionate, clearly defined, and carefully scoped to achieve their policy objective without undermining simplicity or certainty. Poorly targeted measures add complexity and uncertainty, harming compliance.
6. **Stable.** Changes to the tax system should only be made when clearly justified by economic, social, or environmental goals. Transparent, purposeful reforms build confidence and move the system toward greater coherence and long-term stability.
7. **Subject to proper consultation.** Other than in exceptional circumstances, tax changes should be subject to open and meaningful consultation. Adequate time for stakeholder input improves policy quality, practicality, and public trust.
8. **Regularly reviewed.** Tax rules, reliefs, and policy-driven interventions should be subject to regular, transparent review to assess whether they remain relevant, effective, and aligned with current policy goals. Outdated or unjustified provisions should be reformed or repealed to maintain coherence.
9. **Fair and accessible.** The tax system should be fair and accessible in design and in operation, ensuring equitable treatment of taxpayers. Revenue authorities must exercise their powers proportionately, and all taxpayers should have timely access to HMRC assistance, independent appeal, and redress.
10. **Efficient.** The tax system should raise revenue in a way that minimises unnecessary distortions, compliance burdens, and resource misallocation. While all taxes affect behaviour to some degree, tax design should avoid cliff edges, unintended incentives, or inefficiencies that reduce economic wellbeing unless these serve a clearly defined policy aim.

For more information, please see Ten Tenets for a Better Tax System | ICAEW

APPENDIX 2

Consultation on reform to taxation of UK-resident members of LLCs and other reverse hybrids

Illustrative effective tax rate calculations

Scope and assumptions

The estimates below exclude US state and local taxes on trading income, which may add approximately 5% to 13% to the US tax burden.

They also exclude the 3.8% US Net Investment Income Tax on net investment income and gains, which is not creditable against foreign taxes under the US Internal Revenue Code and regulations.

ETR = Effective Tax Rate | ECI = Effectively Connected Income

Scenario comparison: US ECI

Calculation	LLC treated as transparent	Net-of-tax distributions	Recent HMRC position	Full HMRC distribution position
Profit	100.00	100.00	100.00	
Distribution where profit is nil				100.00
UK tax on transparent profit	45.00			
US tax on ECI / foreign tax credit	(37.00)	37.00	37.00	-
Net UK tax	**8.00**			
Distributable profits		63.00	63.00	100.00
US tax treated as part of distribution			37.00	-
Gross amount subject to UK dividend tax		63.00	100.00	100.00
UK dividend tax at 39.35%		24.79	39.35	39.35
Total tax burden	**45.00**	**61.79**	**76.35**	
Effective tax rate (ETR)	**45.0%**	**61.8%**	**76.4%**	**Infinite***

Illustration: US non-ECI

Calculation	Amount
Profit	100.00
UK tax	45.00
US tax on non-ECI**	-
Net UK tax	**45.00**
Effective tax rate (ETR)	**45.0%**

Notes

* An infinite ETR arises where there is no realised profit, but HMRC treats the distribution as a taxable dividend.

This may include an otherwise capital distribution under local law where there is no formal reduction in share capital, despite the absence of shares and US capital being measured by reference to the LLC capital account. It may also include a distribution funded by additional borrowing, where no profit has been realised. HMRC may regard the amount as a deemed dividend, notwithstanding that DT19853 refers to distributions of LLC profits being treated as dividends.

** Illustration assumes US federal tax of 37% is fully relieved against UK tax at 45%, leaving no additional US tax.