BlueCrest: Deemed employee status under the salaried members rules

Employment Tax



20 November 2023

We consider the ‘significant influence’ of *HMRC v BlueCrest Capital Management* on salaried members rules.

Key Points

What is the issue?

Three conditions have to be met in order for deemed employee status under the salaried member rules to apply, so a member need only fail one of the conditions to escape the PAYE regime.

What does it mean for me?

LLPs should revisit their agreements and profit share computations to assess how they interact with the salaried member conditions, particularly Condition A, in the

light of the First-tier Tribunal and Upper Tribunal decisions.

What can I take away?

It is now evident that allocations must be variable by reference to the profits of the LLP, not just constrained by its profits.

The Upper Tribunal has affirmed the First-tier Tribunal's ruling in *HMRC v BlueCrest Capital Management (UK) LLP* [2023] UKUT 232 regarding the application of the salaried members rules. Notably, it dismissed HMRC's request for a limited interpretation of 'significant influence', recognising that the application is not subject to the confines of 'find, mind, grind' but instead involves an 'acutely fact sensitive exercise'. Moreover, the influence can be financial, not just managerial; and over only some, not necessarily all, of the affairs of the partnership.

Background

BlueCrest Capital Management (UK) LLP ('BlueCrest') is an investment firm with multiple members broadly divided into the following functions:

- senior portfolio managers: members with control of a capital allocation of at least $100 million and/or desk-heads who oversee other portfolio managers;
- portfolio managers: responsible for providing investment services; and
- non-portfolio members: involving front-office services such as research or back-office services such as compliance.

BlueCrest appealed to the First-tier Tribunal against an HMRC determination that BlueCrest was liable to pay income tax and NICs under Pay as You Earn (PAYE) in respect of most of its members as the necessary conditions under the salaried members rules were met for all but four members.

The salaried members rules pertain to the circumstances in which a member of a limited liability partnership (LLP) is treated as an employee for income tax and NICs purposes; and consequently the LLP, as a deemed employer, has to collect and account to HMRC for income tax and Class 1 NICs under the PAYE regime with

respect to that member’s partnership drawings.

Three conditions have to be met in order for deemed employee status under the salaried member rules to apply, so a member need only fail one of the conditions to escape the PAYE regime:

- **Condition A:** This is met when, at the beginning of the relevant tax year, it is reasonable to expect that at least 80% of the total amount payable by the LLP to the individual is ‘disguised salary’; i.e. an amount that is fixed or variable without reference to the overall profitability of the LLP.
- **Condition B:** This is met when the mutual rights and duties of a member do not give that member significant influence over the affairs of the LLP.
- **Condition C:** This is met when the member has a capital contribution less than 25% of the ‘disguised salary’ expected to be paid in the relevant year.

The relevant conditions in dispute were Condition A and Condition B. It was accepted by BlueCrest that Condition C was met.

The First-tier Tribunal partially allowed BlueCrest’s appeal, finding that some members – specifically, the senior portfolio managers – failed to meet Condition B. From the facts, as extensively examined by the First-tier Tribunal, it was evident that the senior portfolio managers exerted significant influence by virtue of their roles within the partnership.

However, the judge held that all members met Condition A on the basis that their discretionary allocations were contingent on the performance of the individual members as opposed to the overall profitability of the LLP.

HMRC appealed the decision on the basis that the First-tier Tribunal erred in its construction of the legislation, contending that no member (other than the four members that sat on the executive committee) had significant influence over BlueCrest; and therefore that Condition B was met by all members.

BlueCrest, on the other hand, cross-appealed, arguing that none of its members met Condition A as at least 20% of the members’ pay varied by reference to BlueCrest’s profitability.

What did the Upper Tribunal determine?

The Upper Tribunal held that the First-tier Tribunal interpreted and applied the salaried members rules correctly, so it remained that:

1. Condition A was satisfied by all BlueCrest members, as their compensation was not tied to the partnerships' profitability due to an 'insufficient link with discretionary allocations'.
2. Condition B was not met by the desk heads and portfolio managers with capital allocations of at least $100 million, as they wielded significant influence over the partnership through their roles.
3. Condition B was met by the other portfolio managers and non-portfolio managers, as they lacked substantial influence over the partnership's operations.

On significant influence

One of the key points in this case is that, especially with regards to Condition B, a partnership assessing whether it meets the conditions should undertake 'careful analysis of all aspects of the workings of the relevant partnership'. This involves considering the varying degrees of responsibility and impact that a member may have – including what 'clout' may look like within a specific business.

It is welcome news for partnerships that 'there is no one-size fits all approach to answering Condition B', for it indicates that the scope to fail the condition is wider than once thought. This means that with sufficient evidence, a partnership can prove the various ways that 'significant influence' manifests in a manner that is not necessarily in line with the traditional functions of a partnership.

The Upper Tribunal emphasised that to consider 'significant influence' is an exploration into what the members do in the partnership. While the backdrop of the traditional partnership is helpful to note, it is not determinative of the 'significant influence' question.

The position taken by both the First-tier Tribunal and the Upper Tribunal is promising in that it is reflective of the reality of specialisation and current partnerships structures – in that significant influence over 'affairs' is unlikely to be general in nature. The Upper Tribunal noted that 'it is a bar set too high' if, to fail Condition B, a member must have significant influence over the entirety of the affairs of the relevant partnership.

It follows from this that what 'influence' may mean, and how it presents itself, is also considered broadly under the condition and depends upon the facts of the case. However, both the First-tier Tribunal and Upper Tribunal were comfortable that 'influence' was not restricted to management influence; and that 'significant influence' can be over one or more aspects of the affairs of the partnership, not just over the affairs of the partnership as a whole, as contended by HMRC.

On disguised salary

BlueCrest put forward that the First-tier Tribunal erred in its construction of and approach to Condition A on the grounds that the judge 'set the bar too high in terms of the link required between remuneration paid to each member' and the profitability of the business.

BlueCrest argued that discretionary allocations were variable and subject to limitation should the partnership face any losses. While it was recognised by both tribunals that the allocations were variable, the allocation was tied to personal performance as opposed to profits or losses of the partnership and thus missed the necessary link. Had the discretionary allocation mechanism entitled the members to share in a proportion of the overall profits, in a manner that went beyond mere computation of an individual bonus, Condition A would likely have been failed.

The Upper Tribunal noted that even if a link were established, it is necessary to consider whether it is reasonable to expect that the discretionary allocations for the relevant year would be affected by BlueCrest's profits or losses, which in turn depends upon what is reasonable to expect for the relevant year. In this instance, the discretionary allocations were set without reference to overall profits and losses, meaning that they were not in practice affected by those profits and losses.

Therefore, while the profitability of the partnership determines whether there are sufficient funds to pay the discretionary allocations, this is a separate question to the one presented by Condition A.

What is next?

Given the widening of the scope of significant influence and considering HMRC's adamance that the legislation be interpreted strictly, it will be interesting to see whether HMRC pursues a further appeal, especially in light of the steadfast support that the Upper Tribunal decision gave to the First-tier Tribunal's rigorous investigation of the evidence before it.

Irrespective of whether HMRC appeals this Upper Tribunal decision, LLPs should remain wary of becoming complacent by resting on the Upper Tribunal confirmation that Condition B is broad in scope. Whilst the judgment helpfully breaks down the significance of each term within Condition B, it is clear that any determinations to be made by LLPs in respect of the salaried members rules still involve a fact specific evaluation. In turn, this creates uncertainty as to whether HMRC, or eventually the higher courts, will reach the same conclusion. LLPs should ensure that careful assessment takes place in deciding who may have significant influence, with sufficient evidence to support that decision.

And the question arises: will the more generous interpretation of 'significant influence' withstand the courts' scrutiny in the years to come?

LLPs should also revisit their agreements and profit share computations to assess how they interact with the salaried member conditions, particularly Condition A, in the light of the First-tier and Upper Tribunal decisions. It is now evident that allocations must be variable by reference to the profits of the LLP, not just constrained by its profits. This means a link is required between the profits of the partnership and remuneration paid to each member – though it remains unclear how substantial the link needs to be.

We would like to thank Hayley Rabet, Trainee Solicitor at Katten Munchin Rosenman, for her assistance with this article.

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