By email: carriedinterest@hmtreasury.gov.uk

15 September 2025

Dear HM Treasury

## Reform of the tax treatment of carried interest – Consultation on draft legislation for Finance Bill 2025-26

The BVCA is the industry body and public policy advocate for the private equity, venture capital and private credit (together "private capital") industry in the UK. We represent UK-based private capital firms, as well as their professional advisers and investors, and have a membership of around 600 firms.

The UK private capital industry provides vital investment for growth in the UK. Businesses backed by the industry employ over 2.5 million people across the UK and contribute 7% to GDP. Total private capital investment in UK businesses reached £29.4bn in 2024, with private capital investors supporting almost 1,600 UK businesses in the same year. Private capital invests across the whole of the UK, with 58% of businesses receiving investment in 2024 being outside London.

Carried interest is key to the success of the UK private capital industry. If the UK is to maintain its position as a global hub for private capital, it is critical that the tax rules for carried interest are workable, provide clear outcomes, and are stable in the long term. As we noted in our response of 31 January 2025 to the consultation launched at the October 2024 Budget (published on our website here), we welcome the Government's clear recognition of the unique characteristics of carried interest. We are pleased to have this opportunity to contribute to the construction of a tax regime that properly reflects those unique characteristics.

We would like to thank government officials for their constructive approach to engaging with all stakeholders during this process. We look forward to this continuing as we work towards a new regime that is fit for purpose for both the Government and industry.

## Key points

The private capital industry channels essential investment across the UK and plays an important role in boosting economic growth. While we recognise that the Government's policy decisions are aimed at achieving a balanced outcome, the new effective tax rate of around 34.1% (36.25% in Scotland) will give the UK one of the highest rates of tax on carried interest among key competitor jurisdictions. In addition, other countries continue to improve their tax offerings with a view to attracting the private capital industry, often at the expense of the UK. We would note that both Luxembourg and Belgium are currently introducing new carry regimes; Luxembourg's in particular is regarded as highly competitive and attractive.

Competition therefore remains fierce, and the UK cannot afford to be complacent: tax rates, complexity, taxation of non-residents and the perceived stability of the regime are all critical factors here. In this context, we urge the Government to address the issues with the draft legislation and to ease compliance burdens, as identified in our detailed response below, with a view to improving the UK's attractiveness as a destination for investment and growth. As the Chancellor said when she

spoke at the BVCA Summit last week (on 10 September), in the context of the private capital industry: "tax policy does impact economic growth".

We would also urge the Government to amend the draft legislation to make it clear that the new carried interest tax is an exclusive charge, so that there is no double UK taxation. It would not be right for UK taxpayers to have to pay tax twice, for instance for the same amount to be taxed under the carried interest rules, and then again as interest or a dividend. We understand that the Government's intention is to avoid double taxation, but we are concerned that the current wording is not sufficiently clear in this respect.

Other areas we cover in our response below include:

- **Territorial scope** – the way the new regime applies to internationally mobile individuals must be both proportionate in its scope and practical to operate.
- **Average holding periods** – we welcome the steps that have been taken in the draft legislation towards recognising the industry's concerns, but have flagged a number of areas where significant issues remain. In this context we have made separate recommendations regarding the rules on venture capital funds, credit funds, and funds of funds.
- **Compliance** – many of our remarks highlight practical difficulties individuals may face when seeking to comply with their obligations under the new rules, and we have made a number of suggestions as to how these could be addressed.

We have mostly confined this response to matters that have a direct bearing on the legislation that is the subject of the current consultation. We are, however, also concerned about other issues related to the new rules, notably those regarding the rules on payments on account and Making Tax Digital. We urge the Government to give careful consideration to how these regimes will work once carried interest is brought within the income tax regime, to ensure that the rules are manageable and that taxpayers are able to pay the right amounts of tax at the right times.

We have made separate submissions to officials on these issues, which we regard as matters of significant importance. We look forward to continuing these conversations with you to ensure that the system enables individuals to meet their tax obligations, without substantial additional administrative burdens.

## Territorial scope: section 23J

As mentioned above, the UK will shortly have one of the highest rates of tax on carried interest among key competitor jurisdictions. The UK is also unusual in seeking to tax carried interest arising to non-residents. For both of these reasons, it is crucial that the provisions defining the territorial scope of the reformed carried interest tax charge are seen to be fair and to achieve certainty. Otherwise there is a significant risk of a negative impact on UK competitiveness and the UK's reputation as a place to invest.

### *Overall comment*

The territorial aspects of the new rules are very complex and, although we have suggested some modifications, have the potential to deter and restrict long term non-UK residents from coming to the UK. While we acknowledge that statutory limitations have been introduced to mitigate the

impacts, we remain very concerned that the risk of suffering UK tax on carried interest is one that many non-residents would not accept, especially given the potential double tax that would arise where another tax authority does not agree that the carried interest is covered by the business profits article of the relevant treaty. As has been noted in earlier correspondence, this is not a theoretical risk – we know that Germany, for example, will take a different view of treaty application based on its own case law.

We note that the new carry regime applies to non-UK residents in a different way than for employment income. Under the short-term business visitor (STBV) regime, anyone in a treaty jurisdiction who spends more than 60 days in the UK needs to be reported but would not usually create a UK employment tax nexus as long as they are not "economically employed" in the UK. On the other hand, the new carry regime introduces a cliff edge for non-residents working for global groups (which is not a feature of the employment tax rules).

We would encourage the Government to consider drawing a distinction between individuals who have been resident in the UK and then depart (where we understand the concern that a significant portion of the work undertaken in deriving future carry took place in the UK) and situations where individuals are long term non-residents who visit the UK periodically. This would not resolve all the issues, but it may limit the problems to a narrower group of individuals and would appear to be consistent with the policy underpinning the new regime. We would be happy to discuss this suggestion with you further.

In the remainder of this section we set out comments on the existing draft legislation.

### *Applicable trade and UK tax exposure*

The natural reading of s23I would suggest that there is a "deemed trade" per set of arrangements, i.e. that the "arrangements" which determine the trade under s23I(2)(a) are those under which carried interest arises to an individual from one or more identified investment schemes which are part of the arrangements.

At the stakeholder working group call on 31 July and in subsequent discussions, we understood HMRC to agree with suggestions that this would typically result in a trade per fund on the basis that the arrangements in relation to carried interest would, frequently, be per fund. That said, it would depend upon the fact pattern and the relevant "arrangements" would need to be considered, which would not necessarily mean there was always a "per fund" trade.

In 23J(1), it is stated that an individual carrying on a trade under s23I (in general terms the "per arrangements" trade) is treated as carrying on the trade in the UK if all "applicable workdays" in a "relevant period" are "UK workdays", outside the UK if all applicable workdays in the relevant period are not UK workdays, and otherwise partly in and partly outside the UK.

The calculation relies upon the definitions of applicable workdays and UK workdays, both of which specifically include investment management services which relate to *any* arrangements and not merely services which relate to the arrangements which, under s23I(1) and s23I(2), underpin the relevant trade.

Some of the results of this approach may be seen as unexpected, including those we set out below. A number of these outcomes are not, in our view, in line with the Government's policy intentions, and we would request that the Government amend the legislation to avoid the negative effects which we have identified. We have included, below, a proposed solution for your consideration.

The examples in this section assume that treaty relief is not available. We have made some separate comments on treaties below.

**Examples of anomalous outcomes**

The draft legislation can have anomalous, and potentially unfair, results in the context of internationally mobile individuals who move to work for a different private capital firm, or whose UK work is otherwise unrelated to their carried interest. Further complications arise where an individual performs work that does not relate to a specific fund. We illustrate these issues with the following examples.

### Previous role – Example 1

Mia used to work for a non-UK private capital firm and holds carried interest in Funds 1, 2 and 3. Her previous role did not involve any connections with the UK and she never travelled there in this role. Mia's carry is such that Funds 1, 2 and 3 are separate arrangements for the purposes of the trade in s23I.

Mia leaves for a role in a fund which is just starting up in Europe and which is looking into opening a UK office. In her new role, despite being non-UK resident, she visits the UK frequently looking into the market and meeting potential new hires (activities which are likely to be treated as investment management services).

She ends up with more than 60 UK workdays in a year which is within the relevant period for all the funds in which she holds carry. The next year, carried interest arises to Mia in each of Funds 1, 2 and 3.

Mia's UK work is totally unrelated to the arrangements resulting in her carried interest in Funds 1, 2 and 3. Her carry arose in the context of a totally different role.

However, as drafted, it seems that Mia would be liable to pay UK tax in relation to her carry in each of Funds 1, 2 and 3. She would need to ascertain the applicable workdays for each, and her UK days relating to her new role would count as UK workdays for her carry in each of Funds 1, 2 and 3.

It does not seem fair for activities undertaken in a new role to "taint" the tax treatment of carried interest arising from a previous role. This outcome risks rendering any role requiring work in the UK extremely unattractive for individuals in a similar position to Mia, who are very important to the UK's future success as a global destination for the private capital industry. Mia's carry from her previous role should not be subject to UK tax simply because her new role requires some UK work.

### Clearly distinct work – Example 2

Oliver is a non-UK resident fund manager of a large private capital firm who holds carried interest in Funds A, B and C, which are different strategies of the firm and which are different arrangements for the purposes of the legislation.

Year 1 is part of the relevant period for Funds A, B and C. In Year 1, Oliver is working on a major UK project for Fund A. This means that Oliver performs activity connected to Fund A in the UK. He ends up with over 60 UK workdays and thus a UK tax year.

In Year 2, carried interest arises to Oliver in relation to Fund B. Oliver must file a UK tax return and, despite the UK work being for Fund A, Oliver has 60 UK workdays.

In Year 3, carried interest arises to Oliver in relation to Fund C. Oliver must file a UK tax return and again, despite the UK work being for Fund A, Oliver has 60 UK workdays.

In Year 4, carried interest arises to Oliver in respect of Fund A. Again, he has 60 UK workdays and must file a UK tax return. On this occasion, this is a reasonable outcome since the UK work was for Fund A.

Oliver's UK work is only related to the Fund A arrangements but, as drafted, it would seem all three funds are affected by the UK workdays. The work is clearly in relation to Fund A but, since other arrangements are covered in calculating UK workdays, it would seem that Oliver will need to calculate and pay UK tax for carry arising in relation to *each* of Funds A, B and C. This seems a disproportionate outcome.

### Cross-fund activity – Example 3

Christina works for a large fund house and holds carry in Funds U, V, W, X, Y and Z, all different arrangements under the legislation. She holds a senior position and travels to the UK frequently where she works on a range of matters. Sometimes these are specific to a single fund, sometimes they are part of the wider strategy of the private capital firm, and sometimes they relate to a narrow range of funds.

Year 1 is within the relevant period for Funds U, V, W, X, Y and Z. Christina has 75 UK workdays in Year 1.

60 of these workdays involved activity which was substantially relevant to the firm overall and all funds. 10 of these workdays involved activity for a specific matter for Fund X, although Christina was required to deal with a few other matters in a peripheral way and an issue arose in relation to Fund W which took a couple of hours on one day to resolve.

5 of these workdays involved issues pertinent to the European fund strategies only. These are Funds X, Y and Z.

In Years 3, 4 and 5 carry arises to Christina in respect of each of Funds U, V, W, X, Y and Z. As drafted, Christina would have 75 UK workdays for each. This seems a disproportionate outcome in context.

It appears to be within the intention of the legislation that there is a UK tax year for Fund X and 75 UK workdays. Christina's cross-fund work for 60 days substantially impacted Fund X, her work on the European fund strategies substantially impacted Fund X and she had a separate matter which impacted only Fund X.

It also appears to be intended that there is a UK tax year for Funds Y and Z. Christina's cross-fund work for 60 days substantially impacted Funds Y and Z, and her work on the European fund strategies substantially impacted Funds Y and Z.

However, it seems disproportionate that there are 75 UK workdays for Funds Y and Z when 10 days did not involve work relating to Funds Y and Z. A more reasonable result would be that there are 65 UK workdays for these funds.

It does not seem appropriate for there to be a UK tax year in relation to Funds U, V and W. Although there are 60 days of work which is substantially related to all funds, Christina's other work does not appear to be sufficiently related to Funds U, V and W to warrant the year affecting them in the same way as Funds X, Y and Z. As is indicated above in the example of Oliver, the way the law is drafted is such that the days would be taken into account for each fund. Again, this seems disproportionate.

**Proposed solution**

To address the issues illustrated above, we would suggest introducing a more flexible and pragmatic approach through a test that refers to substantially related activity. This would provide individuals with the option to discount a day as a UK workday in relation to carried interest if it is reasonable for the individual to suppose that the UK work on a particular day was substantially unrelated to the arrangements under which the carried interest arises.

This proposal is intended to address the anomalies set out above without allowing an individual to simply carve up their day and argue that, overall, it was not substantially related to a specific fund.

In the examples above, Mia could clearly take the view that her work in the UK was not substantially related to Funds 1, 2 and 3, and Oliver could also take the view that his UK work was not substantially related to Funds B and C. For Christina, she could not take the view that her work affecting all funds was substantially unrelated to any of them. Equally, she could not take the view that her work on the European funds was substantially unrelated to each of Funds X, Y and Z. However, she could use the option to discount her days working only on Fund X for Funds U, V, W, Y and Z and to discount her days effectively working only on the European strategies for Funds U, V and W.

We are endeavouring in this proposal to tread a middle ground. There is some potential unfairness in the lack of ability to apportion UK workdays across arrangements, and in days potentially counting more than once in relation to the same arrangements if carried interest arises over the course of affected years. However, we recognise that there is merit in simplicity and that (unless the calculation is made on a "per arrangements" basis, which is complicated and open to abuse) there

are going to be "winners" and "losers". We think that there is, nonetheless, scope for some additional, optional flexibility and we should be happy to discuss this (or other possible solutions) further at the most appropriate time.

**Compliance issues**

As a separate point, since there is a trade per set of arrangements, it would be helpful if this could be simplified for compliance purposes. Technically, an individual may have a number of different trades, so an option to aggregate these on a tax return might be useful. This might not be helpful in every case, but an option to aggregate for some compliance purposes is likely to be of assistance.

*Statutory limitations – restriction to qualifying carried interest*

We have previously discussed with officials some examples to illustrate the difficulties that may follow from the position under the draft legislation whereby the statutory limitations do not apply to non-qualifying carried interest. These examples are repeated here for ease of reference.

No other UK carryholders – Example 4

Su is a non-UK resident fund manager who works for a global private capital firm. She concentrates on the Asia strategy and her carried interest is held only in funds with Asian investors and, generally, a focus on Asia. There are no UK carryholders in the funds in which Su holds carry.

Su needs to visit the UK as part of a possible expansion of the investments of the funds she works on to jurisdictions outside Asia. She ends up with 40 UK workdays in one year and 30 in the next.

Su can only rely on the statutory limitation of this not being a UK tax year if her carried interest is qualifying, but this calculation has never been relevant and has thus never been performed. Su would have to ask the firm to perform an analysis of average holding periods to determine the position. This seems an excessive burden on private capital firms and makes this kind of work in the UK very unattractive. As this example shows, it could also make the UK less attractive as an investment prospect.

Leaver and subsequent UK work – Example 5

Allegra is a non-UK resident fund manager who changed jobs for a similar role at another private capital firm. She was granted carried interest in Fund U by her previous employer. In her new role, Allegra is given carried interest in Fund V. The relevant period for Funds U and V includes Years 1-6. Allegra never performs any UK work in relation to Fund U. In Year 2, Allegra has 60 UK workdays all relating to Fund V. In Years 3, 4 and 5, she has fewer than 60 UK workdays. In Year 6, carried interest arises to Allegra in relation to Fund U.

Allegra's carried interest (which is, as in Example 1 with Mia above, completely unrelated to the role in which she performed her UK work) will only be eligible for the statutory limitation as being more than three years prior to a period of three or more non-UK tax years, if it is qualifying.

However, she will have no way of knowing this, and the firm is extremely unlikely to assist a leaver by performing what is a fairly complex calculation. This seems disproportionate and, again, may render roles with potential UK travel unattractive.

UK expansion – Example 6

Barney works for a large, non-UK private capital firm and holds carried interest in various funds. There are no UK carryholders in these funds and they have no connection to the UK.

The firm decides to expand its operations and establish a UK presence with a view to setting up its first European funds. Barney travels regularly to the UK over a couple of years to diligence this possibility, identify and interview candidates, decide upon office space etc. He spends about 30 days in the UK in one year, and about 40 days in the UK the next year. After that, he may need to visit the UK for about 10 days a year, but he will never have more than 60 UK workdays.

Barney will have carried interest arise to him from the various funds, but the question of qualifying or non-qualifying carry will never have arisen. Under the rules, the private capital firm would need to make this calculation for Barney to determine whether or not he can rely on the statutory limitations. This is not something a private capital firm will want to undertake, due to the complexity of the calculation. It is possible that the firm simply chooses an alternative European jurisdiction as a way to avoid this issue.

In view of these examples, we would welcome a provision allowing individuals to take the view at a single point in time that it would not be unreasonable to suppose their carry to be qualifying, and to allow this position to govern the application of the statutory limitations.

### *International double tax relief*

While issues of treaty interpretation do not directly affect the drafting of the legislation, they are clearly closely related. We understand that HMRC intends to publish guidance concerning the operation of tax treaties in the context of the new rules. We think it would be helpful if HMRC could set out, in this guidance, its general position on treaty application (including in relation to the application of the "business profits" article: Article 7 in a typical treaty), and then how this might typically apply in some common scenarios.

We have set out below some points we would like to highlight in the context of relief from international double taxation. The first, relating to unilateral relief, is a request for a legislative change; the remaining points concern treaties and are requests for matters to be covered in HMRC guidance.

**Unilateral relief**

We are concerned that the treatment of carried interest as profits of a trade could have an unforeseen impact on the availability of unilateral relief under the Taxation (International and Other Provisions) Act 2010 (TIOPA), should double tax treaty relief not be applicable for whatever reason. Specifically, under TIOPA s9 (Rule 1), if another territory taxes a capital gain under its domestic law, s9(2) allows relief against CGT. If that gain is treated as carried interest for UK tax purposes, and

therefore charged to income tax, it is not clear that relief under s9(2) would be available. S9(1) does allow for credit against tax on chargeable gains, but only in respect of corporation tax.

We would request that a simple change be made either in TIOPA itself, or in the provisions relating to carried interest, so that credit under TIOPA s9(2) is also available against income tax charged under the carried interest provisions.

**Meaning of "enterprise" and "permanent establishment"**

It is important to note that the new legislation differs from DIMF in ways relevant to treaties. Most significantly, while there is one "deemed trade" across arrangements for DIMF, there may be several under the carried interest rules depending upon the number of "arrangements" in question. It would therefore be helpful if HMRC could clarify how it would identify the deemed "enterprise" for treaty purposes, and how a "permanent establishment" might be created.

**Withholding tax**

It would assist taxpayers if HMRC guidance could also cover how credits for withholding and other taxes under treaties will operate. For example, local withholding taxes on dividends, interest and gains (e.g. relating to real estate) should be creditable notwithstanding that UK residents (and some non-UK residents) will be treated for UK domestic law purposes as receiving trading profit. Equally, UK source withholding (e.g. on interest) should be creditable to those paying UK tax on their carried interest.

We would recommend including, within HMRC guidance, an example similar to the following.

Withholding tax – Example 7

Max is a UK tax resident working at a global private equity firm in the UK. £100 of carried interest arises to Max in 2027/28 from a European fund investment. The underlying fund investment return from which the carried interest has arisen is an Italian source dividend. £26 of Italian dividend withholding tax has therefore been deducted from the investment return at fund level.

On the basis that Max is eligible for the UK/Italy double tax treaty and the treaty rate on dividends is 15%, he can claim double tax relief for £15 of the Italian tax suffered at source on his UK personal tax return.

It would also be helpful if the legislation could set out how the s23I tax charge will apply to carried interest arising from underlying payments that have suffered withholding or other tax, and how the treaty credit for the overseas withholding tax would be calculated.

**ECI arising from US investments**

Where US tax is suffered by UK residents on effectively connected income (ECI) from US investments made by the fund, we would expect double tax relief to be available under the UK/US tax treaty or unilaterally in any event. There are, however, different potential interpretations here, so it would be helpful if the position could be confirmed in HMRC guidance.

### Carried interest where individual deceased: section 23K

We note the new s23K provides that where a person inherits carried interest it will continue to be taxed under s23I. The value of the carried interest at the date of death will be subject to inheritance tax at 40% and the draft legislation does not include a mechanism to provide relief for the amount subject to inheritance tax, or the inheritance tax suffered. Absent relief, this could result in a very high effective tax rate (almost 75%).

We would request that it be made clear that either (i) on the transfer of value on death the carried interest is treated as rebased so that only carried interest which arises in excess of the amount subject to inheritance tax remains within the carried interest charge, or (ii) (perhaps preferable and consistent with the treatment of the carried interest as profits of a trade) that any asset representing or deriving its value from an entitlement to carried interest is not (to that extent) treated as an asset for inheritance tax purposes so that there is no transfer of value.

Another option might be to allow credit for any inheritance tax charged, but that is likely to lead to more complication given, for instance, the timing of such charges and application of nil rate bands. Alternatively, a different approach would be to allow any value that is subject to inheritance tax to be a permitted deduction within the carried interest rules.

### Temporary non-residents: section 23L

We are concerned that, as drafted, the legislation may act as a disincentive to individuals to return to the UK, if they are classed as temporarily non-resident when the new rules take effect in April 2026. We would urge the Government to reconsider the effect of the rules on individuals in this category, given the benefits to the UK economy of attracting talented private capital managers to return to live and work in the UK.

In this context we would highlight two characteristics of the new rules, as follows.

The first is that for an individual who falls within s23L(1), s23L(2) provides that they are treated as carrying on a trade for the period in which they return to the UK, and the amount to be treated as the profits of the trade is 72.5% of the amount of the gain that accrued to them while they were non-resident. They will therefore be taxed at a higher rate than if they had stayed in the UK, when they would have been taxed at a maximum of either 28% or 32% depending on when the carry was paid, and would potentially have benefited from a portion of that carry being non-UK sourced if they were non-domiciled or under the FIG regime at the time.

By contrast, under s23L(2), as the individual will be UK resident at that point, they will be taxable at the higher effective tax rate and there is no provision that will allow them to allocate their deemed trade between UK and non-UK workdays, and to pay tax only on the UK portion. In our view this does not align with the policy intention of taxing non-residents only on carried interest that is attributable to work carried out in the UK, and also creates a significant barrier to people returning to the UK who had left in the 5 years prior to April 2026.

The second issue arises from what we consider to be an ambiguity in the drafting. It is clear in principle that an individual should only be taxed once on the same amount of carried interest. S23L appears to create a new stand-alone charge that is independent of s23I. The practical consequence

of this is that if any other UK tax has been paid in respect of the carried interest, the existing double tax provisions in s23P do not apply. Similarly, no deduction for permitted expenses is available in respect of charges under s23L. We suggest that both s23P and s23M are amended to include references to tax charged under s23L.

We would make a further point concerning the interpretation, in this context, of the UK/US double tax treaty. Under the current rules, where a gain arises to a temporary non-resident, Article 24(2)(b) of the UK/US treaty gives primary taxing rights to the US and Article 24(4)(a) then provides that credit will be available for the US tax suffered against the UK tax charge. We note that the new s23L refers to gains arising during a period of temporary non-residence and includes transitional provisions to tax the resulting gain under s23I. We assume that the use of the word "gain" would mean that the treaty analysis would not change and the UK would give credit for the US tax suffered on the "gain" as is currently the case. It would be helpful if this point could be confirmed in guidance.

## Relief from domestic double tax: section 23P

### *Exclusive charge*

We understand that the intention is for the new s23I to be an exclusive charge such that there is no double taxation. However, we are concerned that it is not sufficiently clear that the draft legislation would have this effect, and that there could be ambiguity as to whether the taxation of allocations of fund profits to carry holders is indeed fully "switched off". We would therefore recommend amending the draft legislation to make this clear. In particular:

- s23P(1) provides that "where s23I applies in relation to carried interest arising to an individual, the carried interest is not chargeable to income tax on the individual under any other provisions….". By contrast, the equivalent provision on chargeable gains, in s103KA(2), explicitly says that any other "chargeable gain or loss" that arises "by virtue of an individual's entitlement to carried interest" is "treated as not accruing" to an individual. In s23P(1) there is no such wording to "cancel" other forms of income arising to an individual, and in s23P(1) the mechanism to turn off other tax charges is triggered by carried interest "arising", not by virtue of the "entitlement". This different approach creates some issues, as illustrated below.
- To work as we understand is intended, the legislation needs to make it clear that no other income tax charge will apply where a charge will arise under s23I at any time. For example, where an amount of carried interest is satisfied out of an allocation of income from a partnership and that amount is paid into escrow under arrangements agreed with external investors, the legislation should be clear that no income tax charge will arise until the conditions for release from escrow are satisfied (i.e. there will be no tax charge under general principles even if the sum is not actually taxed under s23I until a later date).
- s23P(2)(b)(ii) states that "*income tax charged on the individual in respect of the individual's entitlement to the carried interest (including income tax charged…..)*". It is not clear that this will cover income tax charged on income arising from carry entitlements already held as well as income tax charged at the time the carry entitlement is granted. We would suggest that language similar to that included in the revised s103KA is adopted for income tax purposes,

so that credit is available for amounts arising "*to the individual by virtue of the individual's entitlement*".

- It would appear, based on the current drafting, that where carried interest is held by a person other than the individual providing investment management services (for example, a spouse or trust), it could also be subject to tax in the hands of that other person. While tax credit would be available to the individual who performs investment management services, the overall tax charge would be higher than it would have been had the individual held the carried interest directly. For example, in the case of interest it would be taxed at 45% rather than around 34.1%. We would query whether this result is consistent with the goal of making s23I an exclusive charge.

### *Transitional matters*

Section 23P allows relief for (i) tax charged on another person and (ii) income tax charged on the individual in relation to their entitlement to carried interest. There does not appear to be any provision to address a situation where an individual had a capital gains tax ("CGT") charge (including under s103KA) prior to 6 April 2026, but carry is also treated as arising to the individual after 6 April 2026.

For example, credit does appear not to be available in the following widely applicable scenarios:

- In the case of deferred carried interest (for example, if a fund level escrow was in place) where there was a general principles charge prior to the introduction of the new rules. In this scenario, an individual would be likely to have paid CGT on their allocation of capital gains from the fund partnership. When carry is subsequently released from escrow post 6 April 2026, a s23I charge will arise.
- Where a charge arose on the individual by virtue of s103KB on the transfer of their carried interest to a company or trust prior to 6 April 2026.
- Where tax distributions were paid by a private credit fund in 2025/26 and therefore taxed under s103KA, but the related allocations of interest income are made in 2026/27.
- Where a private equity fund achieved the investors' "preferred return" prior to 6 April 2026. Gains were allocated to the managers and CGT was paid, but before any actual payments of carried interest were made to the managers in respect of those gains, the overall performance of the fund declined (it "fell out of carry") so no payments were made at that time. Sometime after 6 April 2026, the fund performance improves sufficiently that carried interest will now be paid. Under the rules as drafted it appears that there will be around 34.1% of tax payable on the cash received post 6 April 2026, with no mechanism to offset this against the CGT already paid.

The new s103KA language should allow the individual to treat the original capital gain as not arising, but in practice there are a number of challenges given the time frame over which charges could arise. It is not always possible or practical to amend earlier year tax returns or file overpayment relief claims. We would also draw attention to the cost and administrative burden both for the taxpayer and for HMRC in dealing with these.

We therefore recommend that provision is made to allow for a credit in these situations so that an individual can make a claim for consequential adjustment to be made in their current year tax return

for CGT previously paid. We note that a similar outcome is contemplated in sub-paragraph 36(4)(b)(ii) in respect of the accruals based election.

### Definitions: section 23Q

*Definitions of "AIF" and "collective investment scheme"*

The expanded definitions of "AIF" and "collective investment scheme" are helpful, but two additional clarifications would be greatly appreciated:

- In limb (a) of each definition, it would be helpful to amend so that it refers to arrangements which permit an external investor to participate in investments "**made or** acquired by" the AIF or CIS (for consistency with the wording for funds of funds in, for example, sub-paragraph 29(9)(a)(i) to avoid any suggestion that there is a deliberate distinction being made here).

- For added clarity, it would be helpful if references to "without participating in the [AIF/scheme] itself" could be amended to "without **directly** participating…", so that it is clear that (for example) a (non-AIF, non-CIS) feeder vehicle into an AIF/CIS would fall within this, despite the participants in the feeder indirectly participating in the AIF/CIS.

### Tax distributions: Schedule A1, paragraph 4

The introduction of the tax distributions provision is very welcome. We would make the following suggestions with the aim of ensuring that the provision works as intended.

*Interaction with sums otherwise qualifying as carried interest under the safe harbour in paragraph 2*

We assume that the possibility (or payment) of tax distributions does not prevent other sums arising from the same fund being treated as carried interest under the "safe harbours" in paragraph 2. However, some of our members have raised concerns that the position may not be as clear as it could be.

In particular, we assume that the fact that tax distributions may be received before the conditions in (for example) sub-paragraphs 2(2)(a) and 2(2)(b) are met should not prevent later sums arising from qualifying as "carried interest" by reference to those paragraphs, simply because a sum (the tax distribution) may arise to the carry holder before the conditions are satisfied. That is, we assume that the sum being tested in paragraph 2 is the actual amount that has arisen, and that the potential for tax distributions to be made is irrelevant.

It would be helpful if the legislation could expressly provide that the fact that the amount of a sum arising is (or could be) reduced by prior tax distributions does not, in and of itself, prevent that sum qualifying as carried interest under paragraph 2 of new Schedule A1.

*"Assumed rate" tax distribution systems*

Sub-paragraph 4(2)(a) (which is limb (a) of the definition of "tax distribution") does not appear to cater for the way tax distribution mechanisms operate in a significant proportion of funds. We understood from the working group call on 31 July that the Government is open to amending this provision to reflect how tax distributions are operated commercially, and therefore set out details below to assist with this process.

A large proportion of funds operate tax distributions on an "assumed rate" system under which the tax on carried interest is computed by reference to a specific combined aggregate rate of tax. This could be, and often is, the maximum combined income tax rate applicable to an individual resident in New York. This approach is standard for US-based managers who frequently have to rely on tax distribution language and therefore seek to make the provisions as simple as possible.

The current drafting of limb (a) of the "tax distribution" definition requires that the sum arises "*only if tax becomes payable as a result of the individual's entitlement to carried interest*". That would appear to raise at least two potential difficulties:

- Under an assumed rate system, tax distributions can be payable to an individual irrespective of the extent to which (or even whether) that particular individual is subject to tax at that point in time. Assumed rate systems are designed as an administrative simplification that can reduce operational costs as it avoids the need to determine the individual tax liabilities of each carried interest participant, because that would be incredibly complex in many cases.

    - For example, tax rates and liabilities will often vary by individual circumstances (including income from other sources) on which the fund manager will not have visibility, and the range of jurisdictions involved can greatly increase the complexity on both computation and the timing of tax becoming payable.

    - We note that this assumed tax rate system does sometimes result in UK managers receiving tax distributions when they do not have a corresponding tax liability. This typically happens where the fund manager is US-based and has UK carry recipients who are simply treated the same as their US counterparts (typically for administrative simplicity). Under the existing regime, those UK recipients normally treat receipts of tax distributions as receipts of carried interest, so do pay UK tax on amounts at the time of receipt.

- Only tax distributions arising to an individual appear to be eligible. In practice, the tax distributions may arise to a person other than the individual: for example, if an individual carried interest participant holds his or her carry through a corporate or trust structure (e.g. for local tax reasons or estate planning).

In addition, the requirement that "tax becomes payable" in order for a payment to qualify as a tax distribution has two effects, which we think may not be in line with the overall policy intention.

First, if the intention is to clarify that a distribution that does not meet this condition is not carried interest, that would result in distributions, or a proportion of distributions, made under an assumed

rate system being taxed as DIMF. The managers who operate that system are by their nature internationally mobile, and we understand it is not the Government's intention to place a disproportionate tax burden on this category of manager, because of the potentially negative impact on the UK's competitiveness. It would also be an odd result given that tax distributions do typically satisfy the definition of carried interest irrespective of the new proposed provision.

Second, the definition of tax distribution is also relevant for the conditional exemption (now renamed as the 100% qualifying carried interest regime) in Chapter 6 and ensuring that a fund is treated as being on the "realisation model". Under the proposed drafting it appears that where a fund operates an assumed rate system, managers may not now be treated as receiving all, or a portion of tax distributions on the realisation model. Again, this will have a disproportionately negative effect on international managers who will often in consequence not be able to access the qualifying carried interest regime. That would be a major issue and so at a minimum we would request that the "tax becomes payable" requirement is carved out of the realisation model definition.

### "Sums arising": Schedule A1, paragraph 8

Sub-paragraph 8(9) deems arrangements to have a tax avoidance main purpose where sums are applied directly or indirectly as an investment in an investment scheme. This replicates wording that exists in the current rules, but it results in arbitrary results as it simply penalises investment into any investment scheme (now with the extended definition to include AIFs). This, in our view, limits entirely legitimate investment for no policy reason, and the arbitrary outcome discourages confidence in the fairness of the overall charge.

If there is a policy desire to ensure such amounts are not reinvested in the funds which receive the investment management services in question, we consider that this could be achieved by excluding investments in unconnected investment schemes using the definition in the average holding period ("AHP") rules. A similar point arises on deferred carried interest under the new drafting, in that carry will not be treated as deferred where sub-paragraph 8(9) would apply (i.e. if deferred amounts are invested in an investment scheme). Again, it is not clear why deferred amounts could not be invested in an entirely separate investment scheme (even a UCITs fund or equity tracker) and again an arbitrary result can follow unless a change is made here.

### Unwanted short term investments: Schedule A1, paragraph 18

The amendments to the unwanted short-term investments provisions address many of the issues and concerns raised during the consultation, which is very helpful.

There is, however, still a material concern in relation to the requirement that the disposal of the putative unwanted short-term investment has "no significant bearing" on whether carried interest arises or the amount of any carried interest.

We appreciate that this requirement has been amended compared to the existing legislation by adding "significant" to seek to mitigate this concern. However, that relies heavily on what is considered "significant" in this context.

A fund manager will clearly endeavour to realise the best price possible on disposal of unwanted investments and may do so at a profit; notwithstanding that an investment is unwanted by the fund, it may be more attractive to others. It is not immediately apparent what would be considered to be "significant". At the extreme, it could be argued that all disposals, whether at a gain or a loss, have a significant bearing on carried interest as the timing and amount of returns (if distributed) all feed into the computations of whether carried interest arises.

We appreciate that "significant" has been deliberately chosen to seek to address this issue in a flexible manner. It would be helpful, however, if clarity could be provided on the point we have set out above, for example to confirm that:

- loss making investments can be ignored;
- the timing of the disposal and the fact that there may have been a profit will not be determinative; and
- whether the effect is significant has to be determined by reference to all the facts.

We also have concerns around the requirement in limb (d) of sub-paragraph 18(2) that there should be a "firm, settled and evidenced intention" to sell within 12 months, and what degree of "evidence" is contemplated. This appears to impose an additional hurdle but with limited purpose, given that limb (e) currently requires there to be an actual disposal within 12 months. In the context of the typical timescale of a deal, it is hard to envisage how such a disposal could take place within that timeframe without it being possible to show that this had been planned from the outset. It is not clear to us what this protects against, or adds to the 12 month requirement in limb (e).

Limb (e) is in itself very limiting, as an investment could fail this condition where closing of a deal is delayed for commercial reasons outside anyone's control, even where it has very clearly been planned from the outset. A better and fairer approach, in our view, would be for limbs (d) and (e) to operate on an "either/or" basis.

We would also request the deletion of the words "by virtue of sub-paragraph (1)" in sub-paragraph 29(3). Investments may or may not be held by virtue of sub-paragraph (1) (i.e. through intermediate holding vehicles). We think this looks like a condition that they must be held in this way if they are to fall within sub-paragraph (3), and we assume that this is not intended.

## Average holding period rules: Venture capital funds: Schedule A1 paragraph 23

### *"Acting together"*

We welcome the removal of the "scheme director condition" from the T1/T2 rules for venture capital funds, and its replacement with a condition that requires the fund to be "*entitled directly or indirectly to exercise relevant rights*" in relation to the relevant investee company (the "relevant rights condition"). However, we note that, unlike the scheme director condition, the relevant rights condition does not allow the entitlement of the venture capital fund "*and one or more investment schemes acting together*" (ITA 2007, s809FZK(8)(a)) to be aggregated.

We do not consider that the situation where the venture capital fund is acting together with another fund will be covered by the new "indirect" entitlement wording, as that is still looking at the rights of the venture capital fund itself (rather than rights it can only exercise together with another person). We can see no reason for the removal of the "acting together" concept for venture capital

funds and would urge that it be reinstated. The removal of the concept is particularly problematic for existing funds that have been relying on it to satisfy the "scheme director condition" but may, when the new regime comes into force, no longer be able to benefit from the T1/T2 rules.

### *Trading status*

The T1/T2 rules for venture capital funds, as with the current IBCI rules, require the fund to have a relevant interest in a "trading company or the holding company of a trading group". The requirement for there to be a trading company or group applies to other T1/T2 rules (e.g. significant equity stake funds).

A particular issue that arises for venture funds is that it is typical for them to equity fund small start-up businesses that are not in a position to rapidly deploy the cash. This can give rise to concerns as to whether those businesses are "trading" while a substantial proportion of their assets are cash.

The trading company/group definition comes from the substantial shareholding legislation and there is associated guidance in the Capital Gains Manual. However, it is not focused on the position of venture capital funded businesses in particular, and so it would be helpful if the guidance for the new regime could provide comfort on the trading status of early stage venture capital backed companies.

### *Carried interest in the form of securities*

More generally, as we have raised in previous submissions, the new regime does not contain alleviating provisions in relation to carried interest received in the form of securities in investee companies. This is a common practice in the venture capital sector, and it is common for the executive to be contractually prevented from disposing of the securities until a certain amount of time has passed (or a specified event or events have occurred).

Where carried interest is constituted by a payment in the form of securities, it will be considered to have "arisen" so that a trading income charge will arise. This is likely to be a "dry" charge as no cash will have been received to fund it. This is problematic in itself, but if the securities are later sold at a capital loss, it will not be possible to use that capital loss to offset the earlier trading income charge. This combination of a dry tax charge and the inability to carry back losses to offset it is particularly problematic. This risks making it less attractive to invest in venture capital funds, at a time when the UK needs more of this investment to drive growth.

We would welcome the opportunity to discuss potential solutions to this problem. We noted in our previous submission that in the US, carry in the form of public stock is not taxed until the shares are sold. This could be an option worth exploring, although it does not address the inability to carry back losses.

## Average holding period rules: Credit funds: Schedule A1 paragraphs 27 and 28

Our overall view is that the AHP legislation, as it relates to credit funds, represents a substantial improvement over the previous IBCI wording. However, there are a few points we believe would benefit from further clarification or adjustment before the legislation is finalised.

*Definition of "debt investment" and "credit fund"*

Debt investments are currently defined by reference to the non-trading loan relationship rules. Broadly speaking, this means that qualifying assets are traditional debt instruments (including convertible debt) and foreign exchange holdings. While some credit funds invest exclusively in these types of assets, many also hold debt-like instruments—such as preference shares—that deliver fixed returns but would not fall within the current definition. Additionally, certain funds specialising in Islamic finance structures or significant risk transfer transactions may also fall outside the scope of the current definition.

We would therefore recommend expanding the definition of "debt investment" to include preference shares and any other debt-like investment. This will ensure that funds meeting the definition of a "credit fund" will be able to apply the simplification to most of their assets, particularly where those assets are structured as preference shares, and that most lending funds will meet the definition of "credit fund".

Certain types of credit fund will also invest in large portfolios of secondary credit where the intention is to dispose of or write off large parts of the portfolio very shortly after acquisition (i.e. these are unwanted short term investments) and hold the remainder of the portfolio to maturity or wind down over many years. We would expect that some of these funds would meet the 40 month holding period test. However, they may not be within the credit fund definition as it may not be straightforward to meet the "50% of total value… held for 40 months or more" test based on the private placement memorandum (PPM). We would suggest that the definition is amended to make clear that the test should exclude "unwanted short term investments".

In addition to the above, there are a few technical points on this definition which we would recommend are considered and either clarified in the legislation or confirmed by way of HMRC guidance:

- The reference to an "unconditional" obligation to advance money. It would be useful to have greater clarity as to what this is intended to capture. For example, in respect of a loan facility agreement which provides for different loans to be drawn down at different times (and at the option of the borrower), would the full amounts committed by the lender under that facility be considered an "unconditional" obligation or would this need to be looked at separately each time a loan under the facility is to be drawn down? There is frequently quite a lot of conditionality to advances on loan facilities (e.g. that no events of default are continuing). It would be helpful to clarify that customary conditions to funding do not prevent the debt investment having been made for the purposes of this rule.

- The requirement for a "money debt" in sub-paragraphs 27(6)(a)(i), (ii) and (iii). The definitions here require the debt investment to be both a loan relationship and a money debt, while under the loan relationship rules a debt has to be a money debt to come within the definition of a loan relationship. Building on the concern noted above, this approach could lead to certain transactions being inadvertently excluded due to the different approach to deeming in different parts of the tax code. For example, an alternative finance arrangement is treated as a loan relationship under CTA 2009, s509, but is not a money debt.

- The reference to the "fund" standing in the position of creditor. We anticipate that this is intended to be construed broadly (i.e. to cover loan relationships held by investment holding companies rather than the fund partnership itself). It would be useful for this to be clarified, given that other section of the AHP rules address this directly.

- The definition of “associated” debt investments in sub-paragraph 27(7)(c)(ii). This definition is limited to situations where the debtor is a company which is a member of a group of companies. It would be helpful to add a third limb to this definition to allow for situations where a debtor is not a company, or the economic group of which it forms part is not a group of companies for UK purposes – classic examples being where there is a partnership or LLP as the ultimate parent of a group, or groups in other jurisdictions which do not have the concept of ordinary share capital (such as groups of LLCs in the US). Either an accounting consolidation test or a 75% economic ownership test, rather than a strict UK group relief test, might be more appropriate here. A similar point applies to sub-paragraph 28(3) which also refers to a UK tax grouping test.

*Definition of “equity investment”*

Equity investment is defined by reference to the “qualifying shares” definition in the QAHC legislation. This, broadly, includes shares and derivative contracts in relation to a company. However, it excludes UK property rich companies. From a policy perspective, we are not sure why UK property rich companies have been excluded from being an equity investment. It will often be the case that a loan is made to a UK property rich company, and there may then be a debt/equity swap at some point in the future.

If the intention is to exclude UK property rich companies, then the mismatch between the reference to "an investment in shares" in sub-paragraph 27(7)(b) and the definition of "qualifying shares" in sub-paragraph 53(2) of Schedule 2 to FA 2022 could also be helpfully clarified. Beyond this, we consider that it might make sense to define “equity investment” by reference to any investments in a company or group of companies that are not “debt investments”.

*Disposals of debt investments*

It is common for credit funds to obtain finance by entering into sale and repurchase (or "repo") arrangements under which the loan (or a number of loans) in which an investment has been made will be "sold" to a third party, with the agreement that the fund will later repurchase the loan(s). Depending on the exact nature of the arrangement, the sale of the loan may involve the legal transfer of title of a loan to the third party (whereas in other forms of repo the sale is by way of an equitable assignment).

From the perspective of the credit fund, this would not be considered commercially to be a disposal of an investment as the economic exposure to the underlying borrower/loan remains with the fund. Rather the aim of these arrangements is to enhance asset level returns on investments. A clear statement as to the correct application of the rules in these scenarios would be welcome.

Separately, we consider that further clarification would be helpful in respect of:

- The meaning of "substantially the same terms". When debt transactions are extended, there are often other amendments (e.g. a variation of the margin). Given that in relation to other

tax provisions there have been concerns, and case law, around the meaning of "substantially", we would recommend providing further clarity here.

- A similar issue arises in respect of the meaning of "substantially the same risks and rewards". For example if, in a struggling group, a creditor exchanges a significant secured creditor position for unsecured subordinated debt or equity based on the commercial deal with the creditors as a whole, it is unclear if the creditor would be regarded as being exposed to the same risks and rewards in respect of the debtor's group before and after the exchange. Further elaboration or guidance relating to the meaning of these provisions would be welcome.

- We would suggest that guidance is provided as to an appropriate approach to assessing whether investments are "worth less" for the purposes of sub-paragraph 27(2)(b). Is this by reference to amount invested, accounting value etc?

- The meaning of "repayment date". Is this intended to be a reference to the final repayment date? Certain debt instruments purport to repay and redraw in full on each repayment date during the life of the debt obligation. To minimise the risk of technical breaches of this provision, it may be helpful to refer to the loan relationship ceasing to exist other than by transfer to another person or repayments without a corresponding redrawing of amounts.

*40-month deemed holding period: sub-paragraphs 28(5) and (6)*

We welcome the inclusion of a provision that extends the holding period for investments that are repaid earlier than originally expected, as this is a common scenario for credit funds. However, the current drafting requires that the scheme had "the positive intention and ability to hold the debt investment until the repayment date".

In practice, credit funds often originate long-term debt with the intention of holding it for more than 40 months, but the debt may be structured with a longer maturity than the fund's life, with the expectation that it will be sold or refinanced before the fund winds down. This makes it difficult to satisfy the test in sub-paragraph 28(6)(b). We suggest amending the language to require "the positive intention and ability to hold the debt investment for at least 40 months", which would better reflect market practice and achieve the intended policy outcome.

Additionally, we would propose that the deemed holding period be revised to the shorter of (i) the original expected holding period, or (ii) the life of the debt, rather than a fixed 40 months. As currently drafted, the provision may unfairly reduce the holding period for certain credit funds when large, long-term debt instruments are refinanced earlier than expected.

Finally, we would request that the provision to extend the holding period of debt repaid before 40 months in sub-paragraph 28(5) be extended to situations where a loan is written off or becomes irrecoverable. There seems no reason why failed investments should be treated more harshly than successful ones for the purposes of these rules and the absence of such a provision creates a perverse incentive to maintain irrecoverable positions for holding period reasons, thus impeding the chances of recovery for the underlying business.

## Average holding period rules: All funds: Current sub-paragraph 28(2)

We welcome the inclusion of sub-paragraph 28(2) and it being made clear that where a fund remains exposed to substantially the same economic risks and rewards, there should be no disposal for AHP purposes. However, this provision should not, in our view, be exclusive to credit funds – there are a great many other private equity and other funds which may make an investment initially in debt with a view to obtaining control of a company and converting that debt to equity.

There is some doubt as to whether that conversion leads to a disposal for the purposes of the scheme under the current rules in any event (since the scheme maintains the same economic exposure to the underlying investment). However, the inclusion of specific language to make this clear as set out in sub-paragraph 28(2) would be welcome for all such funds and is, in our view, in line with the policy intention behind the legislation. We also note that the general provision for "loan to own" investments in s809FZV, which was of more general application, has been removed and we assume the intention is not to make the position worse for funds which are not credit funds.

## Average holding period rules: Funds of funds: Schedule A1, paragraph 29

### *Definition of "fund of funds": sub-paragraphs 29(5) and (6)*

As we have highlighted in our earlier submissions, funds of funds and secondary funds are an increasingly significant section of the private capital market, enabling investors, such as pension funds, to access a wider range of assets than would otherwise be practical, and also facilitating long-term investment by providing a mechanism for different investors to exit at different times.

The changes to the definition of "fund of funds" are generally considered helpful and address or mitigate many of the concerns raised in our previous submissions. There are, however, still a number of material concerns.

**Requirement to be a "qualifying fund"**

As an overarching point, we want to highlight, as we have in prior submissions, the complexity and volume of secondaries structures. This applies not only to the investments they hold but also the funds themselves. A secondaries fund will often consist of multiple "funds of one", widely held parallel funds and collateralised products investing as "one platform" into one or more underlying investments (but as each such vehicle would have its own, different, investment strategy, they will not necessarily always invest in the same underlying investments). We would be happy to provide fuller explanations of these structures. In such cases, identifying the boundaries of the "investment scheme" to be tested can therefore pose practical challenges, and guidance or legislation to assist with this would be appreciated.

The introduction of the requirement for an investing fund to meet the "qualifying fund" definition means that certain funds that would currently qualify as a fund of funds or secondary fund would (or may) no longer fall within the new "fund of funds" definition.

For example, a separate managed account that has a single external investor may no longer qualify if the underlying investor is not a "category A" investor within the QAHCs regime definition. In addition, even if an investor seems likely to qualify as "category A", it is not likely to be feasible or commercially appropriate to ask underlying investors to confirm their "category A" status solely for these purposes. Investors are likely to need to take UK tax advice in this regard, which would lead to

increased costs for the investor. Where this only affects the tax treatment of carried interest holders of the fund, and not the investors' own tax liability, or deal structuring more generally, it would be hard for fund managers to justify making such a request.

Similarly, a fund that was widely-marketed may not meet the genuine diversity of ownership condition simply because its fund documents do not contain the statement and undertakings needed to meet "Condition A" of the genuine diversity of ownership condition, and may not have the relevant information in relation to its investors to properly analyse and/or track whether it can meet the non-close condition. We would note that when the QAHC rules were introduced, there was a transitional rule to allow pre-existing funds to make a self-declaration regarding diversity of ownership; an equivalent provision could perhaps be considered here.

Many funds of funds and secondary funds are not established with the expectation of utilising any of the UK tax regimes that rely on "qualifying fund" status (e.g. QAHCs) or similar regimes that rely on the genuine diversity of ownership condition (e.g. UK REITs), so may not have the necessary wording in their fund documents. Depending on when a fund was first marketed, it may not be able to rely on the existing transitional provision at sub-paragraph 9(3)(a) of Schedule 2 to the Finance Act 2022, which allows for a separate statement to be made to satisfy Condition A (a "Condition A Statement") but only if marketed before 1 April 2022.

We suggest the following solutions for these issues:

1. Reinstate 75% external investors test as an alternative qualification option

   It would be very helpful if sub-paragraph 29(6)(c) could be amended to include the existing qualifying condition – i.e. more than 75% of the total value invested in the scheme will be invested by external investors – as an alternative to being a qualifying fund. This would address the issue of some funds that currently qualify as a fund of funds or secondary funds potentially falling outside the new "fund of funds" definition.

2. Condition A Statement as a permanent alternative (or extended transitional provisions)

   The preferred solution would be that any fund, irrespective of when established or marketed, can make a Condition A Statement.

   The Condition A requirement is formalistic and it is not clear what mischief it is intended to address that would not be covered by a Condition A Statement. For reference, we note this formalistic requirement also continues to create unnecessary difficulties in other regimes where the genuine diversity of ownership condition is used (e.g. UK REITs, QAHCs, and RIF exemption elections).

   We appreciate those regimes are outside the scope of this consultation, but we mention for wider context the practical difficulties faced by funds that meet the genuine diversity of ownership condition in substance but can struggle with Condition A where the relevant UK investment holding structure was not envisaged at the time of fundraising. Indeed, the inability to make a Condition A Statement prevents widely offered funds that might otherwise choose to use the UK as a holding jurisdiction from doing so.

   If it is not possible to allow for a Condition A Statement as an alternative in perpetuity, at a minimum we consider that transitional provisions should be extended so that a statement

can be made if the fund (or multi-vehicle arrangements) was (or were) established prior to this new legislation coming into force.

**Issues for multi-strategy funds**

Multi-strategy funds are unlikely to fall within the fund of funds definition because, by definition, they may not be expected to invest at least 80% in investment schemes or in the acquisition of portfolios of investments from unconnected investment schemes. Multi-strategy funds might not fall within any of the other fund-specific definitions either, given the potential breadth of strategies.

There seems to be no policy reason why the fund of funds rules should not apply to multi-strategy funds in respect of such of their investments as are part of a fund of funds or secondary funds-type strategy (with equivalents in relation to strategies falling within the definition of the other relevant fund types). For example, if a fund of funds makes 75% of its investments into investment schemes and 25% of its investments into direct co-invests (that either do not satisfy the definition of investment scheme or that are direct equity investments), we consider that the 75% of fund of funds investments should be able to qualify for fund of fund treatment (and potentially the 25% as some form of equity stake fund).

As noted more generally, the investing multi-strategy fund will often not be able to obtain the necessary information to apply the AHP rules accurately, so the most pragmatic outcome would be to allow them to access the fund of funds rules for investments made for a strategy that would (on a standalone basis) meet the conditions for the fund of funds rules to apply.

*Definition of "investment scheme" and "qualifying investment"*

The change to rely on the investee entity being an "investment scheme" (and the fact the definition is broader than simply an AIF or CIS) helps mitigate a number of concerns both on qualifying as a fund of funds and in relation to which investments are "qualifying investments".

However, there remain concerns that certain very common types of investment may not be caught in all cases. For example, as indicated above, the new definition of "investment scheme" may not capture investments in certain co-investment vehicles (as not all such vehicles would necessarily be an AIF or CIS) and generally would not capture direct investments made alongside an investment scheme (even where the direct investment is only made available to the fund of funds by agreeing to invest alongside the investment scheme).

We acknowledge that the new 80% threshold in sub-paragraph 29(6)(a) mitigates this issue to some extent for qualification as a fund of funds, but it is not a complete solution (and clearly does not help with the "qualifying investment" aspect).

We do not think it would make sense to expand the definition of investment scheme further to capture such investments, given how "investment scheme" is used throughout the draft legislation.

We suggest, instead, that paragraph 29 could be amended to change certain references (e.g. in sub-paragraphs 29(6)(a) and 26(8)(b)) from "*in [an] investment scheme[s]*" to "*in **or alongside** [an] investment scheme[s]*".

*Additional Points*

We have detailed below some additional important points.

**Acquisition from "unconnected" investment schemes**

As highlighted in our previous submissions, there are various scenarios where a fund of funds or secondary fund may acquire portfolios of investments from another scheme with which it is (or may be) "connected". This remains a concern both for qualifying as a "fund of funds" and in relation to the definition of a "qualifying investment".

We acknowledge that the issues are mitigated to some extent by the new 80% threshold in sub-paragraph 29(6)(a) and the introduction of "reasonable to suppose" in sub-paragraph 29(8)(b) for defining a qualifying investment. However, that does not fully resolve the concerns and it remains unclear what the specific concern is regarding acquisitions from connected schemes.

One element of this issue that we would hope is uncontentious concerns investment schemes that share the same third-party AIFM. This might technically cause a concern that the schemes are connected, even though they are not connected in any substantive sense. We would be grateful if a provision could be introduced to clarify that schemes will not be treated as connected solely as a result of being managed by the same third-party AIFM.

**No person may supply management services to both Investing Fund and GP Fund**

As highlighted in our previous submissions, this condition for "qualifying investment" causes problems because investment manager consolidation means that increasingly back office services are being shared by previously unrelated funds. In addition, as noted above, AIFM services may be provided to multiple unconnected funds by the same third party AIFM, in circumstances where the substantive delegated investment management function is being performed by unconnected parties.

The introduction of "reasonable to suppose" in sub-paragraph 29(8)(b) is not expected to mitigate this issue, because the Investing Fund would be aware of the identity of the manager of the GP Fund.

We appreciate that a decision may have been taken that this requirement needs to remain but we would be grateful if a provision could be introduced to specifically carve-out management services provided by the same third-party AIFM.

In addition, the investment management world is a small one and the definition of investment management services is now very wide. We would therefore request a materiality threshold here (i.e. no person provides "material" investment management services).

## Carried interest treated as 100% qualifying carried interest: Schedule A1, paragraph 30

Certain ("open-ended") real estate, infrastructure, and credit funds do not calculate carried interest on the realisation model basis. These funds typically have long-term investment horizons, and their AHP will ultimately exceed 40 months. However, under the current (pre April 2026) rules, carried interest paid within the first four years of the fund's life may qualify for conditional exemption, while carried interest paid between year four and the time when the AHP exceeds 40 months is taxed as income. Once the 40-month threshold is reached, carried interest reverts to being taxed as capital.

The draft legislation adopts the same approach, with carried interest paid in these timeframes being first qualifying, then non-qualifying, then qualifying again. This is clearly an inconsistent result and

we do not see that the Government should regard this as the right outcome from a policy perspective. This type of fund is becoming ever more important in the private capital sector and therefore, while this issue already exists under the current rules, it is becoming increasingly important, and we would urge the Government to take this opportunity to address it. This could be by extending the relevant holding period test to ten years, whether the carried interest is calculated on a realisation model or not.

### Interpretation: Schedule A1, paragraph 35

*Definition of "major interest", in relation to land*

We note that the definition of "major interest" has been amended significantly. In particular, it now captures only fee simple absolute and (broadly) equivalents outside England and Wales, which would appear to exclude (for example) even 999-year leases. This has knock-on implications for the real estate funds provisions in paragraph 26 and, in effect, significantly narrows the application of those provisions. We consider it would be appropriate to amend this definition so that it does not exclude any interests currently falling within the existing definition.

### Average holding period rules: Information gap issues: general comment on Schedule A1

We remain concerned that there are likely to be significant costs and practical difficulties in obtaining the necessary information from underlying investments to apply the AHP rules in practice.

The problem is particularly acute for funds of funds and secondary funds. When making an acquisition in the secondary market, or as a primary investor if the investment is below certain thresholds, it would typically be commercially impossible to obtain the relevant information rights from the underlying fund manager. Even where some information can be obtained, there is the related issue of the sheer volume of information to process; we have previously provided officials with examples highlighting this issue.

These issues may be more manageable for the very biggest fund managers, who may be able to negotiate information rights more readily by relying on the size of their market presence: although, as mentioned above, in secondary deals even the largest managers would not have access to these information rights. Overall, these issues are expected to present real and material issues for a significant proportion of fund managers. We would also reiterate that these are new rules that are so far largely untested by the industry, and as our members begin the process of testing the rules against their structures, increasing difficulties emerge. We would therefore urge the Government to give careful consideration to the simplifications we have requested above.

We appreciate that these points were raised in the submissions that we made as part of the original consultation, but approaching this from a compliance perspective our members would appreciate specific legislative provisions (and in any event, guidance) to help fund managers who are seeking to comply with the requirements, but where there is a lack of information. We would highlight, in this context, HMRC's new guidance at IFM37800, in which HMRC makes clear that it expects managers to use reasonable efforts to obtain information from their firms. This means that the firms, in turn, need to be able to apply the AHP rules, so that they can assist the individuals to comply with their own tax obligations.

Thank you again for the opportunity to respond to this consultation. We look forward to engaging with you further as the rules and the associated guidance are developed.

Yours sincerely

*Abigayil Chandra*

Abigayil Chandra

Chair, BVCA Taxation Committee