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UK Government Carried Interest Tax Reforms Consultation Process: No New Conditions, Territorial Limits Clarified

Tax Talks on **June 12, 2025**

June 2025 – The UK Government has published its response to the consultation on its proposal to change the tax treatment of carried interest, confirming the expected final shape of the new regime which will take effect from April 2026.

The reforms, first announced in October 2024, mark a significant shift in how carried interest is taxed in the UK. From April 2026, carried interest will be fully brought within the income tax regime and taxed as self-employed trading income. However, in recognition of its “unique characteristics”, as sitting somewhere between pure trading income and investment return, only 72.5% of the qualifying carried interest received will be subject to tax, giving an effective rate of 34.1% (assuming the 72.5% is applied to the current top rates of income tax of 45% and self-employed Class 4 national insurance contributions of 2%).

Background: The Current Regime and the October 2024 Announcements

Currently, carried interest which is not “income-based carried interest” is subject to tax under the capital gains tax regime but with a special rate of 32% (28% prior to April 2025), rather than the standard 24%, applying to it. Income-based carried interest is taxed as trading income in its entirety, but, due to an exclusion for carried interest holders within the employment-related securities regime, only certain carried interest holders are currently subject to the income-based carried interest rules. This exclusion for employment-related securities holders is to be removed.

,The new regime from April 2026, first announced in October 2024, would tax all carried interest as trading income but with the 72.5% multiplier applying to “qualifying carried interest”.

In the October 2024 announcements, the Government stated that income-based carried interest would not be qualifying carried interest and that the income-based carried interest rules would be extended to apply to all carried interest holders, including carried interest holders within the employment-related securities regime.

In addition, the Government considered applying two other requirements for carried interest to be treated as qualifying carried interest, being that the carried interest holder also made a minimum co-investment (the “co-investment condition”) and that the carried interest holder held their carried interest for a minimum time before the carried interest arose to them (the “minimum individual hold condition”).

In another important aspect of the October 2024 announcements, it was acknowledged that moving carried interest from the capital gains regime to the trading income regime would result in non-UK residents coming within the scope of UK tax on their carried interest to the extent that they carried out work in the UK (and subject to any relief from UK tax that might apply to them under any applicable double tax agreement (DTA)).

For further detail on the initial announcement please see our Tax Talks Blog from November 2024.

Overview of the Key June 2025 Announcements

Following significant consultation and responses from across the private fund industry, the Government confirmed on 5 June 2025 that no additional qualifying conditions will be introduced – there will be no co-investment condition or minimum individual hold condition.

The sole requirement for the carried interest to be “qualifying” and benefit from the 72.5% multiplier will be that the carried interest is not income-based carried interest. In short, income-based carried interest is carried interest from a fund with an average asset holding period of less than 36 months, with a tapering applying for average holding period of between 36 and 40 months.

In addition to this, the territorial scope of the regime will be limited through statutory limitations to reduce the impact on non-UK resident individuals who carry out some work related to their carried interest in the UK or on those who were UK tax resident at some point during the life of the fund from which the carried interest is derived.

These statutory limitations (which may be thought of as safe harbours) on the scope of UK tax on non-UK residents' carried interest, are stated to be:

- no work carried out before 30 October 2024 (the date on which the changes were first announced) will be treated as performed in the UK when working out what proportion of carried interest is taxable in the UK (related to work in the UK) and what proportion is not (related to work outside the UK);
- provided that an individual is both non-UK resident for a tax year and carries out work in the UK on fewer than 60 days in the tax year then the individual will be treated as carrying on no work in the UK for that year for the purposes of this apportionment. This will allow people to carry out some work in the UK without risking UK tax on their carried interest; and
- the individual will cease to be subject to UK tax on any carried interest arising in a tax year if the individual was non-UK resident and worked in the UK on fewer than 60 days for each of the prior three tax years. This will mean that UK tax ceases to apply to any carried interest arising a reasonable time after the individual ceases to have relevant links to the UK.

These statutory limitations are welcome news. However, for the purposes of both of the 60 day safe harbours, non-UK resident carried interest holders will need to keep accessible, clear and comprehensive records of time spent and work done in the UK, in case of HMRC enquiry.

In addition to these limitations, for non-UK residents who are resident in a UK DTA jurisdiction, that DTA may result in them only being subject to UK tax on carried interest that can be attributable to a permanent establishment they have in the UK (for the purpose of the DTA). However, the three new statutory limitations should mean far fewer carried interest holders having to rely on relief under a DTA in this way.

In addition, it has been confirmed that carried interest will fall within the payments on account regime that applies to trading income despite industry concerns about the unpredictability of carried interest receipts. This will add some degree of compliance complexity to tax reporting and payment for carried interest recipients, and it is expected that stakeholders will continue to press for a more appropriate outcome on this point.

These decisions reflect the Government's stated aim to strike a balance between fair taxation of UK-based work and maintaining the UK's competitiveness as a global asset management hub. Whether or not the new rules do strike this balance will be seen once the full details of the new rules are understood and applied, but these announcements can generally be considered as an encouraging development.

The Government has also announced that, in light of the removal of the exclusion for carried interest holders within the employment-related securities regime from the income-based carried interest rules and following technical consultation with stakeholders, it will propose changes and improvements to the income-based carried interest rules (referred to as the asset holding period or AHP condition in the response document) and how the fund's average asset holding period is calculated in certain cases.

No Additional Conditions: A Welcome Outcome

As stated above, the Government has decided not to proceed with either of the two additional qualifying conditions it had consulted on:

- a team-level co-investment requirement; or
- a minimum period between award and receipt of carried interest.

This decision follows strong industry opposition. Over 60% of respondents to a member survey conducted by industry bodies said that a co-investment requirement would significantly harm their firm, and over 70% opposed a new holding period. Respondents argued that such conditions would introduce complexity, reduce competitiveness, and unfairly penalise certain fund structures.

The Government acknowledged these concerns. In particular, it agreed that the existing asset-level average holding period condition (currently within the income-based carried interest rules which will be applied to all holders of carried interest as part of the new regime), essentially requiring a 40-month average holding period to obtain preferential tax treatment, already ensures that only long-term rewards benefit from preferential treatment.

This is a welcome response by the Government and aligns with the desire that the new regime is as clear and simple to apply as possible to give industry participants certainty around the tax treatment of carried interest.

Territorial Scope: Statutory Limitations Introduced

The Government has reaffirmed that non-UK residents will be taxed on carried interest to the extent it relates to services performed in the UK. However, in response to industry feedback, it has introduced the three statutory limitations referred to above with the intention of reducing the risk of double taxation and improving the practical operation of the regime.

These three limitations are welcomed and are generally expected to materially restrict the situations when non-UK residents find themselves subject to the UK carried interest tax rules. Nevertheless, while the limitations are intended to provide clarity and proportionality, some technical complexity remains and the extent of such issues may not be fully clear until draft legislation has been published.

In addition, the Government has committed to further engagement on how these rules interact with DTAs where it is expected that there might well be difficulties in aligning the UK treatment of carried interest as attributed to a UK business (or permanent establishment) and the individual's primary residence treating it as an investment return, and this will be an area of scrutiny as the new regime is introduced.

On a related note, for those UK residents who are also US taxpayers, the interaction of the new UK regime and the US regime might result in particular complications and their overall position will have to be considered carefully once the draft rules are published.

Technical Reforms to the Average Holding Period Condition

The Government also announced a series of technical amendments to the AHP condition to ensure that it operates appropriately across different fund strategies, particularly for private credit funds, secondaries and fund of funds, and achieves its intended goal of excluding funds that do not have a long-term investment strategy. These changes include:

- removing existing restrictive rules for direct lending funds;
- introducing new rules for credit funds, which are intended to apply to all types of credit funds and to deem debt investments to be made and disposed of at specific times (known as the "T1/T2" rules);
- streamlining and consolidating rules for fund of funds and secondaries funds, including a new gateway which is intended to better reflect commercial reality; and

- expanding exceptions for “unwanted short term investments”, including in relation to loan syndications and bundles of assets acquired by secondaries funds.

The Government has indicated that these changes are designed to avoid arbitrary or disproportionate outcomes and reflect the growing number of individuals and funds that will be subject to the revised regime from April 2026 as a result of the removal of the employment-related securities exclusion from the rules. As we noted previously in our November article, the existing rules raise some technical complexities when seeking to apply them in practice. The extent to which these proposals will resolve existing uncertainties and deficiencies in the AHP condition will not be clear until draft legislation is available, expected before the end of July.

Payments on Account: No Exemption for Carried Interest

Despite industry calls for an exemption, the Government has confirmed that carried interest will fall within the payments on account regime as a consequence of it coming into the trading income tax framework. In broad terms, this means that tax payments on account of each year’s tax will be based on the previous year’s liability, even though carried interest is often irregular and unpredictable. It should be possible, however, to reduce those payments if it is known that the relevant tax year’s income will be materially less than the previous year’s because no carried interest is expected.

While the Government has acknowledged industry concerns on this point, it argues that other forms of income are similarly unpredictable and that existing mechanisms allow taxpayers to reduce or cancel payment on account amounts to avoid overpayment.

Looking Ahead

Draft legislation is to be published for technical consultation before the parliamentary summer recess (so, expected during July), with final legislation to follow in the Finance Bill 2025–26. The Government has reiterated its commitment to ongoing engagement with stakeholders through its technical working group.

While the outcome is not perfect, and there will no doubt be some concerns left around double tax and aligning double tax relief and the application of DTAs, the Government’s response reflects a pragmatic approach that addresses many of the industry’s concerns.

The decision not to introduce new qualifying conditions and the introduction of territorial limitations are particularly welcome and signal a desire to place the tax treatment of carried interest on a stable and internationally competitive footing.

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