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BlueCrest FTT Decision – Salaried Member Rules and Asset Managers

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The recent decision of the First-tier Tribunal (**FTT**) in BlueCrest Capital Management (UK) LLP v HMRC (29 June 2022) is the first time the UK's salaried member rules (the **Rules**) have been considered in the context of an asset management limited liability partnership (**LLP**). BlueCrest is engaged in providing hedge fund investment management services. In summary, the FTT found that certain of BlueCrest's members who were responsible for managing significant investment portfolios had 'significant influence' over the affairs of the LLP, irrespective of whether that influence on a financial level amounted to managerial influence over the whole of the LLP's affairs, such that those members were not salaried members (but that other members who were not engaged in portfolio management did not have significant influence for these purposes, as explained below).

The decision in respect of the significant influence condition for portfolio managers will be welcomed by asset management LLPs. However, it is generally expected that HMRC will appeal the decision, particularly given that it appears to be at odds with HMRC's approach, as set out in the HMRC Partnership Manual, that only members involved in the top level management of an LLP should treated as having significant influence over its affairs.

Overview of the Salaried Member Rules

The Rules effectively treat an individual member of a UK LLP as an employee for UK income tax purposes unless the LLP member passes one of three tests set out in the Rules. They are intended to apply to LLP members who are more akin to employees than traditional partners in a partnership. Where an LLP member is treated as an employee for such purposes this means, among other things, that:

- the LLP is required to account for income tax and employee national insurance contributions (**NICs**) via PAYE on their remuneration;
- employer NICs are payable by the LLP; and

- any securities acquired by the individual by reason of their deemed employment with the LLP may be within the scope the UK tax employment related securities rules.

For an LLP member not to be treated as a salaried member, they must meet at least one of the following conditions (although the Rules are actually framed around "failing" a condition worded in the opposite way):

- Condition A – it is reasonable to expect that less than 80% of the total amount to be paid by the LLP to the member in the following tax year will be 'disguised salary', which includes both fixed amounts and amounts which are variable if such amounts vary without reference to the overall profitability of the LLP;
- Condition B – the LLP member has 'significant influence' over the affairs of the LLP; or
- Condition C – the LLP member makes a sufficient capital contribution to the LLP (broadly, 25% of their disguised salary).

The BlueCrest decision considered Condition A and Condition B.

Condition A – Variable Remuneration

This condition requires a prospective assessment at the beginning of the relevant period as to whether it is reasonable to expect that less than 80% of the member's remuneration is either fixed or, if it is variable, will vary without reference to the overall profits or losses of the LLP or, in practice, will not be affected by the overall amount of those profits or losses.

BlueCrest LLP members who were responsible for portfolio management were paid discretionary allocations which were calculated, broadly, by reference to the performance of individual portfolios that they were responsible for. Other LLP members' (not responsible for portfolio management) discretionary allocations were not calculated by reference to a profitability metric and were based on individual performance metrics. The FTT found that it was necessary for there to be a demonstrable link between the LLP's profits, on the one hand, and the basis of the calculation of the variable remuneration, on the other, although the bar to showing that there was such a link was set low. Nevertheless, the FTT held there was insufficient evidence of such a link on the evidence in this case.

In particular, BlueCrest had changed its formal remuneration policy applicable to the members involved in portfolio management in early 2014, just before the introduction of the Rules. It had added a term that stated that the additional remuneration of each member would be scaled back if the overall profits of the LLP were insufficient to pay all of the portfolio managers the amounts calculated based on the individual portfolio performance formula. The FTT held that this scaling back term was not sufficient to mean that the variable remuneration was not 'disguised salary' since it simply stated what would happen in any partnership and there was no evidence that any variable remuneration had ever been reduced because of this term.

The FTT also considered whether the anti-avoidance provision in the Rules should apply to the change in policy. The anti-avoidance provision says that any arrangements that have a main purpose of securing that the Rules do not apply to an individual shall be ignored when determining whether the Rules do apply. The FTT stated (albeit this is not directly relevant to the decision) that had the change in policy terms meant that the variable remuneration was not disguised salary, the anti-avoidance provision would have applied such that the change would have been ignored. In this case, the change to the terms of BlueCrest's remuneration policy was insufficient to get BlueCrest through the disguised salary test so the decision on this point was not critical to the FTT's decision. Notably, HMRC argued this point despite HMRC's published guidance which states that HMRC would not consider that the anti-avoidance rule should apply to "genuine and long-term restructuring that causes an individual to fail one or more of the conditions" in the Rules.

Condition B – Significant Influence

In order not to be a salaried member under this test, the mutual rights and duties of the members of the LLP must give the relevant member significant influence over the affairs of the LLP.

In relation to assessing whether an LLP member has significant influence, BlueCrest argued that financial influence as well as managerial influence should be considered. HMRC's position was that only managerial influence over the overall affairs of the LLP should be considered. The FTT agreed with BlueCrest and found that there is no justification for limiting significant influence to managerial influence and that there does not necessarily need to be significant influence over the affairs of the LLP as a whole, but that financial influence or managerial influence could be over an aspect of the affairs of the LLP.

Regarding the portfolio manager LLP members, the FTT found that they made key investment decisions daily and their main function was to generate revenue by engaging in the LLP's core activity and, as such, exercised significant influence over the affairs of the LLP. Furthermore, it was found that, operationally, they were involved in the sort of activities which a partner in a traditional partnership would have undertaken, including recruitment, identifying and exploiting new business opportunities and managing relationships. In light of this it was found that certain of the portfolio manager LLP members had significant influence (and, therefore, were correctly treated as self-employed for UK tax purposes).

Conversely the 'infrastructure' LLP members (involved in business support rather than portfolio management activities) were found not to have significant influence (based on what was demonstrated by the evidence provided) and the FTT considered that the activities that they engaged in (legal, risk, HR, finance, tax etc.) were not ones which would have generally been undertaken by partners in a traditional partnership, but, rather, would be undertaken by specialist employees. It was held that, while they contributed indirectly to the operations of the LLP and assisted the portfolio managers to exercise their significant influence, they did not themselves exercise significant influence over the affairs of the LLP, meaning they should be treated as employees for UK tax purposes.

This decision as to the scope of significant influence will be welcomed by the UK asset management industry, but as noted above is expected to be appealed by HMRC as it gives a materially broader interpretation of Condition B than HMRC's published guidance does.

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