VAT and voluntary carbon credits

Indirect Tax **Environmental**



17 May 2024

The CIOT and ATT continue to engage with HMRC on the interaction of tax issues with developments in the ecosystem service markets. Following the publication of a Revenue and Customs Brief on VAT and voluntary carbon credits, stakeholders were invited to a discussion with the VAT policy team.

HMRC published Revenue and Customs Brief 7 (2024) *VAT treatment of voluntary carbon credits* (tinyurl.com/53pydsuy) on 9 May, which confirms that voluntary carbon credits (VCC) will become taxable supplies from 1 September 2024. The VAT liability is either taxable at the standard rate, or zero-rated where the VCC is in the scope of the Terminal Market Order. HMRC also updated several pages of the corresponding VAT manuals VATSC06581/2/3/4/5 (tinyurl.com/mr4crkzf), with VCCs mainly covered in VATSC06584.

The Joint VAT Consultative Committee had sight of the draft Revenue and Customs Brief for a short time prior to publication and similar themes arose in the post-publication meeting to the CIOT's pre-publication feedback.

Position on input VAT recovery

As the position on the VAT liability will change from outside the scope of VAT to the making of a taxable supply, this raises questions around the input VAT recovery position on the costs related to the VCC. Currently, if the VCC contract is entered into prior to the change in VAT liability and deemed to be a non-business supply, the existing input VAT guidance on non-business costs should be used.

Another point raised was in relation to costs incurred for VCCs both before and after the date of the VAT liability change. VCCs are typically long-term projects and it would aid clarity, certainty and consistency for businesses if additional guidance on this could be provided.

Domestic reverse charge

The Revenue and Customs Brief and VAT Manual VATSC06580 is silent on the domestic reverse charge position. That is, where the responsibility to declare output VAT on a supply is shifted from the supplier to the customer. This is because the domestic reverse charge will not apply to VCCs. Emissions allowances, that is credits that can be used to meet obligations under the UK Emissions Trading Scheme, are subject to the domestic reverse charge anti-fraud mechanism as set out in VAT Notice 735 (tinyurl.com/3rr7yedv). Should HMRC detect fraudulent activity in the VCC sector going forward, it is possible that this position could be revisited in the future.

Other types of environmental project

Stakeholders raised questions on the VAT position for other natural capital projects, such as biodiversity net gain, as a 2023 DEFRA publication mentioned that biodiversity net gain will be subject to VAT (para 5.3 tinyurl.com/vusn4mbj). HMRC have yet to confirm this VAT position within their guidance and the scope of the most recent changes are limited to the VCC market only. That said, HMRC indicated that they will continue to engage with stakeholders on biodiversity net gain and other natural capital areas.

Member feedback

As the environmental land management and ecosystem service markets continue to evolve, HMRC said that they are interested in hearing from stakeholders on scenarios where the existing guidance does not cover the VAT liability position. Whilst the CIOT and ATT are not able to provide technical advice in individual circumstances, we are able to pass on examples of possible gaps in the VAT guidance for this developing sector to HMRC policy team. Please contact us at technical@ciot.org.uk or atttechnical@att.org.uk.

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