

UK Carry Tax: All Change

31 July 2024

Reforming carried interest taxation was a theme that stood strong throughout Labour's election campaign. It therefore surprised no one when, earlier this week, the Treasury published a [Call for Evidence](#) on the tax treatment of carried interest.

What is a Call for Evidence?

The Government has been clear that it will consult on any reform to carried interest taxation before implementation. A Call for Evidence is one method of doing so; it is essentially an invitation to anyone interested to engage in the process of legislative reform. Such engagement can take place via meetings with the Treasury team and/or through the submission of written representations.

The Call for Evidence is drafted broadly, containing three specific questions (although, all relevant input is apparently welcome).

“ Question 1: How can the tax treatment of carried interest most appropriately reflect its economic characteristics? The government notes that there are a range of circumstances in which carried interest is received, and that the characteristics of the reward will not be the same in all cases.

Question 2: What are the different structures and market practices with respect to carried interest? The government is particularly interested to understand how these differences should be taken into account as part of its

reforms.

Question 3: Are there lessons that can be learned from approaches taken in other countries? While many other countries have specific regimes for the taxation of carried interest.”

What happens next?

- The Call for Evidence closes on 30 August. Following this the Treasury will work with the Government in formulating the new carried interest policy, which will be announced at the Budget on 30th October. It is currently unclear whether new rules will take effect from this date or a future date. However, based on comments made in the policy document about non-dom reform (see below) we anticipate that legislation will be made available for comment prior to its coming into force:

“ As part of the legislative process, the government values external comment and scrutiny and wants to ensure that interested parties have an opportunity to share views and feedback on the detail of legislative provisions. To assist in obtaining technical comments on the draft legislative provisions, the government will share plans to engage on gov.uk in due course.” (Policy paper, Changes to the taxation of non-UK domiciled individuals, Published 29 July 2024).

What should we expect?

- The broad nature of the Call for Evidence means that it doesn't provide any information beyond what has already been announced. The key statements made to date are in the Labour Party's manifesto, in which Labour stated that "[p]rivate

equity is the only industry where performance-related pay is treated as capital gains. Labour will close this loophole.”

- The fiscal plan accompanying the Manifesto anticipated that changes to carry tax will raise £585 million in the year 2028/29, although doesn't give details on how this is calculated. The *Financial Times* has since reported that Rachel Reeves has said that the calculation was based on research published by the Resolution Foundation in 2020. Notably this research did not consider any behavioural impact arising from such changes and has therefore been widely criticised.
- In describing the case for and approach to reform, the Call for Evidence contains two particularly useful paragraphs, which highlight the balance that the Government is trying to strike between the desire for reform and wanting to protect the UK asset management industry:

“ 4. While the tax treatment of carried interest is the subject of considerable debate, the government believes that the current tax regime does not appropriately reflect the economic characteristics of carried interest and the level of risk assumed by fund managers in receipt of it. As a result, the government will be taking decisive action.

5. Throughout this programme of work, as elsewhere, the government will seek to protect the UK's position as a world-leading asset management hub, recognising that the sector channels vital investment across the UK, and will play an important role in this government's mission to boost economic growth.”

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- The comment in paragraph 4 of the Call for Evidence around risk undertaken by fund managers ties in with statements made in an interview with the *Financial Times* that Rachel Reeves gave before the election, in which she said that “I don't think it is right that...what is essentially a bonus is taxed at a lower rate than employment income, when you're not putting your own capital at risk...If you are putting your own capital at risk it is appropriate that you pay capital gains tax”. These statements around risk and capital at risk have led people to believe that the carried interest reform is likely to contain a co-investment obligation for carried interest recipients.

Will there be a rate rise?

- There has been speculation about capital gains tax rate rises, and if there are rate rises these are likely to impact carried interest. However, this is a wider discussion than just carried interest, and it is likely that we won't have certainty around rates until the Budget on 30th October. We anticipate that the responses to Question 3 above, looking at carried interest taxation in other countries will feed into considerations around rates.

What should fund managers do now?

- The 30th August is not far away! Therefore, fund managers should decide their course of action quickly.
- The BVCA and AIMA are already engaging with the Treasury on this issue and those who are members of these bodies should feed comments in through those processes.
- For those who are not BVCA or AIMA members, we would be happy to provide assistance with responding to the Call for Evidence.

Is there anything else that fund managers should be aware of?

- The previous Government announced the abolition of the UK's non-dom regime from April 2025 in their last budget. This week the Government published a policy document on this reform. The key message is that the new Government is retaining the prior Government's policy of abolishing the existing non-dom regime and replacing it with a residency-based test. In brief, a person who becomes UK resident after a period of 10 years of non-residence will not be required to pay UK tax on foreign income and gains for four years. A form of overseas workday relief will also be available, with the design principles for this tax relief to be consulted on and then confirmed at the Budget.
- Many aspects of the new policy are still under consideration, including transitional arrangements and the ability to temporarily repatriate overseas income and gains, with "[t]he rate and the length of time that the TRF will be available [being]... set to make use as attractive as possible". In addition, the interaction between the new

rules and inheritance tax, which is currently a domicile-based tax, are still under consideration.

- The Treasury will be operating engagement sessions over the summer on the inheritance tax and overseas workday relief aspects of this policy.

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