

Members of UK LLPs and Significant Influence Commentary on *HMRC v. BlueCrest Capital Management (UK) LLP*

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

James Anderson

Partner / London
44.20.7519.7060
james.anderson@skadden.com

Patrick J. O’Gara

Partner / London
44.20.7519.7097
patrick.ogara@skadden.com

Lorenza De Domenico

Associate / London
44.20.7519.7241
lorenza.dedomenico@skadden.com

Sahej Grewal

Trainee Solicitor / London
44.20.7519.7000
sahej.grewal@skadden.com

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One Manhattan West
New York, NY 10001
212.735.3000

22 Bishopsgate
London EC2N 4BQ
44.20.7519.7000

On January 17, 2025, the UK Court of Appeal (Court) released its decision on whether certain members of BlueCrest Capital Management (UK) LLP (BlueCrest) should be taxed as employees under the UK “salaried members” rules (the Rules). In particular:

- i. The Court found that both the First-Tier Tribunal (FTT) and the Upper Tribunal (UT) erred in law by applying a broad interpretation of Condition B that had been accepted by both the taxpayer and HM Revenue & Customs (HMRC), namely that *actual* influence over the LLP was relevant to the analysis even where the source of such influence was not explicitly conferred by the LLP’s contractual provisions.

The Court disagreed and therefore remitted the case to the FTT for reconsideration under the Court’s view of the correct legal test.

- ii. The Court also upheld the FTT’s and UT’s findings that Condition A was satisfied for all relevant members, on the basis that the discretionary allocations made to portfolio managers and desk heads were disguised salary because the allocations were variable without reference to the overall profits or losses of the LLP.

Going forward, managers may have to rethink compensation arrangements as drafted in waterfalls for LLP agreements.

- iii. The market now faces a degree of uncertainty about Condition B, regarding both prior filed returns, where taxpayers had relied on HMRC views as expressed in the manuals and during the earlier passage of the BlueCrest case, and future periods, since HMRC’s reaction to the judgment has not yet been stated. The key question relates now to whether all significant influence must be exercised pursuant to written rights and duties enshrined in contractual provisions in order to qualify as such.

Many in the industry hope that the taxpayer is successful in being able to appeal to the Supreme Court in order to resolve several textual issues and practical consequences arising from this element of the judgment. It would be surprising if HMRC were not also content to see this appeal proceed, given that the Court has raised the possibility of using form over substance to determine if significant influence can qualify for Condition B purposes.

Key Points on Condition B Made by the Court

- The significant influence required to fail Condition B must derive from the LLP agreement or other contractual or statutory sources of legally enforceable mutual rights and duties. The Court determined this from the wording of Condition B read together with other provisions of the LLP Act.
- Significant influence should not only be specifically sourced from a partnership agreement or deed, but also should not be assessed beyond the *enforceable* rights and duties of the members.
- Accordingly, influence based on unenforceable (*i.e.*, informal or *de facto* arrangements, even if derived from or relying on a governance framework established by the constitutional documents of the LLP) is not considered qualifying influence, in contrast to the wider scope of arrangements permitted to be considered under Condition A. Thus, an executive committee being constituted under the LLP agreement may not assist *per se* in conferring significant influence on its members if those members have no specific rights or duties according to the constitution.
- Condition B therefore demands a textual inquiry rather than a factual one, other than regarding the scope of enforceable rights and duties within the partnership.

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- The Court judges declined to comment further on the application of the test as they saw it to the facts of the BlueCrest case.

As a more general point, the Court favoured a strict approach to interpretation, emphasising that “the incantation of a purposive interpretation” is insufficient if, in context, the statutory words admit only one meaning and “do not produce absurdity.” Almost all of the adduced evidence relating to the development of section 863C ITTOIA was disregarded as irrelevant to establishing the right legal test to apply.

Pending any successful appeal, the market must adjust to a new legal reality: new LLP agreements need to be drafted to clearly delineate the rights and duties of each significantly influential member and regularly reviewed to reflect any changes in the roles and contributions of members. Relying on informal arrangements or “practical realities” in order to evidence qualifying influence, such as executive committee decisions or managing member board minutes, will not be possible.

Notably, given the Court’s other comments, influence over operational or financial matters may not suffice for Condition B unless tied to strategic decision-making that affects the affairs of the LLP as a whole.

Commentary on the Judgment

First, the market is now somewhat in limbo. We wait to see if leave to appeal is sought (and granted), but if not (or if appeal is unsuccessful), the judgment of the FTT would be the final disposition of the matter and that could be over a year away.

The Court’s decision is somewhat of a “double blow” to providing certainty to the market when taken together with HMRC’s 2024 amendment to its approach and guidance on the Targeted Anti-Avoidance Rule (TAAR), as applied to Condition C of the Rules.

Second, the decision is also likely to impact insurance coverage for taxpayers — both for those already insured and deciding with their insurers whether to settle ongoing audits, and for those who may be looking to acquire coverage.

Third, applying the judgment on its terms, there may be a need to consider introducing new terms to existing and future LLP agreements to reflect the actual significant influence of LLP members, and enshrining that influence through drafting in legally enforceable rights and duties. This is somewhat ironic given that such prescriptive delineation appears contrary to the ethos of partnership and ignores general fiduciary and commercial responsibilities, creating a relationship instead more closely resembling employment. Also, a question will need to be addressed about the

extent to which restatements of existing LLP agreements to align legal rights and duties with practical reality can be challenged under the TAAR.

Fourth, the Court’s statements on how to approach the legislation, *i.e.*, very narrowly and without the admission of any context from HMRC’s actions to date, are disappointing for those in the market who worked with HMRC to develop the legislation and subsequent guidance. HMRC arguably had much more influence, in fact significant influence, over the language of the statute than parliamentarians or the UK Treasury, and the HMRC guidance published thereafter espoused a practical approach to the test, looking at the reality of how partners were influencing the affairs of a partnership.

HMRC may have benefited specifically in this case from the narrow statutory approach in the BlueCrest Court of Appeal judgment, but the approach is at odds with how HMRC and the market have understood the test until recently (calling into question whether taxpayers have been well served by the almost decade-long period of engagement with HMRC on the Rules). As things stand, the courts have simply pointed at the barest of interpretations that the UK Parliament could have intended and rendered redundant the detailed discussions between taxpayers and HMRC on the implementation of the Rules.

The Court’s interpretation also leaves open issues regarding the level of comfort that taxpayers can in the future draw from guidance issued by, and engagement with, HMRC when new technical legislation is implemented. There remain questions of judicial review as to legitimate expectation that could have been drawn from the original guidance.

Finally, the Court’s insistence on such a narrow reading of the statute introduces several technical conundrums. The most definitive section of the judgment (paragraph 68) states:

“[I]t seems clear to me that the “significant influence over the affairs of the partnership” contemplated by Condition B must derive from, and have its source in, the mutual rights and duties of the members of the LLP (both horizontally, as between the members themselves, and vertically, as between the members and the LLP) as conferred by the statutory and contractual framework which governs the operation of the LLP, including in particular section 5 of LLPA 2000, regulation 7 of the LLP Regulations 2001, and the relevant provisions of the LLP agreement. Where, as in the present case, the LLP agreement contains both an “entire agreement” clause and a clause excluding the default provisions in regulation 7 of the LLP Regulations 2001, the main focus will be on the terms of the LLP agreement itself.”

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Although referenced earlier in the judgment, this paragraph does not include the crucial word “give,” which is what the statute demands:

“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.” [emphasis added]

The Court directs the taxpayer to focus on the constitutional documents of the partnership, but Condition B effectively demands that the constitutional documents “give” significant influence through mutually enforceable rights and duties of the LLP and its members. Therefore, there may be an argument that giving such influence is not possible where members are already exercising such influence. Furthermore, this fact may have underpinned the lack of specifics in many LLP agreements, given that, once an executive or similar committee is formed or a senior person is appointed to partnership, influence will in practice likely continue to be exercised significantly as it had been in the past (and may have led to partnership being awarded in the first place).

The Court’s highly literal approach risks causing two other linked issues. First, can taxpayers simply draft for significant influence, irrespective of whether it is actually exercised? The judgment just says that the influence must derive from, and have its source in, the rights and duties as set out in the contractual and statutory provisions governing the LLP. Second, the actual provision in Condition B may have no meaning, stating simply that the mutual rights and duties do not give significant influence. Such items never would, on their own; rights confer powers to act, and duties confer obligations to act, and they might be ignored by members (in breach of the LLP agreement), in which case no influence would actually be wielded. It makes sense to read such terms into the provision, but the Court has enjoined taxpayers to read the provision exclusively and literally.

Such points may have appeared too “textual” and theoretical in prior times, and both taxpayers and HMRC might have once preferred a more practical and real-world approach to the Condition B wording, but if the courts intend to rely simply on textual analysis in primacy, then taxpayers will have to consider all construction angles in applying the words of the statute.

Further Technical Background on the Judgment

The Rules were introduced in the Finance Act 2014 to counter the perceived avoidance of income tax and National Insurance contributions (NICs) by members of LLPs. A member of an LLP is deemed to be employed by the LLP under a service contract

(instead of being a self-employed member of the LLP) if all three Conditions A to C in sections 863B to 863D of ITTOIA are met:

Condition A: Condition A is met if it is reasonable to expect that at least 80% of the total amount payable by the LLP to the member for their services will be disguised salary (fixed amounts, amounts that are varied without reference to the overall profits or losses of the LLP, or amounts that are not affected by the overall profits or losses of the LLP).

Condition B: Condition B is met if the mutual rights and duties of the members of the LLP, and of the partnership and its members, do not give the member significant influence over the affairs of the partnership.

Condition C: Condition C is met if the member’s contribution to the LLP is less than 25% of the amount it is reasonable to expect will be payable to the member as disguised salary during the relevant tax year.

BlueCrest is a UK-resident LLP providing investment management and back-office services within the BlueCrest Group. The group’s funds were managed by a Guernsey limited partnership.

HMRC issued (a) determinations against BlueCrest for the tax years 2014/15 to 2018/19 totaling approximately £142 million and (b) a decision for Class 1 NICs of approximately £55.3 million.

The FTT allowed BlueCrest’s appeal for portfolio managers with allocations of \$100 million or more and desk heads, but dismissed the appeal for other portfolio managers and non-portfolio managers. Both parties appealed to the UT, which upheld the FTT’s decision, finding no error of law in the FTT’s construction of Conditions A and B.

Court of Appeal Findings on Condition B

Source of influence: For the purposes of Condition B, the significant influence must derive from the legally enforceable mutual rights and duties of members conferred by applicable statute or the LLP agreement. The Court referred to this influence, grounded in the legally binding constitutional framework of the partnership, as “qualifying influence” for the purpose of the Rules. Where statutory default provisions are excluded, the requisite source for the rights and duties must be found in the LLP agreement itself. The LLP agreement’s entire agreement clause reinforced this conclusion. The Court found that the lower tribunals erred in law in accepting the wider construction of Condition B that was taken as common ground by both parties (and is set out in HMRC’s published guidance) that qualifying influence can derive from *de facto* arrangements (whether legally enforceable or not).

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Significance of influence: The influence must be more than insignificant, with practical and commercial substance in the conduct of the LLP's real-world affairs. Influence that is not "qualifying," such as *de facto* influence exercised by LLP members or parties that are not members of the LLP, can be used to compare and assess the significance of qualifying influence.

Scope of influence: The influence must be exerted over the affairs of the LLP generally, viewed as a whole and in the wider context of the group. An LLP's "affairs" encompass and extend beyond its "business." Condition B involves a focus on decision-making at a strategic level, rather than on how individual members perform their duties in conducting the business.

Further Findings on Procedural Fairness

BlueCrest objected to HMRC relying on an alternative argument on the construction of Condition B (which was formulated during the hearing), asserting that if HMRC had made this argument clear before the FTT hearing, BlueCrest might have submitted different evidence. The Court rejected this objection because:

- BlueCrest's own submissions indicated an understanding that the necessary influence must be found in the mutual rights and duties of the members. An experienced litigant, the company proceeded at its own risk by limiting its evidence.
- The public interest in ensuring taxpayers pay the correct amount of tax justified fresh arguments.
- The alternative, correct construction of Condition B was narrower and still required examination of other sources of influence to determine "significance."