The new carried interest tax regime

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The legislation for the new carried interest regime, effective from 6 April 2026, received Royal Assent on 18 March 2026.

Legislative framework

How does the new charge work?

The new legislation recasts the carried interest tax rules as a new income tax charge. However many elements of it will be familiar.

The disguised investment management fee (DIMF) rules remain in place. All sums arising to an executive from an investment management scheme will be taxed under the DIMF rules unless they are either carried interest or co-investment.

Carried interest receipts are now treated as the profits of a trade that the recipient is deemed to carry on in the year of receipt, and accordingly will be subject to income tax and Class 4 NICs.

Carried interest that satisfies a 40-month average holding period (AHP) condition – which is a refined version of the previous Income-based Carried Interest (IBCI) rules – are regarded as "Qualifying Carried Interest" and subject to a 72.5% multiplier, resulting in a 34.1% effective tax rate for additional rate taxpayers. Non-Qualifying Carried Interest that fails the AHP condition is taxed at an effective rate of 47% for additional rate taxpayers.

How is carried interest defined?

Carried interest is defined in the same way as under the previous rules, as either:

- a profit related return for which there is a significant risk that the amount will not arise; or
- "safe harbour" carried interest which is paid under a conventional fund waterfall with a preferred return of at least 6% per annum.

The Government has, however, taken the opportunity to broaden the definition of "investment management services", which is relevant to whether amounts fall within the DIMF rule to begin with. That definition now explicitly includes the provision of investment advice as well as incidental services such as those provided by in-house counsel and accountants.

What is taxable, and when?

The full amount of a carried interest distribution will be taxable, subject to the 72.5% multiplier. However, the rules permit recipients to deduct an amount of base cost equal to any consideration that they paid in money for their carried interest from their taxable amount. There is no deduction for amounts charged to income tax on award, which are dealt with separately via a credit mechanism (see below).

Amounts received for the sale of carried interest rights will be treated as carried interest in the hands of the relevant individual and these rules will also now capture disposals by connected structures such as holding companies.

The rules that determine when carried interest arises to an individual will be modified in several respects including:

- the "power to enjoy" rules, which treat an individual as having received carried interest that arises to a connected person, are retained, but with technical refinements (including to put beyond doubt that structures owned by persons connected with fund executives can benefit from the shareholder exemption, which prevents most corporate structures from being transparent for the purposes of these rules); and
- the rules dealing with deferral of carried interest have been amended: deferral will be respected where it is the result of "genuine commercial arrangements" (but not if the deferred amount is invested in an investment scheme with the same manager).

Carried interest inherited following a death will, when it pays out, be treated as trading income of the recipient, with no rebasing.

Exclusive charge and double taxation relief

The new carried interest regime is an exclusive charge meaning that an individual should not be subject to any other income tax or capital gains tax (CGT) charge on carried interest that they receive (other than if the original award of carried interest is taxed as employment income).

To prevent double taxation, the rules allow carried interest recipients to credit circumstances that include:

- any income tax they paid on award of their carried interest rights;
- any UK tax paid by another person in respect of the carried interest;
- inheritance tax; and
- CGT paid prior to 6 April 2026 but treated as arising after that date

against their carried interest tax liability. This carried interest-specific rule does not extend to foreign tax, which is dealt with under general double tax relief principles.

Territoriality

One of the effects of the Government's move to tax carried interest within the income tax regime (and, within that, its approach of deeming recipients to be carrying on a trade in the UK to the extent that they perform investment management services in the UK) is that it will bring non-UK residents into scope of UK tax on carried interest for the first time.

Under the new regime, non-UK residents will be potentially subject to tax on carried interest that is attributable to UK workdays, subject to any relevant double tax treaty (DTT). While the Government has maintained its point of principle that where services are performed in the UK, the reward should be taxed in the UK, it has recognised that this position creates some tension in relation to how other countries may treat carried interest under a DTT and may also dent the UK's competitiveness. In response it has created a series of statutory "guardrails" that will constrain the territorial scope of the revised regime in relation to qualifying carried interest. Without more, the new charge to tax on carried interest receipts arising to non-residents would have had no minimum threshold so that any relevant investment management services performed in the UK would have triggered a UK tax exposure in relation to carried interest proceeds relating to those services, subject to the terms of any applicable DTT.

Notably, the guardrails primarily apply to qualifying carried interest. However, there is an exception to this if the individual reasonably expects to meet the 60 UK workday test (see below).

Guardrails

The statutory guardrails limit the extent of the UK tax charge in relation to qualifying (and certain non-qualifying) carried interest by deeming workdays to be non-UK and so excluded. The following three rules will limit the UK tax charge on non-residents in respect of qualifying carried interest:

- all workdays pre-30 October 2024 are deemed to be non-UK;
- all workdays in non-resident years with fewer than 60 workdays ("non-UK years") are deemed to be non-UK; and
- after three consecutive non-UK years, all prior UK workdays are excluded.

These limitations on the reach of the UK's tax net are welcome and are a pragmatic compromise that removes a significant amount of uncertainty and compliance burden that the initial proposals created. The first rule – which excludes services performed before the changes were first announced at the Autumn Budget 2024 - addresses a concern that the new extra-territorial scope of UK carry taxation had an element of retroactivity in its effect. The second rule – which introduces a 60 workday safe harbour – will ensure mobile executives are only taxed in the UK in situations where they have a strong nexus to the UK. This rule was extended during the Finance Bill process to allow certain non-qualifying carried interest to qualify for the 60 workday safe harbour where it is reasonable to assume on the first UK workday of the "relevant period" that carried interest would be qualifying. And the third rule – which creates a liability tail of around three years – provides much needed certainty to leavers ceasing to be UK resident.

UK apportionment

The new rules provide clarity on how carried interest will be apportioned between investment management services performed in the UK and those performed outside the UK through a formulaic time-based apportionment method, which refers to the number of UK workdays in the relevant period.

The formulaic approach can be summarised in the following steps

1. Take the period between inception of the carry arrangement and the latest distribution in the tax year ("the relevant period").
2. Identify all of the days in that relevant period on which the individual does any investment management work ("X").
3. Identify all of those days on which the individual did three or more hours of investment management work in the UK ("Y").
4. The UK proportion is equal to Y divided by X.

It is worth bearing in mind that, once an individual becomes non-resident, under the new regime the UK would not tax carried interest proceeds attributable to non-UK duties performed while they were UK resident.

The first guardrail (deeming pre-30 October 2024 work to be non-UK) means an individual that recently became non-resident would have only limited UK tax exposure. For example, an individual who ceased to be UK tax resident on 5 April 2025 will have a UK tax exposure in respect of carried interest proceeds attributable to their UK duties undertaken between 30 October 2024 and 5 April 2025 but that exposure will be their only exposure and will lapse on 5 April 2028 (even if the relevant carry is not fully realised by that date) provided the individual stays non-resident and does not hit the 60 workday threshold while non-resident.

Note, that if a non-resident, even with the application of these guardrails, still has an exposure to UK tax then relief under an applicable double tax treaty may be available. This is the case if they did not have a P.E.

UK residents who benefit from the proposed new Foreign Income and Gains (FIG) regime for a tax year should be exempt from tax in respect of qualifying carried interest arising to them during that tax year, to the extent those proceeds relate to relevant investment management services performed outside of the UK. Non-qualifying carried interest is subject to a more limited rule, under which only carried interest attributable to pre-arrival work outside the UK will be exempted. The FIG regime will be available for the first four years of UK tax residence.

Executives returning to the UK will want to be mindful of the temporary non-residence rules which seek to curb individuals becoming non-UK resident for a short period of time. Under these rules (which borrow from the statutory residence test) carried interest receipts received during the temporary period of non-residence could become chargeable in the UK.

Average holding period condition

At one stage in the development of the new regime, the Government was exploring the case for further conditions however it has decided that the existing asset-level average holding period (AHP) condition in the IBCI rules will be effective in limiting qualifying carried interest treatment to long-term reward.

Under the previous carried interest tax regime, carried interest that is IBCI was automatically taxed as trading income and unable to access the CGT rate for carried interest. Carried interest is IBCI if the fund in respect of which it is paid has an AHP for its investments of less than 40 months. Essentially the IBCI rules aim to target the carried interest tax regime at funds that are investing for the long term.

The IBCI AHP calculation is complex, especially for funds that undertake large numbers of transactions (such as credit funds). To date that difficulty has been obscured for many funds by the employment-related securities (ERS) exemption, which provides that the IBCI rules do not apply to carried interest that is an ERS. The Government announced that this exemption will be removed with effect from 6 April 2026, when the new carried interest regime takes effect.

The current AHP rules do not operate well in relation to credit funds therefore it is helpful that the legislation addresses many of the issues raised during the consultation process.

Other matters

Tax distributions

There was some doubt surrounding the definition of tax distributions and how they are treated under the new regime. The definition now extends to non-UK tax distributions and is expected to capture most commercial situations.

Payments on account

During the consultation and legislative process, stakeholders raised the concern about the prospect of carried interest falling within the payments on account rules. Although the Government responded to these concerns by recognising that carried interest receipts can be "irregular and unpredictable" it nevertheless confirmed that it expected income tax and Class 4 NICs relating to carried interest to be paid in line with these obligations.

Under the rules, broadly taxpayers are expected to pay two instalments based on the prior tax year's liability in January and July, however it should be noted that under these rules taxpayers are offered considerable flexibility to reduce their payments on account if they believe their taxable income will reduce from one year to the next.

Making tax digital

On the basis that the new carry regime treats carried interest as deemed trading profits, another compliance aspect taxpayers will need to grapple with is "Making Tax Digital for Income Tax". The first phase of this initiative commences on 6 April 2026 and will require certain taxpayers to make quarterly digital updates. Although the first phase coincides with the new carried interest rules, most carried interest recipients will not be within this new reporting framework until April 2027 (unless they have received DIMF and IBCI during the 2024/25 tax year).

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