Opposition policy costing – Carried Interest – Labour Party

Description of policy
Labour would tax carried interest as income. Labour has announced plans to raise almost £500 million by closing a tax loophole enjoyed by a small number of private equity fund managers' (*The Guardian,* 19 September 2021, link). **Rachel Reeves said Labour would change 'the way in which carried interest for private equity firms are taxed'.** Rachel Reeves*:* 'The tax increases that we're proposing, there are three of them. Getting rid of the non dom tax status, having VAT on private school fees and changing the way in which carried interest for private equity firms are taxed' (*LBC*, 7 September 2023, archived).
Additional policy assumptions
The following policy assumptions have been provided by Special Advisors: • Capital Gains Tax (CGT) on Carried Interest (CI) is aligned with Income Tax Rates and taxed as income (in line with the Income Tax rate schedule at 20%, 40% and 45%). • This income should not be treated as employment income, so no National Insurance Contributions are due. • The behavioural response of the affected population should be accounted for by the application of elasticities, which estimate the impact of a tax rate change on the total size of taxable income/gains. • The policy is announced and implemented from April 2024.
Additional technical modelling assumptions or judgements required
CI received by UK tax resident individuals is subject to CGT at rates of 18% (for basic rate taxpayers) and 28% (for higher and additional rate taxpayers) provided it meets certain conditions. CGT treatment is only available where the underlying source of the CI is a chargeable gain (for example, on a disposal of an investment by the underlying fund) and not profits from a trade. In the 2021-22 tax year, CGT was charged on CI gains of around £5bn, with the vast majority of CI recipients being additional rate taxpayers. For this costing, HMRC's latest data on the amount of gains attributable to CI has been grown over the scorecard period using the Office for Budget Responsibility's Autumn Statement 2023 forecast for CGT receipts. When analysing the impact of changes in the rates of tax, elasticities are used to model the behavioural response of taxpayers. The revenue impact of the policy change is first calculated on a 'static' basis, which reflects a scenario in which the tax base remains constant. After this, the application of the elasticities adjusts the result to reflect the anticipated behavioural change (which affects the size of the tax base) in response to the new tax rate. A higher elasticity implies a greater behavioural response across the taxpaying population; in the case of CI, that could be because affected individuals seek to relocate from the UK to other jurisdictions. There is no established standard elasticity for changes to the taxation of CI specifically. In the absence of such an elasticity, standard elasticities typically used to model Income Tax and CGT rate changes

are applied here to provide potential responses, reflecting the high degree of uncertainty. This costing uses the standard elasticity in respect of changes to tax rates on dividend income for additional rate taxpayers [1.4], as well as a midpoint between this and the standard, weighted average elasticity for changes to tax rates on the gains made on a mixture of asset classes that are CGT-liable [3.9].

In moving CI to a full Income Tax schedule, it follows that receipts are collected through the Income Tax Self Assessment regime. Notwithstanding the behavioural impacts captured by the assumptions used, this brings forward the timing of some receipts as compared to under the CGT framework.

Cost/Revenue to the Exchequer over five years

Additional rate dividend behavioural Response estimates:

Total Net revenue post-behavioural costing £m	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**
Step 1: Increased rates (still within CGT)		+100	+100	+100	+200
Step 2: Moving from the CGT framework to the Income Tax framework		+200	+100	+100	+200
Net revenue post-behavioural costing		**+200**	**+100**	**+100**	**+200**

The midpoint elasticity between additional rate dividends and weighted average for gains on all CGT-liable assets estimates:

Total Net revenue post-behavioural costing £m	**2024-25**	**2025-26**	**2026-27**	**2027-28**	**2028-29**
Step 1: Increased rates (still within CGT)		-600	-600	-700	-800
Step 2: Moving from the CGT framework to the Income Tax framework		-900	-700	-800	-900
Net revenue post-behavioural costing		**-900**	**-700**	**-800**	**-900**

Notes:

1. All scorecard costs are presented above as net revenue – that is, they encompass both the static and behavioural effects to show the overall Exchequer impact.
2. Data is presented on a receipts basis, hence no revenue/costs generated in 2024-25.
3. These estimates only capture the impact of the policy change on tax collected specifically in relation to CI. They do not reflect wider impacts in other areas of the tax system – for example, the change in tax collected on the UK consumption and/or other gains and income of relevant individuals.
4. The CI population is both small and internationally mobile. Stated net revenue costs reflect the behavioural responses implied by the application of the elasticities set out above. These behavioural responses are highly uncertain.

Comparison with current system (if applicable):	
Other comments (including other Departments consulted):	
The calculations underpinning these costings were carried out by HMRC's Knowledge Analysis and Intelligence directorate based on the assumptions provided by Special Advisers. Policy officials in both HMRC and HM Treasury have been involved, or otherwise consulted, in the process. Key sources of uncertainty in these costings are: • The forecast for gains subject to CI and therefore the size of the tax base • The behavioural response represented by the elasticities are particularly uncertain. The concentrated nature of the taxpaying population, with around 3,000 individuals in the 2021-22 tax year (most of whom have high levels of income and gains, and can be highly mobile), means that the response of a small number of taxpayers can have material impacts on receipts.	
To be completed by Permanent Secretary's Office Date costing signed off:	26/02/2024
[If applicable] Date revised costing signed off:	