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Carbon Contracts and Taxation of Carbon Units

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Status of the WCC/Peatland Code

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Voluntary Scheme

- Join the scheme you abide by the rules if you want to be able to register/verify your carbon units.
- If you break the rules you will have carbon units cancelled and future units will not be verified.
- Governance process to deal with disputes over interpretation which may have resulted in adverse decisions.
- No sanction other than as above.

Options for landowner

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(a) Operate scheme and sell Pending units

- *Carbon Sale Contract*
- *Project Developer Agreement*
- *Group Agreements*
- *Forest Manager Agreement*

Plus

- Up front money
- Remove unit market price risk

Minus

- Ongoing contractual obligations to 3rd party/potential unlimited liability
- Ongoing WCC/PC obligations – forest maintenance/peat management costs
- No upside if unit market price improves
- Length of scheme – burdening future generations
- Sale to of land to 3rd party – impose obligations and no benefit to purchaser
- Potential to restrict future opportunities – other natural capital accounting not yet established

Options for landowner cont.

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(b) Operate scheme and sell/use (insetting) Verified units

- *Project Developer Agreement*
- *Group Agreements*
- *Forest Manager Agreement*

Plus

- For insetting – remove unit market price risk
- For sale – potential unit market price upside
- No contractual risk to 3rd party
- Sale of land to 3rd party – impose obligations but benefit to purchaser

Minus

- For sale - unit market price risk
- Ongoing WCC/PC obligations – forest maintenance/peat management costs
- Length of scheme – burdening future generations
- Potential to restrict future opportunities – other natural capital accounting not yet established

Options for landowner cont.

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(c) Lease land for tenant to operate scheme

- *Lease*

<u>Plus</u>

- Upfront premium not rent
- Potential to claim royalty on enhanced carbon price – how to value?
- No contractual risk to 3rd party
- No WCC/PC obligations

<u>Minus</u>

- Unless royalty built in no participation in unit market price upside
- Implications of tenant going bust
- Length of lease – removing from future generations
- Potential to restrict future opportunities – other natural capital accounting not yet established

The taxation of carbon credits

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The starting point

- No HMRC guidance – yet
- In the absence of guidance, back to basics
- Fact specific
- Income or capital?
  - Badges of trade
- Tax position once nature of transaction determined

The taxation of carbon credits

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Example 1

- The landowner leases the land to a tenant
  - upfront premium
  - tenant enters in the WCC/Peatland Code scheme
  - lease is for more than 50 years
  - capital and chargeable to CGT at 20%

The taxation of carbon credits

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Example 2

- The landowner enters into Woodland Carbon Credit scheme
  - sells the “pending” units upfront for a lump sum
  - Ongoing contractual obligations
  - No ongoing income stream
  - Capital disposal
  - Contrast treatment with sale of the land and standing timber

The taxation of carbon credits

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Example 3

- The landowner enters into Woodland Carbon Credit scheme
  - retains the “pending units”
  - sells some of the converted carbon credits in 5 years
  - retains some credits to be sold when the price is right
  - Ongoing income stream
  - Commercial woodlands?

The taxation of carbon credits

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Summary

- The tax treatment of each case is fact specific
- Seek early advice on structuring
- Potentially scope to be very tax efficient
- Keep an eye on the overall inheritance tax position

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Thank you

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