

ALERTS

UK LLPs-Salaried Member Rules: UT Decision in *HMRC v BlueCrest Capital Management (UK) LLP*

October 27, 2023

The keenly awaited decision of the Upper Tribunal (“UT”) in *HMRC v BlueCrest Capital Management (UK) LLP* provides helpful guidance for any LLP intending that some or all of its members fall outside the scope of the salaried member rules.

The Salaried Member Rules and Why They Matter

UK LLPs are widely-used as a vehicle of choice for investment management firms in the private capital sector. For tax purposes, a UK LLP is generally treated as a partnership and, subject to the following, its members are generally treated as self-employed partners.

The salaried member rules treat an individual member of an LLP as a ‘salaried member’, and thus as an employee for tax purposes (subject to PAYE and employer/employee NIC), if each of the three following conditions is met. In brief, these are:

- Condition A (‘disguised salary’) – at least 80 percent of the member’s reward is fixed or, if not fixed but variable, varies without reference to the overall profits/losses of the LLP.
- Condition B (‘significant influence’) – the member does not have ‘significant influence’ over the affairs of the LLP.

- Condition C – the member's capital contribution to the LLP is less than 25 percent of the member's 'disguised salary'.

If any one of the conditions is *not* met, then the individual is not a salaried member. Most investment management firms look to structure their affairs so that one or both of conditions A and B are not met.

The First Tier Tribunal ('FTT') Decision

BlueCrest appealed HMRC's determination that certain individual LLP members were salaried members. The appeal only concerned the application of Conditions A and B. (It was common ground that the individual members all met Condition C).

In its first instance decision (released on 29 June 2022), the FTT held that all the individual LLP members who were the subject of the appeal met Condition A and those who were not portfolio managers, or were portfolio managers with capital allocations of less than \$100 million, also met Condition B and were thus 'salaried members'. Portfolio managers with capital allocations of \$100 million or more, and 'desk heads', did not meet Condition B and thus were not 'salaried members'.

UT Decision

Both HMRC and BlueCrest appealed the FTT decision.

In rejecting all 11 grounds of appeal: 2 (re Condition A) from BlueCrest and 9 (re Condition B) from HMRC and upholding the FTT decision, the UT held that in relation to:

- Condition A, there needs to be a meaningful link between at least 20 percent of an individual's remuneration and the overall profits and losses of the LLP; the link cannot simply be that if there is less profit available for distribution, the individual member will receive a lesser amount.
- Condition B, 'significant influence' need not be over the entirety of the affairs of the LLP, or of a managerial nature: operational, financial or managerial responsibility over one or more aspects of the affairs of an LLP may give rise to 'significant influence'.

Having noted the ‘acutely fact sensitive’ nature of the FTT’s decision, as well as the very limited circumstances in which an appellate court, such as the UT, can intervene, the UT rejected (variously) the ‘misconceived’ and ‘highly unrealistic’ way in which HMRC sought to apply the rules, noting that its approach effectively sought ‘to write additional words into Condition B’.

While FTT decisions have no precedent value, the UT decision provides helpful guidance, in particular in respect of Condition B and the proper construction of the terms ‘affairs’ and ‘influence’, and supports the approach that ‘significant influence’:

- can be established by reference to actual (de facto) influence which may not derive from the LLP agreement;
- is substantively determined by reference to an individual’s activities and not simply by reference to any ‘crude’ threshold such as a minimum capital allocation; and
- is not determined by the application of any ‘rigid test,’ but rather by applying the words of Condition B to the facts of the case.

Conclusion

Whilst the situation of each individual member in each LLP will be highly fact-specific, our view remains that LLP compensation arrangements can, with appropriate care and planning, be structured so as to incentivise individual and/or team performance in such a way that Condition A is not met. Similarly, albeit always subject to a careful analysis of the facts and circumstances, we consider that the operation of an LLP can be structured so that relevant individuals do in fact have “significant influence” and hence Condition B is not met, provided that the LLP has genuinely sought to distinguish between true partners and ‘salaried members’ by drawing the demarcating line at the appropriate level. Importantly, the relevant test should not be applied in the restrictive manner sought by HMRC in BlueCrest.

If you would like to discuss any aspect of the salaried members rules as they apply in your particular circumstances, please contact *Dan Roman*, *Nick Fagge* or your usual Schulte contact.

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