Forsters

Tax

Changes to Carried Interest

UK Autumn Budget 2024

The headlines

Holders of Carried Interest will be relieved that in the Budget it has been announced that the rate of CGT applying to Carried Interest (as it arises) will increase from 28% to 32% but not immediately; only on or after 6 April 2025. The decision not to impose an even higher rate will have been influenced by the extensive lobbying which has been taking place to persuade the Government that, if that were to be done, private equity managers would move to favourable jurisdictions such as France, Italy and the Middle East.

However, this 32% rate will only remain in place until the Government has implemented a wider reform package in April 2026. The Government had already sought views on how Carried Interest should be taxed and this call for evidence closed on 30 August 2024.

Now a Budget document has been published which sets out Government thinking, and they will be consulting further on this until 31 January 2025.

The new proposal

The proposal is that a revised Carried Interest tax regime will apply which will sit wholly within the income tax (rather than the CGT) regime. Carried Interest will be treated as trading profits, subject to income tax and Class 4 NICs. The amount of "qualifying" Carried Interest (explained further below) subject to tax will be adjusted by applying a 72.5% multiplier.

The tax charge applying under the new Carried Interest regime will be an exclusive charge. Under the existing regime, Carried Interest has been taxed according to the nature of the relevant amount coming up from the underlying fund/ its assets. So, for example, amounts representing interest income would have been taxed as interest income; under the proposed regime all amounts will be taxed as deemed trading income.

IBCI

Income Based Carried Interest (IBCI) is already taxed as income, but the IBCI regime has not applied to employment related securities so employees/ directors who have made what is known as section 431 elections have been able to keep outside the IBCI regime. The Government now proposes that the IBCI rules will be amended so that employment related securities are not excluded from it. This will be a significant change as, previously, the IBCI regime has distinguished between the self- employed and the employed.

Carried Interest within the IBCI regime will not be "qualifying" Carried Interest. The Government is also now going to consult as to what other conditions need to be satisfied to fall within the "qualifying" category. In particular, there may be a minimum co-investment requirement and/ or a minimum time period between a Carried Interest award and receipt. These new conditions to determine whether Carried Interest is "qualifying" will be added to the existing IBCI legislation.

DIMF

The existing Disguised Investment Management Fee (DIMF) rules will remain in place.

Non–residents and Carried Interest

The deemed trade under the revised regime will be treated as carried on in the UK to the extent that the investment management services in relation to which the Carried Interest arose were performed in the UK, and outside the UK to the extent that the investment management services were performed outside the UK. As a result, 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). This is the same as the approach in the DIMF rules.

What now?

Draft legislation is going to be published during 2025. In the meantime, we and other interested stakeholders will be working to seek to ensure that the proposals put forward by the Government can be implemented in a way which does not result in those involved in the fund management industry leaving the UK for another jurisdiction which they regard as having more favourable rules.

Contact us

Please get in touch with your usual Forsters contact to find out more or contact enquiries@forsters.co.uk.

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