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Case Notes

BlueCrest Salaried Members in the Court of Appeal - De facto significant influence falls apart; the concessions cannot hold

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LLPs that need to consider the Salaried Members Rules in s.863A-G of ITTOIA 2005 now have to contend with two unwelcome recent developments:

- The first and most recent is the Court of Appeal's judgment in *HMRC v BlueCrest Capital Management (UK) LLP* [2025] EWCA Civ 23, that came out on 17 January 2025. Sir Launcelot Henderson's judgment took apart the consensus position (presented by both parties throughout the litigation) that for the purposes of Condition B (s.863C) it is permissible to have regard to *de facto* significant influence. This was rejected in terms. In short, only significant influence flowing from legal rights and duties (most obviously contained in the LLP agreement) will do.
- The second is HMRC's reversal of its generous guidance on the application of the targeted anti-avoidance rule ("**TAAR**") in s.863G, as applied to Condition C (s.863D), which happened back in February 2024.

Historically, HMRC's guidance and approach has been generous when judged against the bare text of the statute as enacted. However, it is certainly not inconsistent with the Technical Note which was published on 27 March 2014 prior to the legislation being enacted which obviously does beg the question of what Parliament thought it was doing. Whilst this may not be enough on an orthodox approach to affect the interpretation of the legislation (as the Court held), it does raise an important question of fairness more broadly. It is not inconceivable that the matter might eventually get to the Supreme Court but one would not be optimistic that the position there would be any different without a significant change in approach to statutory interpretation.

The difficulty for many LLPs is that because HMRC sought to be "helpful" in the past in proposing a practical application of the legislation, they will have been lulled into a false sense of security and may now find themselves in a difficult position as a result of the changes to HMRC guidance and the recent *BlueCrest* decision. In terms of legal complaint, none may be advanced on this ground in a tax appeal. A judicial review will not be straightforward either given the Court of Appeal's previous judgment in *R (Aozora GMAC Investment Ltd) v HMRC* [2019] EWCA Civ 1643 on HMRC guidance and legitimate expectation.

The main risk here is Employer's NICs where time limits sit outside the Taxes Management Act 1970 regime and instead there is a 6-year time limit (at least in England & Wales) under s.9 of the Limitation Act 1980.

LLPs would be well advised to revisit the strength of their position on each of Conditions A-C, both for historic periods as well as going forward, especially when the rate of Employer's NICs is increasing to 15% from April 2025.

The BlueCrest Salaried Members Litigation

Background leading up to the recent Court of Appeal case

The FTT and UT decisions have been summarised in a previous Case Note **here**. However, in summary, Conditions A and B were both in dispute:

(1) **Condition A (s.863B):** It is reasonable to expect 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 affected by such profits).

(2) **Condition B (s.863C):** The mutual rights and duties of (i) the members of the LLP as between themselves and (ii) the LLP and its members, do not give the member significant influence over the affairs of the LLP.

For those unfamiliar with the Salaried Members Rules, the taxpayer generally wants to "fail" these tests because each of Conditions A, B and C must be satisfied before an LLP member is deemed to be an employee.

Before the FTT and UT, BlueCrest lost on Condition A but won on Condition B in respect of some (but not all) of the LLP members on the basis that the FTT had been entitled to conclude that portfolio managers managing a portfolio of £100m or more had significant influence. This was all premised on what was common ground regarding Condition B as recorded by the UT at [83]:

> *"At first sight [Condition B] requires focus upon the relevant agreement or agreements which set out the rights and duties of the members of the partnership. It has, however, been accepted by the Respondent in this case that it is permissible also to consider this question in terms of actual (de facto) influence, which may not necessarily derive from the LLP Agreement or any formal agreement governing the rights and duties of the members of BlueCrest."*

Before the Court of Appeal, HMRC appealed on Condition B whilst BlueCrest's respondent's notice raised an argument on Condition A for those LLP members who had succeeded on Condition B. In short, HMRC succeeded on their appeal on Condition B and resisted BlueCrest's arguments on Condition A (where the reasoning of the FTT and UT was essentially upheld). This is not the end of the matter however – the Court of Appeal has ordered that the case be remitted back to the FTT now that the law has been made clear.

Condition B: Court of Appeal

The stark change of approach by the Court of Appeal arose from HMRC adopting an alternative position during the course of submissions in response to questions from the bench – see [95] where the Court had to consider the fairness of this:

> *"I am not deterred from taking this course by the fact that the construction which I consider to be correct was not advanced by either side in either Tribunal, and it only emerged as a fallback secondary position relied upon by HMRC in this court after we had drawn attention in the course of argument to what seemed to us to be the clear import of the relevant statutory wording. On a question of statutory interpretation, it is our duty to decide for ourselves what the legislation means, and we cannot be bound by any agreement between the parties. There may, however, be procedural issues about the fairness of permitting a party to rely on a new point of law in an appellate court after the facts have been found at first instance, and it is to that aspect of the matter that I now turn."*

The "fallback secondary position" was that Condition B only required one to have regard to legally enforceable rights and duties (whether contractual or statutory). It was this position that the Court ultimately adopted. The Court also found that BlueCrest had no legitimate procedural complaint, other than perhaps on costs (but it is not necessary to discuss this here).

The overall reasoning can be summarised as follows:

- The reference to "mutual rights and duties" must be a reference to the legal rights and duties of the LLP members. The Court's reasoning was heavily influenced by the fact that Condition B appears to use the same wording as s.5(1) of the Limited Liability Partnerships Act 2000 (**"LLPA 2000"**) which makes it clear that the mutual rights and duties are governed either by an agreement or by default provisions contained within r.7 of the Limited Liability Partnership Regulations 2001 – see [64]-[65].
- Where an LLP agreement contains an entire agreement clause (as is common) and the default provisions are excluded, the main focus on ascertaining the rights and duties will be the LLP agreement itself – see [68] and [93].
- Informal or *de facto* influence will not qualify – see [68]. However, the existence of such influence may still be material in judging whether the influence that is in fact provided by the legal rights and duties is "significant" – see [68]-[69] and [94]. On the facts of the case, there was a dominant individual (Mr Platt) who was not an LLP member and who was recognised as having *de facto* influence. Whilst the Court did not comment further, it was at least recognised that this had the potential to undermine the "significance" of the influence that the LLP members may have had.

- The influence that the mutual rights and duties provide must be over the affairs of an LLP generally as opposed to some part of it. The affairs of the LLP include its business but are wider than that – see [70]. A focus on decision-making at a strategic level, rather than how individual members perform their duties, seemed to Sir Launcelot to "accord better with the basic purpose of Condition B".
- The Court at [70] also appeared to suggest that a wider group context could be relevant because the affairs of the partnership had to be "viewed as a whole and in the wider context of the Group". The group in question here was the wider BlueCrest group. It is not clear what this means exactly, but it would appear to suggest that the affairs of the partnership would include how it interacts with other group entities (if any) as opposed to simply how it carried on its own business.
- The test for what is significant does not require a "high level" of influence; it has to be more than insignificant and it must have "practical and commercial substance in the conduct of those affairs in the real world" – see [92].

Taking into account all the points made above, at [112] the Court went on to find that both the FTT and UT fell into error in believing that *de facto* influence was relevant or indeed that the consensus of the parties could dictate how the law would be applied. Whilst the matter will now be remitted to the FTT, this is unlikely to throw up further points of wider significance for other taxpayers.

In terms of the application of this reasoning for other LLPs, much will depend upon their particular fact pattern. The judgment of the Court of Appeal imposes a significantly harder test for LLPs to meet, especially for large LLPs where there will only be a small number of LLP members who sit on management boards with responsibility for the overall LLP. Where that board is recognised and empowered under the LLP agreement, one can be confident that the board members will still likely satisfy the requirement of significant influence. That is, of course, unless there is a dominant individual (whether an LLP member or not) who might undermine the significance of that influence.

By contrast, it is worth considering the example HMRC gave in oral submissions: a head of a tax department at a solicitors firm. Assuming that this person does not sit on a management board for the firm, they will not satisfy the test of significant influence even if they have actual influence over their department and are otherwise seen as a key player in the firm as a whole. Whilst that example was not addressed in the judgment, the Court by its reasoning appeared to agree.

Condition A: Court of Appeal

In short, there is no real change from the decisions below. The wording of Condition A that was the subject of argument is as follows:

> *"An amount within the total amount is "disguised salary" if it—*
>
> *(a) is fixed,*
>
> *(b) is variable, but is varied without reference to the overall amount of the profits or losses of the limited liability partnership, or*
>
> *(c) is not, in practice, affected by the overall amount of those profits or losses."*

There was no dispute that the amount in question was not fixed – rather the question was whether limbs (b) or (c) applied. The argument advanced by BlueCrest was summarised in the judgment at [122] and [123]:

On limb (b) of Condition A:

> *"If the discretionary allocation made to a portfolio manager or desk head is to count as disguised salary within limb (b) of Step 2 in section 863B(3), it must be "varied without reference to the overall amount of the profits or losses of the LLP". This test is not satisfied, submits Ms Hardy KC, because "reference to" does not mean "computed by" but merely imports the existence of a real link between the profits of the LLP and this element of the member's remuneration".*

On limb (c) of Condition A:

> *"…the test must have been intended by Parliament to add something to limb (b), and the word "affected" denotes that the profits or losses of the LLP can impact on the amounts paid to members. The words "in practice" are intended to exclude situations where, in reality, there is no chance of the governing documentation allowing for such an impact to be felt by the members. Here, however, the LLP might in a given year make a loss large enough to reduce or even eliminate discretionary allocations. A real possibility of that nature is enough to show that limb (c) is not satisfied."*

At [127] the Court agreed with HMRC's submissions in response on limb (b), which can be summarised as follows:

- The test of "without reference to overall amount of profits or losses" of the LLP requires something more than the overall amount of profits functioning as a cap.
- In particular, Condition A must be construed purposively to distinguish (i) profits being divided in agreed shares from (ii) a (quasi) employment relationship where a salary might be topped up by a discretionary bonus (but which need not be linked to overall profits). This purposive approach can be justified by virtue of the fact that Parliament chose to use the term "disguised salary" which one can use to "colour" the interpretation of limb (b).

As a result, it was not necessary for the Court of Appeal to address limb (c); nor was it really addressed by the UT below. This means that the only examination of limb (c) is the sparse commentary of the FTT at [156].

Overall, given that the argument on Condition A in BlueCrest was a very narrow one, there is not much by way of guidance in any of the decisions which could help an LLP understand a more nuanced set of facts.

Condition C and the TAAR – a refresher

The TAAR for the Salaried Members Rules is found in s.863G. For present purposes we are concerned with s.863G(1) that provides for a disregard of arrangements which have a main purpose to secure that s.863A(2) does not apply (i.e. has a main purpose to ensure that any of Conditions A-C do not apply).

The most likely real-world application of s.863G(1) is to scupper any arrangements that require LLP members to make capital contributions where those arrangements have a main purpose of ensuring that Condition C does not apply. This was originally addressed by HMRC at PM258200, where they state that one should not take into account:

> *"amounts of capital that are part of arrangements to enable the Individual Member to "avoid" being a Salaried Member where there is no intention that they have permanent effect or otherwise give rise to no economic risk to the Individual Member."*

This was a generous interpretation of the main purpose test. Obviously a main purpose test can still be satisfied even if there is a commercial purpose as well. Leaving aside this general point, HMRC's guidance at PM259305 also suggested that where the following situations are present they may be caught by the TAAR:

- Contributions derive from non-recourse or limited recourse loans.
- The LLP or connected body loans the contributions back.
- The LLP bears the cost of interest on the loan used to fund the contribution.
- The LLP member is only brought into the LLP for a fixed term assignment and it is reasonable to assume that the capital contribution has been made so that the individual fails the test for the duration of that assignment.
- The funds contributed derive from the LLP itself or from a connected body.

These factors were all no doubt informed by HMRC's experience of loan financing from partnership avoidance schemes. Elsewhere HMRC's guidance previously took a pragmatic or even soft approach in relation to the TAAR where an LLP was restructured to avoid the legislation applying - see PM259200:

> *"In applying this test (Targeted Anti-Avoidance Rule (**TAAR**)), HMRC will take into account the policy intention underlying the legislation, which is to provide a series of tests that collectively encapsulate what it means to be operating in a typical partnership.*
>
> *A genuine and long-term restructuring that causes an individual to fail one or more of the conditions is not contrary to this policy aim."*

It is difficult to reconcile this blanket statement with the words of the legislation and the guidance given by the courts on "main purpose" tests elsewhere. HMRC have recognised this more recently (in February 2024) in two respects:

- Removing from PM259310 (see the archive here) the following wording:

> *"A genuine contribution made by the individual to the LLP, intended to be enduring and giving rise to real risk will not trigger the TAAR."*

- Adding a second example at PM259200 which makes it clear that if there is a main purpose this will cause the disregard to be engaged (implicitly regardless of whether the contribution is enduring etc).

These changes may well reflect the law more accurately (albeit facts are key when considering the TAAR given it is a subjective test) but taxpayers may feel justified in complaining that they have previously relied on HMRC's guidance and indeed HMRC's practice of applying the rules. However, this is something that the law may provide no remedy for. What remains to be seen is how HMRC will approach matters going forward now that Condition C may become more prominent if a firm is unable to rely on Condition B being failed. However, regardless of HMRC's approach, firms need think carefully about how they self-assess matters. One point that might potentially be argued, depending on the facts, is that if the matter is unclear, HMRC cannot infer a main purpose in seeking to avoid Condition C if the firm genuinely believed that Condition B was going to be failed in any event, even if that belief is now shown to be mistaken.

Concluding thoughts

The combined effect of HMRC's change of stance in their guidance on Condition C, and the change on Condition B that has been thrust upon them by the Court of Appeal, is undoubtedly going to give LLPs some headaches for both historic and future periods.

LLPs may credibly say that they would have altered the terms of the LLP agreement to reflect *de facto* influence that was already in place. Alternatively, it might have only taken some moderate tweaking to profit sharing arrangements to put matters clearly on the right side of the line for Condition A. For example, HMRC are quite open in their manuals to accepting that the same economic apportionment might give rise to different answers depending on how the division of profits is carried out. Given the intervention of HM Treasury in the car finance fiasco, one can at least envisage a change in the law to soften the impact of the Court's judgment. However, the situation (and certainly the facts of BlueCrest) is unlikely to generate sympathy with the current Government unless there is evidence that the decision is causing widespread chaos. It would be prudent to assume that the Court's decision on Condition B will be the final word for the foreseeable future and for firms to review their potential historic liabilities as well as to consider what changes should be made for the future.

Another thought is that given that the Salaried Members Rules only apply to UK LLPs (see s.1(2) of the LLPA 2000), the question now is why would one go to the trouble of using this form of entity? For some, their regulatory requirements may mean that there is no choice. For others, leaving aside familiarity with LLPs and institutional inertia, the tax implications of shifting to another entity are not necessarily straightforward. However, the latest instalment of the BlueCrest saga may persuade firms that the UK LLP has outlived its usefulness.