

ALERTS

UK LLPs – Salaried Member Rules: Court of Appeal Decision in *HMRC v BlueCrest Capital Management (UK) LLP*

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The recent (and somewhat surprising) decision of the Court of Appeal (“CA”) in *HMRC v BlueCrest Capital Management (UK) LLP* means that the helpful guidance previously provided by the Upper Tribunal (“UT”) on the meaning of the ‘significant influence’ condition (Condition B) can no longer be relied upon. The case seems inevitably bound for the Supreme Court, which we can only hope will provide sensible and reliable guidance.

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 (tax-transparent) partnership and, subject to the salaried member rules, its members are generally treated as self-employed partners.

However, 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 NIO), if each of the three following conditions is met. In brief, these are:

- Condition A (‘disguised salary’) – at least 80% 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[1] – the member’s capital contribution to the LLP is less than 25% 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.

FTT[2] and UT Decisions

In upholding the FTT decision, the UT held that in relation to:

- Condition A, there needs to be a “meaningful link” between at least 20% 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 smaller amount.
- Condition B, ‘significant influence’ need not be over the entirety of the affairs of the LLP, or necessarily 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’.

In relation to Condition B, the UT rejected 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’.

Court of Appeal (“CA”) Decision

Allowing HMRC’s appeal, the CA held that:

- both the FTT and the UT had erred in law and that the ‘influence’ required by Condition B must be ‘conferred by the statutory and contractual framework which governs the operation of the partnership’. Influence over the affairs of the LLP which lacks any identifiable contractual or statutory source in the specified rights and duties is excluded from being the kind of influence which counts for the purposes of Condition B. On the facts of the case, the main focus in this respect had therefore to be solely on the rights and duties conferred on the members by BlueCrest’s LLP Agreement (which effectively constituted the contractual framework governing the operation of the BlueCrest LLP); and
- ‘influence’ has to be ‘over affairs of partnership’ which, in the context of Condition B, ‘connotes the affairs of the partnership generally, viewed as

a whole’, and that ‘[t]he affairs of the LLP are broader than, although they include, the business of the LLP.’

The CA decision makes clear that (i) ‘significant influence’ cannot be established by reference to actual (*de facto*) influence which does not derive (in effect) from the LLP Agreement (so-called ‘non-qualifying influence’); but also that (ii) such ‘non-qualifying influence’ may remain ‘highly material’ in deciding whether the influence that does qualify (so-called ‘qualifying influence’) is ‘significant’ when assessed in the light of any ‘non-qualifying influence’ which may be found to exist on the facts of any given case.

The CA decision also makes clear that a focus on ‘decision-making at a strategic level’ rather than ‘how individual members perform their duties in conducting the business’ accords better with the basic purpose of Condition B.

The CA thus explicitly rejected the conclusion reached by the FTT (and endorsed by the UT) that a portfolio manager with responsibility for managing their own substantial allocation of capital could, by that very fact, be regarded as having significant influence for purposes of Condition B (i.e., could have significant influence notwithstanding that they were not on the management/executive committee of the LLP constituted by the LLP Agreement and did not have any involvement in running the wider affairs of the LLP).

The decision of the UT has been set aside and the case has been remitted to the FTT for it to reconsider the evidence in light of the correct test.

For the sake of completeness we note that the CA also briefly considered Condition A (disguised salary) and upheld the decisions of both the FTT and UT (in HMRC’s favour) that where the overall amount of profits merely functions as a cap on remuneration which is variable without reference to overall profits, such remuneration is ‘disguised salary’.

Conclusion

So where does this leave us? In some respects, the position of an LLP member seeking to rely on Condition B is now worse than HMRC’s own guidance would suggest. Example 2 below (from HMRC’s Partnership Manual PM256200) clearly recognises a founder’s *de facto* ‘significant influence’. Not so the Court of Appeal.

Example 2

This example illustrates an influential individual who is not a manager of the business.

T was the founder of the firm. Officially she is semi-retired and plays no role in either the management or the strategy of the business. In reality, if T indicates her views on the strategy of the business, and the strategy board will almost invariably follow her guidance. T is still associated with the firm and if she was to disassociate herself from the firm, it would be catastrophic for business.

Although T officially has no role, she continues to set the direction and strategy of the firm. T continues to hold significant influence and fails Condition B.

It would also seem, if we follow the CA's reasoning, that a member who does not have any involvement in decisions related to the general affairs of the LLP – for example through membership of a management/executive committee – cannot have significant influence, notwithstanding that that member may be crucial to the success of the business.

While we consider it likely that this saga is bound for the Supreme Court, for now there is greater pressure on ensuring that members who are intended not to be salaried members on the grounds of significant influence (Condition B) can be seen to derive their influence over the affairs of the LLP from the rights and duties expressly conferred upon them by LLP Agreement and, furthermore, to ensure that such influence is over 'the affairs of the partnership generally, viewed as a whole'.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors. On 30 January 2025, the firm will be hosting a 30-minute discussion and Q&A for our clients and contacts to discuss the judgment and practical next steps. You may register for this webinar [here](#) or [here](#).

[1] Condition C is included here for the sake of completeness and not discussed further, although it is at present plagued by its own controversies.

[2] First Tier Tribunal

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