



# TAXATION OF ENVIRONMENTAL LAND MANAGEMENT AND ECOSYSTEM SERVICE MARKETS

Issued 8 June 2023

ICAEW welcomes the opportunity to comment on the Taxation of environmental land management and ecosystem service markets published by HM Treasury on 15 March 2023, a copy of which is available from this [link](#).

For questions on this response, please contact the ICAEW Tax Faculty at [taxfac@icaew.com](mailto:taxfac@icaew.com) quoting REP 55/23.

This response of 8 June 2023 has been prepared by the ICAEW Tax Faculty and ICAEW's Farming Community.

Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

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## ICAEW

Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK  
[icaew.com](http://icaew.com)

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Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

## KEY POINTS

1. Uncertainty is a significant issue affecting the uptake of environmental land management schemes. Current uncertainty regarding the accounting and tax treatment for environmental land management schemes deters landowners from implementing such arrangements. The farming industry requires certainty and a long-term view in order to secure investment for environmental land management schemes, given their long time frames.
2. Any changes in tax policy to encourage environmental initiatives must be part of a coherent decarbonisation strategy for agricultural and land use, as called for in the Climate Change Committee's 2022 Progress Report to Parliament. This will need to consider the taxation of environmental land management schemes alongside other incentives on offer for alternative uses of the land, and whether there is sufficient incentive for landowners to commit land to environmental schemes over other uses. It will also need to consider the extent to which reliefs may impact land use, for instance the conversion of land currently used for food production into land used for environmental purposes to access reliefs. England's strategy should complement that pursued by the other devolved governments.
3. This is a new and evolving area of tax where practical experience of the arrangements is currently limited. For this reason we have grouped our comments under broad themes rather than answering each question individually. At this point, our members are able to provide a limited range of specific practical examples and points of detail, underlining the need for clarity over accounting and tax rules.

## POLICY OBJECTIVES

4. At present the consultation document appears to approach the tax treatment of ecosystem markets from the perspective of agricultural landowners only. Members have advised us that investors, including some from overseas, will consider investing in UK land where there is an attractive return and certainty of treatment (see below). It is therefore important that any policy change is clear on what it is trying to achieve. We do not consider this is sufficiently evident in the consultation document currently. For example:
  - a) What behaviour is the policy trying to encourage?
  - b) Whose behaviour is being targeted?
  - c) Is the objective to encourage markets which address climate change or to provide support to the agricultural industry?
5. We also think that tax policy in the area of climate change should be considered more holistically. For example, how should land being used for renewable energy projects such as wind farms be treated? If the policy is seeking to encourage activities which support net-zero, then arguably these changes could apply more widely and could be used to have a positive impact on other Environmental, Social and Governance (ESG) goals as well.

## EXISTING UNCERTAINTY

6. From our discussions with members, it is apparent that it is unclear how existing accounting and tax rules apply to various environmental land management schemes. This applies to both individuals and companies. In line with our ten tenets, it is important for a tax treatment to be certain and simple. It would be preferable, if at all possible, for the tax rules to follow the accounting treatment, rather than add complexity to the tax system by introducing new bespoke rules. As a starting point, it is vital to clarify how environmental land management schemes should be accounted for correctly. We encourage HM Treasury to work with the Financial Reporting Council and other standard setters to develop consistent accounting across such schemes, as well as supplementary educational material and guidance.

7. Members have advised us that this uncertainty means that clients are very reluctant to commit land and funds to ecosystem service markets. It is a significant block on expanding these initiatives.
8. For existing participants, they are uncertain how receipts and expenses are treated. Due to the different nature and timings inherent in ecosystem service markets projects, it is not currently easy to tell whether something is a capital or a revenue cost. From member feedback, some clients have established companies to manage the risk of potential error (as income and gains are taxed at the same rate).
9. For other taxes, like IHT, it is not clear whether land used for environmental activity would qualify for reliefs such as APR or BPR. Despite the suggestion in the consultation that such activity would be viewed as trading and so would not jeopardise these reliefs, it is not clear from live examples and interaction with HMRC that this is the case. There is also an element of scepticism from the industry around the longevity of any legislative changes in what is a turbulent political environment. These projects will be undertaken over a number of years, maybe even decades. Participants will need assurance that any existing policy and interpretation will continue and that any change in interpretation would not be applied to live arrangements nor invoked retrospectively. This sort of certainty is more likely to be achieved through statute, rather than guidance.
10. Nevertheless, there does need to be flexibility and ongoing review as it is very unclear how these ecosystem markets will develop over time.
11. Members noted that any new rules (whether accounting or tax) or reliefs introduced will need time to bed in and become accepted. It is unlikely that new rules will spur an immediate uptake in environmental land management scheme participation, in particularly amongst farmer landowners who may fear compromising their current inheritance tax (IHT) position. Long-term commitment from the government and certainty over rules and tax reliefs is essential in promoting participation in such initiatives.

## TERRITORIALITY AND USE OF LAND

12. It appears that the government seeks only to apply any advantageous changes in policy to land which would otherwise have met the definition of agricultural land. This could result in a move towards taking land out of traditional agricultural use (eg. food production) to ecosystem markets. This leads to the question of what are the priorities for land use in England and the UK more widely? There is only a finite amount of land and there are already concerns around domestic food production levels and a housing shortage.
13. Where initiatives provide attractive returns and incentives, investors will likely provide funding. If the returns exceed agricultural returns, farming land may be converted to non-farming environmental use. If the uptake of this is larger than expected, this may impact England's food security and other ESG goals.
14. We question why only agricultural land is being considered. We understand that it is undesirable for APR to be extended too far, as this may allow unintended relief for private individuals and non-agricultural landowners. However, the use of brownfield sites for environmental purposes could also be considered. This goes back to having clarity on the tax policy objective. If this goes wider than simply supporting the agricultural sector, then other types of land should be at least considered for inclusion in any policy changes. This may be an area where regulations could be set by DEFRA such that land used under certain approved schemes is brought within the definition of agricultural and APR may therefore apply to it.

15. We note that this consultation only applies to land in England where, when compared to Scotland and Wales, there is much less suitable land available. It would be preferable to develop policy simultaneously across the UK.

## INCENTIVISATION

16. If the government is seeking to reward activities which support net-zero, incentivisation is very important. However, if these incentives are not well thought through there is a risk that these markets become an opportunity for tax avoidance.
17. Thought could be given as to whether it would be more appropriate to develop a new relief as opposed to trying to shoe-horn environmental activities into APR and other existing reliefs which could create more complexity than if an entirely new statutory relief was devised.
18. Any change in policy or relief needs to be taken in consideration with the existing position. For example, favourable tax treatments are available through Woodlands Relief but this is only in point should the trees be felled. To incentivise businesses to grow and retain trees the returns and incentives need to be greater than alternative options.
19. Any incentives will need to take into account the specificities of farming and agricultural land use, for instance crop rotation or the impact of bad weather on outputs. Fluctuations in the use of land must be considered if designing or extending any tax reliefs.

## AGRICULTURAL PROPERTY RELIEF AND BUSINESS PROPERTY RELIEF

20. Farmers are unlikely to undertake a change in activities unless they have absolute clarity that the APR and BPR positions are unaffected. The majority of members who contributed to this response have advised us that this uncertainty has deterred farmers from undertaking environmental activities with their land. For smaller farmers there may be an added concern that undertaking environmental activities may affect the APR and BPR available on their farmhouse, as any change in use of their land may have a more material impact on the availability of reliefs.
21. Our members expressed scepticism that environmental use of land would meet the current definition of BPR should more than 50% of an estate be used for environmental activity. This is because on basic principles there was a view that the activities could be akin to investment, essentially using land to gain a return over time - similar to letting. This reiterates our earlier comments, that landowners would need certainty over the long-term that any tax policy position would remain in place. In line with our ten tenets, certainty should be achieved through statute as opposed to guidance.
22. Members thought that any valuation (for BPR, APR or any newly introduced relief) would need to be based on market value. There would be no incentive to convert to environmental use if only the agricultural value was to be covered by IHT reliefs. If market value were not to be used, it is likely that trees would need to be felled to meet the increase in any IHT liability.
23. Similarly, the requirement for tenancies to be at least eight years would likely deter landowners from entering into rental agreements. Members did not consider this to be a helpful change in policy - existing policy strikes an accepted balance between the interests of landlord and tenant.
24. We note Question 2 of Part 2 regarding the requirement of live undertakings and the ongoing meeting of the conditions to retain relief at the point of transfer. This would likely disincentivise any move into ecosystem markets as such restrictive conditions are not in place for other land transfers under APR and BPR.

## GLOBAL CONSULTATION

25. We understand that similar initiatives have been undertaken in other territories eg. Italy. While we have not been able to develop links in the timeframe of this consultation it might be worthwhile for the Treasury to seek to understand global experience in this area as we are advised that such initiatives have not been without issues and have at times struggled to incentivise the right behaviours. It would be good to learn from the experience of other jurisdictions.

## APPENDIX 1

### ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).