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Carried Interest: UK Tax Update

06 June 2025

On 5 June 2025, HM Treasury (HMT) published its latest update on UK carried interest tax. The paper is available here.

HMT has been consulting on proposals for a revised carried interest tax regime, intended to take effect from April 2026. In brief, the new regime taxes carried interest as UK trading income but creates a class of qualifying carried interest that benefits from a lower rate of tax than normal trading income.

The new paper addresses many stakeholder concerns on the original proposals. It also sets out clear next steps and a timeline for draft legislation (before the start of Parliament’s summer recess: 22 July 2025).

Key headlines are summarised below.

Holding period and co-investment conditions

The government had proposed two conditions to the new qualifying carry regime: (a) a minimum holding period between award and receipt; and (b) a minimum co-investment requirement. Both of these potential conditions have been dropped.

Territorial scope

Taxing carry as trading income means that the UK will exert extra-territorial taxing rights. This has been concerning for those who undertake short-term business visits to the UK and also for those who may leave (or who have already left) the UK, in particular because the application of double tax treaties is not entirely clear.

To reduce the uncertainty (and the need to use international tax dispute resolution mechanisms), three statutory limitations have been proposed by HMT to the regime's territorial scope.

Qualifying carried interest arising to a nonresident will be subject to UK tax only where it relates to services performed in the UK and certain conditions are met. In broad terms:

- any services performed in the UK prior to 30 October 2024 will be treated as non-UK services;
- services performed in the UK by a non-UK resident will be treated as UK services only where the individual meets a new UK workday threshold of 60 or more workdays in the UK in that tax year; and
- any UK services performed in a tax year will be treated as non-UK services once three full tax years (in addition to the then current tax year) have passed in which the individual was neither a UK tax resident nor met the 60-day UK workday threshold.

These amendments should be seen as positive developments and represent positive engagement by the government with stakeholders.

The paper also confirms that apportionment between UK and non-UK carry will be done on a day-count basis. This is a change from the existing approach, which allows for a more qualitative assessment to be made.

Income-based carried interest rules

The income-based carried interest (IBCI) rules recharacterise carry as "bad" or non-qualifying carry where the average holding period of a fund's investments is less than 40 months. HMT have previously announced the removal of the exemption from these rules of carried interest that constitutes an employment-related security (such that these rules will be of wider application). A key focus of the consultation has been to remedy deficiencies in the existing regime, given that it will apply more broadly.

In an update to this aspect of the consultation, several changes have been confirmed to these rules. They appear to clarify the position for certain investment strategies (credit and secondaries/fund of funds in particular), although the detail in the forthcoming draft legislation will be key. Changes include:

- removing the assumption that direct lending funds automatically fail the asset-level average holding period condition;
- introducing a new regime for credit funds that takes a more commercial approach to when investments are made and disposed of;
- revising the existing rules for fund of funds and secondary funds to better reflect commercial practice and make the rules more straightforward to apply;
- amending the rules around short-term unwanted investments to provide for a wider range of commercial scenarios; and
- addressing technical difficulties that exist at present with the scheme director condition and the treatment of tax distributions. These final points are interesting as these are areas where the rules are unclear at present and as such have caused uncertainty for taxpayers given the lack of guidance.

Payments on account

HMT confirmed that the payment on account rules will capture carried interest. Although stakeholders highlighted the distortions that this could create, the paper highlights that "there is a mechanism for taxpayers to make a claim to reduce or cancel payments on account to avoid overpayment of tax."

Other aspects

Other aspects of the proposed regime remain unchanged. Qualifying carried interest is still intended to be subject to income tax and Class 4 National Insurance contributions (after applying a 72.5% multiplier), giving an effective tax rate of 34.1%. All other carried interest will be taxed as disguised investment management fees, giving an effective tax rate of 47%.

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- 06 June 2025 Press Release Kirkland Advises Copenhagen Infrastructure Partners on Strategic Carbon Capture Joint Venture with BKV

- 05 June 2025 Press Release Kirkland Advises BC Partners on Investment in IGS GeboJagema