Policy Report

Reforming the Taxation of Carried Interest: Revenue Modelling

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Executive Summary

'Carried interest' (or 'carry') is one of the main forms of pay in the private equity (PE) industry. Only around **0.01% of the UK population (6,440 individuals) reported any carried interest between 2017 and 2023, but over that period their total carry exceeded £22 billion**. Carried interest is extremely concentrated amongst top executives. In 2020, the **top 100 executives received an average of £15 million in carry each** and paid an average effective tax rate of 29% on their total income and gains (including gains on co-investments taxed at 20%).

Carried interest is currently taxed as a capital gain at a rate of 28%. In June 2024, the FT quoted the then Shadow Chancellor Rachel Reeves as saying: '"I don't think it is right that… **what is essentially a bonus is taxed at a lower rate than employment income**, when you're not putting your own capital at risk". Since entering government, Labour has reiterated its Manifesto pledge to **"take action in respect of the 'carried interest' loophole"** by taxing carried interest like other 'performance-related rewards' and has said it will announce reforms in the upcoming Autumn Budget.

Debates around the appropriate tax treatment of carried interest have centred on a **perceived tension between 'fairness' and fiscal expedience**. It is hard to make the case for taxing carry at lower rates than – for example – the bonuses of bankers or hedge fund managers, except on grounds that doing so is necessary to keep PE executives from leaving the UK. It is therefore unsurprising that **the focus of the PE industry and media has been on the risk of mass exodus** if the Government sees through its Manifesto commitments.

Ahead of the upcoming Autumn Budget, **there remains significant uncertainty about how much potential reforms could raise**. In its Manifesto, **Labour claimed an additional revenue of £565 million per year** by taxing carry like other 'performance-related rewards'. However, prior to the General Election, the **Conservative Government's 'Opposition Policy Costing' (OPC) estimated a revenue loss of up to £900 million per year** from Labour's plan. Until now, these competing claims have not been subject to any independent evaluation.

In this paper, **we assess how much revenue could realistically be raised from increasing the tax rate on carried interest**. This debate has so far been distorted by a lack of quantitative evidence on key characteristics of the carry population relevant to their mobility, with public discourse instead driven exclusively by anecdotes and assertions from industry insiders. This report aims to provide a corrective **based on analysis of de-identified tax data covering all individuals who received carried interest between 2017-2023**.

Policy assumptions

Taxing carried interest as a 'performance-related reward'

The **Government's indication that it plans to tax carry like other 'performance-related rewards' is ambiguous**. Statements made prior to the 2024 General Election seemed to imply alignment with employee performance-related rewards such as bankers' bonuses, which are currently taxed at an effective rate of up to 53.4% (including Employee and Employer National Insurance Contributions). However, such statements have been widely interpreted as seeking to align the tax rate on carried interest with Income Tax on earnings, which is currently a top rate of 45%. **Our main modelling is based on taxing carried interest at a 45% rate**, although we also provide estimates at other rates between 28% to 53%.

International aspects of carried interest taxation

Our modelling assumes that **under the new Foreign Income and Gains (FIG) regime for new arrivals, foreign carry will continue to be exempted for the first four years of residence.** Consistent with the aim of taxing carry like a 'performance-related reward', we expect foreign carry to continue being defined based on where management services were performed. There is also an important policy choice over **how (if at all) to tax carried interest arising to former residents who have performed management services in the UK**. Although taxing former residents could significantly reduce the revenue impacts of emigration, the Government has so far not indicated any intention to pursue this policy so we do not account for it in our modelling.

Estimating the tax base

We first **estimate the tax base for carried interest in 2019/20**. This is not quite as straightforward as simply totalling up reported carried interest from tax returns, because we **must also account for: (1) carried interest that has been 'misclassified'** as residential property gains on tax returns, leading historically to an underreporting of carried interest (although no underpayment of tax); and **(2) foreign carried interest of remittance basis users who have been resident in the UK for more than four years**, which will become taxable under the new FIG regime but is currently not required to be reported to HMRC under the existing non-dom regime (and is also not subject to UK tax).

We then **uprate the 2019/20 tax base to 2025/26 to obtain an estimate of the 'static' tax base in the first year of the reform**, absent any policy changes. Previous estimates have used the projected growth rate in aggregate capital gains published by the Office for Budget Responsibility (OBR); however, the distinctive characteristics of carried interest make this an inappropriate reference point. Instead, we use determinants that are more specific to the PE industry, following Macfarlanes LLP (2024) who apply a methodology developed by Phalippou (2024). Using this approach, our projection of the tax base for 2025/26 is 42% higher than when using the projected growth in aggregate capital gains.

Behavioural responses

The **Opposition Policy Costing** published by the Conservative Government in May 2024 was based on estimates of the overall behavioural response to previous changes in the tax rate on dividends (at the additional rate) and other capital gains. We think that these are an **inappropriate proxy for responses to changes in the tax rate on carried interest**, because this type of pay has very different characteristics from other types of investment income and gains, and carry recipients are a highly specific population.

Instead, our approach seeks to **assess each type of behavioural response separately, with a particular focus on emigration** since this has been emphasised as the most important factor by the PE industry. Unlike the OPC, we draw on the on the specific characteristics of carried interest and the carry population, using relevant quantitative evidence wherever possible. **In absence of quantitative evidence, we make aggregate behavioural adjustments** drawing on our understanding of the policy context and dynamics of the PE industry to assess the direction and magnitude of specific responses.

Emigration

Whilst the image of PE executives as highly international and mobile has some element of truth, we find that there has also been some **hyperbole about the potential emigration response that is not supported by the quantitative evidence**. Three main factors drive this conclusion:

(1) For most carry recipients, the effect of the reform on their total take-home pay would be small. This is because the bottom 80% of carry recipients receive on average only around one third (35%) of their total pay from carry. Even amongst the top 100 best-paid executives, the carry share is still only 60% on average, meaning that an increase in the tax rate on carry from 28% to 45% results in a reduction in take-home pay of 'only' 16%.

(2) Although carry recipients are indeed highly international, they are mostly settled in the UK. Almost half of all carry recipients are foreigners, broadly in line with other top paying positions in the UK financial sector. However, over 90% of carry going to foreigners is received by executives who have lived in the UK for 10 years or more, who are therefore likely to be relatively 'sticky' in their location decisions.

(3) Carry recipients are no more mobile than other top earners. After five years' residence, only around 5% of foreign carry recipients leave each year, declining to 1-2% per year for the longest stayers. Whilst private equity executives clearly travel a lot for work, the quantitative evidence does not suggest a population that is highly mobile in terms of where they live.

These insights can be integrated within a structural model of emigration that allows us to **estimate the likely response of carry recipients based on evidence from past reforms affecting the taxation of top earners in the UK**. Even in a

'worst case' scenario (using the most pessimistic plausible parameters), an increase in the tax rate on carried interest from 28% to 45% only results in a 7.3% reduction in the number of carry recipients living in the UK. Around half of the resulting revenue reduction is due to the cross-base effect on Income Tax: we assume that emigrants not only stop paying UK tax on their carried interest, but also on all other sources of income. Even accounting for this, **'post-emigration' revenue would be negative only if at least two out of every five foreign carry recipients (39%) left as a result of the reform, far exceeding our plausible worst case scenario**.

Other responses

We also assess the impact of other behavioural responses including: (1) **retiming** of carry payments; (2) **tax planning and avoidance** strategies; and (3) **effects on labour supply** (hours, effort, retirement) of PE executives. There is little or no existing quantitative evidence available to estimate these margins of response separately. Consequently, we qualitatively assess their impact and then apply an aggregate reduction to the total 'post-emigration' tax base. This adjustment is necessarily impressionistic, so we consider a range of adjustment percentages, according to 'low', 'central' and 'high' response scenarios. This **adjustment equates to a reduction in the total tax base of between 5% (low) to 15% (high) if carry is taxed at a 45% rate**. We assume that these other responses would be proportionally smaller for smaller changes in the tax rate.

'Post-behavioural' revenue estimate

We estimate that **under our central scenario for behavioural response, increasing the tax rate on carried interest to 45% would raise additional revenue of £0.8 billion per year** using the 2025/26 tax base. However, this estimate is subject to high uncertainty, so we also provide estimates for our 'worst' and 'best' case scenarios, resulting in a **plausible range of between £0.3 billion and £1 billion in additional revenue**. These estimates are only for the direct revenue effects of the reform and do not account for indirect effects on the wider economy. They are also subject to the limitations and uncertainties discussed below.

In Appendix A, we also provide estimates for **alternative tax rates on carried interest between 28% and 53.4%**, which is the effective rate on employment income. In our **worst case scenario, we find that the revenue-maximising ('Laffer') rate is between 44% to 47%**, although increasing the rate above 35% only raises an additional £100 million in revenue, excluding indirect effects. On our central and best case scenarios, we find no Laffer effect below 53%. However, this finding should be treated with caution given that **our modelling is not well-calibrated to account for tax rates on carried interest above 45%**.

Main uncertainties and assumptions

Migration response

The extreme concentration of carry makes the aggregate revenue effect of reforms sensitive to the idiosyncratic responses of a **small number of top executives**. Our modelling accounts for the key characteristics of top executives and estimates individual-level responses, but nevertheless there is a high degree of statistical uncertainty. We also do not account for **coordinated responses at firm level**. This factor could cut both ways since 'bad leaver' clauses make uncoordinated emigration more difficult than in other industries. Nevertheless, we recognise that coordinated responses could be important amongst firms that have multiple European offices. Finally, our migration estimate does not account for the impact of the reform on **immigration**. Over the short to medium term, this impact is likely to be small because only 1% of carried interest and 1.5% of other pay (amongst carry recipients) goes to new arrivals to the UK.

Indirect effects

Our estimates **assume that emigrants' jobs are not replaced and there are no spillover effects on other jobs**. Over the longer term, labour market adjustments could compensate for or exacerbate this effect. To the extent that emigration results in a reallocation of work outside the UK, there would be a negative **impact on supporting industries** such as legal and financial services, although this co-dependence is also one of the factors leading to the agglomeration effect, which tends to make wholesale relocation of PE firms (or offices) more difficult and less likely. Finally, because the tax treatment of carry recipients does not depend on where their investments are located, **wider impacts on UK investment** would depend on the extent of 'home bias' by PE executives, and whether PE is the marginal investor.

Impact of policy choices

Our modelling assumes that the only policy changes are an increase in the tax rate on carried interest under the existing statutory framework, and the application of the new 4-year FIG regime to carry. Other policy designs could result in more or less revenue being raised. A **co-investment threshold would reduce revenue** by preserving preferential tax rates for some carried interest; the effect on revenues would depend on take-up, which in turn would depend on the specific design. Conversely, the Government could **increase revenue and reduce emigration by taxing emigrants** in respect of carry earned prior to departure. This could be achieved either by treating emigration as a deemed disposal of carried interest entitlements or by taxing former residents on carried interest attributable to management services performed in the UK.

Time horizon

Our modelling focuses on the short-term revenue effects of the reform. Specifically, we estimate post-behavioural revenue in 2025/26, although we would not expect revenues over the fiscal 'scorecard' window (i.e. up until 2029/30) to differ substantially from this, for several reasons. First, we expect that most of the emigration response would be one-off, and any immigration effects are unlikely to significantly impact revenues over the short-term. Second, any tax planning and avoidance effects are likely to be small because executives are likely 'locked in' to existing arrangements for funds that have already been formed and will pay carry within the next five years. Third, international evidence suggests labour supply responses of top earners are largely mediated via switches between firms, such that these effects are likely to be muted over the short-term.

The longer-term effects of the reform (after 2030) are highly uncertain and could differ substantially from the short-term effects. The impact on revenues and other economic outcomes would depend on labour market adjustments if the stock of foreigners working in the PE industry declines. Over this longer time horizon, the impacts of the reform on the structure of PE pay and other legal arrangements (which are largely locked in for existing funds) would also start to manifest. Finally, the international competitive landscape for PE could look very different in several years' time, depending on how other countries' preferential tax regimes for carried interest evolve. Although we speculate on some of the forces at play here, these longer-term effects are highly uncertain and cannot be predicted (by us or anyone else) with confidence.

1. Introduction

'Carried interest' (or 'carry') is one of the main forms of pay in the private equity industry. In a companion paper to this one (Advani et al, 2024), we provide some key facts about who gets carry, how much they received, and how much tax they paid, using de-identified tax data accessed via HMRC. Only around 0.01% of the UK population (6,440 individuals) reported having received carried interest at any point in the seven years from 2017 to 2023,[1] but over that period their total carry exceeded £22 billion. In 2020, the top 100 executives received an average of £15 million in carry each and paid an average effective tax rate of 29% on their total income and gains (including gains on co-investments taxed at 20%). Since entering government, Labour has reiterated its Manifesto pledge to "take action in respect of the 'carried interest' loophole" and has said it will announce reforms in the upcoming Autumn Budget.[2]

There remains significant uncertainty about how much these reforms could raise. In its Manifesto, Labour claimed that taxing carried interest like other 'performance-related rewards' would generate additional revenue of £565 million per year. The private equity industry has disputed this, citing concerns that such a reform could lead to a mass exodus of executives from the UK. In the past, recipients of carried interest have also proved highly adept at tax planning, which could further reduce the final tax take. Prior to the General Election, the Conservative Government published an 'Opposition Policy Costing' (OPC) claiming that Labour's plan could actually end up costing the Exchequer up to £900 million per year.[3] However, that estimate has not (until now) been subject to any independent evaluation.

In this paper, we assess how much revenue could realistically be raised from increasing the tax rate on carried interest. First (in Section 2), we outline the policies that we model, which reflect the Government's stated commitments to taxing carried interest like other 'performance-related rewards' and replacing the non-dom tax regime with a 4-year regime for new arrivals. In Sections 3 and 4, we build on Advani et al (2024) to estimate the size of the carried interest 'tax base', and the amount of revenue that would be raised from increasing the tax rate in the absence of any behavioural response. In Section 5, we evaluate the Conservative Government's OPC estimate and explain our own (different) approach. Section 6 provides our estimate of the likely emigration response, based on new quantitative evidence combining the effects of previous reforms and information about the carried interest population. Section 7 discusses other behavioural responses including tax planning.

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[1] Editorial note: tax years are referred to by the later year e.g. '2022' is tax year 2021/22.
[2] https://www.gov.uk/government/calls-for-evidence/the-tax-treatment-of-carried-interest-call-for-evidence
[3] HMT, 'Opposition Costings: Carried Interest' dated 26th February 2024.

Combining these steps of our analysis, in Section 8 we provide our own estimate of how much revenue would be raised from increasing the tax rate on carried interest, after accounting for the direct effects of behavioural responses applied to the projected static tax base for 2025/26. In our 'central' scenario for emigration and other responses, we estimate that raising the tax rate on carried interest to 45% would raise £0.8 billion in 2025/26. Given the high degree of uncertainty regarding emigration and other behavioural responses, we provide estimates for a plausible range of responses. In our 'worst' case scenario, which implies a reduction the number of carry recipients living in the UK of 7.3%, we estimate that the reform would still raise £0.3 billion in additional revenue. These estimates do not account for any indirect effects of the reform on the wider economy (which are even more uncertain), although we discuss these factors in Section 6.

2. Policy Assumptions

Our revenue modelling is based on two policy assumptions derived from official government statements published on 29th July 2024, which indicate in broad terms the policies that the Government intends to announce at the upcoming Autumn Budget:

(1) Tax carried interest like other 'performance-based rewards'[4]
(2) Replace the existing non-dom regime with a 4-year foreign income and gains (FIG) regime for new arrivals[5]

Below, we explain some of the design choices that the Government will face in implementing these policies, and the specific assumptions included in our modelling.

Our estimates do not account for any other policy options that have been 'floated' during recent debates over the tax treatment of carried interest, most notably the proposal by the private equity industry for a 'co-investment threshold' that would preserve preferential tax treatment of carried interest under certain qualifying conditions. The revenue effects of such a policy would be highly sensitive to the design (which would be the major determinant of take-up by private equity executives), and in the absence of any information on this we are unable to provide a quantitative estimate.

2.1 Taxing carried interest as a 'performance-related reward'

Although taxing carried interest like other 'performance-related rewards' may initially sound straightforward, there are several important design choices that need to be specified. At a high level, the Government will need to choose between simply increasing the tax rate on carry within the existing statutory framework for carried interest or embarking on a more radical (and complex) reform that would bring carried interest into charge under Income Tax. In our view, increasing the tax rate under the existing statutory framework is far more likely – and is also far more straightforward to model – so we focus on this option. However, we also briefly discuss the alternative below.

2.1.1 Increase rate within existing statutory framework

The simplest way of implementing Labour's apparent policy intent would be to adjust the current rate that applies to carried interest (28%) to some increased rate, without making any other legislative changes. Since 2015, carried interest has been charged to Capital Gains Tax under a 'bespoke' legislative framework that applies only to carry.[6] This framework sets out specific rules for how the chargeable gain

[4] https://www.gov.uk/government/calls-for-evidence/the-tax-treatment-of-carried-interest-call-for-evidence
[5] https://www.gov.uk/government/publications/2024-non-uk-domiciled-individuals-policy-summary/changes-to-the-taxation-of-non-uk-domiciled-individuals
[6] TCGA 1992 Part III Chapter 5.

should be calculated in relation to various types of underlying fund asset, addresses international issues such as 'foreign' carry and double taxation, and answers several ancillary questions. The purpose of this bespoke framework was to counter some of the planning strategies developed by the private equity industry when carry was taxed under the general rules for capital gains, such as 'base cost shift'.

Under this approach, the only policy choice is which rate to adopt. The Government's aim to tax carry like other 'performance-related rewards' is ambiguous, because under our current tax system, the effective tax rate on performance-related rewards depends on the legal form under which the work was done:

- **Dividend rate (39.35%)** – dividends could be considered a 'performance-related reward' for company owner-managers. The top rate on dividends is 39.35%, which might be seen as an appropriate rate for alignment since most private equity fund assets are shares. This rate accounts for the fact that dividends are – generally – paid out of company profits that have already been subject to Corporation Tax. Gains on the sale of shares have not been paid directly out of profits but the sale price will typically reflect the expectation of future profits.

- **Partner rate (47%)** – any performance-related rewards received by partners in the course of their trade are taxed at a top rate of 47%, comprising 45% Income Tax plus 2% National Insurance Contributions. There is debate about whether private equity executives are (as a matter of current law) 'trading', but that is not the issue here. Instead, the purpose of taxing carry at this rate would be to achieve parity with the performance-related pay of partners who are trading (such as hedge fund managers).

- **Employee rate (up to 53.4%)** – performance-related rewards obtained by employees as a result of their employment are again taxed at a top rate of 47%. However, employers are also required to pay Employer National Insurance Contributions, resulting in an effective rate (depending on incidence) of up to 53.4%. Although not always appreciated, this is the effective rate that currently applies to bankers' bonuses and (non-tax-advantaged) share options of senior managers.

On 17th June 2024, the FT quoted the then Shadow Chancellor Rachel Reeves as saying: '"I don't think it is right that … what is essentially a bonus is taxed at a lower rate than employment income, when you're not putting your own capital at risk". This seems to imply alignment with employee performance-related rewards such as bankers' bonuses, which are currently taxed at an effective rate of up to 53.4%. However, this statement has been widely interpreted as intention to align the tax rate on carried interest with Income Tax on earnings, implying a top rate of 45%.

Our main modelling is based on a 45% rate, although due to the variety of possible rates highlighted above, we also provide revenue estimates at higher and lower rates (see Appendix).

2.1.2 Charging carried interest to Income Tax

Beyond just changing the tax rate, a more radical reform would be to bring carried interest into charge under Income Tax (i.e. to tax it directly 'as income'). Since there are multiple different charges to Income Tax according to the type of income, there are again several options here. One option would be to bring carried interest within the existing regime for taxing other income from investment services, by removing the existing carve-out for carried interest under the Disguised Investment Management Fee rules. This would effectively make carried interest taxable on the same basis as profits from a trade (i.e. an effective tax rate of 47%).

There could be several implications from bringing carried interest fully into the Income Tax regime. For example, the timing of tax charges and payments could be different, there may be different allowances and reliefs available, and the treatment of losses is different for Income Tax and Capital Gains Tax. All these impacts are still relatively minor compared with the effect of a change in the tax rate, but since they entail changes to the tax base, they would be much more difficult to estimate using existing available data. The revenue effects would also depend on the specific policy designs chosen. For these reasons, we do not attempt to provide any estimate of this policy option.

2.2 International aspects of carried interest taxation

There are two key policy choices facing the government regarding the international aspects of carried interest taxation, which both have implications for revenues. First, the Government has announced its intention to replace the existing non-dom tax regime with a 4-year foreign income and gains (FIG) regime for new arrivals. However, it remains uncertain how carried interest will be treated under this new regime. Second, it will be necessary to decide how (if at all) to tax carried interest arising to non-residents, including carry paid to former residents in respect of management services performed while living in the UK. The latter policy issue significantly affects the short-term revenue impacts of emigration, which (as we discuss below) is a first-order consideration in the overall behavioural response to an increase in the tax rate on carry.

2.2.1 Carried interest and the new FIG regime

In the March 2024 Budget, the Conservative Government announced the abolition of the existing non-dom tax regime and its replacement with a new 4-year 'Foreign Income and Gains' (FIG) regime for new arrivals. The Labour Government has announced its intention to proceed with these reforms. Consequently, it is likely that from April 2025, UK-resident private equity executives with more than four years of UK residence who currently claim the remittance basis will face UK tax on an arising basis on their worldwide carry, regardless of where their management services were performed.

The future position for individuals who are still within the first 4 years of residence is less certain. One question is whether carried interest should be within the scope

of the new FIG regime, the new Overseas Workday Relief (OWR) regime, or neither. A second question, if carried interest is within either the FIG or OWR regime, is how 'foreign' carry should be defined. We will address both of these issues below. However, before doing so, we outline the tax treatment of carried interest for remittance basis users (RBUs) under the current regime, since this is likely to form the starting point for reform.

At present, RBUs are not taxed on foreign carried interest unless it is remitted to the UK. The carried interest regime, in turn, defines 'foreign' carried interest as that relating to investment management services performed outside the UK.[7] The method for allocating carried interest between UK and foreign source based on the location of services is not defined in the legislation and HMRC guidelines only indicate that this needs to be done on a 'just and reasonable basis' depending 'on the facts and circumstances of each particular instance'.[8] Although foreign carry is defined by where the individual performed their management services, it is not within the OWR regime (which allows the remittance basis to be applied to earnings from overseas workdays), so unlike OWR is not limited to the first three years of residence.

If the new FIG or OWR regime is applied to carried interest, we assume that foreign carry would continue to be defined based on where the management services are performed. This approach would be much more consistent with the government's broader policy intent to treat carried interest like a 'performance-related reward' than if it was instead defined by the location of the underlying investment assets, in line with the general principles applicable to capital gains (as used to be the case prior to 2015). For the same reason, we think that the duration of the tax exemption for foreign carried interest should be aligned with the new OWR regime, rather than the new FIG regime. However, the Government has not yet confirmed the duration of the new OWR regime and has only stated that this regime will be retained 'in some form'.[9] Under these circumstances, for the purposes of our modelling, we assume that the exemption for foreign carried interest would last for the first four years of residence, the same as under the proposed FIG regime.

2.2.2 Taxation of carried interest on non-residents

The international dimension of the UK's taxation of carried interest is currently asymmetric. As already discussed above, the UK effectively exempts carried interest in respect of management services performed abroad for resident non-

[7] TCGA 1992 s 103KC. This provision suggests that the legislation tacitly acknowledges that carry has the character of a return on work and not capital, as the connecting factor is the place where the services where provided. Based on international tax principles, this connecting factor is consistent with employment income (Article 15 of OECD Model convention) and not with returns from capital where the relevant connecting factors are the location of the assets (for gains from immovable property and withholding taxes on dividends paid by companies) and the residence of the owner (for the rest of capital gains).
[8] HMRC (2024), Investment Funds Manual IFM37322 - Foreign Chargeable Gains: Apportionment: Location of services performed.
[9] HMT (2024), "*Policy paper. Changes to the taxation of non-UK domiciled individuals*".

doms who claim the remittance basis. But for non-residents, the UK currently observes a strict residence basis of taxation regardless of the location of the management services. Consequently, carry arising to an individual who is non-resident is not taxable in the UK even if it relates to management services performed in the UK, and even if the individual is a former UK resident (unless they return to the UK within six years).[10] In our view, this asymmetry is difficult to justify. It can also be highly costly in circumstances where UK-resident private equity executives emigrate prior to receiving carry that was earned from services performed in the UK.

There are three potential policy solutions to this problem:

(1) **Tax UK-source carry on non-residents** – under this option, the regime could shift to a source basis of taxation of carried interest, such that carry relating to management services performed in the UK would be taxable for non-residents. This approach may be challenging from an administrative perspective, as it would require all private equity executives who visit the UK for work purposes to allocate a portion of their carry to the UK for tax purposes. It also risks making the UK less attractive as a location for private equity houses, as it would impose a high tax compliance cost on their foreign executives visiting UK offices. Consequently, we do not recommend this option.

(2) **Tax UK-source carry on former residents** – this is similar to the option above but would only impose UK taxation of carry on a source basis for former UK residents. Specifically, for a defined period after departure,[11] former residents would remain liable to UK tax on any carry arising to them, insofar as the carry related to management services performed in the UK. This 'tail' would significantly reduce opportunities for tax planning, as ceasing to be UK resident in anticipation of a large carry payout would no longer be effective to avoid UK tax in circumstances where the carry was attributable to the period of UK residence.

(3) **Deemed disposal of carry entitlement on departure** – a final option would be to treat the right to carry as a capital asset which is deemed to be disposed of on becoming non-resident. Thus, a CGT charge (at the rate applicable to carried interest) would apply on becoming non-resident, based on the value of the right to the carried interest at the time of departure. This option has the advantage of a 'clean break', negating the need for enforcement against individuals some years after they have left the UK (as would be required with a 'tail'). The downside is the difficulty of valuing the carried interest entitlement prior to the fund actually having exited its investments.

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[10] TCGA 1992 s1M.
[11] The definition of 'former resident' would need to establish a relevant time-period. Given the lifecycle of a typical private equity fund, a 10-year tail would seem to be a suitable timeframe.

Since the Government has given no indication that it wishes to pursue any of these options, we have not directly included them in our modelling. However, a policy of taxing the carried interest of emigrants would have significant implications for the revenue impacts of emigration resulting from an increase in the tax rate on carried interest. Consequently, we return to this issue when discussing the likely migration response (Section 6) and our post-behavioural revenue estimate (Section 8).

3. Estimating the tax base

Although HMRC has released some statistics on total reported carried interest via responses to Freedom of Information (FOI) requests, the Government does not currently publish any official statistics on carried interest, and (until ours) there have been no independent studies on this topic. In our companion paper (Advani et al, 2024), we estimate the tax base for carried interest and note that the few statistics that have been published on carried interest underestimate the total carried interest arising to UK residents in two respects. First, we have identified cases where carried interest appears to have been 'misclassified' as residential property gains on the SA108 tax form, leading to an underreporting of carried interest (although no underpayment of tax). Second, the foreign carried interest of remittance basis users does not need to be reported to HMRC under the existing non-dom regime, and so is missing from standard estimates (and is also not subject to UK tax). We explain below how we account for each of these issues in our main revenue estimates.

3.1 Misclassified carried interest

Since 2017, taxpayers have been instructed to report the amount of carried interest received in a specific box on the self-assessment return (Box 13 in SA108). For the period that we analyse (2018-2020), the total amount of carry reported in Box 13 is £2.6 billion per year on an average, corresponding to a total of 2,360 individuals per year. However, Box 13 does not affect a taxpayer's final tax calculation, so there is a risk that some carried interest is not actually reported in this box, but is only included in the box for total gains taxed at 28% (Box 6), resulting in carried interest being misclassified as residential property gains.[12] In principle, the design of the SA108 form could also result in false positives (i.e. residential property gains reported as carried interest). In our estimation of the tax base, we correct for both types of case.[13] On average, this correction adds around £270 million in carried interest per year over 2018-2020, leading to an adjusted estimate of 2,390 carry recipients per year and bringing total carried interest to £2.8 billion per year.[14]

3.2 Unremitted carried interest

HMRC does not currently collect information on the amount of foreign carry received by remittance basis users (RBUs). In Advani et al (2024), we develop a methodology for estimating the unremitted carry of RBUs, which we can use to

[12] This problem could have been avoided if the box for reporting carried interest had been structured differently on the form, such that it fed directly into the tax calculation. This change to the tax form will now occur anyway as a result of the change in tax rate on residential property gains to 24% (from 2024/25).
[13] For a full explanation of the methodology, see Advani et al (2024).
[14] Advani et al (2024) estimated an additional £274 million (11% of the total carry reported on SA108) per year in carry from false negatives (carried interest reported as residential property gains) and £500,000 per year (0.02% of the total carry reported on SA108) from false positives (residential property gains reported as carried interest), using data from 2017/18 to 2019/20.

Table 1: Estimate of tax base for carried interest, 2019/20

Reported Carry (From SA108 Box 13)		**+ Misclassified Carry** (Carry reported as residential property)		**- Misclassified Carry** (Residential property reported as carry)		**+ Unremitted Carry**	**Final Estimate of Carry Tax Base**	
Value (£mn)	**Count**	**Value (£mn)**	**Count**	**Value (£mn)**	**Count**	**Value (£mn)**	**Value (£mn)**	**Count**
2,698	2,669	266	335	0.8	426	175	3,138	2,608

Notes: The estimates are based on 2020 data.

Source: Advani et al (2024)

model the tax base for 2025/26. As an overview of our methodology,[15] we estimate the worldwide (foreign plus UK) carry of RBUs by matching them to UK-domiciled carry recipients (who are therefore not eligible for the remittance basis) with comparable levels of total earned income (which includes the management fees they are paid from the fund). The difference between this estimate and the amount of carry that the RBUs report is our estimate of foreign unremitted carry. We estimate total unremitted carry to be £280 million per year between 2018 and 2020.

From April 2025, the existing non-dom tax regime will be replaced by a new 4-year FIG regime for new arrivals. As discussed above, we assume that this FIG regime would apply to foreign carried interest arising within the first four years of arrival. For the purpose of modelling the tax base on carried interest that will apply from 2025/26, we therefore restrict our estimate of unremitted carry to RBUs who have been residents in the UK for more than four years. In addition, we restrict the amount of unremitted carry for affected RBUs to be less than or equal to the amount of their UK reported carry, on the assumption that – for long-term resident RBUs – it is unlikely that more than half of their worldwide carry is attributable to management services performed abroad. These adjustments result in an addition of £175 million to the (counterfactual) tax base for 2019/20.

[15] For a full explanation of the methodology, see Advani et al (2024).

4. Static revenue estimate

Using the tax base estimated in the previous section, we next provide a 'static' estimate of the additional revenue from increasing the tax rate on carried interest. This models the mechanical effect of the reform without accounting for any behavioural response. We first provide an estimate using the 'counterfactual' tax base in 2019/20, based on outturn self-assessment data (including misclassified carried interest) for that tax year and adjusted to include our estimate of the unreported foreign carry of remittance basis users who have been residents in the UK for more than four years. Second, we scale up this estimate to account for projected growth in the total amount of reported carried interest (assuming no behavioural response from the reform) between 2020 and 2026, to obtain a relevant estimate of the static revenue in the first year of the reform.

4.1 Counterfactual revenue in 2019/20

In our central scenario, we calculate the additional revenue that would be raised if carried interest were taxed at 45% (instead of 28%). This would have raised additional revenue of £0.5 billion in 2019/20, from a static tax base of £3.1 billion. We also calculate the revenue for alternative tax rates and summarise the results in Table 2.

4.2 Projected revenue in 2025/26

Next, we estimate the static revenue from increasing the tax rate on carried interest in the first year of the reform (2025/26), allowing for growth in total carried interest since 2020 but not accounting for any behavioural response from the reform.

A straightforward approach would be simply to assume that carried interest will grow in line with aggregate capital gains. This was the assumption used in the Opposition Policy Costing (OPC),[16] which applied the Office for Budget Responsibility's (OBR's) forecast for growth in total Capital Gains Tax (CGT) receipts between 2022 to 2026.

However, as we discuss further below, carried interest has some distinctive characteristics which mean that that other capital gains may not be an appropriate reference point. Figure 1 shows that carried interest was more volatile than other capital gains and exhibited faster growth overall between 2017 and 2022. If we restrict the comparison to unlisted shares – on the basis that most carried interest derives from this type of gain – we again find faster but more volatile growth for carried interest. These comparisons suggest that it would be preferable to forecast carried interest using determinants that are more specific to the private equity industry.

[16] HMG, 'Opposition policy costing – Carried Interest – Labour Party' 26 February 2024 (published 7 March 2024).

Table 2: Static revenue estimate with 2019/20 tax base

Tax rate	Static revenue estimate (£bn)	Additional revenue (£bn)
No reform (28%)	0.9	-
Dividend rate (39.35%)	1.2	0.4
Income Tax rate (45%)	1.4	0.5
Income Tax rate + Employee NICs (47%)	1.5	0.6
Income Tax rate + Employee NICs + Employer NICs (53.4%)	1.7	0.8

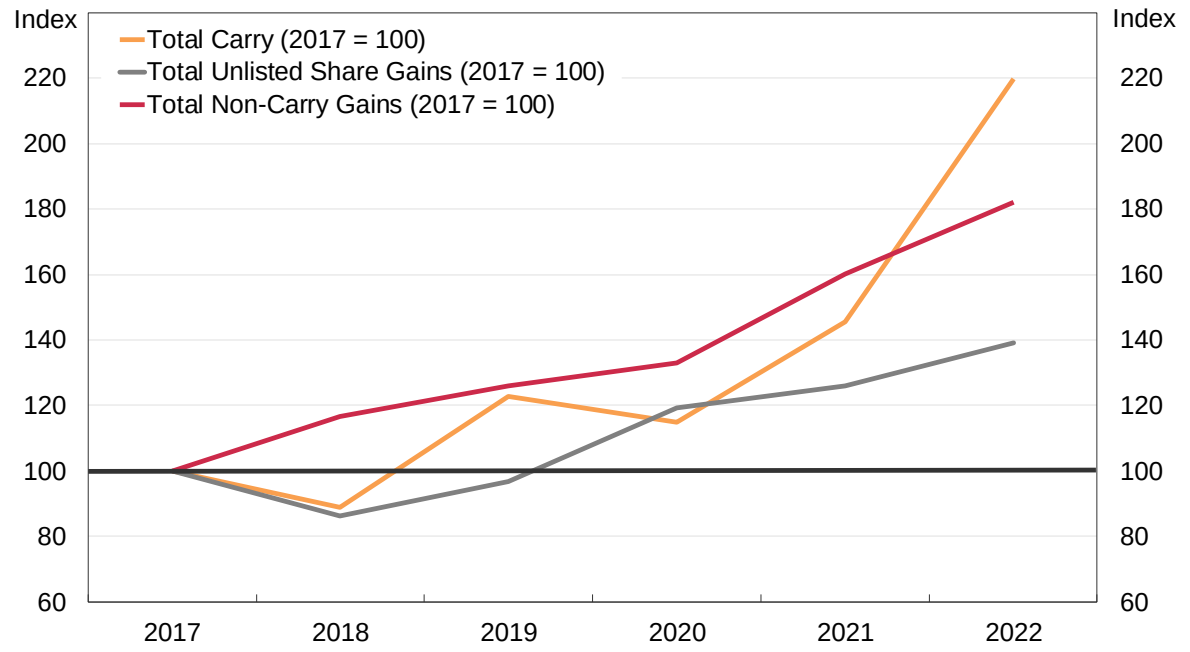
Notes: The different tax rates are applied to the tax base in Table 1. Figures may not sum due to rounding.

Source: 2019/20 tax base from authors' calculations based on HMRC administrative datasets.

The amount of carried interest arising in a particular year depends on two main factors: the size of the funds that are reaching maturity in that year and the rate of return on those funds. Since the typical life of a fund is around 7 years, the fund size for funds that will be paying carried interest within the next 5 years (i.e. within the fiscal 'scorecard' window) is already determined. Most of the growth for funds paying out in the next few years has also now happened and can be estimated from looking at the growth in funds which have recently paid out. Consequently, although still a forecast – since we lack actual outturn data from tax records – the aggregate carried interest that will be paid out in 2025/26 (across all funds) is mostly already determined, subject to major unforeseen economic shocks.

Phalippou (2024) develops a method for estimating historic carried interest payouts at the individual fund level. Taking information on assets under management and returns from the Preqin database, he uses administrative data to calculate the UK share of carried interest arising from European private equity funds. Macfarlanes LLP (2024) extend Phalippou's method to produce forecasts for 2025/26, which are publicly available. Although still subject to some uncertainty, we think that the growth rate derived from the Macfarlanes' estimate is likely to provide more accurate estimate for carried interest than relying on the forecasts for total CGT receipts produced by the OBR.

Figure 1: Total carry, unlisted share gains and non-carry capital gains, 2017 - 2022 (all series indexed to 2017)



Notes: Orange line shows aggregate carried interest; grey line shows aggregate gains in unlisted shares minus carried interest; red line shows aggregate gains for all assets minus carried interest. Each series is normalised to the total for 2017.

Source: Advani et al (2024)

We summarise our projections based on Macfarlanes' forecast in Table 3. We obtain these figures by uprating our estimate of the tax base in 2019/20 using the growth rate (between 2019/20 and 2025/26) in carry as per Macfarlanes' forecast.[17] In the case of no reform on carry, this would mean tax revenue of around £2.1 billion at the current 28% CGT rate. With a 45% rate, total revenue rises to £3.3 billion, implying additional revenue of £1.2 billion from the reform.

For comparison, we also replicate the methodology used in the OPC to get the 2025/26 tax base by simply uprating the tax base in 2019/20 using the growth rate (between 2019/20 and 2025/26) in total CGT receipts as forecasted by the OBR. These results are summarised in Table 3. Projections of the tax base using the Macfarlanes estimates are 42% higher than those using a replication of the OPC methodology.

[17] The total carry estimates provided by Macfarlanes include 15% of unremitted carry from the RBUs. As mentioned earlier, under the new FIG regime, new arrivals (those arriving in the last 4 years) will not be subject to UK tax on their foreign income. Assuming carry will be a part of this preferential tax treatment, Macfarlanes' estimates should be adjusted to subtract the unremitted carry of new arrivals from the tax base. This adjustment will be minor since new arrivals receive roughly 2.3% of all carry receipts among foreigners (Advani et al, 2024) and hence we do not account for this correction in our estimation.

Table 3: Static revenue estimates with 2025/26 tax base

Tax rate	Projection using Macfarlanes forecast		Projection using total CGT receipts forecast	
	Static revenue estimate (£bn)	Additional revenue (£bn)	Static revenue estimate (£bn)	Additional revenue (£bn)
No reform (28%)	2.1	-	1.5	-
Dividend tax rate (39.35%)	2.9	0.8	2.0	0.6
Top income tax rate (45%)	3.3	1.2	2.3	0.9
Income tax rate + employee NIC (47%)	3.5	1.4	2.4	1.0
Income tax rate + employee NICs + employer NICs (53.4%)	3.9	1.9	2.8	1.3

Notes: We obtain the 2025/26 tax base from: (a) Macfarlanes LLP (2024) projections on carried interest, and (b) replication of OPC methodology using latest OBR projections on CGT receipts (OBR, 2024). After determining the tax base, we simply apply the different tax rates to obtain revenue estimates.

Source: Authors' calculations based on 2025/26 tax base from Macfarlanes LLP (2024) and OBR forecast for CGT receipts (2024)

Whilst it would be possible to further extend the methodology developed by Phalippou (2024) and applied by Macfarlanes LLP to produce projections beyond 2025/26, such estimates would be subject to greater uncertainties given that they are more dependent on rate of return forecasts for future years. Aside from the inherent uncertainties in macroeconomic forecasting, it is likely that the forecast determinants for the private equity industry will differ from the wider economy, and so relying on standard economic forecasts of growth or asset inflation may not be appropriate. Given these uncertainties, we focus on providing a revenue estimate for the first year of the reform (2025/26), rather than for the full 'scorecard' window up to 2029/30.

5. Accounting for behavioural responses

In order to provide a more realistic estimate of the revenue that would be raised by the reform, we must also take account of behavioural responses. Indeed, despite some challenges with estimating the static tax base and projecting this forward for 2025/26, challenges in estimating the size of the behavioural response are still a first-order source of uncertainty in our final revenue estimate. In this section, we first outline the methodology used to account for behavioural responses in the Conservative Government's Opposition Policy Costing and explain why we think this approach is flawed. Second, we outline the principles underpinning our own (different) methodology, which we implement in the subsequent sections.

5.1 Opposition Policy Costing

In March 2024, the Conservative Government published an 'Opposition Policy Costing' (OPC) of Labour's proposals for reforming the taxation of carried interest. The costing assumed that carried interest would be taxed at Income Tax rates and 'taxed as income'; it did not account for any changes to the taxation of foreign carry by remittance basis users, since the reforms to the non-dom regime in the March 2024 Budget had not yet been announced. Using these policy assumptions, the OPC provided post-behavioural revenue estimates based on two alternative behavioural elasticities. The resulting revenue estimates ranged from +£200 million to -£900 million in 2025/26, depending on which elasticity was used.

The OPC provides very little detail about the methodology used to obtain the estimates. In relation to the behavioural elasticities, it states only that:

> There is no established standard elasticity for changes to the taxation of CI specifically. In the absence of such an elasticity, standard elasticities typically used to model Income Tax and CGT rate changes are applied here to provide potential responses, reflecting the high degree of uncertainty. This costing uses the standard elasticity in respect of changes to tax rates on dividend income for additional rate taxpayers [1.4], as well as a midpoint between this and the standard, weighted average elasticity for changes to tax rates on the gains made on a mixture of asset classes that are CGT-liable [3.9].

The OPC does not provide any further information about how or why these specific elasticities were chosen, although it suggests that they were amongst the 'policy assumptions' provided by Special Advisors.[18] If so, this seems inappropriate because an elasticity is an empirical estimate of the behavioural response to a given policy, not an assumption about what the policy would be. As a general point, we agree with the recommendations of the Institute for Government and others, that the OPC process requires major reform to remove it from political influence.[19] Given that we lack any information about how the underlying elasticities were estimated

[18] Special Advisors are political appointees rather than civil servants within HMRC or HMT.
[19] https://www.instituteforgovernment.org.uk/comment/opposition-policies-OBR.

(such as the causal identification strategy used), or even what relationship they describe,[20] we are unable to comment further on their validity.

In any case, in our view, estimates derived from changes in the tax rate on other sources of income or gains do not provide an appropriate proxy for responses to changes in taxation of carried interest. This is because carried interest has very different characteristics from dividends and other gains, and the individuals who receive carried interest are a highly specific population. For example, as we explain below, there is very limited scope for 'retiming' of carried interest payments (unlike for dividends or other gains), which tends to reduce the scope for short-term tax planning. On the other hand, as we show in Advani et al (2024), carry recipients are a highly elite and international population, which means that their migration responses will also differ from those of the wider taxpayer population.

5.2 Our approach to behavioural adjustment

The ideal approach to estimating the behavioural response to a given tax reform is to separately estimate the effect of the reform on each type of behaviour (or 'margin' of response), and then to aggregate these elasticities to obtain an overall effect on the tax base. This has the major advantage that it allows researchers to account for the different effects of different policy design choices, to measure not just the direct revenue effects but also the indirect effects of specific responses such as investment decisions, and to account for the fact that some behaviours respond to average tax rates (e.g. migration) and others to marginal rates (e.g., hours worked or effort).

Unfortunately, it is often very difficult to obtain relevant evidence to inform an elasticity estimate for each margin of response in isolation. This challenge is made even more difficult when adding the stipulation that for each relevant behaviour, the evidence requirement is for a causal elasticity (i.e. one that identifies the causal effect of a tax change on the relevant behaviour, rather than just a correlation), and that the evidence should be obtained from a context that is sufficiently similar to the context of the present reform so that it can be treated as having relevant external validity. When required across all possible margins of response, this sets an extremely high bar for evidence that almost no actual policy evaluation is likely to meet.

Our approach is therefore to go as far as we can in the direction of estimating separate margins of response, resorting to aggregate adjustments to the tax base where these are required due to lack of available evidence on specific responses. We make use of quantitative evidence wherever possible, whether from our own previous work or from the wider economic literature. Where no relevant or reliable quantitative evidence exists, we must instead make behavioural adjustments

[20] In particular, whether these estimates are with respect to the tax rate or the net-of-tax ('retention') rate, and whether these estimates account for the change in individuals' tax or retention rates on total income and gains, or only on dividends or taxable gains specifically.

using an understanding of the policy context and the dynamics of the private equity industry to inform an assessment of the direction and magnitude of specific responses.

We focus our analysis on emigration, which (for reasons we explain below) we think is likely to have the largest effect on the overall behavioural response in the context of this reform. The emigration response has been the primary focus of the private equity industry in commenting on the reform, with claims that increasing the tax rate could lead to a mass exodus of UK private equity executives to other jurisdictions.[21] Fortunately, emigration is also a type of behaviour for which there is relatively more quantitative evidence available, thanks to previous work in the UK and internationally that has examined the responses of top earners to changes in tax rates using rigorous quasi-experimental research designs.

For other behaviours besides emigration, there is little or no existing quantitative evidence available that we can use to estimate margins of response separately. Consequently, we instead discuss each margin of response qualitatively, attempting to assess in broad terms whether the response is likely to be large or small given the specific policy design and the private equity context. To 'convert' this analysis back into a quantitative form that we can use to obtain a final post-behavioural revenue estimate, we perform an aggregate adjustment to the post-emigration tax base. This adjustment is necessarily impressionistic, so we offer a range as well as our central estimate.

[21] Jones (2023), 'Changing carried interest tax treatment could push many fund managers out of UK' The Times (22 June 2023).

6. Emigration response

6.1 What factors affect tax-induced emigration?

The theoretical and empirical economic literature on tax-induced migration identifies three major factors that we would expect to influence emigration by top earners, such as private equity executives. This list of factors is not intended to be comprehensive but includes what we view as the most important elements to keep in mind when predicting the likely migration responses of individuals affected by the carried interest reform.

6.1.1 The effect on take-home pay

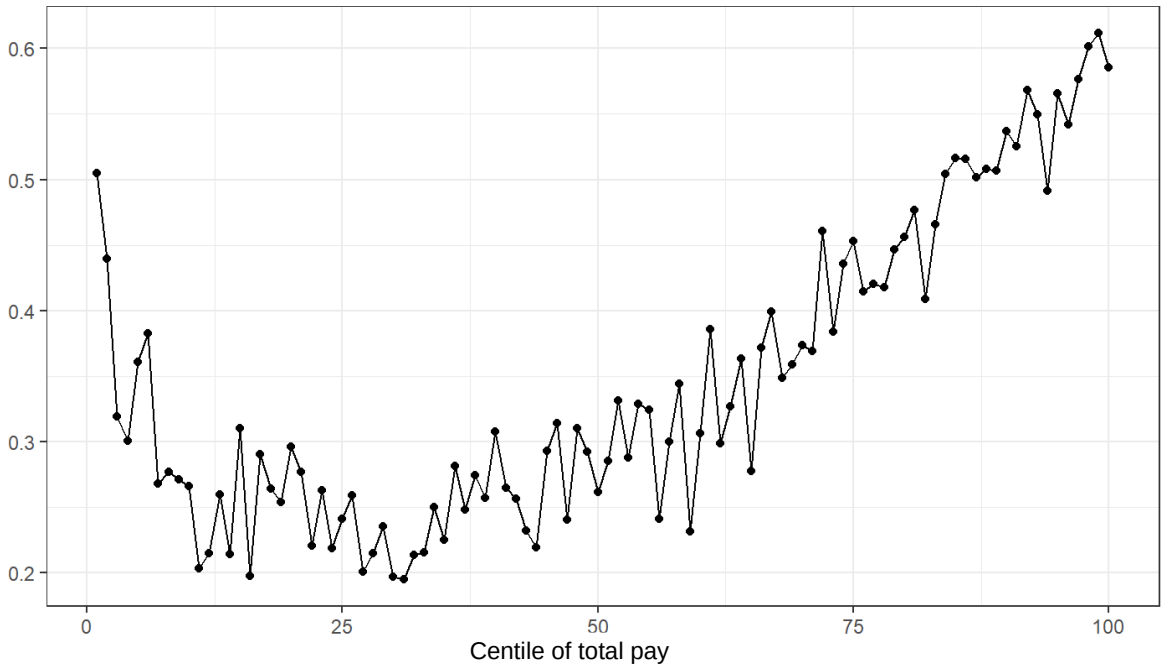
A key insight from the economic literature is that what matters for migration decisions is the impact of the tax change on total take-home pay. This corresponds to the change in the share of total income (and other remuneration) that is retained after tax, or in other words the 'retention rate'. A 10pp increase in the tax rate is much more costly if taxes rise from 80% to 90%, effectively cutting take-home pay in half, than from 10% to 20%, where take-home pay falls by only 11%. This is crucial in the context of a reform on carried interest because the baseline tax rate on carry is currently low. Thus, while an increase in the tax rate from 28% to 45% seems large from the perspective of the tax rate (an increase of around 60%), it implies a much smaller decrease in the retention rate of only 25%.

Moreover, the above calculation assumes that 100% of a private equity executive's pay is in the form of carried interest, whereas in reality, this is almost never the case. We find that the bottom 80% of carry recipients receive on average only around one third (35%) of their total pay from carry. It is only within the top 20% of carry recipients that carry makes up more than half their total pay on average, rising to around 60% of pay amongst the top 100 best-paid executives. This means that most carry recipients would experience a much smaller reduction in their take-home pay than the headline change in the tax rate on carry would suggest.

To take a simple example, suppose that a typical top 100 executive receives, in line with our findings, 40% of their pay from management fees (taxed at 47%) and 60% from carry (taxed at 28%). If their total pay is £10 million, then at current tax rates they take home around £6.4 million after tax. If the tax rate on carry is increased to 45%, they would take home only around £5.4 million after tax. This means that a 60% increase in the tax rate on carried interest (from 28% to 45%) translates into only a 16% reduction in the executive's take-home pay (a reduction in the retention rate from 64% to 54%). Whilst still substantial, this effect is much smaller than might be expected if one were focused on just the change in tax rate on carry.

Figure 2 below displays the share of carry in total pay (carry plus other income) over a three-year period from 2018 - 2020 at different points in the pay distribution of PE executives who receive carry. Amongst the bottom half of carry recipients (ranked by total pay), carry makes up a small share of total pay: less than one third on

Figure 2: Share of carry in total pay (carry plus total income) by centile of total pay, 2018 - 2020



Notes: We divide the population of carry recipients into centiles of total pay (carry plus total income) received between 2018 - 2020. For each centile, we calculate the average share of carry out of total pay in this three-year period. Each centile represents around 36 individuals.

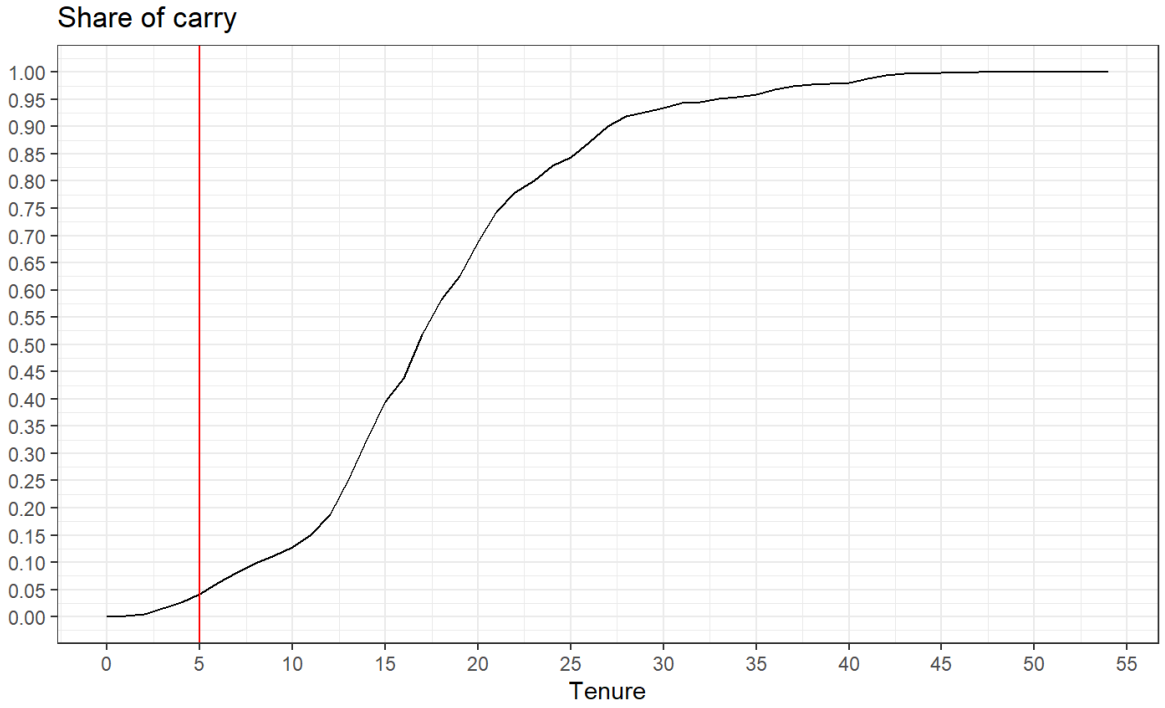
Source: Authors' calculations based on HMRC administrative datasets.

average. Above the 50th percentile, the share of carry in total pay rises steadily, but is only greater than half of total pay (on average) for executives within the top fifth of the distribution. Even within the top 3% (around 100 individuals), the share of carry is still only around 60% on average. Of course, there is variation meaning that the carry share for some individuals will be higher than this, whilst for others it will be lower.

6.1.2 The 'stickiness' of the population

It is now well-established in the empirical economic literature on tax-induced migration that the location decisions of foreigners (especially amongst high earners) are more sensitive than those of natives to tax changes (Kleven, Landais, Munoz & Stantcheva, 2020). This makes sense as foreigners are inevitably less rooted in their new home, compared with those who have never lived anywhere else. However, Advani, Poux & Summers (2024) show that beyond this binary distinction between foreigners and natives, the number of years spent in a country ('tenure') is a key predictor of baseline mobility (measured by emigration rates) and tax-responsiveness. In their study of emigration responses to the 2010 increase in the top Income Tax rate from 40% to 50% (discussed further below), they find a substantial decrease in baseline mobility after around 5 years of residence. Greater tenure coincides with much lower levels of tax-induced migration, converging to similar levels to natives amongst the longest-staying foreigners.

Figure 3: Cumulative distribution of carry going to foreigners by tenure, 2018 - 2020



Notes: We break down the population of carry recipients who are foreigners according to their tenure in the UK. Here, 'tenure' is defined as the number of years since their tax year of arrival, and 'foreigners' are individuals who have arrived in the UK after age 18. For each tenure, we calculate the share of carry out of total carry received in 2018-2020. The chart shows cumulative share of carry at each tenure.

Source: Authors' calculations based on HMRC administrative datasets.

In this context, it is important to note that although carry recipients are indeed very international, they are mostly settled in the UK. Advani et al (2024) show that the share of foreign private equity executives among all carry recipients is close to 50%, in line with other top paying positions in the UK financial sector (Advani, Koenig, Pessina & Summers, 2020). However, Figure 3 shows that the carried interest arising to foreigners overwhelmingly goes to individuals who have been in the UK for a long period of time, with around 90% received by those who have lived in the UK for 10 years or more. In line with the evidence of Advani, Poux & Summers (2024), we would expect this group of settled foreigners to be 'stickier' in their location decisions than those who have more recently arrived in the UK. We develop this analysis further below, in Figure 4.

6.1.3 International competition

The effect of increasing the tax rate on carried interest would undoubtedly make other countries *relatively* more attractive to private equity executives than they are under the status quo. However, it is incorrect to assume that this leads to some sort of 'tipping point' when the size of the tax wedge between countries crosses a certain threshold. People have preferences to live in different places for many

reasons, with some firmly committed to a particular location, others footloose, and the rest somewhere in between. Changes in tax rates only move people marginally in their relative preference for a location. Larger changes will move more people, as there are more for whom the benefit of being in the UK is now outweighed by the change in take-home pay, but this does not imply the existence of a tipping point beyond which an entire industry moves en masse.

There are several economic reasons why the UK is attractive to private equity executives besides the current low tax rate on carried interest. These include proximity to other legal and financial services and existing business networks that may be hard to replicate elsewhere. These factors are memorably captured in an interview with top executive Guy Hands, who noted in 2023 that ""Moving to Guernsey greatly impacted my ability to build and maintain strong relationships with contacts, on which my success in business relied. I lost the flow of the market … For me it was a disaster" (Bow, 2023). This quote encapsulates both the importance of personal networks (which help to explain 'stickiness') and the strong 'agglomeration externalities' that are present in London. Economic theory would suggest, if anything, higher taxes on industries benefiting from such externalities.

There are also benefits to living in the UK beyond financial considerations. Individuals value other factors such as cultural amenities, the quality of healthcare and schooling, and the ability to maintain key social ties (Friedman et al, 2024). The value that they place on each of these will vary from person to person (and for individuals over their life course), reinforcing why it is a mistake to assume that tax increases beyond a certain level must lead to a discrete tipping point in emigration. In their study involving interviews with 35 high net worth individuals, Friedman et al (2024) also find that economic elites often attach social stigma attached to tax-induced emigration. As one interviewee in their study noted disparagingly "You need to be a certain character to move for tax purposes." This suggests that there may be cultural norms that would militate against highly coordinated efforts by private equity executives to relocate.

Finally, whilst it is certainly true that several countries currently have highly advantageous tax regimes for carried interest,[22] and that these locations serve as 'competition' for the UK, the dynamics of international tax competition over the long run are not straightforward. For example, following the UK's recent decision to abolish the non-dom tax regime, Italy announced an increase in the tax charge that it applies to new arrivals. This illustrates that preferential tax regimes are not always stable and that tax increases in one country can precipitate a chain reaction. In this respect, the implications of the fact that the UK is such a major player in the

[22] For example the US (with a federal tax rate on carried interest of 23.8% and an overall tax rate of 34.7% in New York), France (offering a preferential tax rate of 34% although with more stringent qualifying conditions), Germany (exempting 40% of carry from taxation, thus imposing an effective tax rate of around 28.5%), Italy (offering a preferential tax rate of 26% but under more strict conditions) and Spain (exempting 50% of carried interest from tax, thus imposing an effective tax rate of 27%).

European private equity market (with almost half of all funds by value) are ambiguous. On the one hand, other countries might respond aggressively in an attempt to capture some of the UK's market share. On the other hand, they might take the UK's move as a licence to increase their own tax rates.

A major wild card in this dynamic is the outcome of the US election in November. If elected, presidential-candidate Kamala Harris has pledged to tax carried interest above $400,000 at ordinary income tax rates. This would bring the combined top federal and state tax on carried interest for a New York resident to 50.5%.[23] If such a reform were to happen (which is not guaranteed even if Harris does win the election), it would considerably reduce competitive pressure on the UK and decrease the emigration incentives for many UK-resident private equity executives, who might otherwise have considered migrating to the US. Furthermore, this reform would remove the incentive for UK-resident US citizens to emigrate to any other jurisdiction, because even if migrating to a lower-taxed country, they would remain liable to tax on their worldwide carry in the US as a result of their citizenship.[24]

6.2 Empirical analysis using previous UK reforms

To provide a quantitative estimate of the emigration response to an increase in the tax rate on carried interest, we build on our analyses of two large previous reforms affecting UK top earners and the wealthy. First, we draw on analysis of the 2017 'deemed domicile' reform to the non-dom tax regime, which brought foreign income and gains into UK tax for non-doms who had lived in the UK for more than 15 years (Advani, Burgherr & Summers, 2023). Second, we use evidence on the emigration response to an increase in the top marginal Income Tax rate from 40% to 50% in 2010 (Advani, Poux & Summers, 2024).

6.2.1 Emigration response to 2017 'deemed dom' reform

Prior to 2017, all residents who claimed non-dom status (i.e. their permanent home was outside the UK) were eligible to claim the remittance basis of taxation. The remittance basis effectively exempted foreign income and gains from UK tax unless remitted to the UK. The 2017 reform removed access to the remittance basis for non-doms who had been in the UK for at least 15 of the previous 20 years (known as 'deemed doms').[25] This group was very high-income: Advani, Burgherr & Summers (2023) estimate that they had an average of £420,000 in foreign income and gains, on top of £370,000 in UK income and gains.

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[23] The Presidential-candidate Kamala Harris has also proposed to increase the top federal income tax rate to 39.6%.
[24] The only way to avoid any increased US taxation for US citizens would be to renounce to their citizenship. This would trigger an expatriation tax that applies US capital gains tax on the unrealised gains on all of their assets, which makes this an unlikely response.
[25] These are 'Condition B' deemed doms. Condition A deemed doms, who were UK born with a UK domicile of origin, also lost access to the remittance basis, but were not included in the study population.

The reform substantially increased effective tax rates on these deemed doms, reducing their net-of-tax ('retention') rate by an average of 17.8%. The effect was a one-off increase in emigration of around 5pp, estimated by comparing the evolution of the emigration rate of non-doms affected by the reform to a control group of not-yet affected non-doms who had been resident in the UK for between 10 and 14 years. Notably, the increase in emigration was driven by individuals who were paying relatively lower levels of tax prior to the reform and had relatively little UK-source income, indicating weaker economic ties to the UK.

These results are informative for migration under a reform to the taxation of carried interest because there is a large overlap in the affected populations. While carry recipients represent a small minority of the overall non-dom population, 56% of foreigner carry recipients (83% by carry value) were directly affected by the non-dom reform because they had lived in the UK for at least 15 years (Advani et al 2024). Furthermore, when Advani, Burgherr and Summers (2023) focused on the non-dom population working in the finance sector, they found an emigration response that was not significantly different from zero. This is instructive given that carry recipients also work in finance and fit the 'City' stereotype in terms of their demographics (Advani et al, 2024).

We replicate the estimation strategy of Advani, Burgherr and Summers (2023), restricting our sample to remittance basis users (pre-reform) who receive carried interest. We find that the effect of the 2017 reform on the emigration rates of deemed dom carry recipients was negligible. Our results are noisy due to the small sample size and the fact that we can only observe carry from the year 2017, so they must be interpreted with caution. However, the absence of a 'smoking gun' from private equity deemed doms coupled with the muted response of non-doms more broadly working in finance suggests that the response to the proposed reform on carry – which is similar in scale,[26] but does come on top of the previous reform – may also be limited.

6.2.2 Structural model of tax-induced emigration

Advani, Poux and Summers (2024) build a structural model of top-end migration using empirical estimates from the 2010 increase in the top marginal Income Tax rate from 40% to 50% (the '50p reform'). They identify the individual characteristics associated with baseline mobility and tax-induced emigration, and then calibrate the model using the exogenous change in tax rates from the reform. They also use machine learning techniques to examine heterogeneity in the emigration response across different dimensions, such as native/foreigner and the ex-ante (baseline) probability of emigration.

[26] Although unremitted carry is likely to have made up a relatively small share of total remuneration for deemed dom carry recipients, the deemed dom reform also resulted in an increase in the effective tax rate on their personal investment income and gains, unlike the proposed carry reform.

This analysis led to two key findings in the context of the 50p reform. First, the emigration response of natives was extremely muted and not significantly different from zero. This fits with the idea that natives are much 'stickier' than foreigners and are very unlikely to emigrate in response to tax increases. Second, there was significant heterogeneity in the emigration response amongst foreigners. The overall emigration response was almost entirely concentrated amongst those with the highest baseline probabilities of leaving, which equated to those who had been in the UK for the shortest period.

We can use these insights to predict the likely emigration responses of the carry population, given their observable characteristics. The magnitude of the tax change under the 50p reform is broadly comparable to increasing the tax rate on carry to 45%. Although the 50p reform only involved a 10pp increase in the marginal tax rate, amongst the highest earners the reduction in their retention rate was of a similar scale to the impact of the carry reform on top private equity executives.[27] The main note of caution is that although Advani, Poux and Summers (2024) provide estimates restricted to individuals with incomes over £225k, this is still much less 'elite' than the pay of top private equity executives.

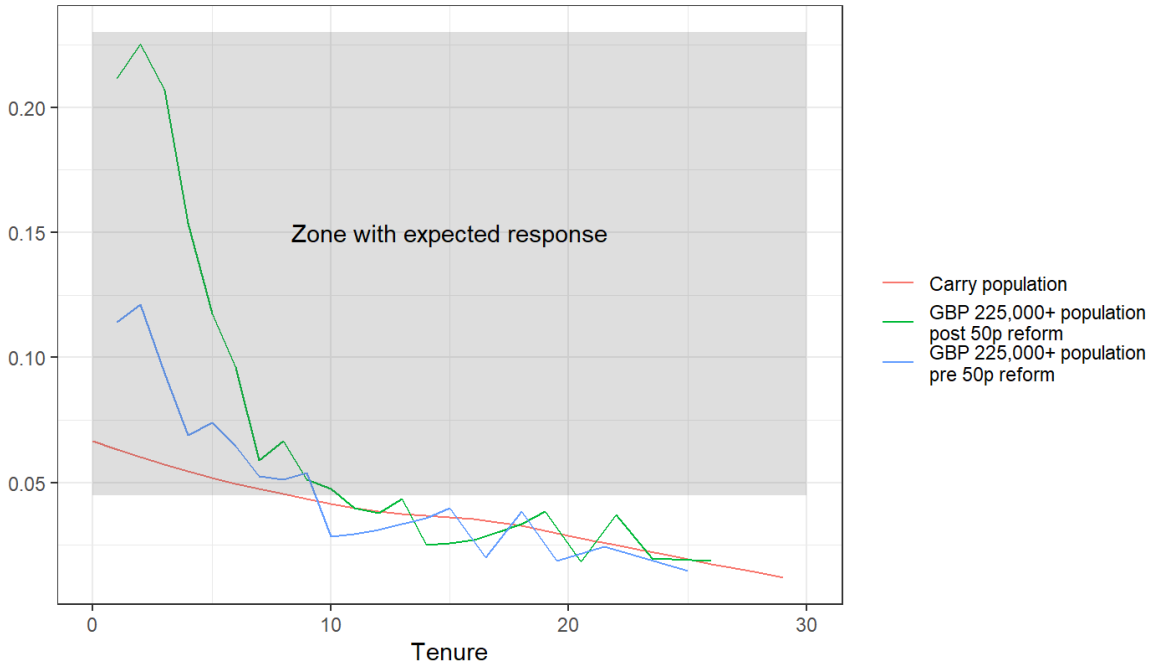
We then apply the structural model from Advani, Poux and Summers (2024) to the specific characteristics of the carry population, in order to estimate their probability of leaving in response to an increase in the tax rate on carry. We find three key results:

First, just like the native top earners studied in the context of the 50p reform, 'native' carry recipients have very low rates of baseline mobility and (we infer) are very unlikely to respond to an increase in tax rates. Their baseline emigration rates are negligible (0.4% per year), and many of those who do leave come back after just a few years abroad.

Second, only around 5% of foreigner carry recipients have a high baseline probability of leaving and (we infer) are therefore likely to respond to a tax increase. Figure 3 shows that these individuals, who could be considered a realistic 'flight risk' based on their baseline mobility, only account for a very small fraction (around 5%) of total carried interest. Figure 4 shows that on average, foreign carry recipients actually display much lower emigration rates within their first few years after arrival than other top earning foreigners.

[27] This is both because for the highest earners their average tax rate converges towards their top marginal rate, and because carry represents less than 100% of the total pay of carry recipients.

Figure 4: Emigration rate among foreigners by tenure



Notes: We compare the emigration rates of carry recipients with top earners (earning over £225K) affected by the 50p reform. The comparison is amongst foreigners and by tenure in the UK. Here, 'tenure' is defined as the time elapsed between the tax year in which carry is received and the recorded tax year of arrival, and 'foreigners' are individuals who have arrived in the UK after age 18. Red, green, and blue lines show the emigration rates of carry recipients, top earners post 50p reform and top earners pre 50p reform, respectively. 4.5% is the threshold on baseline emigration rate beyond which a migration response to a tax increase is expected.

Source: Advani, Poux and Summers (2024) for emigration rates of top earners affected by the 50p reform and authors' calculations based on HMRC administrative datasets for emigration rates of carry recipients.

Third, whilst long-staying foreigners are less likely to leave, a significant minority (5-10%) of the top foreign carry recipients remain relatively mobile (8% baseline probability of emigrating) and are therefore more likely to respond to the reform. We expect that most of the migration impact on the tax base would come from this group.

Overall, our analysis suggests that in addition to natives, who are very unlikely to move for tax reasons, around 85-90% of foreign carry recipients will also not be responsive to tax increases. Among the remaining 10-15% that are susceptible to respond by emigrating, the fraction that would actually leave is difficult to predict precisely and, as such, we provide different scenarios in the following section.

6.3 Post-emigration revenue estimate

6.3.1 Methodology

By utilising emigration semi-elasticities and other empirical parameters from Advani, Burgherr and Summers (2024) and Advani, Poux and Summers (2024), we directly estimate the emigration response to our modelled reform (i.e. increasing the tax rate on carried interest to 45%). We do this in several steps, as follows:

(1) We compute the magnitude of the tax change (known as the 'first stage' for the reform) for each individual in the carry population i.e. we compute the relative decrease in their retention rate (share of remuneration one gets to keep) for each carry recipient.

(2) We apply emigration semi-elasticities (i.e. the percentage point increase in the emigration rate associated with a 1% reduction in the net-of-tax rate) derived from our existing studies of tax-induced emigration by top earner populations.

(3) We apply assumptions about how the impact on the emigration rate translates into a change in the stock of taxpayers, again based on evidence from our existing studies.

The main uncertainties come from the application of the second and third steps, and in particular the external validity of the original estimates in the context of this specific reform. Consequently, in order to document the sensitivity of our resulting (post-emigration) revenue estimate to different assumptions about the relevant parameters, we offer a range of parameters for each step corresponding to 'low', 'medium' and 'high' levels of emigration response.

In relation to step (2), our central estimate (the 'medium' response) is based on a semi-elasticity of -0.2 pp taken from Advani, Poux & Summers (2024) in the context of the 50p reform. This is also close to the -0.26 estimated by Advani, Burgherr & Summers (2023) as the emigration response to the 2017 deemed dom reform. It is higher than the 0.1 estimated by Advani, Burgherr & Summers (2023) for non-doms working in finance specifically.

In relation to step (3), the key question is whether any emigration response would be 'one-off' or whether there would be a lasting change in the emigration rate, leading to a compounding effect where the stock of carry recipients continues to fall over a number of years. The assumption relates to the number of years for which to compound the increase in the emigration rate. Since ex-ante migration rates are small and carry recipients are mostly settled in the UK, our central estimate is based on the assumption that the emigration response is likely to be one-off, rather than compounding substantially over time. This is consistent with the evidence of Advani, Burgherr & Summers (2023) in relation to the emigration response to the 2017 deemed dom reform, where the emigration rate increased in the first year of the reform but subsequently returned to the pre-reform baseline.

Due to lack of data on the non-carry income of carry recipients in years post-2020, we obtain an estimate for revenues in 2025/26 by first computing a backward-looking emigration estimate using data for the years 2018 – 2020. We then adjust the resulting post-emigration revenue estimate by the growth rate of carry between 2019/20 and 2025/26 using Macfarlanes (2024) estimates.

6.3.2 Main results

We obtain a 'post-emigration' revenue estimate that encompasses the direct fiscal impact of emigration on revenues but not any other behavioural responses (which we instead address in the following section). Under our central emigration scenario,[28] post-emigration revenue is £3.2 billion in 2025/26. This is £0.1 billion (3%) less than our static estimate (the scenario with no behavioural response to the tax change).

Around half of the reduction in revenue is due to the cross-base effect on Income Tax: we assume that emigrants not only stop paying UK tax on their carried interest, but also on all other sources of income. Our revenue estimate accounts for this effect by assuming (conservatively) that emigrants pay no UK CGT or Income Tax after leaving.

The private equity industry has emphasised that increasing the tax rate on carried interest could end up reducing revenues compared with the status quo as a result of the emigration response. However, our analysis indicates that post-emigration revenue from the reform would be negative only if at least two out of every five foreign carry recipients (39%) left in response to the reform (implying a 19% reduction in the overall tax base), which would far exceed even our 'worst-worst' case scenario comprising a high emigration semi-elasticity and high compounding over time.

6.3.3 Sensitivity analysis

Since our results depend on the choice of semi-elasticity and the number of years of compounding, we perform sensitivity analysis considering:

1. Low (-0.15 pp), medium (-0.2 pp, as found in Advani, Poux & Summers, 2024) and high (-0.25 pp) semi-elasticities
2. Low (1 year, as found in Advani, Burgherr & Summers, 2024), medium (3 years) and high (5 years) compounding

Table 4 summarises the revenue raised and emigration (or stock reduction) in each scenario.

An important result from our sensitivity analysis is that, if emigration is the only margin of response, even the 'worst-worst' case scenario - high semi-elasticity and a high compounding - generates an additional £0.8 billion in revenue.

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[28] This is based on medium responsiveness (semi-elasticity of -0.2) and low compounding (i.e. one-off effect on stock).

Table 4: Post-emigration revenue estimate for 2025/26 tax base at 45% tax rate, for different values of semi-elasticity and number of years of compounding

Semi-elasticity	Years of compounding	Post-emigration revenue estimate (£bn)	Additional revenue (£bn)	Stock reduction
Low (-0.15 pp)	Low (1)	3.2	1.2	0.9%
	Medium (3)	3.1	1.1	2.8%
	High (5)	3.0	0.9	4.5%
Medium (-0.2pp)	Low (1)	3.2	1.2	1.3%
	Medium (3)	3.1	1.0	3.7%
	High (5)	2.9	0.9	5.9%
High (-0.25 pp)	Low (1)	3.2	1.1	1.6%
	Medium (3)	3.0	0.9	4.5%
	High (5)	2.8	0.8	7.3%

Notes: The case of medium migration response and low compounding (grey-coloured cells) is the central scenario for behavioural revenue estimation.

Source: Authors' calculations based on HMRC administrative datasets.

6.4 Limitations and uncertainties

The quantitative evidence that we have presented so far suggests that, whilst the emigration response to an increase in the tax rate on carried interest could be substantial, it would not constitute the 'mass exodus' that has sometimes been claimed based on industry anecdotes. However, it is important to highlight some key limitations of our evidence and hence some remaining sources of uncertainty regarding the extent and wider impacts of the migration response. By their nature, it is not possible to put quantitative bounds on these issues, but we attempt to provide an assessment of their magnitude and the time horizon over which they may be relevant.

6.4.1 Sensitivity to a small number of top executives

As Advani et al (2024) highlighted, carried interest is extraordinarily concentrated amongst a small number of individuals. The top 100 executives (by amount of carried interest) received over 46% of all carry in 2020, an average of £15 million each. These top executives are more affected by the reform than most of the rest of the carry population, since on average they receive around 60% of their total earnings in the form of carry. The impact of the reform on their 'retention rate' (i.e. the share of all earnings that they retain after tax) is therefore larger than average, at 16%, compared with 10% for the whole population. Moreover, these top executives are somewhat more likely than average to be foreign (50% compared with 45% in the carry population as a whole), although they are also mostly long-term resident in the UK (82% have stayed over 15 years, compared with 56% in the carry population as a whole).

These factors are already directly captured in our structural model of the emigration response. However, there are nevertheless two reasons for caution. First, the model is calibrated using empirical estimates from past reforms affecting populations that, whilst highly elite, are still not as elite as this group of top executives. It is therefore possible that certain factors affecting the emigration decisions of this group are not captured in our approach. Second, the fact that the size of this group is so small relative to their impact on the total tax base means that idiosyncratic responses of specific individuals – which are impossible for us to account for statistically – could have a meaningful impact on aggregate revenues. In theory, both of these points could go either way, but they increase uncertainty and hence the range of potential outcomes.

6.4.2 Coordinated responses

Our quantitative evidence is based on reforms where the emigration response was largely uncoordinated. Although top earners (50p reform) and deemed doms (2017 non-dom reforms) are likely each to have been linked to one another via social and professional networks to some extent, we can reasonably expect that the population of private equity executives affected by carried interest reform would be significantly more networked. Within private equity firms, there is also scope for

'top-down' coordination by senior managers regarding the location of jobs. These factors are not accounted for in our structural model because we cannot directly observe firm-level links between carry recipients, and the model implicitly assumes that individuals are relatively uncoordinated since this was the case in the settings from which our empirical estimates were obtained.

We recognise that warnings of mass exodus by private equity executives are typically tied to the claim that entire private equity firms will relocate abroad. From speaking with industry insiders, we think this claim is more plausible for some types of firm than others. Specifically, in the case of pan-European firms that already have offices in other European countries, top-down coordination to relocate London executives to other offices cannot be ruled out. For US-firms whose European headquarters are in London, relocation might also be feasible over the longer-run although in most cases it would require setting up an entirely new office elsewhere, which – especially given the instability of preferential tax regimes for carried interest across Europe and agglomeration effects in London – seems less likely to us. For UK-based firms that currently have no offices elsewhere, wholesale relocation does not seem plausible other than in exceptional cases.

It is also important to note that the impact of coordination has a flipside. Most private equity partnership agreements contain clauses that forfeit the carry entitlement of private equity executives who are deemed to be 'bad leavers', which would typically include anyone leaving to join another firm. This imposes a very high cost for relocation unless the executive is moving to another international office within the same firm. In other words, the specific context of the private equity industry means that uncoordinated emigration responses (i.e. those not coordinated or at least endorsed at firm-level) may be much smaller than in other industries. This is likely to heighten heterogeneity of emigration responses across firms, whereby firms without the capacity to relocate executives to other offices see hardly any response, and firms with such capacity see a substantial response at least amongst the executives who (owing to their individual circumstances) would be inclined to move.

6.4.3 Taxes paid by emigrants

Our modelling is based on the assumption that individuals who emigrate (i.e. become non-resident for tax purposes) pay no UK taxes after leaving. Even without any reforms to the taxation of non-resident (or former resident) carry recipients, this will tend to underestimate post-emigration revenue because in fact some UK income-sources remain taxable even on non-residents. Advani, Burgherr and Summers (2023) find that emigrating non-doms continued to pay around 40% as much tax after leaving as they had paid while resident, in the three years after the reform. Jakobsen et al (2024) similarly show that wealthy taxpayers emigrating from Sweden continue to pay around 30-40% of their pre-emigration taxes. However, these estimates are highly sensitive to the context, in particular the

extent to which emigrants' incomes are from sources that remain taxable on non-residents.

As we highlighted above in our discussion of policy choices, the Government could – if it wished – significantly reduce the fiscal impact of emigration, either by taxing 'UK-source' carried interest on former residents or by treating emigration as a deemed disposal event. Such measures would almost fully eliminate the short-term effects of emigration on the carried interest tax base. It is important to reiterate that since our modelling does not account for the impact of these measures, either in our static or post-emigration estimates, we will (in this respect) underestimate potential revenue from the reform. However, except insofar as such measures deterred emigration from occurring in the first place, they would not reduce the loss of revenue arising from cross-base effects on Income Tax,[29] or the longer-term impacts on the carried interest tax base from a reduction in the stock of private equity executives working in the UK.

6.4.4 Immigration effects

Our quantitative evidence on migration only covers the emigration response; it does not account for the effects of the reform on immigration. The immigration effects of tax changes are much more difficult to estimate empirically because it is typically not possible to obtain any information about people who never came, unlike for emigration where information is available pre-reform for both those who stayed and those who subsequently left. This challenge explains why there is relatively little evidence on immigration responses in the international literature. The available evidence is mostly limited to 'return' migration, where it has been found that a substantial proportion of wealthy taxpayers who emigrate as a response to tax changes return not long after (Jakobsen et al, 2024).

In the context of reforms to the taxation of carried interest, immigration effects are likely to have only a small impact on the carried interest tax base over the short to medium term i.e. within the fiscal 'scorecard' window. This is because, as Advani et al (2024) show, only a very small share of reported carried interest (1%) goes to new arrivals to the UK. This is partly because new arrivals are more likely to be junior executives with smaller (if any) entitlements to carried interest, and partly due to the effect of the non-dom regime on taxable carried interest, which we assume would be preserved (for the first 4 years of residence) by the new FIG regime. New arrivals do also receive other earnings from management fees etc, but these again make up only a small share (1.5%) of aggregate earnings amongst the carry population. The extent to which a reduction in immigration rates would erode aggregate taxable earnings depends on how the labour market adjusts, as we discuss below.

[29] Resulting from the loss of taxing rights over other earnings (e.g. management fees) after departure.

6.4.5 Indirect effects

An increase in emigration and/or reduction in immigration will tend to reduce the stock of private equity executives working in the UK. However, it is important to draw a distinction between individuals leaving (or not coming to) the UK, and changes in the number of (equivalent) jobs within the UK private equity industry, and within the wider economy. The aggregate effect on jobs will depend on two key factors: first, the extent of substitution between natives and foreigners for jobs in the private equity industry (if there is a reduction in the stock of foreigners resulting from the reform), and second, the extent of substitution between jobs in private equity and other industries within the UK (if there is a reduction in private equity jobs). Together these factors will determine how the direct migration effects of the reform translate into indirect fiscal and economic impacts.

These indirect effects are highly uncertain and are not accounted for in our modelling. In the short term, as we have already discussed, the direct fiscal effects of migration are likely to be small, especially if the government were to implement measures to tax carried interest on former residents. However, the short-term indirect effects of migration on jobs are likely to be amplified by frictions that limit immediate adjustments in the labour market: crudely, loss of individuals is more likely to translate into loss of the corresponding jobs, in the short-term. In the longer term, the direct fiscal effects of migration are likely to be larger, but the indirect effects on jobs may be ameliorated by labour market adjustments for example natives 'stepping up' to jobs previous done by foreigners, or foreigners substituting into other sectors within finance and the wider economy.

To the extent that reforms to the taxation of carried interest result in a shifting of private equity jobs (and associated work by private equity executives) outside the UK, this is likely to have impacts on co-dependent industries such as legal and financial services. The co-dependence of these industries is one of the factors leading to the agglomeration effect that we described earlier, which tends to make wholesale relocation of private equity firms (or offices) more difficult and less likely to occur. However, to the extent that such moves do still occur, one would expect negative impacts on linked legal and financial services firms in the UK. The extent of these impacts would again depend on substitution effects, with different implications in the short and the long term. As such, it is extremely difficult to assess their magnitude, let alone quantify them precisely.

A final concern regarding the indirect effects of migration by private equity executives is on investment in UK businesses. It is important to begin this discussion with the basic point that the tax treatment of carried interest depends solely on where private equity individuals are resident and (for remittance basis users) where they perform their management services. It does not depend on where the investments that they make are located. Consequently, an increase in the tax rate on carried interest does not directly disincentivise private equity executives (whether resident in the UK or abroad) from investing in UK companies. The main channel through which wider impacts on UK investment could occur as

a result of the reform is if the relocation of private equity executives outside the UK made them less likely to choose UK investments – resulting from 'home bias' – and if this effect was not offset by other investors making those investments instead.

It is clearly possible for private equity firms still to buy UK companies from abroad, as they do now (and conversely, much of the capital they allocate currently is not to UK firms). To the extent that home bias matters and moving abroad makes it more difficult or less likely to access profitable investment opportunities, this creates a countervailing force against large-scale migration, because leavers would miss out on valuable investment opportunities. This was the key lesson from Guy Hands' self-reported experience of leaving the UK for Guernsey (Bow, 2023). However, it is extremely difficult to provide any assessment of the scale of indirect effects resulting from home bias by private equity executives who do leave (or no longer come to) the UK, since for most UK firms needing investment, UK-based private equity is not the marginal buyer, and if the UK private equity industry were smaller, the capital which they currently invest may well be allocated directly or through some other intermediary to similar firms.

7. Other responses

In this section, we consider a variety of other behavioural responses besides migration, including: (1) retiming of carry payments; (2) tax planning and avoidance strategies; and (3) effects on the labour supply (hours, effort, retirement) of private equity executives. Since there is no available quantitative evidence on each of these responses (except for some relevant international evidence on labour supply), we assess them qualitatively with the aim of determining their likely magnitude. Although, individually, each of these responses are likely to be of secondary importance compared with the migration response, we make an aggregate adjustment to our post-emigration revenue estimate in order to account for them collectively.

7.1 Retiming

For many forms of infrequent income and gains, such as dividends and disposals of personal assets, retiming effects can have a major impact on revenues from changes in the tax rate, especially in the short-term. For example, it is well-documented that a substantial share of the aggregate tax base elasticity observed from the 10pp increase in the top rate of Income Tax between 2010/11 to 2012/13 can be attributed to short-term retiming effects, particularly for dividends (HMRC, 2012; Browne & Phillips, 2017). This is to be expected since company owners often have significant control over the timing of their dividend distributions, especially for close companies. Similarly, changes in CGT rates often lead to significant retiming of disposals, via forestalling ahead of reforms or deferral of disposals in anticipation of emigration, death, or policy change. This is again because asset owners usually have significant control over whether and when they sell their assets.

These experiences might lead one to conclude that we should make a large adjustment for retiming effects when estimating the revenue from increasing the tax rate on carried interest. However, as we explained above, it is a mistake to assume that past responses to reforms affecting dividends or other gains are a good guide for the present reform. This is because the legal and commercial context of the private equity industry severely restricts the capacity of private equity executives to retime their carry payments. This is for two reasons:

First, retiming when carried interest arises would usually require accelerating or deferring *disposals of the funds' investments*, since carry is normally triggered as soon as the fund's hurdle rate is passed. Doing this would have real impacts on the fund's returns to third party investors, because it would involve exiting investments early or late compared with the strategy that would yield investors the largest gross returns. We assume that a private equity firm that did this would suffer reputational damage outweighing the tax benefit, even if such a strategy was permitted under the terms of the fund. We do not think that the third-party investors would collude in retiming for tax purposes, as many (even most) such investors are already tax exempt.

Second, the only other option would be to attempt to *retime payments out of the fund*, so that these occur either in advance of or after exit from the underlying investments, depending on whether the aim was to accelerate or defer the tax charge. There is already targeted anti-avoidance legislation to prevent tax-motivated deferrals,[30] because even with stable tax rates, these can confer a significant tax advantage on private equity executives who are (for example) considering becoming non-resident. Any tax-motivated arrangements that allowed carry to be paid 'conditionally' ahead of passing the hurdle to accelerate the tax charge could similarly be countered using targeted anti-avoidance rules. It would also be possible to legislate to change the standard timing of the tax charge on carried interest so that it depends directly on disposals, which is already the approach in the US.[31]

Our assessment is therefore that there is almost no scope for significantly accelerating or deferring the time when carry arises to private equity executives. Not only are retiming effects likely to be much smaller than has previously been observed for dividends or other gains, but they may even be smaller than those for other types of performance-related earnings such as bankers' bonuses. Whilst we cannot rule out that there would be some revenue loss from retiming, we think that this is likely to be very small in the short-term, and negligible in the medium to long term.

7.2 Planning and avoidance

In many contexts, tax increases can result in additional tax planning or avoidance behaviours. First, reforms to the tax base can sometimes open up opportunities for new planning or avoidance strategies that would not have been effective under the previous rules. Second, increases in tax rates obviously increase the incentive to engage in tax planning, and may make some strategies financially worthwhile where they would not have been economical at lower tax rates. However, we again think that there is relatively little scope for behavioural change in the specific context of the reform that we are modelling. This is mainly because our modelling assumes that the only change to the tax treatment of carried interest would be to increase the tax rate under the existing statutory framework. This has several implications.

First, in the absence of any changes to the tax base, there would be limited scope for *new* tax planning strategies. It is sometimes possible for a pure change in tax rates to precipitate new tax planning and avoidance strategies, where it opens up incentives for shifting into a lower taxed base. In this case, if carried interest was taxed at 45% (or higher), there might be a new incentive to seek returns from funds' investments in the form of dividends, which are taxed at a lower headline rate of

[30] TCGA 1992, s103KD.

[31] Issues of liquidity from this 'dry' tax charge on individuals should not be overstated as the US experience shows that if the tax charge arises before the distribution of carried interests the fund will usually do 'tax distributions' to allow carry recipients to pay their tax liabilities in each year.

up to 39.35%. However, insofar as dividends are paid out of profits that have been subject to Corporation Tax, there is no objection to this since the effective rate would actually be higher. Although it would be possible to resort to strategies such as dividend recapitalisations to extract distributions without underlying taxable profits, this would again have implications for third party investors that are likely to make the strategy commercially unappealing.

Of course, if the Government decided to embark on more major reform, such as charging carried interest to Income Tax or introducing a new co-investment threshold that preserved preferential tax treatment for some carried interest, then such changes to the tax base could introduce unforeseen opportunities for new tax planning or avoidance strategies. In particular, we think that a co-investment threshold could open up major opportunities for 'gaming' the threshold in ways that may be difficult to foresee or legislate against. In that case, we would caution that there was a significant risk of unexpected planning and avoidance behaviours, although by their nature these would be difficult to predict precisely and would be highly contingent on the policy details. However, we can largely discount this risk for the purpose of our estimate, given the specific (more limited) policy assumptions that we are modelling.

A further reason to think that tax planning or avoidance behaviours are unlikely to be large is the existence of a well-developed network of targeted anti-avoidance rules that already operate in the context of carried interest. We have already mentioned, for example, the provisions against tax-motivated deferrals of payment to executives. Although an increase in the tax rate on carried interest would increase the incentive for tax avoidance, we would question how much scope there is for new schemes. Put another way, private equity executives are already very well-advised and could be expected to already have optimised their tax affairs to the extent possible under the existing regime, even at a 28% tax rate. Unless the increase in tax rate itself creates the opportunity for new strategies (as discussed above), we see limited risk of an increased uptake of existing schemes.

It is, however, possible that aligning the tax rates on carried interest with Income Tax could lead (in the long run) to private equity firms changing the overall structure for remunerating their executives more fundamentally. The extent to which this occurs will largely depend on how valuable the existing structure of carried interest incentives is for the private equity industry from a purely commercial perspective (i.e. absent the tax break), and this has not previously been tested, at least in the UK. If removing the tax break on carried interest leads private equity firms to rebalance total remuneration more towards management fees or to other types of performance-related reward, this would tend to suggest that the reform may have removed a distortion to the labour market that could lead to a more economically efficient structure of remuneration. Such a change could have significant indirect effects on the private equity industry but should not result in any direct loss of revenue.

7.3 Labour supply effects

The premise of the Government's proposed reform to the tax treatment of carried interest is that these payments are – in substance – a performance-related reward for services performed by private equity executives, rather than a return to capital that they have put at risk. As we show in Advani et al (2024), most carry recipients currently put little to no capital at risk themselves, leading us to the conclusion that carry is indeed mostly (and often exclusively) a return on labour by private equity executives. In this context, it makes sense to think of an increase in the tax rate on carried interest as mainly akin to an increase in taxes on top earnings, since in practice it has the effect of reducing the net return on the work undertaken by those affected.

The classic economic starting point for analysis of the labour supply effects of increasing taxes on labour is that there are two countervailing forces at play here. First, the 'substitution effect', which results from the fact that an increase in tax rates makes leisure time (which is not taxed) relatively more attractive compared with working (which is taxed). This will tend to reduce labour supply. However, there is also an 'income effect' working in the opposite direction. This is because an increase in tax rates reduces take-home pay, which may mean that an individual needs to work more (or harder) to maintain the same standard of living. Consequently, as a matter of pure theory, it is not obvious whether a tax increase should result in a reduction or an increase in labour supply since this depends on (across all affected individuals) which out of the substitution and income effects dominates.

It follows that the labour supply effect of increasing the tax rate on labour is an empirical question, and one that is sensitive to the specific context. A further challenge in the empirical literature is that it can often be difficult to observe labour supply responses directly. Studies which simply look at the effect of a tax increase on the total size of the tax base will not be suitable for inferring labour supply responses because changes in the tax base could be due to a variety of other types of response (such as retiming or tax planning, as we have already considered in this paper). What is needed are studies that cleanly identify the causal effect of a change in the effective tax rate on labour, on specific labour supply responses, such as hours worked, effort, or retirement.

The two best studies on labour supply responses that are closest to our present context (in that they focus on top earners) are from reforms in Switzerland and Denmark. Martínez, Saez & Siegenthaler (2021) find that in response to a Swiss 'tax holiday', whereby Income Tax was effectively reduced to nil for one year, top earners adjusted their taxable income via retiming responses but there were minimal changes in their labour supply. However, Kleven et al (2024) examined a tax reform for top earners in Denmark and identified a more significant labour supply response that was mediated by job switches, leading to a distinction between short-run and longer-run labour supply effects.

There remains an issue about how informative these existing studies are for predicting the labour supply response to an increase in the tax rate on carried interest. As we show in Advani et al (2024), carry recipients are an extremely elite group, with significantly higher remuneration (even on average) than the top earners studied by Martínez, Saez & Siegenthaler (2021) and Kleven et al (2024). A preliminary question is whether the substitution or income effect is more likely to dominate (on average) at these extremely high levels of remuneration. A related question concerns the exact channels through which labour supply responses might be mediated. For example, retirement seems a relatively more likely margin of response than changes in hours or effort, given the dynamics and wider incentives of the private equity industry.

We would not feel confident taking labour supply elasticities directly from Martínez, Saez & Siegenthaler (2021) and Kleven et al (2024) and applying them to the present reform, although if we did so then the resulting adjustment would still be quite small, equating to a reduction in the post-emigration tax base of somewhere between 2% and 10% (at a 45% tax rate). Perhaps the most informative indication of the likely scale of labour supply responses is the lack of any suggestion by the private equity industry that these would be first order compared with the migration response, which has been heavily emphasised. This leads us to be reasonably confident that if there is a negative labour supply response it would be relatively small compared with the migration response, for which we have been able to provide some quantitative bounds.

8. Post-behavioural revenue estimate

The final step in our analysis is to adjust our post-emigration revenue estimate to account for the other responses identified in the preceding section. We do not try to account for each of these responses separately, partly because we lack relevant quantitative evidence that we could apply at this level of granularity, and also because some of the responses may interact (for example: tax planning or avoidance is likely to be a substitute for labour supply responses). Consequently, to obtain a post-behavioural revenue estimate, we apply an aggregate percentage adjustment to our post-emigration tax base, aiming to collectively account for all other responses besides emigration.[32]

8.1 Adjustment for other responses

To reflect uncertainty over the magnitude of other responses besides emigration, we provide a range of adjustment percentages according to 'low' (5%), 'central' (10%) and 'high' (15%) response scenarios. The 'high' response scenario reflects both a high labour supply response (10%) plus a non-trivial (5%) amount of retiming and tax planning/avoidance. As we have noted, we think that the scope for retiming and (additional) tax planning is minimal in the context of carried interest, and a tax base response of 10% attributable to reductions in labour supply would be at the upper end of estimates obtained from the international literature. Consequently, we think that a 15% adjustment is a reasonable 'worst case' scenario and 10% is probably central.

Table 5: Post-behavioural revenue estimate on 2025/26 tax base at 45% tax rate

Additional response	Post-behavioural revenue estimate (£bn)	Additional revenue (£bn)
15% over 'worst-worst' migration response (Worst case)	2.4	0.3
15% over central migration response	2.7	0.7
10% over central migration response (Central estimate)	2.9	0.8
5% over central migration response	3.1	1.0
5% over 'best-best' migration response (Best case)	3.1	1.0

Source: Authors' calculations based on HMRC administrative datasets.

[32] This implicitly assumes that other responses are not a substitute for emigration. In other words, individuals first decide whether to emigrate, and then other responses are relevant only for those who decide to stay. To the extent that there is in fact an interaction, larger 'other responses' should lead to a lower emigration response.

8.2 Main result and interpretation

Our central estimate of the additional revenue raised from increasing the tax rate on carried interest to 45% is £0.8 billion in 2025/26. This is based on our central emigration scenario plus a 10% reduction in the post-emigration tax base to account for other responses. In our 'best case' scenario, additional revenue is £1 billion. In our 'worst' case scenario, comprising a high emigration response and high other responses, the additional revenue is £0.3 billion.

Beyond the inherent uncertainties in our estimates, which we have already emphasised, there are two important points to note when interpreting these results:

The first concerns the impact of policy choices. Our estimates assume that the *only* changes in the taxation of carried interest would be an increase in the tax rate (to 45%) under the existing statutory framework, plus the application of the new 4-year FIG (or OWR) regime to carried interest, using broadly the same definition of foreign carry as at present. Other policy designs could result in more or less revenue being raised. Most notably, a co-investment threshold would reduce revenue by facilitating the continuation of preferential tax rates for some share of the total carried interest tax base; the extent of such a reduction would depend on take-up, which in turn would depend on the specific design. In the other direction, taxing carried interest on emigrants would increase revenue by reducing the direct fiscal effects of emigration, at least in the short-term.

The second issue concerns the time horizon for our estimate. We have attempted to estimate the post-behavioural revenue in the first year of the reform i.e. 2025/26. We would not expect the revenue effects over the fiscal 'scorecard' window (i.e. up until 2029/30) to differ substantially from this, for several reasons. First, any immigration effects are unlikely to significantly impact revenues until after 2030 because, as we have discussed above, new arrivals account for a small share of the total taxable remuneration of carry recipients. Second, any tax planning and avoidance effects are likely to be small before 2030 because executives are likely 'locked in' to existing arrangements for funds that have already been formed and will pay carry within the next five years. Finally, Kleven et al (2024) find that labour supply responses are largely mediated via switches between firms, such that these effects are likely to be muted over the short-term.

In the longer-term (after 2030), the revenue and indirect effects of increasing the tax rate on carried interest are highly uncertain and could differ substantially from the short-term effects. This is mainly because the immigration effects of the reform would come into play at this time horizon. The impact on revenues and other economic outcomes would depend on how the labour market adjusts if the stock of foreigners working in private equity declines, which is especially difficult to predict. Over the longer-term, the impacts of the reform on the standard structure of private equity remuneration would also start to manifest, as well as the effects of other legal arrangements that are currently locked in for existing funds. Finally, the

international competitive landscape for private equity could look different in several years' time, depending on how other countries' preferential tax regimes for carried interest evolve. Although we have speculated about some of the forces at play here, these longer-term effects are essentially impossible for us (or anyone else) to predict with confidence.

9. Conclusion

The prospect of taxing carried interest like other 'performance-related rewards' has generated significant controversy, centred around a perceived tension between 'fairness' considerations and fiscal and economic expedience. It hard to make the case for taxing carried interest at lower tax rates than – for example – the bonuses of bankers or hedge fund managers, except on grounds that doing so is necessary to keep private equity executives from leaving the UK. It is therefore unsurprising that the focus of the private equity industry and media has been on the risk of mass exodus, if the Government follows through on the commitments that it set out in its Manifesto.

The debate over carried interest has so far been distorted by a lack of quantitative evidence on the carry population and their potential mobility, with public discourse instead dominated by anecdotes and assertions. Our analysis – in this paper and our companion paper (Advani et al, 2024) – aims to provide some balance and perspective to this debate. We find that whilst the image of private equity executives as international and highly mobile has some element of truth, there has also been a degree of exaggeration, leading to hyperbole about the potential migration response to tax increases that we think is not supported by the quantitative evidence. Three factors in particular drive our conclusion that the emigration response to increasing tax rates on carried interest would be much smaller than industry and media sources have suggested.

First, the effective magnitude of the tax change would be smaller than commonly supposed: even amongst the top 100 best-paid executives, carry only makes up 60% of their total pay on average, equating to a 16% reduction in total take-home pay if the carry rate is increased to 45%. Second, although a large share of carry recipients are foreigners, over 90% of the carry going to this group is received by individuals who have lived in the UK for 10 years or more, who are therefore likely to be relatively 'sticky' in their location decisions. Third, baseline emigration rates amongst carry recipients are remarkably low, and indeed lower than for other top earners: after five years' residence, only about 5% per year leave, declining to 1-2% per year for the longest stayers (Figure 4). Whilst private equity executives clearly travel a lot, these statistics do not suggest a population that is highly mobile in terms of where they live.

There is nevertheless high uncertainty about the revenue that would be raised from taxing carry at equivalent rates to other performance-related rewards, after accounting for emigration and other behavioural responses. Our central estimate is that at a tax rate of 45%, the reform would raise an additional £0.8 billion in 2025/26, but a plausible range is between £0.3 billion and £1 billion. These estimates only account for the direct fiscal effect of the reform and represent the short-run response. Ideally, policymakers would also account for the indirect effects of the reform – for example on jobs, linked industries, and investment – which in this case would be mediated almost entirely through the migration response and long-run labour market adjustments. Although we lack the data that would be needed to make any quantitative assessment of these effects, we recognise this as an important agenda for further research.

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Appendix: Revenue Estimates at Alternative Tax Rates

Methodology and limitations

In this appendix, we provide alternative revenue estimates for tax rates on carried interest between the current rate (28%) and the top effective rate on employment income (53.4%). For several reasons which we explain further below, we do not attempt to provide estimates for rates above 53.4%. One major reason is that higher rates than this would generate new opportunities for tax planning by shifting into other lower-taxed forms of income. Indeed, given the opportunity to take bonuses as partnership profits, income-shifting would also be a major concern (not directly accounted for in our model) at carry rates above 47%, so our estimates for rates above this level should also be treated with caution, although we show them for the sake of completeness.

When providing estimates for rates other than 45%, we do not apply any specific adjustments to our structural model of emigration, since this model already factors in the relevant change in the retention rate (depending on the applicable tax rate on carry) when estimating the emigration response. However, this approach relies on an assumption that emigration rates vary linearly with respect to changes in the retention rate (in other words that the relevant semi-elasticity is constant at different tax rates). This assumption is plausible when applying the model to rates that are close to the 45% rate used in our primary specification but may be less reliable at much higher or lower rates.

The aggregate adjustment that we make for other behavioural responses (besides emigration) equates to a 5%, 10% or 15% reduction in the total tax base in our 'low', 'central' and 'high' response scenarios, respectively at a 45% tax rate on carry. It obviously would not be sensible to apply the same magnitude adjustment for a 29% tax rate on carry (i.e. an increase of 1pp instead of 17pp). We therefore scale the adjustment based on how far the applicable tax rate is from 28% (at which these adjustments are trivially zero). Accordingly, on our 'central' scenario with a 10% adjustment at a 45% rate, each 1pp increase in the tax rate above 28% equates to a 0.59pp reduction in the total tax base. Again, the nature of this adjustment means that more caution is required the further the applicable rate is from the 45% rate used for our primary specification.[33]

Results and interpretation

Figure A1 plots the 'revenue curves' at different tax rates under our worst, central and best case scenarios for behavioural response (as well as the static effect with no behavioural response). Table A1 shows the underlying numbers. In line with our

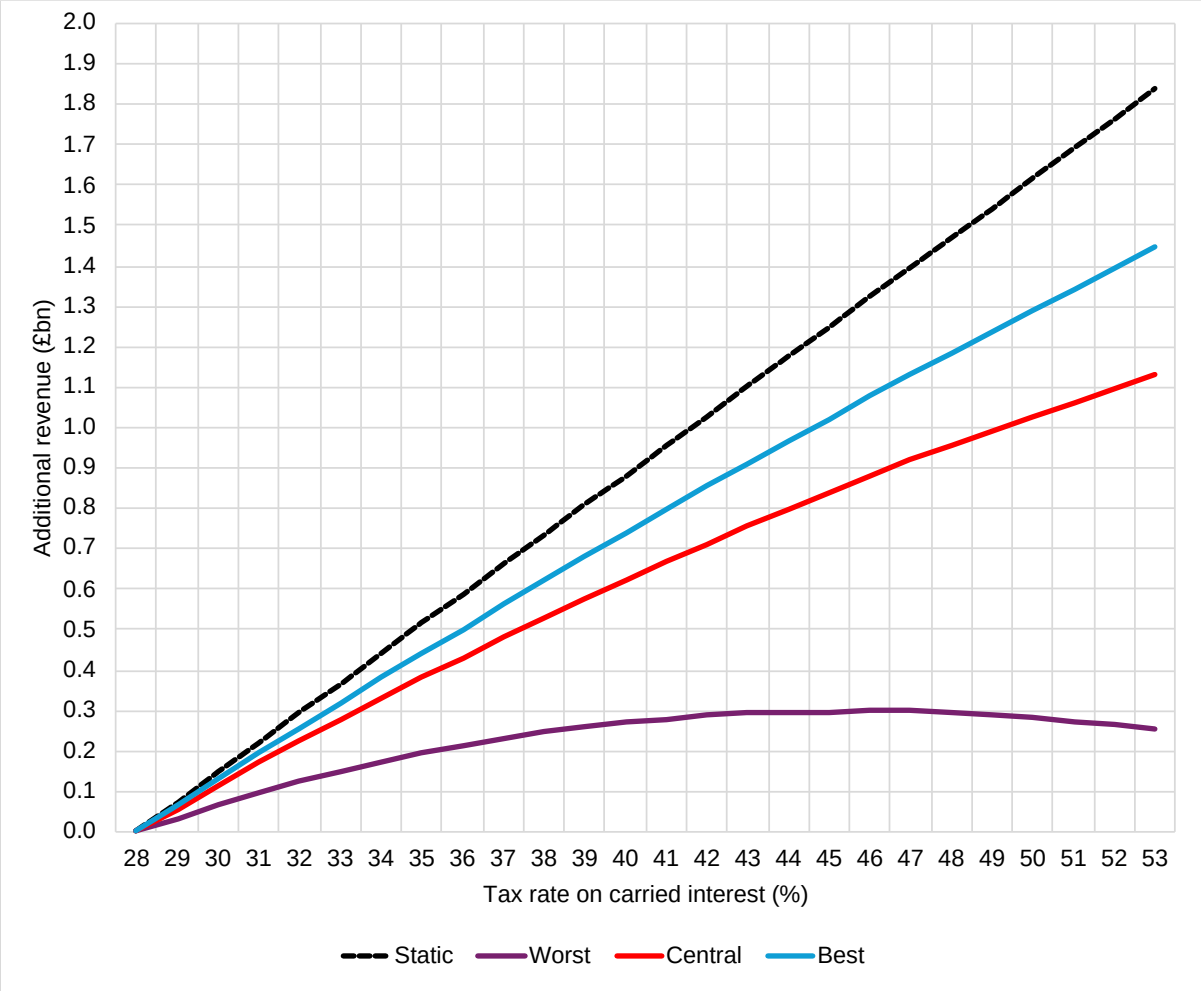
[33] Ideally, we would implement the adjustment for other behavioural responses using a tax base elasticity with respect to the retention rate. However, this approach faces several practical complications and the simpler (albeit crude) approach of using an aggregate adjustment to the tax base is equivalent when focusing just on modelling a 45% rate.

approach to estimating revenue at a 45% rate, our 'worst' scenario is based on the worst-worst emigration response (high response and high compounding) and high other responses (equivalent to 15% at 45p rate). The 'central' scenario is based on a central emigration response (medium response and low compounding) and medium other responses (equivalent to 10% at 45p rate). The 'best' scenario is based on low emigration response (low response and low compounding) and low other responses (equivalent to 5% at 45p rate).

In our worst case scenario, we find that the revenue-maximising ('Laffer') rate is between 44% to 47%,[34] and increasing the rate above 35% only raises an additional £100 million in revenue. However, as discussed in Section 6, this worst case scenario assumes an emigration response that would be extreme in comparison with previous reforms, even accounting for key characteristics of the carried interest population. On our 'central' and 'best' case scenarios, we find no Laffer effect below 53%. However, this specific finding should be treated with caution given that our modelling is not well-calibrated to account for tax rates on carried interest above 45%. The most we can say with reasonable confidence is that under our central and best case scenarios for behavioural response, increases in the tax rate on carried interest continue to raise additional revenue up to at least a rate of 45%.

[34] This does not mean that policymakers should be indifferent between these rates, because although they generate the same direct revenue, their indirect effects would be larger at higher rates since there would be larger reductions in the stock of carry recipients living in the UK.

Figure A1: Post-behavioural revenue estimates under 'worst', 'central' and 'best' case scenarios, using 2025/26 static tax base



Notes: 'Worst' scenario is based on worst-worst emigration response (high response and high compounding) and high other responses (equivalent to 15% at 45p rate); 'Central' scenario is based on central emigration response (medium response and low compounding) and medium other responses (equivalent to 10% at 45p rate); 'Best' scenario is based on low emigration response (low response and low compounding) and low other responses (equivalent to 5% at 45p rate).

Source: Authors' calculations based on HMRC administrative datasets.

Table A1: Post-behavioural revenue estimates under 'worst', 'central' and 'best' case scenarios, using 2025/26 static tax base

Tax rate	Static revenue (£bn)	Post-behavioural revenue (£bn)		
		Worst	Central	Best
28%	0.00	0.00	0.00	0.00
29%	0.07	0.03	0.06	0.06
30%	0.15	0.07	0.11	0.13
31%	0.22	0.10	0.17	0.19
32%	0.29	0.12	0.22	0.26
33%	0.37	0.15	0.28	0.32
34%	0.44	0.17	0.33	0.38
35%	0.51	0.19	0.38	0.44
36%	0.59	0.21	0.43	0.50
37%	0.66	0.23	0.48	0.56
38%	0.73	0.25	0.53	0.62
39%	0.81	0.26	0.58	0.68
39.35%	0.83	0.26	0.59	0.70
40%	0.88	0.27	0.62	0.74
41%	0.96	0.28	0.67	0.80
42%	1.03	0.29	0.71	0.85
43%	1.10	0.29	0.76	0.91
44%	1.18	0.30	0.80	0.97
45%	**1.25**	**0.30**	**0.84**	**1.02**
46%	1.32	0.30	0.88	1.08
47%	1.40	0.30	0.92	1.13
48%	1.47	0.29	0.96	1.19
49%	1.54	0.29	0.99	1.24
50%	1.62	0.28	1.03	1.29
51%	1.69	0.27	1.06	1.34
52%	1.76	0.26	1.10	1.39
53%	1.84	0.25	1.13	1.45
53.40%	1.87	0.25	1.14	1.47

Notes: 'Worst' scenario is based on worst-worst emigration response (high response and high compounding) and high other responses (equivalent to 15% at 45p rate); 'Central' scenario is based on central emigration response (medium response and low compounding) and medium other responses (equivalent to 10% at 45p rate); 'Best' scenario is based on low emigration response (low response and low compounding) and low other responses (equivalent to 5% at 45p rate).

Source: Authors' calculations based on HMRC administrative datasets.