

Dealing with biodiversity net gains Accounting treatment and direct tax

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BNG background

- Requires developers to make a BNG of at least 10% within the red line of their development site, on other land that they own, or through buying BNG units from third parties.
- The principle of BNG is to ensure that natural habitats are either created or improved as part of development, and that future development has a positive impact on biodiversity. The damage caused by development must be offset by the improvements in biodiversity made by the developer, with an overall 10% gain.
- BNG became mandatory in England under the Environment Act 2021 from 12 February 2024 (for most major developments), and from April 2024 for small development sites.

BNG background

- BNG can be achieved in three ways:
 - on-site – within the boundary of the developer's project
 - off-site – outside the boundary
 - via the statutory biodiversity credits scheme. Statutory credits are a last resort way of acquiring biodiversity units needed to achieve BNG. If developers buy statutory credits, this is because it is not possible to restore habitats on-site or by buying off-site units
- If developers cannot achieve BNG on their own land, they will have to make off-site gains by using off-site biodiversity units on other landowners' land

Biodiversity units

- For the purposes of BNG, biodiversity value is measured in standardised biodiversity units.
- The number of biodiversity units will depend on the size, quality, location, and type of land.
- To sell units you need to:
 - use the statutory biodiversity metric to measure the biodiversity value of your existing land and calculate how many units of habitat creation or enhancement could be generated on the land
 - register your units as a biodiversity gain site on a national public register recording on the register the allocation of the off-site gains to a developer, who will use it to achieve their BNG
- The landowner is legally responsible for creating or enhancing habitat and managing that habitat for at least 30 years.

Back to basics – why is the accounting important?

- Why is the accounting treatment important?
 - Impact on financial statements
 - Income recognition
 - Provisioning for future costs
 - Solvency
 - It influences the tax treatment
 - Timing
 - Quantum
 - Income or capital
- Do you have an exchange or a non-exchange transaction?

Back to basics – grants vs contracts accounting

Contract

- Recognise income as service is provided
 - Income is spread if it is linked to the service
- Usually unrestricted

Grant

- Recognise income when entitled, probable and measurable
 - Income is recognised up-front
- Often restricted

Characteristics of Contracts

- Offer, acceptance and consideration
- Benefits to both parties
- Clear agreement

Characteristics of a grant

- Payment is made following a grant application to an organisation that regularly provides grants
 - The monies are freely given with no expectation of a direct benefit commensurate with the funds provided
 - The supplier is not undertaking outsourced activities on behalf of the funder where the services provided are ones ordinarily provided by the funder (i.e. supplier is not acting as a subcontractor)
 - Any monitoring is no more than simply ensuring the monies are properly spent
 - If the funding is withdrawn there is no legal redress for the supplier to have the payment reinstated
 - Funding may be drawn down as a reimbursement of expenditure rather than an advance payment for services
 - There is a clawback provision within the agreement such that monies not spent can be reclaimed by the funder
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- In relation to monies received by charitable organisations need to ascertain whether monies are 'freely given' and for the 'wider public benefit' or if there is a direct benefit to the funder

Accounting for contractual revenue

- Assess each contract on its merits
- Do performance obligations exist?
 - Actively track performance
 - Recognise income in line with the stage of performance
 - Consider stage of completion
- No direct performance obligations
 - Establish what the obligations are under the contract
 - Establish if a reliable value can be placed on those obligations
 - Calculate the NPV of the provision
 - Account for the income and create a provision that is reassessed annually

Challenges of recognising provisions

Challenges

- How do you cost it?
- What about inflation?
- How do you know what you've provided?
- What if your model doesn't work?
- What information do you put on file?

Back to basics – direct tax

- What tax exposure might there be?
- Income that relates to a primary purpose trading activity exempt under the primary purpose trading exemption
 - Does the income come within the charity's objects?
 - Contracts for services – can be exempt from direct tax if the services are provided as part of the primary purpose trade.
 - What services might a charity provide to landowners, or developers? Assessing or advising on biodiversity?
- A trade that is undertaken to raise funds rather than undertaken in carrying out charitable objects will not be within the exemption and profits of that trade will be taxable (unless another exemption applies).

Back to basics – direct tax

- How might amounts received be taxed?
 - Capital gain – is there a capital sum derived from an asset?
 - If so, TCGA 1992, s256 exemption may apply
 - Income from land – is there a payment to occupy or otherwise use land or exercise rights over land?
 - If so, CTA 2010, s485 exemption may apply for charitable company, or
 - ITA 2007, s531 exemption for charitable trust
 - Trading income
 - Primary purpose – CTA 2010, s478 or ITA 2007, s524 exemption for “charitable trade” – trade exercised in the course of carrying out **a** primary purpose of the charity
 - *Primary purpose trading is trading which contributes directly to one or more objects of a charity set out in its governing document (CC35 para 3.6)*

Income from land?

- Most BNG arrangements are not a lease over land or a payment by the payer (i.e. developer) to occupy or use land but an agreement to manage land over a period.

Capital gain?

- Despite the terminology – biodiversity net gain – we're not dealing with a gain for CGT purposes and so the CGT exemption will not apply.
- But could it, is structured differently?

Capital gain?

- Charity grant a lease over land to developer for a premium (P)
- Use formula $P \times (50 - (Y - 1)) / 50$ to calculate amount taxable as rental income and gain
- P is the amount of the premium, and Y is the number of complete periods of 12 months comprised in the effective duration of the lease.
- Example – P is £1,000,000 and Y is 30
- $£1\text{m} \times (50 - 29) / 50 = £420\text{k}$ taxed as rental income & £580k included in gain computation
- Third-party appointed by developer to deal with maintenance of land
- Benefit to charity – exempt income/gain & no ongoing financial obligation to maintain land
- Benefit to developer – acquires an offsite interest in land to fulfil its BNG obligation
- Downside to developer – must ensure land is managed/improved for 30 years

Trading

- Carrying on a trade with a view to profit
- Exempt if a primary purpose trade
 - For the exemption to be in point there needs to be a trade
 - Profit does not prevent the exemption applying
- A trade that is undertaken to raise funds rather than undertaken in carrying out charitable objects will not be within the exemption and profits of that trade will be taxable (unless another exemption applies), *even if those profits are used to meet the charity's objects*

Trading

- Consider: a biodiversity contribution to be used by a charity solely towards biodiversity works at the charity's land (the Biodiversity Land), such work being determined under a biodiversity land agreement (BLA).
- Arguably, a charity might be providing something in return to the grantor/payor under a BLA in enabling the grantor to meet requirements imposed under a planning agreement that requires it pay the biodiversity contribution to the charity.
- This could be construed to be a service. In which case we suggest that it would be a primary purpose trading activity where the charity's objects are conservation / biodiversity based and so exempt.

Preservation and conservation as an object

- The advancement of environmental protection and improvement includes preservation and conservation of the natural environment and the promotion of sustainable development.
- The conservation of a specific habitat or area of land, including areas of natural beauty and scientific interest; flora, fauna and the environment generally.
- The promotion of sustainable development and biodiversity.
- How does selling BNG units fit in with this?
 - Receiving payments from a third-party to undertake the activity that is the charity's object
- Might a charity that has land holdings legitimately include biodiversity as a primary purpose?
 - Good steward of land/public benefit
 - Must be within charity's constitution/governing documents & must avoid mission creep

Trading subsidiary

- Should a trading subsidiary carry out the activity?
 - It will be subject to CT in the normal way
 - But will make a cash donation to its parent charity
 - The donation qualifies for CT relief in the subsidiary and is exempt from tax when received by the charity
 - The subsidiary has up to 9 months after the tax accounting period end to make the donation
 - Subsidiary must have sufficient distributable reserves

Trading subsidiary

- What interest in the land might the subsidiary need?
 - Will the charity need to grant a lease over the land to the subsidiary?
 - Simple lease – no premium – rent would need to be an arm's length amount
 - Rental income in charity exempt under income from property exemption
 - Rental expense deductible in subsidiary
- How will the subsidiary be financed?
 - Will it be self-financing
 - Will it have sufficient cash, at the right time, to make Gift Aid payments
 - Modelling recommended

Back to basics – computation of taxable profits

- Charitable company (within the charge to corporation tax) - the profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes – CTA 2009, s46
- Charitable trust (within the charge to income tax) – the profits of a trade for a tax year must be calculated on the cash basis unless an election is made under s25C(1) to calculate profits in accordance with GAAP – ITTOIA, s24A
- Income recognition and recognition of expenditure (under GAAP) will determine the amount of profit for tax and accounts purposes

Top tips

- Always review the agreements
- Have transparent costing models
- Keep file notes
- Know your objects
- Plan ahead
- Model likely profits , CT and Gift Aid

Questions?

Thank you

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