Office for Budget Responsibility

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# Supplementary forecast information release

# Costing of changes to the carried interest regime

1.1 The OBR is releasing this information following a request for further detail in respect of the costing of changes to the carried interest regime, in our October 2024 *Economic and fiscal outlook*. We will, as far as possible, meet any requests to release supplementary forecast information where this will improve the quality of public debate on the public finances. Our full release policy is available on our website.

1.2 This release briefly describes the measure, sets out the data sources and modelling used to estimate the costing, and discusses the main sources of uncertainty around this central estimate, following the OBR's policy costings process.[1] As set out in the *Charter for Budget Responsibility*, the Government is responsible for producing all policy costings. In the case of tax policies the costings are typically produced by HMRC. The OBR's role is to provide independent scrutiny and certification of whether the Government's policy costings are reasonable and central. [2]

## Policy description

1.3 From April 2025, the lower and higher rates of capital gains tax (CGT) on carried interest (CI) will increase from 18 and 28 per cent respectively to 32 per cent.[3] From April 2026, carried interest will be classified as trading profits under the income tax framework at a discounted effective tax rate equivalent to 72.5 of income tax plus Class 4 NICs rates. This will result in an effective marginal tax rate of 34.1 per cent for additional-rate payers (outside Scotland), who receive the vast majority of carried interest.

## Data

1.4 The base data is the latest CGT data from 2022-23 self-assessment tax returns held by HMRC.

1.5 British Private Equity & Venture Capital Association (BVCA) data was also used to estimate parameters like holding periods and average returns where relevant.

[1] See our *Briefing paper No. 6: Policy costings and our forecast*, March 2014.
[2] This means that the full datasets underpinning tax policy costings are generally held by HMRC. Therefore, requests for access to any datasets not available at the sources referenced in this note should be directed to HMRC.
[3] Carried interest refers to the share of profits that executives are entitled to receive from the investments of a fund they manage. For more detail, see the HMRC Investment Funds Manual, January 2025.

## Modelling

### Static costing

1.6 To create the baseline, the base data is projected forwards using the CGT forecast,[4] including the adjustment made for forestalling in advance of anticipated CGT changes.[5] Because of the timing of CI payments and receipts, this adjustment makes very little difference to the final costing.

1.7 The base is adjusted to account for the decreases in the Annual Exempt Amount (AEA) in April 2023 and 2024. From 2026-27 it is also adjusted mechanically to account for the change in the non-domicile foreign income and gains regime announced at the March 2024 Budget. This leads to an approximate 6 per cent uplift in the CI tax base.

1.8 The static costing increases the tax rates on the carried interest gains identified above to 32 per cent from April 2025 and to 34.1 per cent from April 2026. This is done under the assumption that all gains were due to be liable at the existing higher rate of 28 per cent.[6] The resulting receipts are compared to the baseline estimate of receipts, and the increase in revenue constitutes the static costing.

1.9 The move to the IT framework in April 2026 removes the ability to offset CI gains against other CGT losses. HMRC estimated the static impact of this by multiplying the amount of main rate CGT losses that were offset against carried interest gains in 2022-23 by the change in the tax rate at which relief is granted (8 percentage points, the difference between 20 per cent and 28 per cent). With £250 million of losses offset, this led to a static accruals costing of £20 million, which was grown through the scorecard with the baseline growth for carried interest gains. This was then adjusted to account for the change in tax rates that relief would have been granted at.

### Behavioural response

1.10 Carried interest is typically received by fund executives with significantly less freedom over when and how they realise gains than other forms of capital gains (the funds paying carry within the forecast period have largely already been established). For this reason, the behavioural response modelled is different from that for main rate CGT gains. The main behavioural avenue for reducing liabilities is expected to be emigration. There is assumed to be no opportunity for forestalling in between the announcement and implementation of the policy.

1.11 HMRC used a multi-criteria decision analysis (MCDA) approach to assign 25 per cent of gains (around the top-earning 12 per cent of the carry population) in the 2022-23 base to a 'high' behaviour group (who are considered more likely to emigrate in response to the policy), broadly in line with the experience from previous measures affecting high earners,[7]

[4] For more information on the OBR's CGT forecast, see OBR, *Forecast in-depth: Capital gains tax*, April 2024.

[5] See paragraph 4.28 in our *Economic and fiscal outlook*, October 2024. This increased 2024-25 receipts by around £2 billion.

[6] Analysis of SA returns show that over 99 per cent fall into the higher bracket.

[7] Notably the 2017 reforms to the non-domicile regime and HMRC's evaluation of the impacts of that measure.

and the remainder to a 'low' behaviour group (assumed to have a limited response to the policy within the scorecard period).[8]

1.12 For the 'high' behaviour group, a retention rate elasticity of 4.2 was used. This means that for a 1 per cent reduction in retained gains, realised gains are expected to reduce by 4.2 per cent. This is similar to HMRC's estimated retention rate elasticity for changes to the CGT rate for financial gains, and in effect assumes that the 'high' behaviour group would leave the UK were the tax rate to be fully aligned with the marginal rate of income tax.[9]

1.13 For the 'low' behaviour group, HMRC assumed that individuals will be unable to adjust their behaviour relating to funds established before the policy announcement. After the announcement, behaviours may include taking less carry income, increasing co-investment, and switching careers or retiring. Comparing these behaviours to other established elasticities leads to an estimated average retention rate elasticity of 1.4 for the low behaviour group. HMRC assume, based on BVCA data, that in the final year of the forecast period 5 per cent of new funds will begin distributing carry, leading to an effective elasticity of 0.1 for the lower behaviour group in 2029-30 and 0.0 in all prior years. This has a minimal effect on the costing (Table 1.3).

1.14 Behaviours reducing carried interest liabilities will likely also impact tax receipts from other headings, including main rates CGT and income tax and NICs (Table 1.3):

- For the high behaviour group, HMRC assumed that other forms of income reduce by the same proportion as carry income, consistent with the main behaviour for this group being emigration. HMRC used tax return data on main rate CGT and employment income relative to CI gains for this group to estimate the reduction in receipts.

- For the low behaviour group, HMRC assumed that there will be some switching of income to main rate gains. (HMRC assumed no switching to income tax as CI will remain at a preferential rate). They use the standard 12.5 per cent gains-to-income switching assumption, but scale this by 28 per cent in line with the proportion of CGT main rate gains within total non-carry income for this group.[10]

1.15 Taxpayers may also adjust to losing the ability to use other CGT losses to offset CI gains from April 2026 (such as by disposing of fewer assets). To account for this, the static costing for this element of the policy was scaled down by an amount depending on the size of the relief (48 per cent in 2029-30, when the relief would be 10.1 percentage points).

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[8] The choice of factors used in the MCDA model was informed by the literature and expert opinion. It included residency and domicile status, age and length of time spent in the UK, country of origin, foreign versus UK income dependence, presence in the top fraction of carry recipients, and whether an individual had recorded carry income in multiple periods.
[9] This holds for the top-earning 11 per cent of the population, before accounting for interactions across measures. See paragraph 1.16. For more detail on CGT behaviour, see OBR, *Supplementary release: Costing of changes to the main, BADR, and IR rates of Capital Gains Tax*, January 2025.
[10] For more detail on gains-to-income switching, see OBR, *Supplementary release: Costing of changes to the main, BADR, and IR rates of Capital Gains Tax*, January 2025.

## Interactions with other measures

1.16 The costing was mechanically adjusted to account for the increase in main rates announced on 30 October 2024, which reduces revenue gain as lost main rate gains would have been taxed at a higher rate. Additionally, to account for the wider incentive effects of the increase in several capital taxes in the October 2024 Budget on high earners, the size of the 'high' behaviour group was increased from 11 per cent to 12 per cent, in line with the adjustment made to the October 2024 costing of reforms to the non-domicile regime.[11]

## Table 1.1: Key parameters

| Parameter | Value | Description |
|---|---|---|
| **Tax rates (per cent)** | | |
| Change in tax rate on carried interest from April 2025 | 28-32 | Tax rate on carried interest (assuming all gains are to higher rate taxpayers) before and after April 2025. |
| Change in tax rate on carried interest from April 2026 | 32-34.1 | Tax rate on carried interest before and effective tax rate after April 2026 (assuming all gains are to higher rate taxpayers). |
| **Tax base (per cent)** | | |
| Share of carried interest gains received by additional rate IT payers | 100 | All carried interest payments are assumed to go to those whose incomes bring them into the top rate brackets of IT and CGT. |
| Uplift to tax base from the reform to the non-domicile regime. | 6 | The increase to the carried interest tax base resulting from the reformed non-domicile regime. |
| CGT losses offset (£ million) | 250 | The amount of CGT losses offset against carried interest gains in 2022-23. |
| **Behavioural assumptions** | | |
| High behaviour share (per cent) | 12 | The share of the taxpayer population expected to have a response covering emmigration. |
| Retention rate elasticity for high behaviour group | 4.2 | The elasticity of carried interest gains with respect to the share of retained gains. |
| Retention rate elasticity for low behaviour group[1] | 1.4 | The elasticity of carried interest gains with respect to the share of retained gains. |
| Proportion of new contracts distributing in 2029-30 (per cent) | 5 | The share of post announcement contracts distributing carry (0 in every year prior to 2029-30). |
| Proportion of IT change relating to gains shifting (per cent) | 12.5 | The share of overall behaviour that is assumed to represent CGT shifted into income tax following a 1 percentage point reduction in the gap between IT and CGT tax rates. |
| Low behaviour group main rate gains proportion (per cent) | 28 | The proportion of main rate CGT gains within the total non-carry income of the low behaviour group. |
| Reduction in loss realisation in 2029-30 (per cent) | 48 | The behavioural reduction in the value of losses realised that would have been used to offset carried interest gains (lower in prior years). |

[1] This only applies to 5 per cent of gains and only in 2029-30.
Source: OBR

[11] For more detail on the costing of reforms to the non-domicile regime, see OBR *Supplementary release: Costing of changes to the non-domicile regime*, January 2025.

## Table 1.2: OBR determinants used in costing

| | Forecast | | | | | |
|---|---|---|---|---|---|---|
| | 2024-25 | 2025-26 | 2026-27 | 2027-28 | 2028-29 | 2029-30 |
| Pre-measures CGT forecast (£ billion) | 15.7 | 21.5 | 21.1 | 24.2 | 26.8 | 29.3 |
| Equity prices (FTSE all-share index) | 4,537 | 4,742 | 4,918 | 5,092 | 5,271 | 5,461 |

Note: The difference between the pre-measures and post-measures CGT forecast is the direct effect of measures, such as the changes to CGT rates, plus the indirect effect of the policy package on determinants that affect the CGT forecast.
Source: OBR

## Final costing

1.17 The costing rises over time to around £0.1 billion by the end of the forecast. HMRC expects behavioural adjustments to continue beyond the forecast period, particularly for the low behaviour group, which will reduce revenues. The removal of offsetting CGT losses against CI gains slightly increases revenues from 2027-28.

## Table 1.3: Costing of changes to the taxation of carried interest

| | £ billion (unless otherwise stated) | | | | | |
|---|---|---|---|---|---|---|
| | Forecast | | | | | |
| | 2024-25 | 2025-26 | 2026-27 | 2027-28 | 2028-29 | 2029-30 |
| Static costing (CGT and IT + NICs) | 0.0 | 0.0 | 0.2 | 0.7 | 0.5 | 0.6 |
| Behaviour | 0.0 | 0.0 | -0.2 | -0.5 | -0.5 | -0.5 |
| *of which:* | | | | | | |
| High behaviour | 0.0 | 0.0 | -0.2 | -0.5 | -0.5 | -0.5 |
| Low behaviour | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Post-behavioural costing | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 |
| *of which:* | | | | | | |
| Net CGT | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 0.0 |
| Net IT | 0.0 | 0.0 | -0.1 | 0.1 | 0.1 | 0.1 |
| Net NICs | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| *Memo: removing loss offsetting net effect (£m)* | *0.0* | *0.0* | *0.0* | *21.5* | *24.6* | *27.1* |

Note: This table uses the convention that a negative figure means a reduction in PSNB.
Source: OBR

1.18 This policy costing was assigned a 'very high' uncertainty rating.[12] The main source of uncertainty was the magnitude of the behavioural response, with uncertainty over the modelling also being high.

[12] See the 'Policy costings uncertainty ratings database – October 2024' spreadsheet at OBR, *Policy costings*, November 2024.