Howden Capital, Advisory & Placement

Tax Insurance Update: Salaried Member Rules

September 2023

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Salaried Member Rules

Background and Tax Risk Overview

Profit allocations from a UK limited liability partnership ("LLP") to its partners are not subject to employer or employee national insurance contributions, unless certain anti-avoidance legislation (referred to as the "Salaried Member Rules") applies to reclassify the partners as 'disguised employees' whose partnership allocations should be treated as 'disguised salary' for tax purposes (resulting in significant PAYE and National Insurance implications for the LLP).

The rules apply to disguised employment relationships where an individual meets all three of the legislative conditions, broadly outlined as:

- Condition A is met if more than 80% of the amount payable to an individual member is 'disguised salary' (i.e. a fixed salary or variable salary amount that is not calculated by reference to the LLP's profits);
- Condition B is met if an individual member does not have significant influence over the LLP's affairs; and,
- Condition C is met if an individual member has not made a significant capital contribution into the LLP (i.e. an amount greater than 25% of the disguised salary expected during the relevant period).

Additionally, a Targeted Anti-Avoidance Rule may disregard arrangements or structures where the main purpose, or one of the main purposes, is to secure that an individual is not to be considered a Salaried Member.

Blue Crest Decision & Recent HMRC Activity

In June 2023, the Upper Tribunal ("UT") heard an appeal by BlueCrest Capital Management (UK) LLP ("BlueCrest") in relation to the First Tier Tribunal's ("FTT") application of the Salaried Member rules to its members, particularly in respect of Conditions A and B. This has significantly added to the uncertainty surrounding the proper application of the Salaried Member rules given the potential for further appeals following the UT's judgement and also any impact of that judgement on taxpayers that are relying on aspects of the original FTT ruling.

Additionally, we are aware of a general increase in HMRC scrutiny in this area, with HMRC having issued Regulation 80 Determinations to a number of UK LLPs and/or challenged them under the Salaried Member rules.

In light of this HMRC scrutiny, and in anticipation of the UT's decision in BlueCrest, Howden CAP has seen a significant increase in the number of enquiries concerning the availability of a tax insurance solution for LLPs at risk of a HMRC challenge under the Salaried Member rules.

How Tax Risk Insurance Can Assist

Provided robust defence arguments exist, the tax insurance markets have been willing to offer insurance solutions to mitigate the accumulated financial risk that can be associated with the Salaried Member rules. This has been particularly relevant for hedge funds, but is also applicable more widely to other UK LLPs making significant profit allocations to members.

Such a tax insurance policy would be put in place to cover the risk of HMRC successfully contending that profit allocations from a UK LLP to its members should be considered as disguised salary. Clients have primarily sought cover for employer national insurance contributions and apprenticeship levy.

In addition to mitigating the financial exposure, another potential benefit of insuring this tax risk would be to facilitate the better alignment of risk between the members of the partnership during the periods relevant to the risk and any future members of the partnership.

Whether the risk is ultimately insurable is highly fact-dependent given the nature of the rules/conditions, and pricing for Salaried Member risks can vary from sub-2% (e.g. where there are robust defence arguments and there has been no HMRC scrutiny) to in excess of 10% (e.g. where there is an ongoing dispute with HMRC) of the amount insured.

At the outset, insurers will be keen to understand whether tax advice was sought on the establishment of the LLP and if this advice was implemented appropriately at the time. For example, strong defence arguments can often be demonstrated where the potentially less subjective Condition C has not been met.

The underwriting process will also be heavily fact-dependent, but to underwrite the risk, we typically expect insurers to focus on the following areas (among others):

- the documentary evidence available to demonstrate that the relevant conditions have not been met (noting the FTT decision in BlueCrest placed the burden of proof on the taxpayer); and,
- the particular role/influence of each member and what has happened in practice regarding their remuneration. For example, how has the determination of each members’ profit allocation been documented year on year and can it be demonstrated that the LLP has conformed to any remuneration policies that have been put in place.

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