

FARMING NEWS

AS environmental credits become more prominent and more markets open for them, questions are increasingly rising about their tax status. Are they capital assets whose sale is subject to CGT? Do they actually qualify as income instead? What is their significance for inheritance tax? Are they subject to VAT? For that matter, are they even taxable at all?

We approach these questions here by discussing in turn the three current Government-backed environmental credits in the UK.

CARBON CREDITS*Distinct Asset*

Currently sequestered through compliance with the Woodland Carbon Code or Peatland Carbon Code, these are voluntary offsets representing either carbon removed from the atmosphere by appropriately-registered woodland, or carbon not emitted because environmental improvements are made to a peatland site.

These carbon schemes lead to a tradeable credit that is clearly distinct from the land by which it was secured. For example, you could sequester 15 years of woodland carbon, then sell the land, then sell the carbon some time later. Therefore, carbon behaves as a distinct asset to be bought and sold in itself, rather than purely a way of quantifying a certain type of service.

Biodiversity Net Gain is similar in that technically a landowner could agree to enter land into a conservation covenant, sell the units upfront, then sell the land, subject to the covenant. A conservation covenant secures any agreed improvements for the 30-year period of the covenant at the devaluation of the land, which is now restricted in its potential usage in a similar way to land that has been used for woodland creation.

The Government is explicit in that VAT is not chargeable on the sale of voluntary carbon credits. Beyond this, however, the situation becomes more complex.

Income Tax

Income from commercially-managed woodlands is not normally subject to either income or corporation tax. Likewise, money from the sale of commercial trees/timber is not subject to Capital Gains Tax (CGT).

However, carbon credits are distinct from the trees to which they relate. One could, if all paperwork had been correctly completed at the right time, clearfell a stand of woodland and sell off the timber but either retain the car-

Questions arising over environmental credits

Land agent and surveyor expert **Hugh Townsend** shares his thoughts on the taxation of environmental credits



bon credits relating to the stand or sell them to someone completely different.

Selling the trees is not selling the carbon credits. This relates to an almost philosophical debate about what a carbon credit actually is, which is also important for how carbon is handled in tenancy situations. The net result is that it is not clear whether any or all of these exemptions would actually apply in woodland carbon transactions. Some tax accountants would tell you that they definitely will; others are less certain.

Peatlands do not benefit from exemptions from income, corporation and CGT, so all we can say for sure is that VAT appears not to be applicable to peatland carbon sales.

VAT

We should note that HMRC's position regarding VAT on voluntary carbon offsets, such as under the Woodland and Peatland codes, is subject to some caveats. Their reasoning is not explicitly anything to do with wanting to encourage the market, but rather that they do not consider carbon credits to be either goods or a service, so they fall outside of VAT's scope. That they "have seen no evidence of the existence of a genuine secondary

trading market" in woodland and peatland credits is apparently relevant.

Note also that because the credits are not vatable on sale, this may affect the ability to claim VAT on payments needed to secure them, such as professional advice on compliance with the Woodland Carbon Code and management costs.

Asset depreciation

Land under a long-term obligation to maintain either woodland, BNG or improvements to peatland may suffer from a reduction in value, including for capital tax purposes and on the balance sheet (with all the implications that might bring). Effectively the land may be devalued in order to secure the various credits. Proper advice must therefore be sought on all of these matters.

Inheritance Tax

Inheritance tax would be applied to the land used for carbon sequestration as usual as for any woodland use. Commercially-managed woodlands are frequently eligible for Business Property Relief, and farmed peatland, even where stocking has been reduced to enable environmental improvement to the peat, is potentially subject to both Business and Agricultural Property Reliefs, depending on the pre-



► **Carbon Credits, Biodiversity Net Gain and Nutrient Offsets are expected to gain traction as farmers look to diversify and increase their incomes** David Martyn

cise nature of the farm businesses involved.

BIODIVERSITY NET GAIN

Providing a service

In the case of BNG, the nature of transactions is still less clear. BNG as a tradeable commodity has arisen because under the Environment Act 2021, by the end of 2023 the UK will require a 10% net gain in biodiversity for all developments which need planning permission. Where this cannot be provided within the “red line” of the development, it must be found elsewhere, which can be achieved by paying landowners to undertake activities that improve biodiversity on their land.

The market for this is complex as we have discussed elsewhere. The notion of “credits” comes from the fact that the improvement to biodiversity achievable on a site is given a set number according to the Government’s “Biodiversity Metric 3.1”. Developers will need a certain amount of biodiversity according to the Metric, and landowners will be able to supply a certain number. We describe the amount of biodiversity transacted

between the two as an exchange of “biodiversity credits”.

In tax terms, this may be seen as payment for a service, rather than the sale of an asset. A landowner is paid by a developer to take and properly administer certain physical actions a developer legally requires to carry on their own activities. Therefore, intuitively, one would think that BNG qualifies as income only. However, this is not necessarily the case. Biodiversity Net Gain is similar to carbon credits in that technically a landowner could agree to enter land into a conservation covenant, sell the units upfront, then sell the land subject to covenant. Unlike woodland carbon, where the units are established by the vendor alone, this would only be possible once a BNG purchaser has agreed to buy the units and the works have started. A conservation covenant secures any agreed improvements for the 30-year period at the devaluation of the land, which is now restricted in its potential usage in a similar way to land that has been used for woodland creation. If the landowner vacates the land, the suc-

cessor is bound by the conservation covenant regardless of whether the original party took payment for the units upfront. This would suggest that the units would indeed be classed as an asset.

We are finding that this rapidly-emerging market provides many and varied ways of “skinning one’s cat”. One way of being paid for BNG is to enter a 30-year agreement (a conservation covenant) with an appropriate “responsible body” and manage the land in a certain way to secure the BNG. This seems to unambiguously be a service. Another way is to lease the land to the developer for 30 years, and the developer as lessee would then enter into the conservation covenant and contract the landowner back onto the land to carry out their obligations. This may have a capital element to it, as per the rules for long leases. Ultimately, we can only speculate until the BNG process becomes mandatory.

Income and Capital Gains Tax

We have not yet come across an exemption suggesting that either the capital element would not be subject

to CGT or that the income element would not be subject to income or corporation tax. Where land is leased out, Stamp Duty Land Tax may also be involved.

Inheritance Tax

Inheritance tax is also relevant here. Where BNG land clearly remains part of a farm business, the BNG element should not disqualify it from Agricultural Property Relief (APR) or Business Property Relief (BPR). This might occur when, for example, stocking and fertiliser inputs are reduced on a pasture field, but the animals grazing it are still sold at market. However, if the BNG element means the land is no longer used for any agricultural purpose at all – for example, if a large water feature is created – these reliefs may be lost.

Particularly radical rewilding activity could have this impact in the long

term. However most higher-value habitats on the Metric which are likely to be relevant to farmers (as opposed to things such as urban limestone pavements or coastal sand dunes) will likely still be appropriate for some agricultural use. The very highest value habitats a farmer could create would include specialised heathland or wetland areas, which usually need sympathetic grazing to keep their condition, or traditional hay meadows, which can still be used for their stated purpose. Woodlands created for BNG may lose their APR but, as mentioned above, may still retain eligibility for BPR if managed appropriately.

Note that some eligibility for APR is not necessarily the same as complete eligibility. If a property is placed under a 30-year agreement which binds any future owners to farming it in a way which significantly reduces its agricultural output, the agricultural value of the property as a proportion of its total value may be reduced, with some of its value being considered by HMRC to be of amenity use only. Therefore, APR may no longer cover 100% of its value.

NUTRIENT OFFSETS

Further broken down into phosphate and nitrates, these are actions for which landowners are paid to attempt to counteract harm to a watercourse from effluents from developments flowing into watercourses.

The legal requirement for such action has arisen from a landmark piece of European case law and as such is only currently relevant to certain types of European protected sites. At the moment there are two main areas where this is relevant: the Solent waterway running between Hampshire and the Isle of Wight, in which several Special areas of Conservation and RAMSAR sites have issues with Nitrates; and the Somerset Levels and Moors, and a RAMSAR site to the north of the county which faces issues with phosphates. However, we would not be surprised if the UK Government picks up a taste for such measures to improve water quality in general and we expect these to be rolled out extensively.

Politically, there is dire need for a “stop-gap” measure to show action is being taken to address the harm from untreated sewage entering watercourses, a problem which will require many years of consistent investment into our water infrastructure to solve entirely.

One presumes these offsets will be treated in a similar way by HMRC as BNG.

We are not accountants and every case should be checked with an accountant before relying on any of the opinions and views we have put forward.

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