



HMRC Publishes Draft Legislation for New UK Carried Interest Tax Regime

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Background

On July 21, 2025, HM Revenue and Customs (HMRC) published the long-awaited draft legislation (Draft Legislation) for the new UK carried interest tax regime (New Regime) that will apply from April 6, 2026. Under the New Regime, carried interest that would previously have been taxed as capital gain will instead be treated as trading income and subject to income tax and Class 4 National Insurance contributions (NIC) for any carried interest arising from that date.

The Draft Legislation was introduced following a long period of consultation between HMRC, HM Treasury and industry. Publication of the Draft Legislation marks the start of an eight-week technical consultation on the legislation, running until September 15, 2025. The purpose of the technical consultation is to resolve any drafting inconsistencies or other necessary amendments for the legislation to work as intended; the commercial principles underlying the new carried interest taxation are now effectively set.

Who is likely to be affected

The New Regime will impact individuals who receive carried interest, where either the individual is a UK tax resident at the time of receipt or the carried interest relates to investment management services performed in the United Kingdom by a non-UK resident where the individual meets certain conditions. There is no grandfathering under the New Regime for carried interest awarded prior to April 6, 2026, so from that date, capital gains treatment for carried interest receipts is simply no longer available.

Main features of the new regime

In line with the current carried interest tax regime, the New Regime applies where an individual performs investment management services directly or indirectly in respect of an investment scheme (i.e., an Alternative Investment Fund or a collective investment scheme —see further below) under

any arrangements and a sum of carried interest arises to the individual under those arrangements. As stated above, the Draft Legislation provides that the individual is treated as carrying on a trade, and carried interest (less any permitted deductions) is treated as the profits of that trade.

The principal division of carried interest taxation into two tax regimes is retained: carried interest that does not satisfy the 40-month investment portfolio holding requirement — previously income-based carried interest and now termed "Non-Qualifying Carried Interest" under the Draft Legislation — remains subject to full income tax and NIC. Carried interest that does meet the 40 months portfolio holding period and other applicable conditions will be classified as "Qualifying Carried Interest" subject to a special rate of tax: the new legislation will provide that carried interest (subject to limited permitted deductions) is treated as trading profits for tax purposes but Qualifying Carried Interest (less deductions) is subject to a multiplier of 72.5 percent, whereas Non-Qualifying Carried Interest is not. Under the current highest income tax rate of 45 percent and NIC of 2 percent, the 72.5 percent multiplier would result in an effective 34.1 percent combined tax and NIC rate for Qualifying Carried Interest (less permitted deductions).

The Draft Legislation includes detailed provisions for determining the average holding period of an investment scheme and has specific provisions relating to the time of acquisition of various types of investment, which are similar to the provisions in the current income-based carried interest rules in the disguised investment management fee legislation. The main change is that the Draft Legislation treats credit funds generally in the same way as other funds.

Under the Draft Legislation, the definition of carried interest remains based on characteristics (very broadly, considering the priority waterfalls of payment for investors and circumstances under which carried interest holders are permitted to participate). However, the scope of "investment schemes" has been expanded to include Alternative Investment Funds (AIFs), i.e., non-retail investment funds established as corporate entities and that qualify as "Alternative Investment Funds" for the purposes of the Alternative Investment Fund Managers Regulations 2013. The definition was previously limited to investment funds defined as collective investment schemes under section 235 of the Financial Services and Markets Act 2000 — which applied to most investment schemes but had a specific exclusion for closed-ended corporate funds. A driving factor behind the expansion to include AIFs is the availability of the lower carried interest tax rate for such corporate arrangements; however, the corporate inclusion is not necessarily positive for all arrangements.

A further change is the introduction of the asset-level average holding period for employment-related securities from April 6, 2026; employment-related securities are excluded from current income-based carried interest rules but will be included within the Non-Qualifying Carried Interest rules under the New Regime.

Exclusive regime and double taxation

Generally, carried interest will only be chargeable to income tax under the New Regime and not subject to income tax under any other provisions. However, if a tax charge arises in respect of carried interest under section 62 (earnings) or Part 7 (employment income related to securities) of the Income Tax (Earnings and Pensions) Act 2003, that income tax charge will still stand, but the individual may make a claim for the carried interest charge under the New Regime to be adjusted to prevent double taxation. The relief given is that which is "just and reasonable," rather than pound for pound. The New Regime does not, however, deliver an "exclusive regime" as was originally proposed. Double tax relief is similarly available where UK tax has been charged on another person in relation to the same carried interest. However, there is no express double tax relief in respect of non-UK tax, but double tax treaty relief may be available, depending on the terms of the treaty. The election to charge carried interest to tax as it arises, rather than when received under the current regime, is also included in the Draft Legislation under the New Regime to allow individuals who are taxable on carried interest in the United Kingdom and another jurisdiction to align the timing of the tax charges in order to facilitate double tax treaty claims. As carried interest will be trading profits under the New Regime, the relevant treaty article is likely to be the business profits article, but that may not align with the other jurisdiction's treatment of carried interest. Therefore, the ability to claim double tax treaty relief is uncertain under the New Regime.

As described above, the New Regime retains a significant number of principal features that were present in the current legislation. The Draft Legislation also sets out the circumstances in which carried interest is deemed to arise to an individual where it actually arises to another person — which are equivalent to the current rules under the disguised investment management fee regime. In addition, numerous anti-avoidance provisions will still apply where arrangements are entered into in order to fall within certain provisions of the regime.

HMRC concessions

The Draft Legislation also reflects the Government concessions made in the policy update from June 5, 2025, on the carried interest tax reform, which were the subject of prolonged discussion between HM Treasury and industry and ultimately accepted as too difficult to introduce. Specifically:

- There will no minimum co-investment requirement or minimum carried interest holding period condition.
- The geographical scope of the New Regime has been reduced, so that UK investment management services performed by a non-resident individual in a tax year do not give rise to UK tax where such services do not exceed 60 UK working days (broadly defined as three hours of work performed in the United Kingdom on a given day).

- UK resident individuals leaving the United Kingdom will not be subject to UK tax on their carried interest payment if three full tax years (in addition to the current tax year) have passed, during which the individual was neither UK tax resident nor met the above 60 UK workday threshold.

Conclusion

The Draft Legislation is clearly set out, although there are likely to be some technical changes following the consultation period. It also clarifies certain areas that are uncertain under the current legislation. The Government's June climbdown on aspects, including abandoning the requirement for managers to pay for their carried interest award and foregoing a minimum carried interest holding period at manager level, removed some of the key sticking points.

Going forward, it will be simpler for taxpayers under the New Regime to apply the rules for carried interest, as it will be solely within the income tax regime rather than split between capital gains tax and income tax as it is currently (assuming that in either case, the tax rate for carried interest would have been set at the same level regardless of which tax regime applies).

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