Natural capital: new value, new tax questions

Environmental

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Natural capital schemes offer landowners new revenue opportunities, but their varied tax treatment and long-term commitments require careful consideration and planning.

Key Points

What is the issue?
Natural capital schemes can generate valuable new income for landowners, but the tax treatment varies according to the scheme, arrangements and circumstances involved.

What does it mean to me?
Advisers must consider whether receipts are income or capital, how different credits

are taxed, and the implications for purchasers and landowners.

What can I take away?
Natural capital can offer attractive diversification opportunities, but long-term land commitments, differing tax treatments and potential effects on future use require careful planning.

The term ‘natural capital’ was first coined in 1973 by E F Schumacher in his book *Small Is Beautiful*. There are various definitions, but broadly, natural capital comprises the elements of nature and the environment that have value to society, including the living and non-living aspects of ecosystems.

In recent years, the government has increasingly sought to protect and enhance natural capital, including through schemes that give an economic value to environmental improvements. The Natural Capital Committee was established as an independent advisory body to the government in 2012, with many of its functions subsequently taken on by the Office for Environmental Protection.

Ecosystem services

Four schemes are particularly relevant to landowners and developers. Explained below, they provide mechanisms through which environmental improvements can generate credits with a financial value. These arrangements form part of what the government describes as ‘ecosystem services’.

Biodiversity Net Gain credits

In England, property developers must generally deliver a biodiversity net gain of 10% when developing land. Biodiversity is measured by reference to the availability and quality of habitats for wildlife. A baseline assessment is taken first, against which the required uplift is measured.

Developers can achieve the required biodiversity net gain by creating biodiversity on-site or off-site, including on other land they own, or by purchasing biodiversity credits from landowners. If these options are insufficient, they can purchase statutory biodiversity credits from the government.

Nutrient neutrality

New developments providing overnight accommodation in certain river catchments in England may only proceed if they will not cause additional nutrient pollution through excess nitrogen or phosphorus entering waterways. Developers can incorporate mitigation into their development plans, arrange off-site mitigation with landowners or others, or purchase nutrient credits from a mitigation scheme within the same river catchment.

Landowners can create nutrient credits by changing the use of their land or improving drainage and sewerage, and then sell the resulting credits to developers operating within the same catchment.

The rules are due to change under the Planning and Infrastructure Act 2025. The Act came into force in December 2025 and, at the time of writing, Natural England is consulting on the implementation of the new regime and its implications for nutrient neutrality.

Woodland and peatland carbon credits

Under the voluntary Woodland Carbon Code and Peatland Code, which operate across the UK, landowners can generate carbon credits by planting new woodland or restoring degraded peatland. These credits can be sold to businesses or other organisations seeking to offset carbon emissions or support environmental projects. Many businesses choose to become ‘carbon neutral’ for philanthropic or public relations purposes.

The two schemes operate differently. Woodland creation actively removes carbon dioxide from the atmosphere, while peatland restoration reduces emissions that would otherwise arise from degraded peat.

Opportunities for landowners

Taken together, the natural capital schemes described above offer landowners opportunities to generate revenue from their land.

Some credits are purchased by developers or businesses to meet legal or planning requirements, while others are bought voluntarily. For landowners, this can provide a useful source of diversification, particularly at a time when farming margins are

under pressure.

It is sometimes possible to generate more than one type of credit from the same plot of land, known as ‘stacking’. The key consideration for stacking is ‘additionality’: the same environmental benefit cannot be counted twice. For example, reducing the use of fertilisers and planting trees on the same plot of land would produce separate environmental benefits. Reducing fertiliser use could decrease nutrient run-off and generate nutrient credits, while planting trees could sequester carbon and could generate woodland carbon credits.

Where stacking generates more than one type of credit or unit, the tax treatment may differ for each one.

Tax treatment

After a period of uncertainty, HMRC published guidance on 14 May 2026 on the tax treatment of ecosystem services (see tinyurl.com/mpr87t65). Although the guidance represents HMRC’s interpretation rather than the law, it provides welcome clarity in an area where the tax treatment has been uncertain.

The following is necessarily a high-level summary. The tax treatment of each project will depend on its particular facts and circumstances, including the use of land, the ownership structure and the contractual arrangements.

Accounting treatment

In general, the tax treatment of natural capital receipts should follow the accounting treatment. Where a landowner uses the cash basis, a receipt should be brought into account when it is received. Otherwise, Generally Accepted Accounting Practice (GAAP) applies, which may result in a receipt being recognised immediately or spread over the life of the agreement. Further guidance is expected from the ICAEW in 2027.

Income or capital?

A key issue is whether receipts from natural capital schemes should be treated as income or capital.

HMRC’s view is that receipts are normally trading income. However, capital treatment may be arguable in some circumstances. For example, a large upfront payment could represent consideration for a restrictive covenant over the land, or compensation for the impairment or loss of use of an asset, such as where the land is permanently sterilised and taken out of productive use.

The period over which the ecosystem service must be maintained is also relevant to this distinction, although it will not be conclusive.

The distinction can have significant tax consequences. A capital receipt may be subject to capital gains tax of 24%, rather than income tax of up to 45% (or an effective rate of 60% if it pushes the taxpayer’s income over £100,000). Business Asset Disposal Relief or rollover relief may also be available, depending on the circumstances.

However, income treatment can also have advantages where an upfront receipt is recognised over the life of the agreement:

- Expenditure incurred in maintaining the scheme can be offset each year against the apportioned income. By contrast, if the payment is taxed as a single upfront capital receipt, tax relief may not be available for subsequent expenditure.
- Part of the tax liability is effectively deferred because only a proportion of the receipt is recognised each year.
- Reporting income annually also supports the argument that the business is trading, which can be relevant to matters including loss relief and Balfour planning for inheritance tax purposes.

Tax treatment for landowners

Income and corporation tax

For Biodiversity Net Gain, nutrient credits and the Peatland Code, receipts will normally be treated as trading income.

Where the landowner continues to farm the land or the land generating the credits does not form a substantial part of the overall farming trade, the receipts may be treated as farming income. In that case, the usual tax rules applying to farming,

including averaging, will apply.

Where the arrangements relate to a property business, the treatment will depend on the rights granted. If a landowner lets land to an intermediary that generates the credits, the receipts will be property income. If the intermediary does not acquire an interest in the land, payments to the landowner will instead be trading income.

Expenditure incurred in maintaining the scheme will normally be deductible against the trading or property income, subject to the usual rules, including those for lease premiums and reverse premiums. Capital allowances may also be available for qualifying plant and machinery.

For corporation tax purposes, receipts from natural capital schemes will normally be treated as trading income. Where the receipts arise from a property business, they will instead be treated as property income.

Woodland Carbon Code

Different rules can apply to woodland. Income from commercial woodlands is exempt from income tax, although expenditure relating to that exempt income is consequently not deductible. Otherwise, the receipts will generally be treated as trading income. Where an intermediary acquires an interest in the land and generates the credits, payments made by the intermediary to the landowner will be treated as rent.

Capital gains tax

As discussed above, credits may exceptionally be treated as capital disposals, in which case the normal capital gains tax rules will apply. Disposals of the underlying land are also subject to the usual rules, with reliefs including Business Asset Disposal Relief, holdover relief and rollover relief potentially available depending on the circumstances.

Inheritance tax

Land subject to an environmental agreement may qualify for agricultural property relief under the Inheritance Tax Act (IHTA) 1984 s 124C. Business property relief may also be available, subject to the usual conditions. Entering into an environmental management agreement should not, in itself, prevent land from

qualifying for conditional exemption from inheritance tax.

Special rules apply where the landowner is a charity. It will normally benefit from the exemption for profits of a charitable trade, provided the activity falls within the charity’s primary purpose. This may be the case, for example, where its charitable purposes include the preservation of land.

Tax treatment for purchasers

The tax treatment of natural capital credits for purchasers will depend on why they are acquired and whether they are held for the purposes of a trade or as a capital asset. Credits purchased wholly and exclusively for the purposes of a trade will be an allowable expense. Credits purchased for land held on trading account will be deductible for trading income purposes; otherwise, they will be treated as capital expenditure.

Property developers

Income tax: Expenditure on Biodiversity Net Gain or nutrient credits is allowable expenditure for property developers. However, where the land is not held on trading account, the expenditure is treated as capital expenditure and is not deductible against trading income.

Capital gains tax: Where the land is not held on trading account, the expenditure is added to the cost of the land and may be allowable if it falls within the requirements of the Taxation of Chargeable Gains Act (TCGA) 1992 s 38. Where the expenditure has been deducted against trading income, it is not also allowable for capital gains tax purposes.

Corporation tax: Expenditure on Biodiversity Net Gain or nutrient credits is deductible against trading income for property developers where the land is held on trading account. Otherwise, it is added to the cost of the land and deductible on disposal.

Voluntary purchase of carbon credits

Income tax: Credits purchased for the purposes of a trade under a legal obligation will be deductible. Other purchases, including those made for ESG or philanthropic reasons, may also be deductible, subject to the wholly and exclusively test and the rules applying to general philanthropic expenditure. If credits purchased for a trade are subsequently sold, the sale proceeds will be treated as trading income. Intermediaries buying and selling carbon credits as a trade will be taxed under the normal trading rules.

Capital gains tax: Credits acquired as a long-term investment will be subject to capital gains tax on disposal.

Corporation tax: Credits acquired as part of a legal obligation will be deductible from trading income. Disposals will either be treated as trading income or subject to the corporation tax rules on chargeable gains.

Indirect taxes

The VAT and stamp duty land tax treatment varies according to the type of credit and the arrangements involved. HMRC has confirmed that the same general principles will apply to similar non-statutory arrangements.

VAT

Biodiversity Net Gain: Sales of statutory biodiversity credits are outside the scope of VAT. Other sales are subject to VAT at the standard rate.

Nutrient credits: Sales of nutrient credits are likely to be subject to VAT.

Woodland and peatland carbon credits: These credits are usually subject to VAT unless they are:

- the first issue of voluntary carbon credits by a public authority;
- voluntary carbon credits held as an investment where there is no economic activity;
- donations made to voluntary carbon credit projects; or
- sales of voluntary carbon credits from self-assessed projects with no independent or third-party verification.

Stamp duty land tax

Payments for ecosystem services are not themselves assessable to stamp duty land tax (SDLT). However, SDLT will apply where the arrangements involve the acquisition of land, the grant of a lease or the creation of a covenant.

Practical considerations

Natural capital schemes can involve significant long-term commitments. Land may need to be maintained for at least 30 years for Biodiversity Net Gain units and potentially 75 years or more for nutrient credits. Before entering into an agreement, landowners should consider:

- **Impact on land values:** The restrictions placed on the land may affect its value, although valuers report differing views on the likely impact.
- **Financing and borrowing:** Any reduction in the value of the land, or restrictions associated with the scheme, may affect the availability or amount of secured borrowing.
- **Exit and future sale:** A future purchaser will inherit responsibility for complying with the scheme, potentially affecting the landowner’s exit options.
- **Future use of the land:** Participation may restrict future farming or development opportunities.
- **Succession and inheritance planning:** The long-term nature of the commitments may have implications for future generations who inherit the land.
- **Future need for credits:** A landowner should consider whether they may need credits themselves in future. For example, a farmer required to sequester carbon under an agreement to supply produce to a supermarket could find that, having already sold all the credits they can generate, they have to buy credits back from the market at a higher price.

In conclusion

Natural capital schemes can provide landowners with an attractive additional income stream while contributing to wider environmental goals. However, their long-term commitments and evolving tax and regulatory treatment mean that landowners should consider both the immediate tax consequences and the longer-

term implications for their land before entering into an arrangement.