



HMRC guidance on the taxation of ecosystem service payments

HMRC has published long awaited guidance on the UK tax treatment of payments made in connection with ecosystem services. This is a very welcome development, following a prolonged period of uncertainty for landowners, developers and advisers. We have been pleased to contribute to discussions with HMRC as this guidance was developed.

While the guidance does not answer every question or cover all fact patterns, it provides helpful clarity on the core tax principles applying to the main ecosystem service markets and related payments. We would strongly encourage anyone wanting to understand the tax position for ecosystem services to refer to the full HMRC guidance for detail and then seek appropriate advice for how it applies to specific circumstances.

Scope of the guidance

The guidance sets out HMRC's approach to the taxation of payments made to landowners for providing ecosystem services. These include arrangements designed to deliver ecological benefits such as biodiversity enhancement, nutrient mitigation and carbon sequestration. It focuses primarily on statutory and government backed schemes, but also explains the general principles HMRC will apply to similar non statutory or private arrangements.

The tax treatments are considered from the perspective of both:

- The party paying for or purchasing the ecosystem service, and
- The landowner or manager creating and maintaining the service.

Ecosystem services covered

The guidance covers:

Statutory schemes in England

- Biodiversity Net Gain (BNG)
- Nutrient neutrality

Government backed voluntary schemes (UK wide)

- Woodland Carbon Code
- Peatland Code

It also explains how similar principles apply to other emerging land based environmental markets.

Biodiversity Net Gain (BNG)

BNG is mandatory in England and requires developments to deliver a minimum 10% gain in biodiversity. This may be achieved:

- On the development site,
- Off site through biodiversity units created on other land, or
- As a last resort, by purchasing statutory biodiversity credits from the government.

Off site biodiversity units must usually be secured and managed for at least 30 years and are registered and monitored through formal agreements overseen by local authorities or responsible bodies.

Nutrient neutrality and nutrient credits

Nutrient neutrality applies in certain English river catchments affected by nutrient pollution. Developments must demonstrate no net increase in nutrient loading.

Developers may achieve this through on site measures, off site mitigation arranged with landowners, or the purchase of nutrient credits created through activities such as land use change or infrastructure improvements. These arrangements often involve long term land management commitments, frequently lasting 75 years or more.

Nutrient credits cannot usually be traded by purchasers in the same way as carbon credits.

Woodland and Peatland Carbon Codes

The Woodland Carbon Code and Peatland Carbon Code are voluntary schemes providing quality assurance for land based carbon projects.

Landowners initially obtain Pending Issuance Units (PIUs), which may later convert into verified Woodland Carbon Units (WCUs) or Peatland Carbon Units (PCUs). Verified units represent a tonne of carbon dioxide equivalent removed from, or prevented from entering, the atmosphere. Carbon units can be sold on the open market and are commonly retired by purchasers to offset emissions, although they may also be held or traded.

Stacking of ecosystem services

The guidance confirms that different ecosystem services may, in some cases, be delivered on the same land. This is referred to as ‘stacking’. Whether stacking is permitted depends on the specific scheme design and whether there is a risk of double counting environmental or financial benefit.

Importantly, where stacking occurs, the tax treatment of each type of payment or credit must be considered separately.

Direct tax treatment – developers and buyers

- Payments made by property developers to meet statutory BNG or nutrient neutrality requirements are generally deductible for income or corporation tax where incurred as part of a trading activity, subject to normal rules.
- Where expenditure is capital in nature, it may be deductible in computing capital gains.
- Carbon credits purchased for use in a trade (for example, to offset emissions) are generally deductible. Credits held for investment purposes may fall within capital gains rules.

Direct tax treatment – landowners

- Payments received by landowners for ecosystem services will generally be taxable.
- In most cases, receipts are treated as trading income, either:
 - As part of an existing farming or land based trade, or
 - As a deemed trade through commercial occupation of land.
- Specific rules apply to woodlands. Income from commercially occupied woodlands is generally outside the scope of income tax, although this exemption can be lost depending on how the land is used. The guidance confirms that this woodlands exemption extends to all ecosystem service income derived from the commercial occupation of woodland. So, for instance, BNG woodland units may well fall outside the scope of income tax.
- HMRC states that ecosystem service payments will normally be income rather than capital. Capital treatment is only likely in very limited cases, for example where payments compensate for permanent loss or sterilisation of the land.



Expenditure incurred by landowners

Costs incurred in creating ecosystem services, such as land works, professional advice and legal arrangements, may be deductible depending on how the land is used:

- Against trading income where part of a trade,
- Against property income in some landlord scenarios, or
- As capital expenditure for capital gains purposes where not otherwise allowable.

Capital allowances may be available for qualifying plant and machinery.

Other taxes

- VAT: Sales of BNG units by taxable persons are subject to VAT at the standard rate. Statutory biodiversity

credits sold by the government are outside the scope of VAT. Specific VAT rules apply to carbon credits but most compliance market credits and voluntary carbon credits are in scope.

- Stamp Duty Land Tax (SDLT): Payments for ecosystem services alone are not generally subject to SDLT, but SDLT may apply where land or interests in land are acquired.
- Inheritance tax (IHT): Legislation applies from 6 April 2025 to ensure that land under qualifying environmental management agreements can continue to benefit from agricultural relief, subject to conditions. The guidance, as a standalone document, does not provide any further detail. However, it's very important to review the legislation when considering this relief; it does not apply to all land in environmental schemes.

What the guidance doesn't say

The guidance is designed to be thematic; it's not practical for it to seek to answer every taxpayer's questions as there are a myriad of different legal structures which can occur within the ecosystem services sector.

However, there are some reoccurring common questions where the sector would still welcome clarity. We will continue to engage with HMRC and other relevant stakeholders on these matters on behalf of our clients and the wider sector. These questions include the following:

Accounting treatment

The guidance states that income recognition follows normal principles:

- Under the cash basis for qualifying unincorporated businesses, or
- Under Generally Accepted Accounting Practice where the accruals basis applies.

However, the HMRC guidance does not go on to give any opinion as to what this treatment should be under UK GAAP. Saffery is currently working with the ICAEW to draft guidance on accounting for the sale of BNG units. The accounting considerations are complex and highly

technical but hopefully this guidance will be published over the coming months. Accounting for the sale of carbon is also complex but perhaps better understood. We would recommend that accounting advice is sought before entering into any contracts to ensure you understand the likely outcomes.

VAT

There are still aspects of VAT treatment where HMRC has not formally opined on, such as the place of supply when selling carbon credits to foreign purchasers and the ability to recover VAT on costs incurred where the relevant output has been many years earlier.

The new guidance specifically covers BNG and carbon units but doesn't make any specific reference to VAT treatment on the sale of any other ecosystem services. We would generally expect the treatment for these to follow that of the guidance released for Voluntary Carbon Credits, but advice should be taken.

Source and further reading

This summary is based on HMRC's published guidance on the [taxation of ecosystem services and associated environmental markets](#). Clients should refer to the full HMRC documentation and manuals for detailed rules, examples and limitations before entering into any arrangements.

We would be happy to discuss how this guidance may apply to your particular circumstances; please get in touch.



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