FINDEX

Biodiversity Credits & Carbon Credits

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Conservation covenants

- What are they
- Tax treatment
  - Division 31 deduction
  - D4 event
  - Other payments

Carbon credits

- What are they
- Tax treatment
  - Division 420 (ACCU's)
  - General rules / CGT (non-registered units)

Biodiversity agreements

- What are they
- Tax treatment
  - NO Division 31 deduction
  - D4 event
  - Other payments
  - Sale of biodiversity credits

Others (not addressed today)

- Carbon sequestration (carbon sink forests)
- Solar and wind farms
- Agri tourism

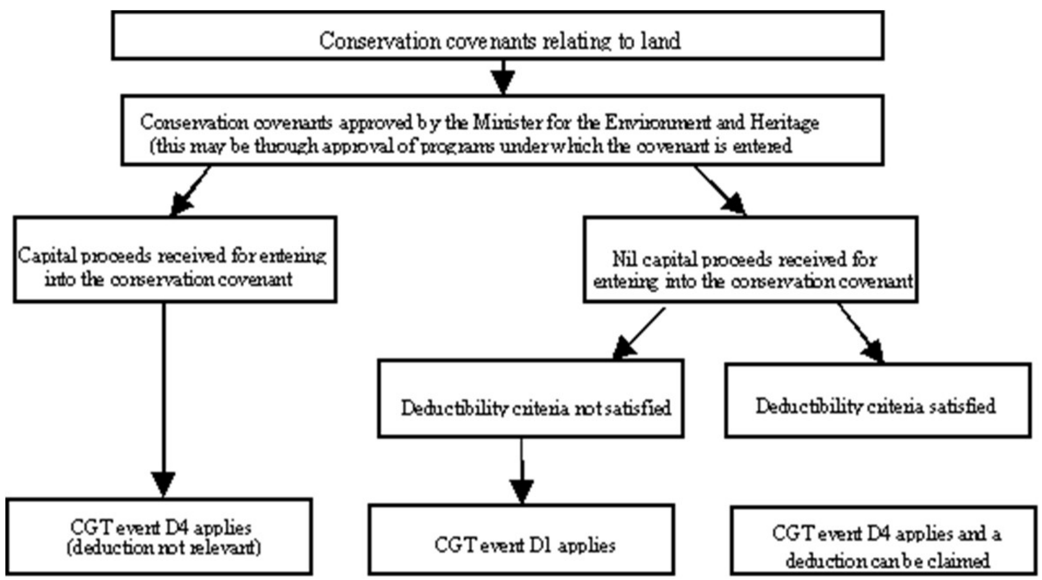
Conservation covenants

What are they?

- Landowner enters into a conservation covenant over the land they own that:
  - Restricts or prohibits certain activities that could degrade the environmental value of the land; and
  - Is permanent and registered on the title; and
  - Is approved in writing by the relevant Environment Minister.

How are they taxed?

- CGT provisions

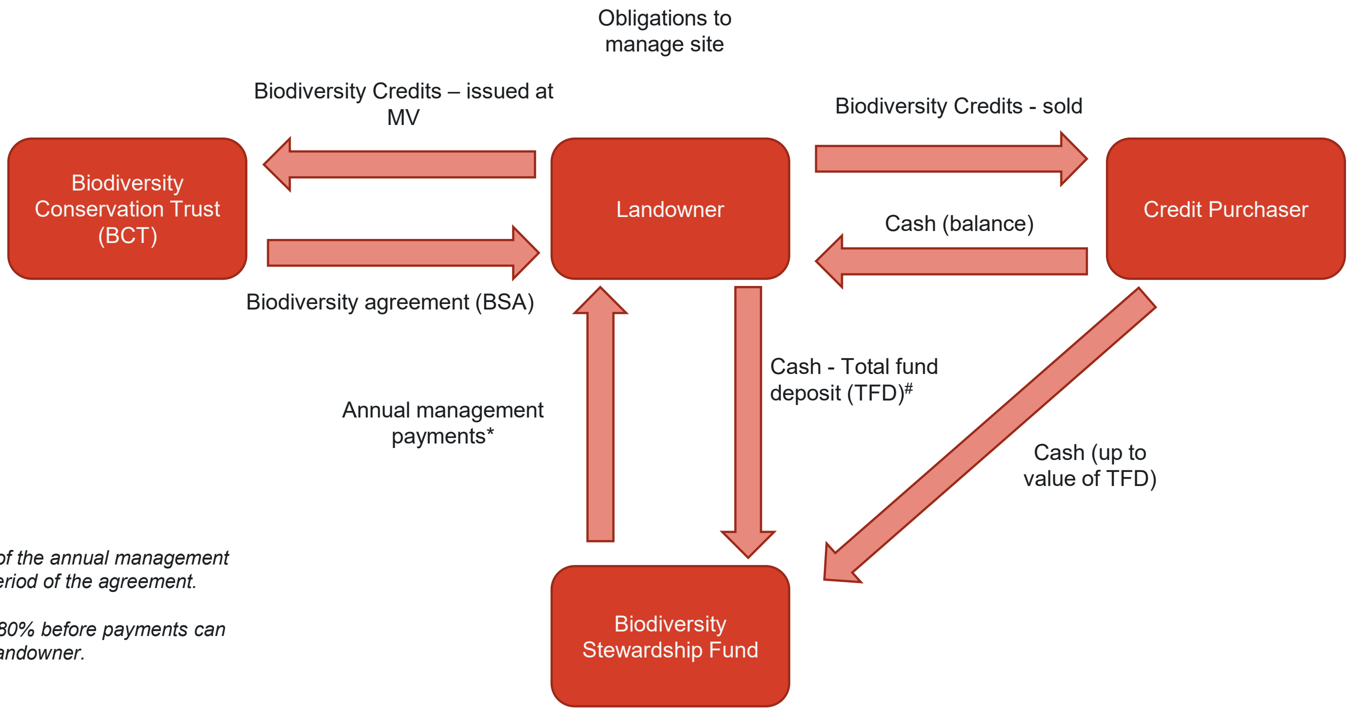


← Div. 31 deduction

← Div. 31 deduction & D4

Biodiversity agreements & biodiversity credits

NSW Scheme: Biodiversity Stewardship Agreements (BSA)



 # The present value of the annual management payments over the period of the agreement.

** Must be paid up to 80% before payments can start being made to landowner.*

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Biodiversity agreements & biodiversity credits

Tax implications for a BSA (a conservation covenant):

1. **CGT event D4** at the time of <u>entering into the BSA</u>
   - Capital proceeds are the value of the credits at issue time (there is a 'pricing guide' to support this – it's not just market value).
   - Cost base of land is that part of the cost base that is attributed to the covenant.
   - No Div 31 deduction as landowner received capital proceeds (biodiversity credits) for entering into the agreement.
   - CGT discount and/or SB CGT concessions may be available.

2. **CGT event A1** at the time of <u>selling the credits</u>
   - Capital proceeds are the value received for sale of credits (i.e. 'normal' CGT proceeds).
   - Cost base is CGT event D4 proceeds + TFD*.
   - CGT discount and/or SB CGT concessions may be available but be careful of acquisition date (date of BSA, date of credit sale agreement etc) and conditions under s152-10 (are the credits active assets?).

**There is contradicting guidance from the ATO as to whether the TFD should reduce the A1 proceeds (CR 2009/77), or whether the TFD is added to the A1 cost base (various PBR's). Net impact is ultimately the same.*

3. Payments out of TFD are assessable income (s6-5). Costs incurred in performing agreed protection/site management actions are deductible (s8-1).

Biodiversity agreements & biodiversity credits (cont)

Other things to consider:

- Landowner will not receive payments from TFD until TFD reaches 80%; credit sale should happen alongside the BSA.
- What do the credit sale agreements/contracts actually say: when will the CGT be triggered, v when will cash be actually received?
- How will entering into the BSA impact future use of the land – current use, impact on future sale value, 'active asset' for the purposes of Div 152, etc?
- Could the activity be considered ordinary income from an isolated profit-making venture (not CGT)?
- GST – value of credits could push > $75k requiring registration of a landowner who otherwise wouldn't be registered, and collection/remittance of GST on credit sale.
- Land tax: land tax concession under s10(1)(p) for land under BSA.
- Who is the landowner, and what are the specific considerations for that legal structure:
    - SMSF: cashflow for pensions, sole purpose test, concessional tax treatment on particular types of income
- Who will practically undertake the required conservation activities, and is this realistic/willing?

Carbon credits → Australian carbon credit units ("ACCU")

What are they?

"*ACCUs are a tradable financial product. They incentivise carbon abatement activities through projects ranging from reforestation to energy efficiency.*" *(Aust Govt Clean Energy Regulator website)*

Defined for tax purposes in s420-10, which includes that the credits are those "*for which there is an entry in a Registry account (within the meaning of the Australian National Registry of Emissions Units Act 2011).*"

How are they taxed?

Division 420 of ITAA 1997 deals with the acquisition, holding and surrendering of emission units (which include ACCUs and Kyoto units).

s420-5 (4 key features of tax accounting for registered emissions units):

(1) You bring your gross expenditure and gross proceeds to account, not your net profits and losses on disposal of a registered emissions unit.

(2) The gross expenditure is deductible.

(3) The gross proceeds are assessable income.

(4) You must bring to account any difference between the value of your registered emissions units held at the start and at the end of the income year. This is done in such a way that:

(a) any increase in value is included in assessable income; and

(b) any decrease in value is a deduction.

Carbon credits → Australian carbon credit units ("ACCU") (cont)

<u>How are they taxed (cont)?</u>

Choice of 3 methods to determine closing value at year end:

1. FIFO
2. Actual cost (MV at issue or cost of purchase)
3. Market value

First year you can choose any method (default method is FIFO).

In following years, you can continue to choose any method BUT, cannot use actual cost method if FIFO used in prior year.

Carbon credits → Australian carbon credit units ("ACCU") (cont)

How are they taxed (cont)?

New concessional rules received royal assent 23 June 2023 (Treasury Laws Amendment (2023 Measures No. 2) Bill 2023) that:

1. Allows proceeds from selling ACCUs and income derived from farm abatement activities supporting such units, are treated as PP income for PP's eligibility for concessional tax treatment under the FMD Scheme and tax averaging.
2. Holders of ACCUs that are carrying on a PP business are taxed based on the **net gain** from their ACCUs **in the year they are sold**.

However, the concessional rules are effectively only available to individuals carrying on PP business as sole trader or in partnership (or certain situations as a beneficiary of PP trust), and don't apply to ACCU's:

- Acquired pre-1 July 2022;
- Purchased from a third party (unless purchased from a CSP); or
- Credits issued by the Clean Energy Regulator (CER) for projects not connected to their primary production business.

In other words, the concessional treatment has very limited access/benefits!

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Carbon credits → other carbon credit units (not ACCU's)

How are they taxed?

Credits that are 'informal' carbon credit schemes or those that are considered 'non-registered units' are taxed under 'normal' income and deduction rules, i.e.:

- s6-5 (ordinary income)
- s8-1 (deductions)
- CGT provisions

Q&A


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