HM Treasury

The Tax Treatment of Carried Interest - Consultation on Qualifying Conditions

Government Response and Policy Update

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ISBN: 978-1-917638-18-0 PU: 3521

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Chapter 1

The Tax Treatment of Carried Interest

Background

1.1 At Autumn Budget 2024, the government announced its proposals to reform the tax treatment of carried interest, a form of performance-related reward received by fund managers, to ensure that the tax regime appropriately reflects the economic characteristics of the reward.

1.2 Following an increase in the applicable rate of Capital Gains Tax to 32%, which took effect from April 2025, a revised tax regime for carried interest will be introduced from April 2026 which sits wholly within the Income Tax framework, with all carried interest treated as trading profits and subject to Income Tax and Class 4 National Insurance Contributions (**NICs**). Taking account of the unique characteristics of the reward, the amount of 'qualifying' carried interest subject to tax will be adjusted by applying a 72.5% multiplier.

1.3 The government published a Summary of Responses and Next Steps document at Autumn Budget, following a call for evidence which ran between 29 July and 30 August 2024. This document outlined how the revised regime will operate and committed to explore points of technical detail with stakeholders through the establishment of a working group.

Consultation on Qualifying Conditions

1.4 The Summary of Responses and Next Steps also launched a consultation, set out in Chapter 4 of that document, exploring the case for further conditions of access (in addition to the existing asset-level average holding period condition) in order for carried interest to be treated as qualifying, specifically:

- A minimum co-investment requirement, measured at team level;
- A minimum time period between a carried interest award and receipt.

1.5 The consultation ran from 30 October 2024 to 31 January 2025 and over 60 responses were received from a range of individuals, businesses, advisory firms, representative bodies and academics. Officials also held several meetings with interested parties. The government is grateful to all those who provided insights during the consultation.

1.6 Chapter 2 of this document summarises the responses received to the consultation and the government's response. Chapter 3 provides an update on the implementation of the revised regime and issues arising from discussions with the technical working group.

1.7 The government will bring forward legislation for the revised tax regime for carried interest, including the detail set out in this document, in Finance Bill 2025-26. Ahead of that, the government will publish draft legislation for technical consultation. Officials will continue to meet with stakeholders, including through the technical working group, to undertake that technical consultation.

Chapter 2

Qualifying Conditions: Summary of Responses and Government Response

Overview

2.1 Chapter 4 of the Summary of Responses and Next Steps published at Autumn Budget 2024 outlined that the government was exploring the case for further conditions of access (in addition to the existing asset-level average holding period condition) in order for carried interest to be treated as qualifying, specifically:

- A minimum co-investment requirement, measured at team level;
- A minimum time period between carried interest award and receipt.

2.2 As set out in the Summary of Responses and Next Steps published at Autumn Budget 2024, the call for evidence conducted between 29 July and 30 August 2024 identified a number of practical challenges associated with implementing a co-investment condition, especially if the requirement was applied on an individual-by-individual basis. It is for that reason that only a requirement measured at the 'team' level was considered via this consultation, with the government stating that it would not proceed with any new condition which risks creating arbitrary or distortive outcomes or which would be unworkable in practice.

2.3 Chapter 4 of the Summary of Responses and Next Steps set out the terms of the consultation and specifically invited input on the following questions:

- Question 1: Recognising the challenges in this area, how might any team-level co-investment requirement be most successfully constructed?
- Question 2: Are there any further risks and/or wider considerations, beyond those identified via the call for evidence, that should inform decisions on whether the government progresses with a co-investment requirement?

- Question 3: How might the length of any new time-based condition best be designed to reflect the nature of carried interest rewards?
- Question 4: Do you foresee any unintended adverse consequences for fund managers in existing funds from a government decision not to introduce transitional arrangements on the introduction of a condition of this kind?

2.4 This Chapter summarises the responses received to these questions and sets out the government's response.

Aggregate minimum co-investment condition

Summary of Responses

2.5 The vast majority of respondents opposed the introduction of a minimum co-investment requirement even if measured at a team level. Respondents said such a requirement would be complex and impractical, making the UK tax regime for carried interest less competitive compared to other jurisdictions and potentially causing distortions in the market.

2.6 Several respondents made the point that fund managers are already expected to co-invest alongside investors to ensure interests of all parties are aligned and that it was therefore not necessary for the government to use tax policy to intervene in the operation of the market. Respondents also queried the conceptual link between a co-investment commitment and carried interest with some suggesting that the government's decision to move carried interest into the Income Tax framework weakened the case for a minimum co-investment requirement.

Q1: Recognising the challenges in this area, how might any team-level co-investment requirement be most successfully constructed?

2.7 Respondents said the rules would need to be drafted broadly so as to reflect the wide variety of structures that are used in practice. In particular, the definition of 'fund' should be wide enough to include contributions made via an aggregator or feeder vehicle, parallel fund or alternative investment vehicle.

2.8 Respondents also focused on the definition of 'team', which they said would need to be wide enough to include indirect commitments made via family, friends or an affiliated entity. Several respondents also argued that commitments made by the 'house' (i.e. one of the vehicles in the fund manager's corporate group) should count towards any requisite co-investment.

Q2: Are there any further risks and/or wider considerations, beyond those identified via the call for evidence, that should inform decisions on whether the government progresses with a co-investment requirement?

2.9 Respondents highlighted a number of wider considerations beyond those identified via the call for evidence. One such consideration was the appropriate threshold for a co-investment requirement. Respondents said this would vary from fund to fund but the prevailing view was that 1% would typically be appropriate although concerns were raised that this would be prohibitive for certain strategies and the largest funds. It was suggested that the threshold for funds above a certain size could be reduced as a way of mitigating this issue.

2.10 Some respondents also made the point that new firms entering the market may lack the available capital to make material co-investments into their first fund, meaning that a co-investment requirement would put such new entrants at a competitive disadvantage. That, in turn, could damage efforts to attract a greater diversity of talent to the industry.

2.11 Respondents also argued for transitional provisions for existing arrangements in the event that this proposal was taken forward. Existing funds structured around current rules could have limited scope to increase co-investment in order to meet the requirement.

Government response

2.12 As acknowledged in the Summary of Responses and Next Steps published at Autumn Budget 2024 and confirmed through subsequent engagement, implementing a minimum co-investment requirement would have a number of practical challenges, with a risk of creating unintended and/or distortive outcomes. Reflecting this, and the conceptual distinction between carried interest and returns on co-investment, the government will not proceed with the introduction of a minimum co-investment requirement.

Minimum holding period for carried interest rights

Summary of responses

2.13 The majority of respondents similarly opposed the introduction of a minimum time period requirement. Again, concerns were raised that it would make the UK less competitive compared to other regimes. The UK already has an asset-level average holding period condition, which requires that the relevant fund holds its assets for at least 40 months, on average, in order to access preferential tax treatment in full. No other carried interest regime has such a condition and a time period requirement measured at individual level.

2.14 Several respondents also suggested that to the extent the government was concerned about carried interest being used as a short-term performance reward, protections already exist in the form of tax charges on awards of carried interest (including the employment related securities (**ERS**) rules). Some respondents suggested that if the government were to introduce a minimum time period requirement, it would need to be combined with reforms to the ERS regime.

Q3: How might the length of any new time-based condition best be designed to reflect the nature of carried interest rewards?

2.15 Respondents said the average time period between reward and receipt varied from fund to fund depending on investment strategy and asset portfolio. The time period could exceed 10 years in venture capital funds but be far shorter in other funds.

2.16 The appropriate time period suggested by respondents varied considerably. Some respondents suggested a time period as short as 12 to 18 months. Others suggested 24 months (to align with Business Asset Disposal Relief rules), 40 months (to align with the existing asset-level average holding period condition) or five years (to align with the most comparable rules in other jurisdictions).

2.17 Various situations were also highlighted where respondents felt special rules would be required:

- 'Deal-by-deal' carried interest models, which can see carried interest arise significantly earlier than on a 'whole of fund' model. The condition could therefore disadvantage deal-by-deal arrangements despite the existence of clawback provisions meaning that overall economics of the two models were similar;
- Fund managers who join or leave their firm part way through the life of a fund would also be at risk of being negatively impacted because their holding period would naturally be shorter than individuals who are in place for the life of the fund;
- A similar point could arise for individuals who receive incremental awards throughout a fund's life, with some respondents suggesting it would be very difficult in practice to track which carried interest receipt related to which incremental award.

2.18 Most respondents felt that unless specific provision was made for such situations (which would add complexity) individuals would be unfairly excluded from qualifying carried interest treatment.

2.19 Several respondents also argued that if a minimum time period requirement was introduced, it would be possible to satisfy the requirement by holding back carried interest in a blocked or escrow account until the minimum time period has elapsed.

Q4: Do you foresee any unintended adverse consequences for fund managers in existing funds from a government decision not to introduce transitional arrangements on the introduction of a condition of this kind?

2.20 Many respondents argued that transitional arrangements would be required if a condition of this kind was introduced. It was suggested that not doing so would adversely affect existing funds established when the current rules were in place, which may have structured their arrangements differently had they been aware of the requirement.

Government response

2.21 As set out in the Summary of Responses and Next Steps published at Autumn Budget 2024, the tax treatment of qualifying carried interest under the revised regime reflects its unique characteristics. This includes the long-term nature of the reward, with a typically lengthy period between award and payout. The purpose of a minimum time period requirement would be to ensure that only rewards of a genuine long-term nature can access qualifying carried interest treatment.

2.22 Having carefully considered responses to the consultation, the government has concluded that the existing asset-level average holding period condition, combined with the tax rules which apply to awards of carried interest, are effective in limiting qualifying carried interest treatment to long-term rewards. As a result, the government considers that the complexity associated with a minimum time period requirement would not be proportionate and will not be proceeding with its introduction.

Chapter 3

Update on the Implementation of the Revised Tax Regime for Carried Interest

3.1 In the Summary of Responses and Next Steps document published at Autumn Budget 2024, the government recognised the complexity of legislation in this area and the need for detailed technical consultation as the revised regime is implemented. The government committed to establishing a technical working group for this purpose.

3.2 Over 50 businesses, advisory firms, and representative bodies have joined the working group, which has met on several occasions to discuss various aspects of the revised regime. The government is grateful to all members of the working group who have contributed their time and expertise. The working group will continue to serve a valuable function in the run-up to the introduction of the measure in April 2026 as the government finalises the details of the revised regime.

3.3 This Chapter sets out the government response to some of the issues raised through the working group and other discussions with stakeholders, as well as outlining the next steps in the implementation of the revised regime.

Average holding period condition

3.4 As announced at Autumn Budget 2024, the government will legislate to remove the exclusion for ERS from the asset-level average holding period (**AHP**) condition currently contained in Chapter 5F, Part 13 of the Income Tax Act 2007[1], ensuring that the rules apply fairly to all fund managers who receive carried interest under the revised regime.

3.5 In addition to the removal of the ERS exclusion, the government committed at Autumn Budget 2024 to make targeted amendments to the AHP condition to ensure it operates effectively. The government recognised that some funds, in particular private credit funds, faced practical difficulties in applying the AHP condition to their investment

[1] While these rules are currently referred to as the 'income-based carried interest' (IBCI) rules, given that all carried interest will be taxed under the Income Tax framework from April 2026, to avoid confusion they are referred to in this Chapter 3 as the AHP condition.

strategy despite in substance carrying out a long-term investment strategy.

3.6 The government is grateful for the extensive input on these matters from a range of stakeholders. Those discussions have brought to light a range of areas where amendments to the AHP condition can be made to improve its operation without undermining the core purpose of the rules, which is to exclude funds which do not carry on a long-term investment strategy.

3.7 The government therefore intends to make a number of legislative changes to the AHP condition, including the following (with statutory references being references to the current legislation in Income Tax Act 2007):

- Remove the rule in section 809FZQ which treats carried interest arising from a direct lending fund as automatically failing the AHP condition unless it falls within the narrowly drawn exemption in section 809FZR, which the government has concluded is unnecessarily restrictive and does not reflect the range of investment strategies in the market;

- Introduce a new bespoke provision for all types of credit fund, modelled on those for other fund strategies, which makes the rules more straightforward to apply and better reflects commercial reality by deeming debt investments to be made and disposed of at a specific time (so-called 'T1/T2' rules);

- Remove the specific provision for loan to own strategies at section 809FZV, which will be made redundant by the new T1/T2 rules for all types of credit fund;

- Replace the existing T1/T2 rules for fund of funds and secondary funds (at sections 809FZO and 809FZP respectively) with a single provision which covers both investment strategies, with the gateway to those rules being amended to better reflect commercial practice and the mechanics of the T1/T2 rules streamlined to ensure they are straightforward to apply;

- Amend the existing rules in section 809FZF for unwanted short-term investments so that they apply to a wider range of commercial scenarios in which a fund might dispose of an asset very shortly after acquiring it, including in relation to loan syndications and bundles of assets acquired by secondary funds;

- Address various technical issues, including application of the scheme director condition (section 809FZK) and the treatment of tax distributions (distributions made by funds so that fund managers can manage tax liabilities which arise prior to carried interest actually being received).

3.8 Taken as a whole, this package of amendments is intended to ensure that the AHP condition operates fairly and does not create arbitrary or distortive outcomes in respect of particular investment strategies. They do so while retaining core features of the AHP condition, including the mechanics for calculating the average holding period and the concept of conditionally exempt carried interest, which will continue to be of central importance in ensuring that access to qualifying carried interest treatment in the revised regime is appropriately limited.

Territorial scope of the revised regime

3.9 The Summary of Responses and Next Steps document published at Autumn Budget 2024 explained that the deemed trade under the revised regime will be treated as carried on in the UK to the extent that the relevant investment management services are performed in the UK, with the effect that non-UK residents will be subject to Income Tax on carried interest to the extent that it relates to services performed in the UK (subject to the terms of any applicable double tax agreement).

3.10 The territorial scope of the revised regime reflects an important principle. The government is clear that carried interest is, in substance, a reward for the provision of investment management services. It follows that where those services are performed in the UK, the reward should be taxed in the UK. In particular, the government is not willing to maintain a position in which a fund manager can spend many years working in the UK, only to become non-resident shortly prior to receiving carried interest and thereby not be subject to UK tax on the reward.

3.11 Stakeholders who have engaged with the government since the announcement at Autumn Budget 2024 recognise that it is appropriate for the government to ensure that work which takes place in the UK is taxed fairly. However, stakeholders have also raised a range of concerns about how the territorial scope of the revised regime will work in practice, in particular whether there is a risk of double taxation where a non-UK resident is taxed on carried interest both in their jurisdiction of residence and the UK.

3.12 The UK has an extensive network of double taxation agreements (**DTAs**). The government's view is that a typical DTA will allocate taxing rights to the UK in respect of carried interest received by a non-resident which is attributable to a UK permanent establishment[2]. This reflects the fact that carried interest is, in substance, a reward for the provision of investment management services. The UK's domestic legislation will reflect this fact.

3.13 The government recognises, however, that there may be uncertainties relating to other jurisdictions' approach to the application of DTAs, in particular in cases where carried interest is treated as an

2 Under the provision of the DTA which relates to business profits, which is typically Article 7.

investment return under another jurisdiction's domestic law. Although there are established mechanisms to resolve international tax disputes, the government acknowledges that the potential need to rely on such processes creates uncertainty, which in turn risks discouraging fund managers from choosing to work in the UK.

3.14 In recognition of this uncertainty, the government intends to introduce three statutory limitations on the territorial scope of the revised regime. These limitations will ensure that the territorial scope of the revised regime applies in a proportionate way, balancing the government's dual aims of ensuring that the rewards for work which takes place in the UK are fairly taxed and maintaining the UK's attractiveness as an international hub for asset management activity.

3.15 The statutory limitations, which will apply where qualifying carried interest arises to a non-resident, are as follows:

- In order to provide proportionate transitional rules, any services performed in the UK prior to Autumn Budget 2024 (30 October 2024) will be treated as if they were non-UK services;

- Any UK services performed in a tax year in which an individual is neither UK tax resident nor meets a new UK workday threshold will be treated as if they are non-UK services. The UK workday threshold will be met if an individual who is not UK tax resident spends at least 60 workdays in the UK in the relevant tax year;

- Any UK services performed in a tax year will also be treated as if they were non-UK services if three full tax years (in addition to the then current tax year) have passed during which time the individual was neither UK tax resident nor met the UK workday threshold.

3.16 These statutory limitations will apply as a matter of UK domestic law and will be in addition to any relief available under an applicable DTA (for example, where the relevant individual does not have a UK permanent establishment, which will be a question of fact in each case).

3.17 The government also intends to provide clarity on how carried interest is apportioned between investment management services performed in the UK and those performed outside the UK. In order to provide certainty for taxpayers, as well as enable HMRC to effectively monitor compliance, the government will mandate a time-based apportionment method, by reference to the number of UK workdays in the relevant period.

3.18 As a consequence of the provisions set out in paragraphs 3.15 to 3.17 above, qualifying carried interest which arises to a non-resident will only be subject to UK tax where it relates to services performed in the UK (determined by reference to the number of UK workdays) and all of the following apply:

- The UK services were performed within the previous three tax years;
- The UK services were performed in a tax year in which the individual was UK tax resident or met the UK workday threshold;
- Where there is an applicable DTA, the UK services are attributable to a UK permanent establishment of the relevant individual.

3.19 The government considers that this strikes an appropriate balance between ensuring work carried out in the UK is fairly taxed while preserving the UK's competitive position as a global asset management hub. Moreover, our approach will place the tax treatment of carried interest on a stable footing for the long term. The government will continue to work with stakeholders on technical aspects as it implements these aspects of the revised regime, including further detailed discussions on HMRC's approach to the application of DTAs.

Update on Other Issues

3.20 Through the technical working group and other meetings with stakeholders a wide range of detailed issues relating to the implementation of the revised regime have been considered. Many of those issues will be addressed in the draft legislation for the revised regime and the government looks forward to further engagement with stakeholders following publication of the draft clauses.

3.21 One particular issue raised by several respondents relates to the payments on account rules in section 59 of the Taxes Management Act 1970. Payments on account due under these provisions are calculated by reference to a person's total Income Tax and Class 4 NICs liability for the previous tax year. The government can confirm that under the revised regime Income Tax and Class 4 NICs paid in the previous tax year on carried interest will be relevant to the calculation of any payments on account due. While the government recognises that carried interest receipts can be irregular and unpredictable in nature, the same is true of other forms of trading profit. There is a mechanism for taxpayers to make a claim to reduce or cancel payments on account to avoid overpayments of tax.

Next Steps

3.22 The government will bring forward legislation for the revised tax regime for carried interest in Finance Bill 2025-26. Before the Summer Recess, the government will publish draft legislation for technical consultation. Officials will continue to meet with stakeholders, including through the technical working group, in order to undertake that technical consultation.

Annex A
List of Respondents

7percent Ventures
Accel
Addleshaw Goddard
Alternative Investment Management Association and Alternative Credit Council (joint response)
Alvarez & Marsal
Ansor LLP
Antin Infrastructure Partners
Apax
Apposite Capital LLP
Arcmont Asset Management
Ashurst LLP
BDO LLP
BGF
Blackstone
British Private Equity and Venture Capital Association
Centre for the Analysis of Taxation
Clayton, Dubilier & Rice LLP
Charterhouse Capital Partners LLP
Cinven
CMS Cameron McKenna Nabarro Olswang LLP
CVC Secondary Partners
Dawn Capital LLP
Dechert LLP
Deloitte LLP
DLA Piper International LLP
ECI Partners LLP
EQT Group
Evelyn Partners
Eversheds Sutherland (International) LLP
Ernst & Young LLP
Founders Forum Group
Fried, Frank, Harris, Shriver & Jacobson (London) LLP
Grant Thornton UK LLP
Gresham House
HgCapital Trust plc
HgCapital
Institute of Chartered Accountants in England and Wales
Johnston Carmichael LLP
Kohlberg Kravis Roberts & Co Partners LLP
KPMG LLP
Macfarlanes LLP
Managed Funds Association
MM&K
Osborne Clarke LLP

Permira Advisors LLP
Proskauer Rose (UK) LLP
PricewaterhouseCoopers LLP
Ropes & Gray International LLP
RSM UK Tax and Accounting Limited
Saffery LLP
Schulte Roth & Zabel International LLP
Sidley Austin LLP
Simmons & Simmons LLP
Simpson Thatcher & Bartlett LLP
Squire Patton Boggs LLP
Startup Coalition
Travers Smith LLP
Welwin Lobo
White & Case LLP

A number of representations were also provided in a personal capacity.

HM Treasury contacts

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