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27 April 2021

When are carbon offsets tax deductible?

A client approached me last week asking me whether carbon offsets were tax deductible.

A carbon offset is defined by Greenpeace as a way of paying for others to reduce emissions or absorb carbon dioxide to compensate for one's own emissions. For example, by planting trees to suck carbon out of the atmosphere as they grow, or by delivering energy-efficient cooking stoves to communities in developing countries.

I cannot find anything on HMRC's website on the matter and the only published commentary that I have seen says no more than 'it all depends'.

Does the way in which it is paid matter? For example, an airline includes an option for a business to pay for the offsets at the point of sale when buying a ticket – is that deductible as part of the cost of the journey? Then again, if the purpose of carbon credits is to help others to be energy efficient does that mean that the expenditure cannot by definition be wholly and exclusively for the purposes of the trade of the person paying for them? Given the ever greater importance of environmental issues it seems surprising that there is no clear answer on this.

Do readers have any experience of HMRC's attitude which they can share?

Query 19,733– Mr Green.

Deduction is available if expenditure is only for the purposes of the trade.

There are no specific rules for obtaining a deduction for carbon offsets so the usual rules will apply. In most cases the availability of a deduction will depend on whether the expenditure is wholly and exclusively for the purposes of the trade (ITTOIA 2005, s 34, CTA 2009, s 54). If a business uses the fact that it is offsetting emissions to make its products or services more attractive to customers and/or to assist in recruiting and retaining employees, it should be possible to show that the expenditure is wholly and exclusively for the purposes of the trade.

Expenditure is not deductible if it has a dual purpose even if the business purpose is the main purpose.

In *Bentley Stokes and Lowless v Beeson* [1952] 2 All ER 82 Romer LJ said: 'If in truth the sole object is business promotion, the expenditure is not disqualified because the nature of the activity necessarily involves some other result, or the attainment or furtherance of some other objective, since the latter result or objective is necessarily inherent in the act.' Applying that principle to Mr Green's client, the fact that they are paying to plant trees that will absorb carbon emitted by someone else should not be a problem, as reducing the emissions of others is inherent in the buying of carbon credits. If the client is incurring the expenditure to demonstrate their green credentials to assist in selling their products or services or in recruiting and retaining staff, it should be possible to show that this is the sole object of the expenditure. This assumes that the client would be mentioning its policy on carbon offsetting in its marketing to

customers or in recruitment. If the client buys carbon offsets because the business owners feel strongly about climate change, but does not publicise internally or externally that it is doing this, that would be more problematic as it would then be difficult to show the expenditure is wholly and exclusively for the purposes of the trade.

Although in that case, if the business is a company and instead of purchasing carbon credits it makes a donation to a charity which looks after woodlands, such as the Woodland Trust, it could get tax relief as a qualifying charitable donation (CTA 2020, s 189).

The position is slightly different if an airline includes an option for a customer to pay for carbon credit offsets when buying a ticket. – *Catherine Robins, Pinsent Masons LLP*.

Only clear way for relief might be if a third-party charity was involved.

In the case of the carbon offset being included in the cost of travel, whether optional or not, as Mr Green states, the wholly and exclusively rules will need to be met per ITTOIA 2005, s 34 and CTA 2009, s 54.

It could be argued that where the carbon offset is not optional, it should be deductible with the rest of the expenditure.

HMRC's *Business Income Manual* at BIM37400 states where there is an incidental benefit to the consumer (if only for their conscience), this does not prevent the deduction. However, as mentioned above, the wholly and exclusively test is still not met.

In practice, if a carbon offset is included automatically and not quantified, it may make sense to take a view on the situation.

Having said this, in most cases the carbon offset will be optional and one would therefore concede that the cost thus fails the above wholly and exclusively statutory test.

However, where the carbon offset is carried out, as is sometimes the case, via a separate third-party charitable organisation, there is more to consider.

There is a key distinction between charitable donations and normal expenditure under the qualifying charitable donation rules. Relief may therefore be obtainable for companies after computing their adjusted profits, whereas sole traders and partners of partnerships can claim the relief in the gift aid section of the tax return for the relevant individual.

The complications around carbon offsets can sometimes be problematic for businesses and there has hence been a wider discussion in the travel industry as to whether the income element should be treated as trading income.

As Mr Green comments above, there is no specific clear answer on this, but upon examining, the only clear way any relief might be available is where a third-party charity is involved.

It would be hoped that globally more relief would be available for a cause such as this but, looking at the US and Canada, there is specific guidance to state that the costs are only deductible when a registered charity procures the carbon offset. This is entirely irrelevant for UK tax but it shows that if something is not backed up by legislation, it simply will not wash. – *Jake Thomas, Elman Wall*.

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4789

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