



The Sale Of Carbon Credits – The Tax Treatment

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With the Environment Bill having recently become the Environment Act and the Agriculture Act pushing “farming for the environment”, it is timely to look at the tax treatment of environmental income streams such as “carbon credits”. The use of such credits has rather cynically been called “green washing”.

There is a need for more guidance on the treatment of carbon credits which is potentially complex for tax purposes – to forensically understand the management of woodland that gives rise to the credit to justify the appropriate tax treatment.

When the taxpayer has obtained the carbon credits under the woodland carbon guarantee (WCaG) scheme, the property owner basically calculates how much CO₂ they can capture (or sequester) by growing trees. They then have the option to sell that captured carbon in the form of woodland carbon units (WCUs) to the government for a guaranteed price every five or ten years until 2055/56 ([reference](#)). Alternatively, they can sell the units on the open market.

To determine whether there is a tax liability one should return to the forensic understanding and consider the nature of the units and the underlying woodland.

Income Tax on woodland generally

There are arguments to say that the income can be tax free. If the woodland is commercially managed then it could be argued that the income could be exempt from income tax. ITTOIA 2005, s 768 ('Commercial occupation of woodlands') says:

1. 'No liability to income tax arises under Chapter 8 of Part 5 (income not otherwise charged) in respect of income arising from the commercial occupation of woodlands in the UK.
2. For this purpose the occupation of woodlands is commercial if the woodlands are managed:
 1. On a commercial basis, and
 2. With a view to the realisation of profits.'

HMRC's Business Income Manual at BIM67701 provides similar guidance. However, in the absence of any clear HMRC guidance on the sale of WCUs point, opinion is divided as to the tax treatment and sellers may take a more cautious approach on the basis that this is a separate contract relating to the offsetting units. Sellers may therefore provide for tax liabilities in the financial projections relating to the proposal. The first government auction of units was in early 2020 so any position adopted by HMRC may not yet have been tested in tribunal.

The government's WCaG scheme does, however, provide relevant but non-binding comments. The advice and guidance for customers applying for WCaG (tinyurl.com/wepdfsfw) implies that the s 768 exemption is available on the sale of the carbon credits covered by that scheme.

In Forestry Commission document: [Creating a new woodland; woodland carbon guarantee](#), under 'Taxation of commercial forestry', it states: 'Currently, profits arising from the commercial occupation of woodlands are not chargeable to income tax and corporation tax and the value attributable to trees is exempt from

capital gains tax.’ However, how certain can tax advisers be that the carbon credits find themselves in the exemption for woodlands?

Consideration around the possible tax-free income stream from carbon credits is another factor to consider and needs guidance from HMRC. In the meantime, there must be forensic understanding of the woodland activity so that an informed decision can be made, and advisers need to keep a watchful eye on government guidance.



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