English carried interest: the new characterisation presupposes subjection to Income Tax, with adverse effects on expatriates and non-residents

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The new framework requires a review of existing carry structures, because the absence of grandfathering and its taking effect from 6 April 2026 make even arrangements already in place relevant for those payments arising from that date. In parallel, asset management groups must implement robust procedures to track AWP, UK work days, the residence position of individual beneficiaries, and cash-flow analysis.

From 6 April 2026 the United Kingdom radically changed the carried interest regime, which has been brought within Income Tax — albeit under specific rules — but many points remain to be clarified, especially in the case of individuals leaving the country, those who carry out certain activities across multiple jurisdictions, and new residents.

Historically, carried interest was taxed by default as a capital gain, provided that it was linked to the returns of the investment fund — and therefore, broadly, of the vehicle in question — that there was genuine economic alignment with the other investors, and in the absence of parallel arrangements relating to the provision of services. Subsequently, HMRC developed a series of operational tests in order to establish clearly whether a carried interest qualified as income (and was therefore subject to Income Tax), including, inter alia, where it is in fact treated as, or at least comparable to, a success fee (for example where the holding period is less than 36 months), or where the manner of payment resembles a bonus and is included within a remuneration package.

The change, as anticipated, is structural and unprecedented: carried interest is no longer taxed according to the underlying nature of the return of the relevant entity, but as "trading income" (thus as employment or professional income, depending on the case). The newly introduced regime applies where an individual performs, directly or indirectly, their activity within an employment relationship or a provision of services in which part of their remuneration (carried interest) is determined by reference to the economic performance of a specific investment and, generally, is paid over several periods.

The new provisions produce a general recharacterisation effect, with significant consequences not only for the rate (Income Tax at marginal rates of up to 45%, plus pension contributions), but also on the administrative side, since carried interest as reformed, and from April 2026, falls within the ordinary rules of income taxation, including tax reporting mechanisms and withholding obligations, with an evident impact also on the tax governance rules of investment structures.

An important corrective is represented by the mechanism of so-called qualifying carried interest, whereby only 72.5% of the relevant income is subject to tax (with an effective rate of approximately 34% for taxpayers in the highest band). Qualification as qualifying carried interest depends on the weighted average holding period of the investments in the fund. If the weighted average holding period (AWP) is equal to or greater than 40 months, the entire carried interest can benefit from the reduced multiplier; if it is less than 36 months, none qualifies; between 36 and 40 months a progressive mechanism applies instead.

The rules in question also apply where the individual is not tax-resident in the United Kingdom, to the extent that the carried interest is attributable to qualifying activities in the United Kingdom. The connecting criterion adopted is that of UK work days, understood in general terms as the days on which the person carries out at least three hours of relevant activity in the United Kingdom. The legislation and commentary nevertheless highlight certain limitations for qualifying carried interest, including the irrelevance of days prior to 30 October 2024, of days falling within tax periods of non-residence with fewer than 60 UK work days, and, in certain cases, of days prior to a continuous period of at least three years of non-residence with fewer than 60 UK work days per year.

It should also be noted that this provision produces effects even with regard to individuals who have left the United Kingdom and who, during their period of residence, had maintained positions relevant for carried interest purposes. Under the Temporary Non-Residents rules, an individual who acquires foreign tax residence after a qualifying period in the UK and then returns (after less than 5 years) could be subject to taxation on certain income positions (including carried interest) accrued in the meantime.

The first interpretative issue consists in the treaty characterisation of the income. While UK domestic law treats it as trading income, the other contracting State might characterise it as a capital gain: this can give rise to a risk of asymmetric taxation, with a possible risk of double taxation where it is not possible to apply the domestic or treaty provisions on credit for taxes paid abroad.

It follows, inter alia, that the new domestic legislation does not eliminate the need for an analysis of tax residence and of the presence of a personal permanent establishment. On the contrary, it reinforces it: the more the UK extends its taxing power over non-residents, the more necessary it becomes to verify whether the applicable treaty permits or limits that claim, and which State must then grant the relevant tax credit.

The FIG regime, in force from 6 April 2025, replaced the previous regime for resident non-domiciled persons, thereby allowing foreign-source income and gains not to be subject to UK taxation for the first four years of residence.

The central issue is to define where carried interest sits within the relevant income category: since the new UK legislation appears to include it within employment income or income deriving from the provision of services (and not as a capital gain subject to a specific regime), it follows that, except in the (rather isolated) cases of an activity carried out entirely outside the United Kingdom, that income must be regarded as UK-source. The taxation regime at this point would depend on the application of an empirical mechanism: since the FIG allows the individual to make use of a mechanism to exclude part of the trading income based on the days spent on UK territory (so-called Work Days Relief – WDR), the same criterion should apply to carried interest itself.

It is therefore essential that the individual beneficiary of carried interest claims not only the application of the FIG regime but also the WDR in relation to those income items eligible for such relief (since otherwise the risk could be that of being left without an empirical parameter, that is, without the computation of the working days spent on UK soil).