

**Deloitte.**



# Bluecrest Court of Appeal

Deloitte Private Equity  
Summary of Judgment

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# Bluecrest Court of Appeal summary

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On Friday 17 January, the Court of Appeal published its decision in *Bluecrest Capital Management (UK) LLP* (“Bluecrest LLP”) v HMRC which is a case that concerns the application of the salaried member rules, and in particular focusses on the meaning of significant influence for the purposes of these rules.

## Background

### *The Salaried Members Rules*

The Bluecrest case concerned the application of the salaried member rules (set out in sections 863A-863G ITTOIA) which is anti-avoidance legislation that treats certain LLP members as employees for tax purposes (known as “salaried members”) unless one of the following three conditions is not met:

- Condition A (“disguised salary”) – it is reasonable to expect that at least 80% of the total amount payable by the LLP to the member will be ‘disguised salary’;
- Condition B (“significant influence”) – the members do not have significant influence over the affairs of the LLP; or
- Condition C (“capital contribution”) – The member’s capital contribution to the LLP is less than 25% of the ‘disguised salary’ which it is reasonable to expect will be payable to the LLP member.

“Disguised salary” for the purposes of the above conditions includes, broadly, any amount which is fixed, variable otherwise than by reference to the overall amount of profits or losses of the LLP and amounts otherwise unaffected by the overall profits or losses of the business.

The Bluecrest Court of Appeal decision focuses primarily on the meaning of Condition B (significant influence), as well as giving briefer consideration to Condition A in respect of portfolio managers and desk heads. It was accepted by both parties that Condition C was met and so this was not considered as part of the case.

### *Background to the Bluecrest case*

Bluecrest LLP is part of a hedge fund management group, providing investment management services as a sub-investment manager in respect of the group’s funds,

as well as providing back-office services to other group entities. HMRC had broadly contended that

- (1) most members of Bluecrest LLP did not have significant influence over the affairs of the LLP and;
- (2) in respect of portfolio managers and desk heads, it was reasonable to expect that 80% or less of the total amount payable by the LLP to the member was 'disguised salary'.

Accordingly, HMRC contended that these members of the LLP were considered salaried members and so subject to employment income tax and employee / employer NIC in respect of their profit allocations.

The case has been through the First Tier Tribunal ("FTT") and Upper Tribunal ("UT"), before most recently being heard before the Court of Appeal. One of the key points for consideration in the case was whether different categories of members of the LLP were considered to have significant influence for the purposes of Condition B.

The FTT (as upheld by the UT) had held that certain members of the LLP (including portfolio managers with a trading book in excess of \$100m) should be considered to have significant influence by adopting a broad interpretation of the meaning of significant influence, including that this did not have to be over the affairs of the LLP as a whole, and can include direct financial influence and is not limited to managerial influence.

HMRC appealed the decision on the grounds that the UT had erred in its construction of condition B, with Bluecrest also being permitted to pursue a protective cross appeal.

## The Court of Appeal decision

### **Condition B**

#### *"Qualifying Influence"*

The Court of Appeal overturned the previous rulings of the FTT and UT in respect of the meaning of Condition B. In particular, the Court of Appeal held that the significant influence contemplated by Condition B of the salaried member rules *"must derive from, and have its source in, the mutual rights and duties of the members of the LLP"*, in accordance with the *"clear and unambiguous"* legislative wording of Condition B.

Accordingly, this means the determination of whether members are considered to have significant influence for these purposes, must stem from the legally enforceable mutual rights and duties outlined in the LLP agreement itself and the relevant statutory framework (which the Court described as *"qualifying influence"*).

Accordingly, the main focus should be on the terms of the LLP agreement itself and regard should not be given to influence over the LLP which does not arise from any identifiable contract (or statute).

The Court of Appeal found that both the FTT and UT had applied a much broader interpretation of Condition B (which had also been supported by HMRC's published guidance), having regard to the actual ('de facto') influence members of the LLP may have over the LLP, which may not have arisen from the LLP agreement itself and may not have been legally enforceable.

The example was given of Mr Platt, one of the co-founders of Bluecrest and CIO and COO of the General Partner and one of the members of the Group ExCo but not a member of the LLP. In practical terms. *"The combination of those roles doubtless meant that Mr Platt could usually, and perhaps always, ensure that his wishes were followed throughout the Group; but none of those roles had its origin in any of the mutual rights and duties of the members (of whom Mr Platt was not one) under the LLP Agreement. Accordingly, any influence which Mr Platt may have exerted over the affairs of the LLP was non-qualifying for the purposes of Condition B."*

#### *Significant influence over the affairs of the LLP*

However, whilst such factors are not considered "qualifying influence", they remained relevant for determining whether the qualifying influence was "significant". Whilst it was noted that the meaning of "significant" is not defined in the legislation, the Court of Appeal held that as well as having its source in the mutual rights and duties of the LLP members, it must be "over the affairs of the partnership".

It was stated that the affairs of the partnership should be viewed as a whole and in the wider context of the group, and that this was wider than just the business of the LLP. In particular, the Court of Appeal felt that the purpose of Condition B accorded better with focusing on strategic level decisions rather than how individual members perform their duties in undertaking the business of the LLP.

#### *Outcome*

Accordingly, the Court of Appeal held that both the FTT and UT had *"erred in law in accepting the wider construction [of Condition B] which is reflected in HMRC's published guidance... In particular, the FTT approached its all-important examination and evaluation of the evidence on the mistaken basis that the necessary qualifying influence over the affairs of the LLP could be found not only in the LLP Agreement and any other sources of enforceable mutual rights and duties, but also in any defacto arrangements which were in place from time to time, however informal they may be, and whether or not they were legally enforceable."*

As such, the decision of the UT was set aside and the case was returned to the FTT to reconsider the evidence based on the correct statutory interpretation of Condition B.

### ***Condition A***

Whilst the decision predominantly focused on the meaning of Condition B, the Court of Appeal upheld the decisions of the FTT and UT in respect of the application of Condition A that where the overall profits of the LLP only function as a cap on profit allocations to LLP members (which are otherwise variable without reference to the underlying profits of the LLP) then such profit allocations would be considered disguised salary for the purposes of the salaried member rules. As such, it was held that condition A was met by the relevant members of the LLP (including the portfolio managers and desk heads).

### **Reflections**

The Court of Appeal's decision represents a much narrower interpretation of the meaning of significant influence for the purposes of the salaried member rules than is set out in HMRC's current guidance. Accordingly, where LLP members are relying on Condition B, we would recommend reviewing the terms of the LLP agreement (and any other contractual arrangements that may be in place) to consider whether this supports such members as having "qualifying influence".

It should then be considered whether this is regarded as "significant" in the context of the affairs of the LLP as a whole and particularly whether this pertains to more strategically focused decisions as opposed to how the LLP members perform their duties.

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