

CLIENT ALERT

UK Salaried Member Rules: First Decision on Application to Investment Management LLPs

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On 29th June, the UK's First-Tier Tax Tribunal issued its judgment in [*BlueCrest Capital Management \(UK\) LLP v HMRC*](#), the first case to consider in detail the UK's salaried member rules. The decision provides LLPs and their advisers with helpful guidance on when partners in LLPs will be taxed as employees. Importantly, the Tribunal's judgment is that a partner may have "significant influence" over an LLP even if the partner's influence only extends to a part of the business. This is broader than HMRC's published interpretation of the legislation.

Background

The salaried member rules were introduced in 2014 to prevent LLPs elevating staff to partnership and so disguising what would otherwise be an employment relationship for employment tax purposes in order to save on employment taxes. Although such individuals were not "partners in the business" in the traditional sense, they were taxed as such. This resulted in a tax saving, including the cost of employer National Insurance contributions.

Under the salaried member rules, members of an LLP are treated as employees for tax purposes except in certain prescribed circumstances. The decision in *BlueCrest* concerned two such circumstances, the following conditions:

- **Condition A:** it is reasonable to expect that less than 80% of the total amount payable by the LLP to the member will be "disguised salary" (broadly speaking, amounts which are fixed or which are variable but without reference to the overall profits of the LLP); and
- **Condition B:** the member has "significant influence" over the affairs of the LLP.

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If either of these conditions were satisfied, *BlueCrest* would have been able to treat the relevant individuals as partners without the salaried members rules applying.

Condition A: Disguised Salary

The decision concerns the application of the salaried members rules to different classes of senior staff at *BlueCrest*, referred to in the judgment as the “portfolio managers” and the “non-portfolio managers”. Their profit shares comprised three main components, including a discretionary allocation determined by the board each year.

BlueCrest argued that the discretionary allocation satisfied Condition A on the basis that the portfolio managers' discretionary allocations would be abated if the LLP did not make sufficient profits to pay such amounts. The Tribunal found this was not enough. While it was not necessary for the allocations to “track” the profits of the LLP, it was held that there must still be a link between the overall profitability of the LLP and each member's own profit allocation.

Condition B: Significant Influence

In HMRC's view, only the most senior partners are those who have a “real say” in the business and therefore exercise “significant influence” on the business (and are excluded by Condition B). Their interpretation has been that “significant influence over the affairs of the partnership” means that the relevant individual must have significant *managerial* influence *over the firm as a whole*. As such, it would be unusual for anyone outside the executive committee to satisfy Condition B and even those in the executive committee may not be deemed to have sufficient influence.

The Tribunal found that there was “no justification” to limiting the interpretation of “significant influence” to “managerial influence”. It was found to be possible to exercise significant influence where such influence was over operational and financial matters. Additionally, the Tribunal concluded that there is nothing in the legislation requiring influence to extend to the affairs of the LLP “as a whole” – significant influence over one aspect of the LLP's affairs was sufficient.

The case was a partial win by the taxpayer. Portfolio managers with capital allocations of \$100 million or more and “desk heads” (who both had their own capital allocations and supervised more junior portfolio managers) were found to have “significant influence”. They had financial influence and were involved in other partner-like activities (e.g. hiring). However, while the decision suggests that non-portfolio managers (including “front-office”, legal and compliance personnel) could wield the necessary level of influence, *BlueCrest* did not persuade the Tribunal that this was the case.

Concluding Thoughts

While it is helpful to have judicial guidance on these rules, the decisions of the First-Tier Tribunal are not binding on other courts and tribunals and it remains to be seen how HMRC will respond to this decision. In the meantime, there remains some uncertainty as to the correct interpretation of the law.

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Firms should reconsider the application of the salaried members' rules to their businesses in light of the judgment and, to the extent they are relying on Condition A, may now wish to revisit the link between member remuneration and the overall profitability of the firm.

For those relying on Condition B, the decision highlights the importance of keeping clear written records of decision-making processes to evidence the influence that particular individuals have over the business. Simply elevating such individuals to an executive committee is unlikely to be of assistance unless that committee exercises real decision-making power. Firms should be aware that any superficial measures may be viewed as an attempt to circumvent the rules and so should reflect the commercial reality of the arrangements.

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