



HM Revenue
& Customs

Investment managers: capital gains tax treatment of carried interest

Who is likely to be affected?

Individuals involved in investment management for private equity or other investment funds, who are members of a partnership, or involved in arrangements including partnerships. These individuals will be affected if they receive a sum chargeable to capital gains tax (CGT) which is linked to the successful performance of a fund ("carried interest") and they have been paying an effective rate of tax on such sums which is below the rate of capital gains tax.

General description of the measure

Individuals will normally be charged to capital gains tax on the full amounts they receive in respect of their carried interest. Deductions will only be allowed in respect of sums actually given by the individuals as consideration for acquiring the right to that carried interest. The measure will not affect genuine investments in funds made by managers on an arm's length basis (known as "co-invest").

Policy objective

This measure will make the tax system fairer by ensuring that individuals to whom a gain arises in the form of carried interest are taxed on their true, economic gain and that planning tools designed to ensure they are taxed on a lower figure, to achieve a lower effective rate of tax are not effective.

Background to the measure

This measure was announced at Summer Budget 2015.

Detailed proposal

Operative date

This measure will have effect on all carried interest arising on or after 8 July 2015, whenever the arrangements were entered into.

Current law

Carried interest arises from an individual's participation in an investment vehicle, typically a partnership. Sums allocated to an individual in satisfaction of carried interest are treated, for tax purposes, as though the individual and not the partnership had carried out the transactions which gave rise to the sums in question. Where a chargeable asset held by a partnership is disposed of, a chargeable gain accrues to the individual and is calculated in accordance with the chargeable gains legislation. HMRC has published Statement of Practice D12 (SoPD12) which sets out an agreed interpretation of how the chargeable gains legislation operates in these circumstances. The application of SoPD12, together with tax planning techniques, can result in fund managers being charged to capital gains tax on amounts significantly lower than their actual economic returns.

Proposed revisions

Legislation in Summer Finance Bill 2015 will introduce new sections in Part III of the Taxation of Chargeable Gains Act 1992 to require the treatment set out below for sums received by managers in respect of their carried interest. For this purpose, carried interest will be defined by reference to the disguised investment management fees legislation introduced at Chapter 5E, Income Tax Act 2007 by section 21 of the Finance Act 2015.

The new sections will provide that, where an individual performs investment management services for a collective investment scheme through an arrangement involving one or more partnerships, then any sums received in respect of carried interest under that arrangement will constitute a chargeable gain and be subject to capital gains tax. This will cover the entire sum received by an individual, regardless of the items notionally applied to satisfy the carried interest at the level of the partnership or other entity in the fund structure.

Only specified sums will be allowable as a deduction against the sum received when calculating the chargeable gain to ensure that individuals are charged to tax on their true economic profit. In particular, a deduction will only be allowed for consideration actually given by the individual (if any) in return for the carried interest rather than for the amount that would be allowed under SoPD12. Provision will be made to ensure that credit is given for employment income tax charges where relevant.

This measure will not affect the taxation of performance-linked rewards which are charged to income tax.

Summary of impacts

Exchequer impact (£m)	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
	nil	+265	+375	+390	+390	+375
	These figures are set out in Table 2.1 of Summer Budget 2015 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Summer Budget 2015.					
Economic impact	This measure is not expected to have any significant macroeconomic impacts. A behavioural response of those affected by the measure is included in the costing.					
Impact on individuals, households and families	This measure will have an impact on, at most, several thousand individuals in private equity firms or elsewhere in the investment management sector who are currently in arrangements which result in a low effective rate of capital gains tax on their carried interest. The measure is not expected to impact on family formation, stability or breakdown.					
Equalities impacts	This measure will affect individuals receiving carried interest from investment funds. These are likely to share protected characteristics with others of above average means, and equality groups represented in lower income groups are less likely to be affected.					

Impact on business including civil society organisations	This measure will have no direct impact on business and civil society organisations. It will impact indirectly on the investment fund businesses that use the services of individuals who are affected by this measure. Such individuals may have to pay a higher effective rate of tax on their performance linked rewards but this is expected to result in a negligible ongoing compliance cost for investment funds and their investors.
Operational impact (£m) (HMRC or other)	The costs to HMRC of implementing this change are not expected to be significant.
Other impacts	<p><u>Small and micro business assessment:</u> investment fund management business which are small and micro businesses will be indirectly affected to the extent that the individuals involved in those businesses benefit from the current treatment set out in SoPD12 or the other tax planning tools which will targeted by this measure. Those individuals may have to pay a higher effective rate of tax on their performance-linked rewards, although this is not expected to involve additional costs to small and micro businesses.</p> <p>Other impacts have been considered and none have been identified.</p>

Monitoring and evaluation

The measure will be monitored through monitoring of disclosures of new avoidance schemes to circumvent the measure, and through communication with taxpayers and practitioners affected by the measure.

Further advice

If you have any questions about this change, please contact Rob Clay on 03000 570649 (email: rob.clay@hmrc.gsi.gov.uk) or contact James Coward on 03000 579560 (email: james.coward@hmrc.gsi.gov.uk).

1 CGT: carried interest

- (1) In Part 3 of TCGA 1992 (individuals, partnerships, trusts and collective investment schemes etc), after section 103K insert –

“CHAPTER 5

CARRIED INTEREST

“103KACarried interest

- (1) This section applies where –
 - (a) an individual (“A”) performs investment management services directly or indirectly in respect of an investment scheme under arrangements involving at least one partnership, and
 - (b) carried interest arises to A under the arrangements.
- (2) If the carried interest arises to A in connection with the disposal of one or more assets of the partnership or partnerships –
 - (a) the amount of the chargeable gain accruing to A on the disposal in respect of the carried interest is to be treated as an amount equal to the amount of the carried interest less any permitted deductions, and
 - (b) the chargeable gain is to be treated as accruing to A at the time the carried interest arises.
- (3) If the carried interest arises to A in circumstances other than those specified in subsection (2), a chargeable gain of an amount equal to the amount of the carried interest less any permitted deductions is to be treated as accruing to A at the time the carried interest arises.
- (4) Subsections (2) and (3) do not apply in relation to carried interest to the extent that –
 - (a) it is brought into account in calculating the profits of a trade of A for the purposes of income tax for any tax year, or
 - (b) it constitutes a co-investment repayment or return.
- (5) For the purpose of subsections (2) and (3) “permitted deductions” in relation to A means such parts of the amounts specified in subsection (6) as is just and reasonable.
- (6) The amounts referred to in subsection (5) are –
 - (a) the amount of any consideration in money given to the scheme by or on behalf of A wholly and exclusively for entering into the arrangements referred to in subsection (1)(a) (but not consideration in respect of co-investments),
 - (b) any amount that constituted earnings of A under Chapter 1 of Part 3 of ITEPA 2003 (earnings) in respect of A’s entering into those arrangements (but not any earnings in respect of co-investments or any amount of exempt income within the meaning of section 8 of that Act), and
 - (c) any amount which, by reason of events occurring no later than the time the carried interest arises, counts as income of A under the enactments referred to in section 119A(3) in respect of A’s participation in the arrangements referred to in subsection

(1)(a) (and section 119A(5) applies for the purposes of this paragraph as it applies for the purposes of section 119A(4)).

For the purposes of this Act no other deduction may be made from the amount of the carried interest referred to in subsection (2) or (3).

- (7) Where the carried interest arises to A by virtue of his or her acquisition of a right to it from another individual for consideration given in money by or on behalf of A, the amount of the chargeable gain accruing to A under subsection (2) or (3) is, on the making of a claim by A under this subsection, to be regarded as reduced by the amount of the consideration.
- (8) In this section –
 - “co-investment”, in relation to A, means an investment made directly or indirectly by A in the scheme, where there is no return on the investment which is not an arm’s length return within the meaning of section 809EZF(2) of ITA 2007;
 - “co-investment repayment or return” means a repayment in whole or in part of, or a return on, a co-investment.

103KB Carried interest: consideration on disposal etc of right

- (1) For the purposes of section 103KA, consideration in money or money’s worth received or receivable by an individual for the disposal, loss or cancellation of a right to carried interest is to be treated as carried interest arising to that individual at the time of the disposal, loss or cancellation.
- (2) But subsection (1) does not apply if and to the extent that the consideration is a disguised fee arising to the individual for the purposes of section 809EZF of ITA 2007.

103KC Carried interest: foreign chargeable gains

In a case where section 103KA applies, a chargeable gain accruing or treated as accruing to an individual in respect of carried interest is a foreign chargeable gain within the meaning of section 12 only to the extent that the individual performs the services referred to in section 103KA(1)(a) outside the United Kingdom.

103KD Carried interest: anti-avoidance

In determining whether section 103KA applies in relation to an individual, no regard is to be had to any arrangements the main purpose, or one of the main purposes, of which is to secure that that section does not to any extent apply in relation to –

- (a) the individual, or
- (b) the individual and one or more other individuals.

103KE Carried interest: avoidance of double taxation

- (1) This section applies where –
 - (a) capital gains tax is charged on an individual by virtue of section 103KA in respect of any carried interest, and
 - (b) at any time, tax (whether income tax or another tax) charged on the individual in relation to that carried interest has been paid by him or her, and

- (c) any sum so charged is not a permissible deduction under section 103KA(6)(b) or (c).
- (2) In order to avoid a double charge to tax, the individual may make a claim for one or more consequential adjustments to be made in respect of the capital gains tax charged as mentioned in subsection (1)(a).
- (3) On a claim under this section an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.
- (4) The value of any consequential adjustments made must not exceed the lesser of –
 - (a) the capital gains tax charged as mentioned in subsection (1)(a), and
 - (b) the tax charged as mentioned in subsection (1)(b).
- (5) Consequential adjustments may be made –
 - (a) in respect of any period,
 - (b) by way of an assessment, the modification of an assessment, the amendment of a claim, or otherwise, and
 - (c) despite any time limit imposed by or under an enactment.

103KF Interpretation of Chapter 5

- (1) For the purposes of this Chapter, carried interest “arises” to an individual if, and only if, it arises to him or her for the purposes of Chapter 5E of Part 13 of ITA 2007.
- (2) In this Chapter –
 - “arrangements” has the same meaning as in Chapter 5E of Part 13 of ITA 2007 (see 809EZE of that Act);
 - “carried interest”, in relation to arrangements referred to in section 103KA(1)(a), has the same meaning as in section 809EZB of ITA 2007 (see sections 809EYC and 809EYD of that Act);
 - “investment scheme” and “investment management services” have the same meanings as in Chapter 5E of Part 13 of that Act (see sections 809EZA(6) and 809EZE of that Act).”
- (2) This section applies in relation to carried interest arising on or after 8 July 2015 under any arrangements, unless the carried interest arises in connection with the disposal of an asset or assets of a partnership or partnerships before that date.
- (3) In subsection (2), “arise”, “arrangements” and “carried interest” have the same meanings as in Chapter 5 of Part 3 of TCGA 1992 (as inserted by subsection (1) of this section).

2 Disguised investment management fees

- (1) In section 809EZB of ITA 2007 (disguised investment management fees: meaning of “management fee”), after subsection (2) insert—
 - “(2A) For the purposes of subsection (2)(b), the return on the investment is reasonably comparable to the return to external investors on the investments referred to in subsection (2)(a) if (and only if) —
 - (a) the rate of return on the investment is reasonably comparable to the rate of return to external investors on those investments, and
 - (b) any other factors relevant to determining the size of the return on the investment are reasonably comparable to the factors determining the size of the return to external investors on those investments.”
- (2) This section applies in relation to sums arising on or after 8 July 2015 (whenever the arrangements under which the sums arise were made).
- (3) In subsection (2), “arise” has the same meaning as it has for the purposes of Chapter 5E of Part 13 of ITA 2007.

Explanatory Note

Clauses 1 and 2: Capital gains tax: carried interest

Summary

1. These clauses change the way that investment fund managers who receive carried interest compute their chargeable gains. When carried interest arises on or after 8 July 2015 the gain will normally be equal to the sum received. Deductions will be allowed only for actual acquisition costs paid in the form of money (and not as money's worth) and for amounts previously taxed as earnings.

Details of the clauses

Clause 1: CGT: carried interest

2. Clause 1, subsection 1 introduces new Chapter 5 into Part 3 of the Taxation of Chargeable Gains Act (TCGA) 1992.

Chapter 5

3. Chapter 5 contains sections 103KA to 103KF which provide new rules for the taxation of carried interest which arises to individuals who provide investment management services.
4. New section 103KA(1) sets out the circumstances in which the section applies. Several terms used have the same meaning as in the Income Tax Act (ITA) 2007 (see subsection (8) and new section 103KF).
5. New section 103KA(2) applies when the carried interest which arises is derived directly or indirectly from a disposal of assets held by a partnership within an investment fund structure. It provides that the chargeable gain accruing on that disposal is of an amount equal to the carried interest arising, less certain specific deductions, and that it accrues when the carried interest arises.
6. New section 103KA(3) applies when carried interest arises in any other circumstances. It provides that a chargeable gain accrues when the carried interest arises, and in an amount equal to the carried interest less similar specific deductions.
7. New section 103KA(4) excludes certain amounts of carried interest from the chargeable gain which accrues. The exclusions are:
 - Amounts brought into account in calculating A's trading profits; and
 - Amounts which constitute repayment of principal or return on a co-investment (see subsection (8)). In this context, a return will by definition be an arm's length return.
8. New section 103KA(5) limits the deductions which are permitted in computing the chargeable

gain which accrues. The permitted deductions are just and reasonable apportionments of amounts specified in subsection (6). The meaning of "just and reasonable" is not defined, but in order to be allowed as a deduction, an amount must be closely associated with the acquisition of the right to the carried interest which has arisen, or with the arising of the carried interest itself.

9. New section 103KA(6) specifies the only amounts all or part of which may be permitted deductions in computing the chargeable gains mentioned in subsections (2) and (3). These are:
 - Money (but not money's worth) given to the investment scheme by the individual for being admitted into the arrangements under which the individual provides management services. Money given for co-investments (see subsection (8)) is excluded (under section 103KA(6)(a));
 - Amounts which have been taxed as income on the individual when he or she acquired the right to the carried interest by entering into the arrangements. Amounts treated as earnings in respect of co-investments and "exempt income" within section 7 of the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 are excluded (under section 103KA(6)(b)); and
 - Other amounts which have been taxed as income on the individual in connection with his or her participation in the arrangements under which the individual provides management services and the carried interest arises, up to the time it arises (under section 103KA(6)(c)).
10. New section 103KA(7) applies when carried interest arises to an individual who acquired the right to it from another individual. In these cases, the person to whom the carried interest ultimately arises may make a claim to HM Revenue & Customs (HMRC) for their gain to be reduced by an amount equal to the money they gave as consideration for the right. No deduction is due automatically: a claim must be made and the normal rules which govern time limits, the method by which the claim is made and the other relevant conditions also apply.
11. New section 103KA(8) defines terms used elsewhere in section 103KA. In order to be a "co-investment" an investment must yield a return which is an arm's length return, and no other. "Arm's length return" is defined in section 809EZA(2) of ITA 2007.
12. New section 103KB applies when an individual disposes of his or her right to carried interest, either by selling it, surrendering it, allowing it to lapse or in any other way apart from the carried interest actually arising. Consideration receivable for the disposal is treated as carried interest in the hands of the recipient arising at the time of the disposal, whatever form that consideration takes and whenever it is actually received. However, this rule does not apply if the consideration is a disguised fee for the purposes of the disguised management fee rules in section 809EZA of ITA 2007.
13. New section 103KC is relevant where the individual to whom the gain arises is taxed on the remittance basis. There will be a foreign chargeable gain if any of the management services performed under the arrangements under which the carried interest arises were performed outside the United Kingdom. In these cases, the chargeable gain which accrues under section 103KA(2) or (3) is apportioned by reference to the services performed outside the UK expressed as a fraction of all the services the individual performed. This applies instead of the

normal rule at section 12(4) TCGA 1992, and the remittance basis rules apply to foreign chargeable gains determined under this rule, as they apply to foreign chargeable gains determined under section 12(4) TCGA 1992.

14. New section 103KD is an anti-avoidance rule. It applies where there are arrangements which are intended to ensure that the rules in section 103KA do not apply to an individual or individuals, or to the whole of an amount of carried interest arising to an individual, where they would otherwise apply.
15. New section 103KE is a general rule to ensure that any gain charged as a result of section 103KA is not actually or effectively taxed a second time on the same individual. Where there is such a double charge, and tax other than capital gains tax charged by virtue of section 103KA has actually been paid by the individual to whom the carried interest arose, that individual may make a claim to HMRC to eliminate the double charge. The claim must be for adjustment of the capital gains tax charged, and HMRC will make just and reasonable adjustments which do not exceed the lesser of the capital gains tax charged under section 103KA and the amount of 'other' tax. Other tax charges which arise before the capital gains tax charge will generally be deductible under section 103KA(5): this section applies principally where other tax charges arise after that time.
16. New section 103KF gives the meaning of certain words and phrases used in sections 103KA to 103KF.
17. Subsection (2) specifies that the rules in sections 103KA to 103KF have effect in relation to any carried interest that arises on or after 8 July 2015, unless that carried interest is derived from a disposal of partnership assets which took place before that date.
18. Subsection (3) ensures that for the purposes of the commencement provision in subsection (2), carried interest and other terms have the same meaning as they do in Chapter 5 of Part 3 of TCGA 1992.

Clause 2: Disguised investment management fees

19. Subsection (1) introduces new subsection (2A) into section 809EZB of ITA 2007.
20. Section 809EZB(2A) explains what is meant by the phrase "reasonably comparable" in section 809EZB subsection (2)(b). That subsection requires that the return on an investment made by a fund manager be reasonably comparable to the return in the same kind of investments made by external investors. New section 103KA(8) TCGA 1992 (see above) uses the conditions in section 809EZB(2) ITA to define a "co-investment".
21. Subsection (2) specifies that the new definition in section 809EZB(2A) applies in relation to any management fees arising on or after 8 July 2015.
22. Subsection (3) ensures that, for the purposes of the commencement provision in subsection (2), "arise" (and, by extension, "arising") has the same meaning as in the disguised management fee rules in Chapter 5E of Part 13 of ITA 2007.

Background note

23. These new provisions are effective from the date of their announcement on 8 July as part of the Summer Budget 2015 in order to prevent the forestalling which would otherwise be likely. They have been introduced to support the Government's policy that taxation should be fair and, to that end, should so far as possible reflect the reality of circumstances. It ensures that

tax is paid on true economic gains enjoyed by the individuals affected by the new rules.

24. HMRC will monitor the impact of these provisions through disclosures of new avoidance schemes to circumvent the measure, and through communication with affected taxpayers and practitioners.