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Case Notes

HMRC v BlueCrest Capital Management (UK) LLP [2023] UKUT 00232 (TCC)

The Upper Tribunal has released its decision in [HMRC v BlueCrest Capital Management \(UK\) LLP](#) [2023] UKUT 00232 (TCC), upholding the earlier FTT decision [2022] UKFTT 204 (a partial win for the taxpayer) and essentially agreeing with its reasoning for the most part.

Leaving aside a general point about the difficulties parties face in mounting an *Edwards v Bairstow* challenge, the Upper Tribunal decision has given (slightly) more detailed guidance on the salaried members rules in s.863A-G of ITTOIA 2005. However, questions remain regarding the test of "significant influence".

Background

By way of background, there are essentially 3 conditions that need to be satisfied before an LLP member is treated as an employee for tax purposes:

- (1) **Condition A** (s.863B): It is reasonable to expect as at the "relevant time" that at least 80% of the total amount payable by the LLP in respect of the member's performance is "disguised salary". That is, it is either fixed or variable but variable without reference to the overall profits or losses of the LLP (or is not in practice).
- (2) **Condition B** (s.863C): The mutual rights and duties of (i) the members of the LLP as between themselves and of (ii) the LLP and its members, do not give the member significant influence over the affairs of the LLP.
- (3) **Condition C** (s.863D): The member's contribution to the LLP is less than 25% of the reasonably expected disguised salary. Specific rules for how to measure a contribution are set out in ss.863E-863F.

The FTT decision

Before the FTT, there was no dispute that Condition C was satisfied.

The FTT found that Condition A was satisfied for all relevant LLP members. This was because, on the facts, the remuneration of the LLP members, whilst variable because it was discretionary, was without reference to the overall profits/losses of the LLP. The fact that individual awards might be reduced if there was insufficient overall profit was insufficient. Whilst the FTT found that there is no need for a LLP member's remuneration to "track" the LLP's overall profits and losses [138] but they do need to be by reference to them (even though the FTT recognised that this was a low threshold [146]). For good measure, the FTT found at [156] that the remuneration was not "in practice" affected by the overall profits/losses.

The FTT, in an *obiter* finding at [167], also found that certain resolutions passed which had a purpose of ensuring that Condition A was not met were to be disregarded under the TAAR in s.863G.

On Condition B, the FTT found that this condition was not met in relation to certain portfolio managers with a portfolio of over US\$100m, together with desk heads, on the grounds that these individuals did have significant influence. HMRC had also accepted that members of the original executive committee of the LLP had significant influence. For these purposes the FTT had found that "significant influence" was not limited to "managerial influence" [172]-[177] and that the "affairs of the partnership" was not restricted to the affairs of the partnership generally but could be in respect of "an aspect of the affairs of the partnership" [178]-[181]. This was so despite the fact that an LLP might be subject to external control from the wider group as well which made high level strategic decisions [183]- [184]. The FTT also appeared to agree with the parties that "significant influence does not need to be exercised through a formal constitutional procedure, but requires a realistic examination of the facts" [188].

The Upper Tribunal decision

HMRC appealed on Condition B whilst the taxpayer appealed Condition A. The taxpayer had also appealed the finding on the TAAR under s.863G but its appeal was withdrawn on this by the time of the hearing.

The Upper Tribunal essentially agreed with the FTT's reasoning on Conditions A and B but the decision provides some further detailed reasoning:

Condition A

The difficulty for the taxpayer on this condition was that, even on the FTT's low threshold test, the FTT still found that the remuneration was not by reference to the overall profits/losses of the LLP. As the Upper Tribunal observed at [144], the only contractual link between the remuneration and the profits/losses was the ability to limit discretionary allocations where losses were incurred. This was not sufficient.

In particular, the Upper Tribunal at [149] emphasised that the test in Condition A is framed by whether it is reasonable to expect that 80% of total remuneration is "disguised salary" being:

- (a) A fixed amount

(b) Variable, but without reference to the overall amount of LLP profits/losses

(c) Variable but not in practice affected by the overall amount of LLP profits/losses.

The argument obviously focused on (b) or (c). The Upper Tribunal essentially suggested a two level test:

(1) Did the link qualify *in principle* to permit remuneration to fall outside (b) or (c)?

(2) Even if the link did qualify in principle, what was the reasonable expectation? For example, on the facts if there was reasonable expectation as to sufficient profits such that discretionary allocations would not be affected, one would still fall within (b) or (c). This would require factual findings for each year in question.

The Upper Tribunal found at [153] that the need for sufficient profits did not qualify since it was too indirect. This was before one considered the second level of whether on the facts there was a reasonable expectation etc (albeit the FTT had found sufficient facts on this for the taxpayer to lose as well).

On the facts the Upper Tribunal found the remuneration was decided without reference to profits; merely because (both practically and legally) there had to be sufficient profits to fund the remuneration was not enough. The purpose of Condition A was to “to isolate payments of the kind one would find in a traditional partnership, where the partners share in profits and losses” and weak linkages to profits would not be sufficient in this context.

This is not a particularly surprising result. Further, given the existence of the “in practice” test in (c), it will be difficult for taxpayers to avoid satisfying Condition A unless the remuneration is truly variable and this is before one even considers the TAAR in s.863G.

Condition B

Both before the FTT and the Upper Tribunal it was common ground that when one was considering the significant influence test one looks not only at the relevant agreement setting out the rights and duties of members but also to consider actual (de facto) influence – see [83]. HMRC raised 9 grounds of challenge but only the points of wider interest (essentially grounds 1-4) are discussed below.

The short wording of Condition B is worth setting out since this illustrates the word by word challenge made by HMRC:

“Condition B is that the mutual rights and duties of the members of the limited liability partnership, and of the partnership and its members, do not give M significant influence over the affairs of the partnership.”

Responding to HMRC’s arguments, the Upper Tribunal held that there is no key touchstone test to apply in terms of the approach to Condition B. In particular, high level distinctions between an employee and partner, whilst useful, were not determinative nor was “the application of any other rigid test of this kind”. Ultimately it is an “acutely fact sensitive exercise” – see [86].

The Upper Tribunal upheld the FTT in its interpretation of the phrase in Condition B of “over the affairs of the LLP”. This did not mean the entirety of the affairs of the partnership – the FTT had been correct to find that control over any aspect of the affairs of the partnership could be sufficient – see the Upper Tribunal at [91]-[92] (but see below for some further thoughts on this).

The Upper Tribunal also rejected HMRC's approach to what form of influence counted for the purposes of the test. HMRC were essentially arguing that only managerial influence was sufficient as opposed to the influence that one might have from being a significant generator of profit. The Upper Tribunal disagreed, the question of "influence" is (again) fact sensitive but could include responsibility for operational activities, financial performance and/or financial responsibility or managerial responsibility - see [99].

Last, the Upper Tribunal also rejected HMRC's challenge that the FTT had erred in law as to what "significant" had meant when applying the test of "significant influence". As to what constitutes "significant", this was something the Upper Tribunal refused to provide a gloss on. It obviously denotes something more than just "influence" but ultimately whether the test is satisfied "depends upon the facts of the particular case" - see [105].

Comment

The Upper Tribunal's conclusion on Condition A is unsurprising on the facts found and it is unlikely that this aspect of the case will go any further.

In terms of Condition B, the Upper Tribunal's rejection of any hard edged test or gloss of what constitutes "significant influence" looks right given the sparse statutory language (insofar as this can be viewed as a standalone point). However, this obviously does create uncertainty for taxpayers in how to apply the test in practice as well as how to evidence matters. Prudent advisers will no doubt have regard to the fact that regardless of HMRC's difficulties in challenging the FTT's findings of fact, those findings do appear to be on the generous side for the taxpayer and there is no guarantee that another FTT would necessarily follow the same approach.

The key issue which might merit further consideration is what is meant by the "affairs of the partnership". As is hinted at by the Upper Tribunal's reasoning at [92], there is a potential interplay between what is "significant" in terms of influence and the part of the affairs of the LLP over which it is exercised (i.e. whether it is an important part). One can readily see an argument that having sufficient influence over a significant part of an LLP's business (but not directly over the entirety of its affairs) could still amount to "significant influence over the affairs of the partnership". The Upper Tribunal's conclusion is that it is not necessary to even go this far (i.e. to have any reference to the entirety of the affairs of the LLP) but essentially for reasons that the legislation would raise issues for large partnerships. However standing back:

- This is only the case if "significant" were to be read as something like "controlling or directing" which not even HMRC appeared to be arguing for (in a scenario where they had lost the argument that influence did mean managerial influence).
- The Upper Tribunal at [93] acknowledged HMRC's point that a "real" partner would also have to meet Conditions A and C in order to be caught, but did not think this point could justify "reading into a Condition a restriction which is not present in the Condition" - but query whether the above argument would entail any reading in.

Whether any of the above ultimately avails HMRC on the facts as found is another matter. Further, regardless of any appeal, it may be that the decision is a trigger for the draftsman to have a second attempt at what is on any view quite "high level" legislation.