HM Treasury

The Tax Treatment of Carried Interest: Call for Evidence

Summary of Responses and Next Steps

October 2024

HM Treasury

The Tax Treatment of Carried Interest: Call for Evidence

Summary of Responses and Next Steps

October 2024

This publication is available at: www.gov.uk/official-documents.

Any enquiries regarding this publication should be sent to us at public.enquiries@hmtreasury.gov.uk

ISBN: 978-1-917151-56-6 PU: 3463

Contents

Chapter 1
Introduction

1.1 On 29 July 2024, the government announced a commitment to reform the tax treatment of carried interest and published a call for evidence. The call for evidence, which formed the basis for an intensive period of engagement with stakeholders, sought to explore the economic characteristics of carried interest, different structures and market practices and what lessons could be learned from approaches taken in other countries.

1.2 Carried interest is a form of performance-related reward received by fund managers. Currently, carried interest can be subject to Capital Gains Tax (**CGT**) where certain conditions are met. As set out in the call for evidence, the government is committed to taking action to ensure that the tax regime appropriately reflects the economic characteristics of the reward.

1.3 The call for evidence closed on 30 August 2024. Over 100 responses were received from a range of individuals, businesses, advisory firms, representative bodies and academics. Officials also held a number of meetings. The government is grateful to all those who provided insights during the call for evidence.

1.4 Informed by this work, at Autumn Budget 2024 the Chancellor of the Exchequer announced the government's proposals to reform the tax treatment of carried interest. This document sets out those proposals in detail, including areas for consultation.

1.5 **Chapter 2 summarises the responses to the call for evidence and sets out the key themes. Chapter 3 then sets out the government's response and details of the reforms announced at the Budget. Finally, Chapter 4 seeks views on additional policy options which the government is considering.**

1.6 Recognising the complexity of the legislation in this area, the reforms set out in Chapter 3 will take effect from April 2026, allowing for a period of technical consultation. The Chancellor of the Exchequer announced at Autumn Budget 2024 that, in the interim, the two CGT rates for carried interest would both increase to 32%. This change, which will be legislated in the Autumn Finance Bill 2024, will apply to carried interest arising on or after 6 April 2025 and remain in place until the implementation of the wider reform package in April 2026.

Next Steps

1.7 The consultation set out in Chapter 4 will run until 31 January 2025. Written representations should be made to carriedinterest@hmtreasury.gov.uk. The government would also welcome the opportunity to meet with interested stakeholders prior to written representations being submitted – requests for meetings should also be sent to carriedinterest@hmtreasury.gov.uk.

1.8 Draft legislation covering the policy set out in Chapter 3 and any outputs from the consultation in Chapter 4 will then be published during 2025, allowing for technical consultation ahead of its inclusion in a Finance Bill.

Chapter 2

Summary of Responses

Overview

2.1 The call for evidence published on 29 July 2024 invited input on the following questions:

- Question 1: How can the tax treatment of carried interest most appropriately reflect its economic characteristics?
- Question 2: What are the different structures and market practices with respect to carried interest?
- Question 3: Are there lessons that can be learned from approaches taken in other countries?

2.2 Respondents recognised that the government has made a clear commitment to reform the tax treatment of carried interest and most focused their responses on how they thought that reform should be undertaken.

2.3 Respondents generally emphasised the importance of ensuring a regime that supports the competitiveness of the UK's asset management sector, particularly in relation to proximate jurisdictions, by offering bespoke tax rules for carried interest that meets certain conditions. Respondents also generally expressed a preference for a simple, principles-based regime, rather than prescriptive rules, and urged the government to undertake further consultation on specific policy proposals.

2.4 The call for evidence did not focus on specific policy proposals. Nevertheless, respondents proposed a wide range of ideas for delivering on the government's commitment to reform the tax treatment of carried interest.

2.5 Some of the policy proposals put forward included:

- A mandatory minimum co-investment requirement, calculated across the fund management team
- Changes to the rules around minimum average holding periods, to further encourage long-term investment
- A mandatory minimum period of time between the right to carried interest being awarded to a fund manager and that carried interest being paid out, to better reflect the long-term nature of the reward

- A flat tax rate, rather than the current approach, under which the effective rate can be a blend of the applicable marginal tax rates for capital gains, interest income and dividend income
- More favourable treatment for venture capital firms, and in some cases small and emerging private equity funds, to support scale-up businesses

2.6 Meanwhile, many respondents specifically cautioned against:

- Reclassifying carried interest as employment income with PAYE obligations, which respondents argued would give rise to a number of practical problems
- A mandatory minimum co-investment requirement that is calculated on an individual-by-individual basis
- Any new rules that replace the fundamental features of the existing tax regime for carried interest, such as the established definition of carried interest and rules for computing carried interest receipts
- Making significant changes to the tax treatment of carried interest without bringing forward appropriate transitional provisions

Q1: How can the tax treatment of carried interest most appropriately reflect its economic characteristics?

2.7 This section summarises the responses received to Question 1 in the call for evidence. The call for evidence noted 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.

2.8 Many respondents described carried interest as a form of investment return, reflecting the fact that it is a share of the profits of an underlying fund. Respondents noted that payment is contingent on the growth in value of the assets held by the fund and is not guaranteed, with a significant risk that carried interest is never received. Respondents said most funds will not pay out any carried interest for the first few years of the fund's life meaning any payment is, in their view, is akin to a return on a long-term investment rather than short-term remuneration. It was noted also that carried interest is important for staff retention and aligns the interests of fund managers and investors.

2.9 Other respondents took a different view and argued that carried interest is, in substance, the same as a performance-related bonus. These respondents noted the close link between carried interest and the services provided by the individual as a fund manager. Respondents also highlighted the limited amount at risk when an individual acquires carried interest.

2.10 Some respondents felt it was difficult to fit carried interest into conventional categorisations that exist within the UK tax system and argued it has unique characteristics that justify a bespoke tax regime.

The existing UK tax regime for carried interest

2.11 Most respondents who commented on the existing tax regime said that it supports the UK as an attractive location to manage private capital funds, with current tax rates being broadly comparable to other relevant jurisdictions. The regime was also described as flexible and principles-based, able to accommodate a range of different asset classes. Some respondents nevertheless said that the regime is complicated and could be simplified as part of the reform. Others said that the existing rules are also well understood by industry and that any reform should build on the existing approach.

2.12 Many respondents said the regime already reflects the economic characteristics of carried interest because the tax treatment is determined by the underlying nature of the return. If carried interest comprises interest income, for example, then it will be taxed as income and not capital.

2.13 Several respondents noted that the effective rate of tax on carried interest was typically greater than 28% given the reward would generally be 'blended' in nature – i.e. constitute a mixture of capital gains and income. If part of the reward constitutes dividend income, for example, that element will be taxed at 39.35% for additional rate taxpayers resulting in a higher effective tax rate.

Co-investment

2.14 Respondents said that most investors already expect fund managers to co-invest and put their own capital at risk. By having 'skin in the game', the interests of managers and investors are aligned. The amount managers are required to co-invest is agreed when the fund is established and will vary between funds. Respondents suggested private equity funds typically require a co-investment of between 1% and 3% of the fund's value. Respondents suggested that requirements are typically lower for private credit funds because expected returns are lower (given interest rates are fixed and loans will not be repaid above par).

2.15 Respondents said senior fund managers generally contribute a greater share of the co-investment compared to junior managers because they typically have more capital available to invest. Fund managers will often have to borrow (and pay interest on this borrowing) in order to satisfy their co-investment requirement. Some respondents said that managers in new or smaller funds might have less capital to invest than managers in established, larger funds.

2.16 A 1% co-investment requirement was suggested by several respondents as being both reasonable and putting the UK on a par with jurisdictions which already require co-investment such as Italy and France. However, several respondents outlined multiple potential challenges associated with such a requirement. Several respondents discussed, for example, whether the requirement should be applied at an individual or team level. Most respondents were opposed to an individual level requirement, arguing that this would have a disproportionate impact on junior managers (who are less likely to have significant resources available to fund their co-investment) and make it harder to attract new talent into the industry.

2.17 Some respondents said it was also important that any co-investment requirement was drafted in a manner which continued to give flexibility as to how funds were structured and was not overly prescriptive. It would, for example, need to continue to accommodate complicated, global fund structures and allow indirect (and not just direct) co-investment. Respondents also noted that transitional provisions would need to be considered given that existing funds cannot easily be restructured to increase the amount of co-investment in order to comply with new requirements.

Carried interest holders and holding periods

2.18 The current minimum average holding period requirement for investments under the UK regime – 36-40 months – was described as being in the 'middle of the pack' compared with other jurisdictions.

2.19 Responses illustrated a wide range of average holding periods depending on the type of fund. The average holding period for a private equity fund was commonly estimated at five years with venture capital funds tending to have longer holding periods. Some respondents supported an increase in the current requirement to five years.

2.20 Respondents said that fund managers wait, on average, for seven years before carried interest is paid out by the fund although managers of venture capital and other types of funds will often wait even longer – reflecting generally longer investment holding periods.

Interactions with other tax rules

2.21 A number of respondents commented that amendments to other tax rules, such as changes to the taxation of non-UK domiciled individuals, could impact on the competitiveness of the UK's asset management sector and the carried interest rules should therefore not be considered in isolation.

2.22 Several respondents cited the introduction of the Qualifying Asset Holding Companies regime in 2022 as a recent, positive development for the UK asset management industry.

Q2: What are the different structures and market practices with respect to carried interest?

2.23 This section summarises the responses received to Question 2 in the call for evidence. The call for evidence highlighted the government's desire to better understand how different fund structures and market practices should be taken into account when designing reforms to the carried interest tax regime.

2.24 Respondents explained that carried interest is one element of a fund manager's remuneration package, alongside other features like salary and bonuses.

2.25 Some respondents set out the typical structure of UK-based investment funds, in which carried interest is only realised where returns exceed an agreed 'hurdle' (often 8%), with the consequence that fund managers are at risk of missing out on carried interest entirely. Where this 'hurdle' is met, further returns are shared between carried interest holders and other investors (typically split 20% / 80%). Carried interest can either be linked to individual assets and paid out on a deal-by-deal basis, or tied to the performance of the fund 'as a whole' and paid out on that basis.

2.26 Many respondents noted that this structure is designed to align the incentives of fund managers with the performance of the fund and, by extension, the interests of external investors.

2.27 Respondents also stressed that fund structures are becoming ever more complex, reflecting the diverse range of investors' commercial, regulatory and tax requirements. While a 'standard' structure might only involve a single limited partnership fund, in practice many structures are significantly more complex, involving a range of feeder and parallel vehicles, aggregators, holding companies and so on. The exact structure in each case depends on factors like the specific investment mandate, the location of investors and the jurisdiction in which carried interest holders are based. Some respondents said that carried interest, having historically been a feature of closed-ended funds, is now becoming more common across open-ended and hybrid funds.

2.28 Some respondents reflected that the ever-increasing complexity of fund structures might make it challenging to introduce new conditions (e.g. a co-investment requirement) for accessing a preferential tax regime. Others asked that the government introduce appropriate transitional provisions as part of any new regime, so that existing funds are not adversely impacted by structural conditions that were not in place at the time fund arrangements were put in place (and which are now difficult to meet).

2.29 In terms of relevant market practices, responses from representative bodies, advisory firms, businesses and individuals provided expertise on a range of investment strategies, including private equity, venture capital, private credit, infrastructure and real estate. This yielded valuable insight into the variety of different structures across the market.

2.30 Many respondents praised the existing UK tax regime for taking account of the range of existing structures at present and recommended that any reforms continue to accommodate the full range of potential structures and investment strategies. Some respondents focused on particular aspects of the existing regime, including how the income-based carried interest (**IBCI**) rules apply to different investment strategies.

Q3: Are there lessons that can be learned from approaches taken in other countries?

2.31 This section summarises the responses received to Question 3 in the call for evidence. The call for evidence noted that many other countries have specific regimes for the taxation of carried interest, but that their detail and conditions for access vary.

2.32 Respondents generally agreed that the current UK tax regime for carried interest is well understood despite its complexity and has supported the UK's attractiveness for internationally mobile fund managers. Nevertheless, respondents noted that there is strong competition from jurisdictions across the United States, Europe and the Middle East. The majority of respondents felt that to remain competitive, the UK would need to benchmark itself against the tax treatment of carried interest in proximate jurisdictions such as Germany, France, Italy and Spain. A small minority of respondents felt that the UK regime is already less competitive than most proximate jurisdictions.

2.33 Respondents highlighted that all major jurisdictions with developed private capital industries tax carried interest at a lower rate than employment income in at least some circumstances. Often, they charge a flat tax rate on carried interest, rather than looking to the underlying source of the sum (as is currently the case under the UK rules).

2.34 Respondents provided detailed information and commentary about tax regimes for carried interest in a wide range of jurisdictions, including the US, France, Italy, Spain, Germany, Sweden and Hong Kong. Some respondents picked out key features of these regimes: for example, mandatory minimum co-investment requirements, and a minimum period of time between the right to carried interest being awarded to a fund manager and that carried interest being paid out.

2.35 Respondents made some broader comments on international precedents when assessing options for reforming the UK regime. Some respondents emphasised that the UK already has a world-leading asset management sector, whereas the many other jurisdictions covered above are trying to attract asset managers for the first time. As such, some respondents urged caution when looking to these regimes for examples.

2.36 Many respondents urged the government to ensure that any new rules allow for the full range of private capital investment strategies and fund structures. In doing so, some respondents pointed to rules in other jurisdictions which they considered were overly prescriptive and difficult to apply in practice.

2.37 A list of all respondents can be found in the Annex.

Chapter 3

Government Response and Next Steps

Overview

3.1 Having carefully considered the responses to the call for evidence, the government continues to believe there is a compelling case for reform. Beyond initial changes to the applicable CGT rates, the government intends to introduce a revised tax regime for carried interest which will ensure that the reward is taxed in line with its economic characteristics, put the tax treatment of carried interest on a fairer and more stable footing for the long term and safeguard the strength of the UK as an asset management hub.

3.2 As announced at Autumn Budget 2024, the government will:

- Introduce a revised tax regime for carried interest which sits wholly within the Income Tax framework, with all carried interest treated as trading profits and subject to Income Tax and Class 4 National Insurance Contributions (**NICs**). Taking account of the unique characteristics of the reward, the amount of 'qualifying' carried interest subject to tax will be adjusted by applying a 72.5% multiplier.

- Amend the IBCI rules to remove the exclusion for employment-related securities, ensuring the rules apply equally and fairly to all recipients of carried interest. The government will also work with industry to make targeted amendments to the IBCI rules to ensure they operate effectively, especially in the context of private credit funds.

3.3 Carried interest will be qualifying where it is not IBCI. In addition to the existing average holding period test, the government will consult on policy options for introducing further conditions to ensure that access to the computational rules for qualifying carried interest is appropriately limited. Details of this consultation are set out in Chapter 4. Any such further qualifying conditions would be incorporated into the IBCI rules (see further at paragraph 3.20 below).

3.4 Given the complex nature of legislation in this area, the government recognises the importance of undertaking technical consultation to ensure that the revised regime is robust and effective. For this reason, the reforms will take effect from April 2026, allowing time for detailed engagement with expert stakeholders.

Income Tax regime

3.5 The government's view is that carried interest should, in principle, be taxed as a reward for the provision of investment management services. At the same time, the government recognises that carried interest has unique characteristics which set it apart from other types of reward. It is a direct share of the profits of a fund, with a typically lengthy period between award and payout and a material risk of never being received. Those unique characteristics lead to a range of different international approaches to taxing carried interest.

3.6 To reflect that balance, the government will legislate to introduce a revised tax regime for carried interest within the Income Tax legislative framework. This revised regime will provide that carried interest is subject to tax as profits of a deemed trade, but with special computational rules for qualifying carried interest. The result will be a regime which is simpler, fairer and more stable – ensuring that fund managers pay their fair share of tax while recognising the importance of preserving the UK's competitive position as a global asset management hub.

3.7 The revised regime for carried interest will sit alongside the existing disguised investment management fee (**DIMF**) rules, which will be retained (subject to any necessary consequential amendments).

3.8 The revised regime will apply where carried interest arises to an individual in respect of arrangements under which the individual performs investment management services (broadly replicating the circumstances in which, under current rules, section 103KA of the Taxation of Chargeable Gains Act 1992 (**TCGA**) is engaged). The basic rule will be that an individual is liable to Income Tax and Class 4 NICs in respect of carried interest they receive as if they were carrying on a trade for that tax year and the carried interest constituted profits from that trade[1].

3.9 The amount of trading profits brought into charge will be determined by computational provisions based on section 103KA TCGA. This will ensure that the amount brought into charge is equal to the sum of carried interest which arises to the individual, less a limited number of permitted deductions (broadly, consideration paid for the right to carried interest and any amount treated as income on award).

3.10 A provision based on the existing section 103KB TCGA will also be introduced, with consideration received on a disposal of a right to carried interest deemed to be carried interest which arises to the individual.

3.11 The revised regime will retain key fundamental and well understood concepts which run throughout the existing legislation, such as the definition of carried interest in section 809EZC and 809FZD

[1] The application of this provision will be limited to carried interest and will not impact the return received by other investors, where the normal rules will continue to apply. This includes co-investment returns received by fund managers who also receive carried interest.

of the Income Tax Act 2007 (**ITA**). Provisions based on the following existing aspects of the TCGA regime will also be incorporated into the revised regime:

- The targeted anti-avoidance rule in section 103KD
- Section 103KF, which enables external investors to claim relief where carried interest arrangements cause a reduction in their base cost in the fund's assets
- Section 103KFA, which enables an individual to elect for carried interest to be deemed to arise at an earlier date
- The rules in section 103KG which set out when carried interest arises to an individual, including where payment of carried interest is deferred under commercial arrangements

3.12 The tax charge under the revised regime will be an exclusive charge. No other tax charge will apply to carried interest, including any CGT or Income Tax charge which might otherwise arise on ordinary principles. This will represent a major simplification of the existing tax rules, removing the complex interaction between ordinary principles and statutory overlays. There will no longer be any need to undertake the often complex exercise of determining the underlying nature of the sum received.

Qualifying carried interest

3.13 Special computational rules will apply to qualifying carried interest – that is, carried interest which is not IBCI (see paragraph 3.20 below).

3.14 Where an individual receives qualifying carried interest, the amount of trading profits which would otherwise be brought into charge will be multiplied by 72.5%. The net amount, after applying the 72.5% multiplier, will be the amount brought into charge as trading profits and taxed at the individual's applicable marginal rate of Income Tax (plus NICs).

3.15 The result will be a bespoke effective tax rate for qualifying carried interest, reflecting the unique characteristics described in paragraph 3.5 above. The vast majority of qualifying carried interest will be received by additional rate taxpayers. The government will consider whether and how it is appropriate for the multiplier to also be applied to other tax bands.

Territorial scope

3.16 The deemed trade under the revised regime will be treated as carried on in the UK to the extent that the investment management services by virtue of 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.

3.17 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 mirrors the approach in the DIMF rules.

4-year FIG regime

3.18 From April 2025, the remittance basis of taxation will be replaced by a new 4-year foreign income and gains (**FIG**) regime.

3.19 Qualifying carried interest will be subject to an equivalent provision to section 103KC TCGA, enabling any qualifying carried interest which relates to non-UK services to benefit from relief under the FIG regime. Non-qualifying carried interest subject to the IBCI rules will continue to be subject to the same provisions as currently, with only IBCI relating to 'pre-arrival services' able to benefit from relief under the FIG regime.

Amendments to the IBCI rules

Qualifying conditions

3.20 As set out in paragraph 3.3 above, carried interest will be qualifying carried interest where it is not IBCI. Chapter 4 contains details of a consultation on policy options for additional qualifying conditions (beyond the existing average holding period requirement), either by reference to the amount of capital invested by fund managers into the funds they manage or the period of time between the award of carried interest and its receipt. Any such further qualifying conditions would be introduced into the IBCI rules.

Removal of ERS exclusion

3.21 The IBCI rules currently contain an exclusion, at section 809FZU ITA, for carried interest which arises in respect of an employment-related security (**ERS**). As a result of this ERS exclusion, the application of the IBCI rules is limited to fund managers who are self-employed – generally where the fund manager is a self-employed member of a firm structured as an LLP.

3.22 The government does not believe that distinguishing between employees and self-employed LLP members in this way is justified. The current effect of the ERS exclusion is to make arbitrary distinctions between different asset managers based solely on their corporate structure, as well as providing a route for fund managers to effectively 'opt out' of the rules by becoming employees. The government will therefore legislate to remove the ERS exclusion, ensuring the IBCI rules apply fairly to all fund managers who receive carried interest.

3.23 The removal of the ERS exclusion from the IBCI rules will not impact the application of the ERS rules to awards of carried interest to employees, where the rules will continue to operate as currently.

Further amendments

3.24 The government recognises that the IBCI rules can be difficult to apply in some circumstances – in particular for private credit funds. The government understands that the difficulty in applying the IBCI rules leads many private credit funds to seek to rely on the ERS exclusion. While the ERS exclusion was never intended to serve as an 'opt out' from the IBCI rules, the government recognises that the removal of the ERS exclusion could have a disproportionate impact on private credit funds without any appropriate mitigating action.

3.25 The private credit market has developed substantially since the IBCI rules were originally introduced and the government believes there is a case for making targeted amendments to the rules to ensure they work appropriately for private credit funds. The government will work with expert stakeholders to consider appropriate amendments while ensuring the IBCI rules continue to limit qualifying carried interest treatment to funds engaged in long-term investment activity.

Transitional provisions

3.26 Although the reforms set out in this chapter represent a major legislative change, they do not impose new conditions or requirements which could not reasonably have been foreseen when existing funds were established. The government therefore does not consider that there is any case to exclude existing fund structures from the revised regime once it takes effect in April 2026 or provide any other transitional provisions.

Next steps

3.27 The government intends to establish a working group with stakeholders to explore points of technical detail in connection with the policy set out in this chapter ahead of publication of draft legislation during 2025.

3.28 Stakeholders with relevant technical expertise who wish to join the working group should email carriedinterest@hmtreasury.gov.uk.

Chapter 4

Consultation on Qualifying Conditions

Overview

4.1 As set out in Chapter 3, from April 2026 the revised regime for carried interest will include special computational provisions for qualifying carried interest which recognise the unique characteristics of the reward. In order to ensure that access to qualifying carried interest treatment is appropriately limited, the government is exploring the case for further conditions for carried interest to be treated as qualifying, specifically:

- A minimum co-investment requirement
- A minimum time period between a carried interest award and receipt

4.2 As explained in paragraph 3.20 above, any new condition would be introduced into the IBCI rules.

4.3 The government recognises that there are a number of practical challenges associated with implementing a co-investment condition. For this reason, the government is particularly interested in exploring a condition which requires a minimum period of time between the right to carried interest being awarded to a fund manager and that carried interest being paid out as a means of ensuring qualifying carried interest is limited to carried interest which is a genuine long-term reward. Any next steps would be set out after the consultation set out in this chapter closes.

4.4 Please see paragraph 1.7 above and paragraph 4.18 below for details on the duration of this consultation and how to respond or enquire about this consultation.

Aggregate minimum co-investment condition

Rationale

4.5 The government understands that in most private capital funds, investors will expect the fund managers to make a substantial co-investment. As set out in Chapter 2, some respondents to the call for evidence suggested that it could be appropriate to limit qualifying carried interest treatment to fund managers who are exposed to a material amount of risk in connection with the funds they manage.

4.6 As noted in paragraph 2.34, carried interest regimes in some other jurisdictions have a mandatory co-investment requirement. Design approaches vary, but generally the required level of co-investment is a percentage of total investor commitments. In some cases there is a requirement that an individual fund manager's own share of the co-investment is equal to their proportionate entitlement to carried interest.

4.7 The government acknowledges the arguments for such a co-investment requirement, notwithstanding that carried interest and returns on co-investment are separate concepts (and there are no plans to change the tax treatment of co-investment returns). However, there are a number of practical challenges with implementing a co-investment requirement.

Previous engagement

4.8 The call for evidence yielded significant insight on both current market practice for co-investment and issues relating to the design of any possible co-investment condition (see paragraphs 2.14 to 2.17 above). Key themes from this were:

- **Definitional challenges**: respondents consistently stressed that fund structures are increasingly complex and can involve, for example, a range of different feeder, parallel and aggregator vehicles. Respondents also stressed the variety of carried interest award entitlements, with individual fund managers' entitlement to carried interest often varying over the lifetime of the fund. This raises a number of challenging issues in designing a minimum co-investment condition, including how to define the fund structure in respect of which the co-investment obligation is tested, how to define whether an individual fund manager holds co-investment in that vehicle, and whether a co-investment requirement which is proportionate to carried interest entitlements is workable.

- **Differential approaches across different investment strategies**: engagement with respondents with experience of a variety of different investment strategies demonstrated a variation in the level of co-investment typically deemed appropriate and feasible. This level of variation shows the difficulty of selecting an appropriate level for a universal minimum co-investment condition and raises the question of whether and, if so, how to differentiate across investment strategies.

- **Impact on junior managers and new market entrants**: a consistent message received from respondents was that a minimum co-investment condition imposed at the level of individual fund managers would disproportionately impact those less able to raise the upfront capital to meet the condition – in particular, more junior fund managers or new entrants to the market.

Areas for further consideration

4.9 The government recognises the challenges outlined above, which will inform any future decision making in this area. It is not the government's intention to create or risk arbitrary and/or distortive outcomes, or to progress unworkable options. This includes any co-investment requirement applied on an individual-by-individual basis, which the government recognises would be difficult to implement in a way which is proportionate and fair.

4.10 The government invites further views on introducing a minimum co-investment condition which could be measured at a team level – for example, by reference to the aggregate co-investments in the fund held by carried interest holders or anyone connected with them. Points on which representations are welcome include:

- How to define the 'fund' for the purposes of any new condition
- The minimum levels of co-investment required
- What types of co-investment arrangements would count for the purposes of meeting the condition
- The time period during which the condition must be satisfied
- Transitional arrangements

4.11 If there are further risks and/or wider considerations that should be highlighted in this context, the government also welcomes representations covering these.

Question 1: Recognising the challenges in this area, how might any team-level co-investment requirement be most successfully constructed?

Question 2: Are there any further risks and/or wider considerations, beyond those identified via the call for evidence, that should inform decisions on whether the government progresses with a co-investment requirement?

Minimum holding period for carried interest rights

Rationale

4.12 Part of the unique nature of carried interest rewards is that holders are typically expected to wait a substantial period before they receive carried interest, and that there is a material degree of uncertainty around whether the carried interest will ever be received. This could be reflected in the revised regime through a requirement that fund managers have held their carried interest rights for a minimum period of time prior to receipt of carried interest, as a condition for it to be treated as qualifying carried interest.

4.13 A new time-based condition of this nature would sit alongside the existing average asset holding period requirement in the IBCI rules. The average asset holding period requirement is assessed at the level of the fund, ensuring that funds which are undertaking an activity which is not long-term investment in nature cannot access qualifying carried interest treatment. By contrast, a new time-based condition would be assessed at the level of the individual, focusing on the length of time the individual waits to receive carried interest.

Previous engagement

4.14 Respondents to the call for evidence consistently emphasised the length of time fund managers must wait to receive carried interest as a contributing factor to its unique economic characteristics, and why it can be differentiated from other types of performance related pay (such as annual bonuses). Limited specific responses were received on the design of a minimum holding period condition for carried interest rights, although the government is aware that this is required by some other jurisdictions.

Areas for consideration

4.15 The government invites views on the merits and design of a condition requiring a minimum length of time between the award of the right to receive carried interest and carried interest arising to the fund manager in order for that carried interest to be treated as qualifying carried interest. The key areas identified for consideration are set out below.

Length of minimum time period

4.16 Respondents to the call for evidence consistently reported that fund managers wait a significant length of time to receive payments of carried interest. The average figure quoted was seven years – with longer periods common for funds with certain investment strategies. However, the government is also aware of significant variation across investment strategies. Moreover, there are circumstances in which individual fund managers may have held their carried interest rights for a shorter period of time, notwithstanding a typical fund lifecycle – e.g. new joiners.

Question 3: How might the length of any new time-based condition best be designed to reflect the nature of carried interest rewards?

Transitional arrangements

4.17 Whilst a minimum holding period condition for carried interest rights was not in place when existing funds were established, the government does not currently consider that transitional rules should be necessary in order that fund managers with carried interest rights held in connection with those funds are appropriately accommodated. However, there may be specific fact patterns to consider as part of any final determination on this point.

Question 4: Do you foresee any unintended adverse consequences for fund managers in existing funds from a government decision not to introduce transitional arrangements on the introduction of a condition of this kind?

Next steps

4.18 The consultation set out in this Chapter 4 will run until 31 January 2025. Representations should be made to carriedinterest@hmtreasury.gov.uk.

4.19 After this consultation closes, the government will analyse and publish a response to the views' expressed by stakeholders. These views will feed into considerations on whether to proceed with introducing any additional qualifying conditions and the design of any such condition. The government is committed to technical consultation on any draft legislation that flows from this – alongside the draft legislation discussed at paragraphs 3.27.

Annex

List of Respondents

Alcentra
Alternative Investment Management Association
Alvarez & Marsal
Ansor LLP
Antin Infrastructure Partners
Apax
Apposite Capital LLP
Arcmont Asset Management
Ares
Ashurst LLP
Association of Foreign Banks
August Equity LLP
BDO LLP
Blackstone
British Property Federation
British Emerging Manager Institute
British University Finance Directors Group
British Private Equity and Venture Capital Association
Charity Tax Group
Charterhouse Capital Partners LLP
Chartered Institute of Taxation
Clayton Dubilier & Rice LLP
Cleary Gottlieb Steen & Hamilton LLP
CMS Cameron McKenna Nabarro Olswang LLP
City of London Law Society Tax Committee
Crowe U.K. LLP
Dawn Capital LLP
Dechert LLP
Deloitte LLP

Diversity VC
DLA Piper International LLP
DragonChasers
DWF Law LLP
ECI Partners LLP
Entrepreneur First
Episode 1 Ventures LLP
EQT Group
Eversheds Sutherland (International) LLP
Ernst & Young LLP
Farmlend
Flowbio Ltd
Forvis Mazars LLP
Founders Forum Group
Francis Clark LLP
Fried, Frank, Harris, Shriver & Jacobson (London) LLP
General Atlantic (UK) LLP
Gide Loyrette Nouel LLP
Global Infrastructure Investor Association
Grant Thornton UK LLP
Hayfin Capital Management
Haysmacintyre LLP
HgCapital Trust plc
Institute of Chartered Accountants in England and Wales
IK Partners
Index Ventures
Institute of Directors
The Investment Association
IP Group plc
Johnston Carmichael LLP
Kennet Partners Ltd
Kings College London
Kirkland & Ellis International LLP
KPMG LLP
Lightrock LLP

Limbic
Livingbridge EP LLP
Macfarlanes LLP
Managed Funds Association
Metis Labs
Molten Ventures plc
MTech Capital
Muddy Machines
MVM Partners LLP
Novogaia
Osborne Clarke LLP
Outward VC
Pactio Technologies Limited
PAI Partners
Palmer
Park Square Capital
Pemberton
Permira Advisers LLP
PricewaterhouseCoopers LLP
Reach Industries
Ropes & Gray International LLP
RSM UK Tax and Accounting Limited
Saffery LLP
ScaleUp Capital Limited
Simmons & Simmons LLP
Simpson Thacher & Bartlett LLP
Startup Coalition
Tax Policy Associates Ltd
Travers Smith LLP
Trident Tech, Inc
UK Bioindustry Association
Vialto Partners
Withers LLP

A number of representations were also provided in a personal capacity.

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk