

# THE POLLUTER PAYS PRINCIPLE AND LAND REMEDIATION: A COMPARISON OF THE UNITED KINGDOM AND AUSTRALIAN APPROACHES

SALLY-ANN JOSEPH\*

*The Polluter Pays Principle (PPP) is the commonly accepted practice that the costs of pollution should be borne by those who cause it. It is recognised as a principle of international environmental law and is a fundamental policy of the Organisation for Economic Co-operation and Development and the European Union, and their member states. The taxation system can be used to implement pollution control aspects of environmental policy. One way this can be affected is in the form of financial assistance through subsidies (such as tax credits for installing carbon capture equipment on a coal plant) or tax expenditures. While such assistance compromises the strict interpretation of the PPP (because it spreads the cost to all taxpayers, not only polluters), exceptions have been devised to assist in implementing the principle.*

*One form of pollution is contamination of the land. The United Kingdom provides acquirers of contaminated land relief from corporation tax for expenditure incurred in remediating land for urban development. This tax expenditure provision fails a strictly applied PPP. However, an exception to the PPP applies to ensure that this measure is not inconsistent with the PPP. Australia, on the other hand, provides an income tax deduction for the costs of land rehabilitation provided certain conditions are met. There is no one scheme but rather a number that are industry-centric focused rather than activity based. These tax expenditures also fail a strictly applied PPP. In addition, there is no exception to the PPP that can be applied. Australia's practice of using tax expenditures (as currently legislated) to address land degradation measures therefore violates the PPP.*

## I INTRODUCTION

Taxation has a social, economic and political role in society.<sup>1</sup> In addition, it is increasingly being used as an environmental tool. Using taxation policy to encourage environmental responsibility is consistent with an Organisation for Economic Co-operation and Development (OECD) report that advocates member countries use environmentally related taxes to 'provide an incentive to polluters to modify their production and consumption behaviour'.<sup>2</sup>

An alternative to, and in many cases complementary to, 'environmentally related taxes' is financial assistance provided by the tax system in the form of tax expenditures. This equates to taxpayer-funded subsidies. Yet there is an adage that says the polluter should pay. Can these two diametrically opposed propositions be reconciled? This paper attempts to answer this by examining, comparing and contrasting specific tax incentives that are either designed to, or

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\* Sally-Ann Joseph is a researcher at the School of Taxation and Business Law (Atax), University of New South Wales. The author wishes to thank the anonymous referees for their constructive comments. An earlier manuscript was presented at the 104<sup>th</sup> Society of Legal Scholars Annual Conference, Edinburgh, 6 September 2013.

<sup>1</sup> Natalie Stoianoff and Mary Kaidonis, 'Rehabilitation of Mining Sites: Tax, Accounting and Serving the Environment' in J. E. Milne, K. Dektelaere, L. Kreiser and H. Ashiabor (eds) *Critical Issues in Environmental Taxation: International and Comparative Perspectives, Vol 1* (Oxford University Press, 2004) vol 1, 247.

<sup>2</sup> OECD, 'Environmentally Related Taxes in OECD Countries, Issues and Strategies' (OECD, 2001) 16.

have the effect of, cleaning up or rehabilitating contaminated land. These are the United Kingdom's (UK) land remediation relief (LRR) and the Australian mine site rehabilitation, land degradation and environmental protection provisions. Specifically, these tax provisions are assessed as to whether they adhere to the polluter pays principle (PPP). This paper does not address whether those who benefit should compensate the community, that is, the beneficiary pays principle.<sup>er</sup>

The next section describes the polluter pays principle as it has evolved from its economic origins to its application to environmental issues and acceptance as a legal principle. It also canvasses the exceptions to the PPP and when taxpayer-funded assistance is permissible under the PPP. Section 3 outlines the UK and Australian assistance packages and assesses whether these are consistent with the PPP. The uneasy affiliation between the exceptions and tax expenditures is discussed in section 4 followed by the conclusion in section 5.

## II THE POLLUTER PAYS PRINCIPLE

### A Description

The 'polluter-pays principle' (PPP) underpins most of the regulation<sup>3</sup> pertaining to the environment in particular and sustainable development generally. Originally an economic principle, it has evolved into being both an environmental principle and a legal principle.

In economic terms, the PPP is designed to correct improper cost allocation. This improper cost allocation has resulted from the common belief that resources such as air and water were not scarce and, as a result, freely available. By not taking the cost of these resources into account in the production and/or consumption of goods and services, an 'externality' arises. An externality (or external cost) results when someone's actions cause an uncompensated loss of welfare to others. This is generally referred to as a cost on society. Costs associated with pollution are considered to be externalities.

Another way of phrasing this is that the costs of these resources are not adequately reflected in the product price.<sup>4</sup> This failure to properly allocate costs stimulates over-production, which, in economic theory, ultimately leads to market failure.<sup>5</sup> This can be avoided if polluters are made to bear the cost of their pollution.<sup>6</sup> Thus, by 'internalising' these externalities, the cost of pollution is borne by the polluter. This is the basis of the PPP.

Applying the PPP in economic theory suggests that the polluter should pay the full cost of environmental damage caused by their activity. This would create an incentive to reduce the damage caused, at least to the level where the marginal cost of pollution reduction is equal to the marginal cost of the damage caused by such pollution.<sup>7</sup> While this may control pollution, in economic theory it does not reduce it.

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<sup>3</sup> Used here in its ordinary meaning rather than as a reference to command and control measures.

<sup>4</sup> Kenneth R. Reed, 'Economic Incentives for Pollution Abatement: Applying Theory to Practice' (1970) 12 *Arizona Law Review* 51.

<sup>5</sup> Ursula Kettlewell, 'The Answer To Global Pollution? A Critical Examination of the Problems and Potential of the Polluter-Pays Principle' (1992) 3(2) *Colorado Journal of International Environmental Law and Policy* 429-478; H. Kim, 'Subsidy, Polluter Pays Principle and Financial Assistance among Countries' (2000) 34(6) *Journal of World Trade* 115.

<sup>6</sup> Kettlewell, above n 5.

<sup>7</sup> R. Kerry Turner, 'Environmental Policy: An Economic Approach to the Polluter Pays Principle' (CSERGE Working paper PA 92-04, Centre for Social and Economic Research on the Global Environment, 1992).

This has led to an extended interpretation of the PPP whereby polluters should pay damage costs as well as control costs. From an environmental perspective, the aim of the PPP is to integrate the use of the environment, including its waste assimilation capacity, into the economic domain through the use of economic instruments such as pollution charges and permits.<sup>8</sup> Thus the PPP implies, and supports, establishing a system of fiscal charges by which polluters finance public policy to protect the environment.<sup>9</sup> As such, it serves as a mechanism for pollution abatement and control<sup>10</sup> and is acknowledged as an official benchmark for the evaluation of environmental policy.<sup>11</sup> As an environmental principle, the focus is on how much should be paid rather than who should pay.

The PPP has been incorporated into both national and international environmental policy. It is included in the United Nation's 1992 Rio Declaration and Agenda 21 as part of a set of broad principles to guide sustainable development globally.<sup>12</sup> The European Community adopted the principle when establishing the European Union.<sup>13</sup> It is also the basis of tax provisions encouraging land rehabilitation in both the UK and Australia.

As the PPP has evolved and assumed additional functions and meanings, it has become widely recognised and accepted as a legal principle.<sup>14</sup> Although its precise legal definition remains difficult to ascertain, the core of the principle derives from basic principles of fairness and justice: people and entities should be held responsible for their actions, intended or otherwise.<sup>15</sup>

It has become a frame of reference for lawmakers as well as policymakers. It is the essential conceptual basis for a range of legal instruments at the core of environmental legislation. It can be non-binding, only mentioned in the preamble of legislative documents, or it can be binding in that the PPP is included as an operative measure in legislation.<sup>16</sup> The courts have also invoked it as an interpretive aid.<sup>17</sup>

In the same way it has evolved from an economic principle, to an environmental principle and then legal principle, so the PPP has evolved from an economic control cost, to an environmental damages cost and then to a compensatory cost. Having developed into a

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<sup>8</sup> Ian Mann, *A Comparative Study of the Polluter Pays Principle and its International Normative Effect on Pollutive Processes* (Forbes Hare, 2009).

<sup>9</sup> Nicolas de Sadeleer, *The Polluter-pays Principle in EU Law – Bold Case Law and Poor Harmonisation* <<http://www.tradeenvironment.eu/papers>>.

<sup>10</sup> Kettlewell, above n 5.

<sup>11</sup> Sanford E. Gaines, 'The Polluter-Pays Principle: From Economic Equity to Environmental Ethos' (1991) 26 *Texas International Law Journal* 463.

<sup>12</sup> United Nations Conference on Environment and Development, *Rio Declaration on Environment and Development*, UNCED Doc. A/CONF.151/5/Rev. 1, 31 ILM 874 (1992) Principle 16.

<sup>13</sup> Single European Act, 17 Feb. 1986, 1987 OJ (L 169) 1.

<sup>14</sup> OECD, 'The Polluter-Pays Principle: OECD Analyses and Recommendations' (Doc. OCDE/GD(92)81, 1992), 9.

<sup>15</sup> Sally-Ann Joseph, 'Why should there always be a loser in environmental taxation?' in L. Kreiser, J. Sirisom, H. Ashiabor and J. E. Milne (eds) *Environmental Taxation and Climate Change: Achieving Environmental Sustainability through Fiscal Policy*, (Critical Issues in Environmental Taxation, Edward Elgar, 2011) vol 10, 63.

<sup>16</sup> Margaret Rosso Grossman, 'Agriculture and the Polluter Pays Principle' (2007) 11(3) *Electronic Journal of Comparative Law* 1-66; Nicolas de Sadeleer, *Environmental Principles: From Political Slogans to Legal Rules* (Oxford University Press, 2002).

<sup>17</sup> Examples include the Court of Justice of the European Union Case C-378/08 and joined cases C-379/08 and C-380/08; the UK High Court in *Re Mineral Resources Ltd, Environment Agency v Stout* [1999] 1 All ER 746; India Supreme Court in *Indian Council for Enviro-Legal Action v Union of India & Ors* (1996) 3 SCC 212; Canada Supreme Court in *Imperial Oil Ltd v Quebec (Minister of the Environment)* 2003 SCC 58 and Switzerland Federal Supreme Court in 1C\_231/2012.

principle of polluter liability, the PPP is epitomised in international law in the ‘Trail Smelter’ case.<sup>18</sup> Here the arbitration tribunal held that the polluting state (Canada) should pay compensation to the United States for the trans-boundary harm<sup>19</sup> caused by activities in its territory. The owner and operator of the polluting smelter was not a party to the arbitration. That is, strict liability was invoked.

If liability is ‘strict’ then fault, whether intentional or negligent, need not be established. The decisive factor is that the damage was caused by the defendant’s conduct and therefore only a causal link need be established between the action (or lack thereof) and the damage. Because it can be difficult to establish fault in environmental liability cases, it is considered that environmental objectives are better reached using strict liability.<sup>20</sup> Strict liability is also consistent with the PPP.<sup>21</sup>

## B      *Exceptions*

Whether viewed as an economic, environmental or legal principle, the ideology of the PPP is that the PPP precludes public aid. That is, taxpayers should not fund the costs of cleaning up or otherwise rectifying pollution.

The PPP was first formulated in 1972 when the OECD promulgated the ‘Recommendation of the Council on Guiding Principles concerning International Economic Aspects of Environmental Policies’ (“Guiding Principles”).<sup>22</sup> In accordance with its mandate to further international trade, the OECD adopted the PPP as the recommended method for allocating costs of production. Specifically, it stated that ‘[s]uch measures should not be accompanied by subsidies that would create significant distortions in international trade and investment.’<sup>23</sup>

This was reiterated in the OECD’s 1974 ‘Recommendation on the Implementation of the Polluter-Pays Principle’ (“Implementation”), which stated that member nations should observe the PPP, and, as a general rule, ‘not [to] assist the polluters in bearing the costs of pollution control whether by means of subsidies, tax advantages or other measures’.<sup>24</sup> However, it did provide for three specified exceptions.<sup>25</sup> Firstly, governmental assistance is permissible where the implementation of environmental policy objectives within a prescribed and specific time results in the development of significant socio-economic problems. The circumstances must

<sup>18</sup> United States v Canada, UN Rep Int’l Arb Awards 1905 (1949).

<sup>19</sup> The term ‘trans-boundary harm’ is used almost exclusively for environmental issues arising under international law. It implies a direct line of causation from activity to physical consequences. This is to be contrasted with the terms ‘cross-border’ and ‘transnational’ that arise from less tangible impacts that arise from economic or political activities that cross sovereign borders. See X. Hanqin, *Transboundary Damage in International Law* (Cambridge: Cambridge University Press, 2003).

<sup>20</sup> European Commission, ‘White paper on environmental liability’ (COM(2000) 66 final, 9 February 2000). See also Eric Thomas Larson, ‘Why Environmental Liability Regimes in the United States, the European Community and Japan have grown Synonymous with the Polluter Pays Principle’ (2005) 38 *Vanderbilt Journal of Transnational Law* 541.

<sup>21</sup> Kathleen Sergerson, ‘Liability for Environmental Damages’ in H. Folmer, H. L. Gaber and H. Opschoor (eds) *Principles of environmental and Resource Economics* (2<sup>nd</sup> ed, Edward Elgar, 2000) 420.

<sup>22</sup> OECD, ‘Recommendation of the Council on Guiding Principles concerning International Economic Aspects of Environmental Policies’ (OECD Doc. C(72)128, 26 May 1972) <<http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=4&Lang=en&Book=False>>.

<sup>23</sup> OECD, above n 22.

<sup>24</sup> OECD, ‘Recommendation of the Council on the Implementation of the Polluter-Pays Principle’ (OECD Doc C(74)223, 14 Nov 1974, <<http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=11>>.

<sup>25</sup> OECD, above n 24.

be exceptional such as to facilitate transitional periods when implementing stringent pollution control regimes. The second exception relates to aid provided to encourage the development of pollution control technologies and abatement equipment. In addition, if government provides aid to achieve specific socio-economic objectives that 'would have the incidental effect of constituting aid for pollution-control purposes', then such aid is not considered to be inconsistent with the PPP.

These exceptions were devised as a result of negotiations between governments where it became apparent that environmental subsidies were preferable to import duties in aiding distressed industries. That is, limited use of government subsidies to assist in underwriting environmental costs could mitigate demands for trade protection.<sup>26</sup> The Implementation did note that, if assistance was to be given, this should be selective and targeted to the specific economic sector experiencing difficulties. It should also be adapted to the specific socio-economic problem and limited to predetermined and well-defined transitional periods, as well as structured to minimize distortion of international trade and investment. In addition, all OECD members should be notified of such assistance.<sup>27</sup>

In 1991, the requirement against assistance was further relaxed, permitting redistributive charging systems,<sup>28</sup> also referred to as 'self-financing environmental management schemes'.<sup>29</sup> Here pollution charges imposed on a specific group of polluters are redistributed back to the same group, providing them financial assistance.<sup>30</sup> The European Community Commission holds that where the revenue is applied to public pollution control measures, the PPP is not compromised but applying it to private measures would be a deviation.<sup>31</sup>

A strict interpretation of the PPP disallows such assistance. Proponents of this argument advocate that environmental costs should be considered a cost of doing business and the ability to cover these costs as a factor in industry competitiveness.<sup>32</sup> This view is supported by multilateral trade negotiations, which are increasingly aimed at removing or winding-back government subsidies such as export credits and agricultural supports.

Traditionally, subsidies have been understood as financial assistance provided by government to the private sector.<sup>33</sup> Such assistance may be in the form of spending government revenue such as investment in interest and providing loans at preferential interest rates, or in the form of revenue foregone such as tax concessions or exemptions. The OECD has attempted to

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<sup>26</sup> Candice Stevens, 'Interpreting the Polluter Pays Principle in the Trade and Environment Context' (1994) 27 *Cornell International Law Journal* 577, 580.

<sup>27</sup> OECD, above n 24.

<sup>28</sup> OECD, 'Recommendation on the Use of Economic Instruments in Environmental Policy' (OECD Doc C(90)177, 31 January 1991) <<http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=41&InstrumentPID=38&Lang=en&Book=False>>.

<sup>29</sup> James A. Tobey and Henri Smets, 'The Polluter-Pays Principle in the Context of Agriculture and the Environment' (1996) 19(1) *The World Economy* 63.

<sup>30</sup> Gaines, above n 11; Robert Hertzog, 'Environmental Fiscal Policy in France' in S. E. Gaines and R. A. Westin (eds) *Taxation for Environmental Protection: A Multinational Legal Study* (Quorum Books, 1991) 15.

<sup>31</sup> European Economic Community, 'Council Recommendation of 3 March 1975 Regarding Cost Allocation and Action by Public Authorities on Environmental Matters' (1975) 18(L 194) *Official Journal of the European Communities* 1.

<sup>32</sup> Stevens, above n 26, 582; Robert Morris, 'A Business Perspective on the Competitiveness Effects of Environmental Policies' in OECD (ed) *Environmental Policies and Industrial Competitiveness* (OECD, 1993).

<sup>33</sup> Hyung-Jin Kim, 'Subsidy, Polluter Pays Principle and Financial Assistance among Countries' (2000) 34(6) *Journal of World Trade* 115, 115.

identify, measure and monitor environmental subsidies, including establishing a notification and consultation system.<sup>34</sup> However, as many of these subsidies are classified under different types of government assistance (such as regional, research or employment assistance), the data is incomplete and unreliable. Indeed, what is considered to be a subsidy also varies between countries.

Whilst all OECD member countries acknowledge the PPP, some governments may decide that the public should bear all or part of the costs of pollution control, or at least that they aid polluters with some form of technical or financial assistance. Reasons over and above the permissible exceptions include the difficulty of accurately defining and/or identifying the classes of polluters and the acknowledgement that some polluters may not be fully capable of internalising these costs without assistance.<sup>35</sup>

Subsidies, or forms of financial assistance, are often considered important environmental policy tools.<sup>36</sup> They have varying and complicating impacts on the environment so much so that it has been commented that ‘the role of subsidies has been one of the most controversial issues in environmental policy’.<sup>37</sup> That the harm caused by subsidies is not sufficiently recognised is suggested to be one reason why subsidies have not been properly regulated.<sup>38</sup>

### III COUNTRY COMPARISON

No OECD member country formally ratified the Guiding Principles or Implementation recommendations.<sup>39</sup> However, the ‘Declaration on Environment: Resource for the Future’<sup>40</sup> was adopted by the governments of OECD member countries (which includes the UK and Australia).<sup>41</sup> Specifically, the governments declared that they would:

Seek to introduce more flexibility, efficiency and cost-effectiveness in the design and enforcement of pollution control measures in particular through a consistent application of the Polluter-Pays Principle and a more effective use of economic instruments in conjunction with regulations.<sup>42</sup>

While the 27 principles enshrined in the United Nations Rio Declaration on Environment and Development are legally non-binding, they were endorsed by the 178 countries meeting there, including the UK and Australia. Designed to commit governments to ensure environmental protection and responsible development, Principle 16 states:

<sup>34</sup> OECD, ‘Financial Assistance Systems for Pollution Prevention and Control in OECD Countries’ (OECD Environment Monographs No 33, June 1990); OECD, ‘Trade and Environment: Environmental Subsidies’ (Report on a meeting of management experts held under the OECD Labour/Management Programme, OCDE/GD (95) 16, 1995).

<sup>35</sup> Australia’s Future Tax System Review Panel, ‘Australia’s future tax system: Report to the Treasurer’ (Final Report, Part 2: Detailed analysis, December 2009) chapter E2.

<sup>36</sup> Kim, above n 33.

<sup>37</sup> Ibid, 117.

<sup>38</sup> Ibid, 139.

<sup>39</sup> Larson, above n 20; Kim, above n 33.

<sup>40</sup> OECD, ‘Declaration on Environment: Resource for the Future’ (OECD Doc C(85)111, 20 June 1985) <<http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=68&InstrumentPID=65&Lang=en&Book=False>>.

<sup>41</sup> Noted in OECD, ‘Decision-Recommendation of the Council on the Co-operative Investigation and Risk Reduction of Existing Chemicals’ (OECD doc C(90)163/Final, 31 January 1991) <<http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=59&InstrumentPID=56&Lang=en&Book=False>>.

<sup>42</sup> OECD, above n 41, [8].

National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.<sup>43</sup>

Essentially, the implementation of the PPP depends on government policies. With respect to the rehabilitation of contaminated land using the taxation system, the UK applies a strict interpretation of the PPP. It also focuses on the activity that gives rise to the pollution. Australia, on the other hand, does not overtly apply the principle and is industry (or taxpayer) centric.

#### A United Kingdom

A basic rule of UK taxation is that capital expenditure cannot be written off (as a total single deduction) for tax purposes. Instead, tax relief for capital expenditure is given via the capital allowances system which allows for periodic deductions over time. Governments may target investment in specific assets for policy reasons. The ‘land remediation relief’ (LRR) is a corporation tax concession for expenditure incurred to clean up contaminated land, derelict buildings and to eradicate Japanese knotweed. It is not a type of capital allowance but has a similar effect.

In UK law, ‘pollution’ is defined as the release of harmful or potentially harmful substances into the land, water or air.<sup>44</sup> Under the *Environmental Protection Act 1990* (EPA) it is the role of local authorities to identify ‘contaminated land’. Such land is defined as being in a condition, caused by substances in, on or under the land, firstly so as to cause, or has the ‘significant possibility’ of causing, significant harm or, secondly, to cause, or likely to cause, water pollution.<sup>45</sup> ‘Harm’ is defined broadly to cover health, environmental quality, sensory offences and damage to property.<sup>46</sup> The *Corporation Tax Act 2009* (CTA 2009), on the other hand, does not require that the harm be ‘significant’ or that the possibility of harm be significant.<sup>47</sup> The CTA 2009 also makes it clear that the substances must be the only cause of the contamination.

The LRR is a financial incentive to rehabilitate land deemed unusable as a result of contamination by previous industrial activity.<sup>48</sup> That is, it must have been acquired in a contaminated state. It was introduced as an urban regeneration measure. It was designed to provide an incentive towards the redevelopment of previously developed (or brownfield) land and thereby increase the amount of land available for housing.<sup>49</sup> It also had the objective of increasing the rate of remediation of contaminated land.<sup>50</sup> Chemicals and hydrocarbons are the principal causes of pollution but the LRR is also used to facilitate the removal of asbestos from commercial buildings.<sup>51</sup>

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<sup>43</sup> UN, ‘Rio Declaration on Environment and Development’ (Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992) <<http://www.un.org/documents/ga/conf151/aconf15126-1annex1.htm>>, [16].

<sup>44</sup> EPA s 1; Pollution Prevention and Control Act 1999 section 1.

<sup>45</sup> EPA s 78A.

<sup>46</sup> EPA sub-s 1(4).

<sup>47</sup> CTA 2009 s 1145.

<sup>48</sup> The Corporation Tax (Land Remediation Relief) Order, 2009 No 2037, Explanatory Memorandum.

<sup>49</sup> The Corporation Tax (Land Remediation Relief) Order, 2009 No 2037, Explanatory Memorandum.

<sup>50</sup> HMRC, ‘Evaluation of the Urban White Paper Fiscal Measures’ (HM Revenue & Customs Research Report No. 16, May 2006).

<sup>51</sup> *Ibid.*

Originally the *Finance Act 2001*, the principal legislation is now the CTA 2009. The relief is in the form of a 50 per cent deduction over and above an accelerated allowance of 100 per cent and applies to both capital and revenue qualifying expenditure. Companies with losses arising from remediating qualifying land are able to claim a cash payment of 16 per cent of the loss.

The PPP is stated to be fundamental to the policy underlying the LRR.<sup>52</sup> It applies only for dealing with legacy issues created by previous owners of the land. That is, an unrelated third party must have acquired the land in a contaminated state. Introduced in 2001<sup>53</sup> for contaminated land only, the LRR was extended in 2009 to cover derelict buildings and land infested with the noxious Japanese knotweed. Amendments were also made to ensure ‘that polluters do not benefit directly or indirectly from the relief’<sup>54</sup> thereby further endorsing the strict application of the PPP. Relief is denied if the company, or a person connected with it, was responsible for any part of the contamination.<sup>55</sup> This can extend to the contamination spreading or worsening, and applies even if, at the time the action was taken, it was standard industry practice and not considered to be contamination.

Thus, in the UK and with respect to the LRR, the PPP is applied strictly in that the polluter does not receive any benefit. However, neither does the polluter pay. The taxpayer effectively pays 150 per cent of the expenditure incurred in cleaning up contaminated land and derelict buildings and removing infestations of Japanese knotweed.

The question then becomes: does one of the exceptions apply? The policy intent behind the LRR is to regenerate previously unusable land for housing. The land is unusable because it is contaminated by previous industrial activity, particularly through chemicals and hydrocarbons. This meets the definition of ‘pollution’. The presence of asbestos would also qualify as ‘pollution’ as defined in UK law.

The first exception deals with a significant socio-economic problem arising in exceptional circumstances as a result of implementing environmental policy objectives. While a shortage of housing land could be considered a ‘significant socio-economic problem’, this was not the result of the implementation of an environmental policy objective. It is also not a temporary measure and therefore fails the first exception. For the second exception to be applicable, there must be an investment in pollution-control technologies or abatement equipment. This, therefore, also does not apply. Considering the definition of ‘pollution’, the third exception is satisfied. That is, the LRR is consistent with having a specific socio-economic objective that, incidentally, also serves a pollution-control purpose. The LRR is therefore not considered to be inconsistent with the PPP.

That the polluter does not receive any benefit needs to be qualified. There is the potential for conformity with the PPP to be undermined by commercial reality. Instances can arise where the vendor and purchaser agree to ‘share’ the tax credit. While this may speed up the negotiation process for qualifying sites, if the vendor is also the polluter they may gain a share of the benefit of the LRR through a higher land price.

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<sup>52</sup> HMRC, ‘CIRD60000 Land Remediation Relief’ (HMRC Manual), CIRD60025, CIRD60120.

<sup>53</sup> The Finance Act 2001 and applied to expenditure incurred between 11 May 2001 and 31 March 2009. This was as a response to the independent Urban Task Force chaired by Lord Rogers – see Urban Task Force, *Towards an Urban Renaissance* 1999.

<sup>54</sup> HMRC, ‘Land Remediation Relief’ (HM Revenue & Customs, Technical Note, 24 November 2008) [4.2].

<sup>55</sup> CTA 2009 s 1150; Refer to the Corporate Intangibles Research & Development Manual CIRD60000 for details on the operation of the LRR < <http://www.hmrc.gov.uk/manuals/cirdmanual/CIRD60000.htm>>.

## B Australia

Australian taxation only permits an immediate deduction for capital expenditure in particular circumstances where the tax law specifically permits. Concessional provisions pertaining to the prevention and cleanup of contaminated land are contained within the income tax division dealing with capital allowances.

In Australia, the *Environment Protection and Biodiversity Conservation Act 1999* (EPBCA) is the Federal Government's central piece of environmental legislation. It provides a legal framework to protect and manage nationally and internationally important flora, fauna, ecological communities and heritage places — defined in the EPBCA as matters of national environmental significance. Pollution, however, is a state matter with each state and territory having a form of environmental protection legislation. Federal governments have, nevertheless, attempted to introduce pollution-related legislation such as carbon pricing.

In New South Wales' *Protection of the Environment Operations Act 1997*, 'pollution' is categorised as water, air, noise or land pollution and each is individually defined. 'Land pollution' or 'pollution of the land' is defined as the release of any solid, liquid or gaseous matter that causes, or is likely to cause, degradation of the land that results in any actual or potential harm, loss or property damage, provided it is not trivial. What is considered 'trivial' is not stated and no guidance is provided in regulations or otherwise. While the 'harm' referred to in the land pollution definition is in relation to the health or safety of human beings, animals, terrestrial life or ecosystems, 'harm' to the environment is defined to include any direct or indirect alteration of the environment that results in its degradation and includes any act or omission that results in pollution.

Although the term 'pollution' is statutorily defined in Western Australia's *Environment Protection Act 1986* to include 'direct and indirect alteration of the environment...to its detriment or degradation', the Supreme Court decided that the term 'pollution' should be given its ordinary meaning of 'physically impure, foul or filthy' otherwise the mere cutting of the lawn or picking flowers could constitute an alteration to the environment to its detriment.<sup>56</sup> Dictionary definitions include to 'contaminate or defile (the environment)',<sup>57</sup> 'to make foul or unclean; dirty'.<sup>58</sup>

The principal applicable taxation legislation is the *Income Tax Assessment Act 1997* (ITAA 1997). There are three major sets of provisions dealing with the cleaning up of and/or rehabilitation of contaminated land. Terms such as 'pollution', 'harm' and 'contaminated land' are not defined and therefore take on their ordinary meaning when used. Indeed, the Commissioner of Taxation contends that the statutory definition of non-tax related legislation does not translate to tax legislation.<sup>59</sup> It is the Commissioner's opinion that (1) the ordinary meaning of 'pollution' is limited to some sort of contamination and (2) an adverse change to the environment not due to contamination is not pollution.<sup>60</sup>

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<sup>56</sup> *Palos Verdes Estates Pty Ltd v Carbon* (1991) 6 WAR 223; *Burnett v Morley and Swan* [2008] TAsRMPAT 85, [33]. For more on this see Sally Joseph, 'Environmental protection provisions – how useful are they?' (2012) 41(1) *Australian Tax Review* 29-41.

<sup>57</sup> Australian Oxford Dictionary.

<sup>58</sup> Macquarie Dictionary.

<sup>59</sup> See Joseph, above n 56.

<sup>60</sup> ATO ID 2003/17, 22.

The provisions dealing with land rehabilitation are the mine site rehabilitation,<sup>61</sup> the land degradation<sup>62</sup> and the environmental protection provisions.<sup>63</sup> These differ in scope and application but have the rehabilitation of ‘damaged’ land in common. When introduced, their policy intent was not always clearly articulated and, in these circumstances, must necessarily be inferred from the accompanying documentation and discourse.<sup>64</sup>

The mine site rehabilitation concession is a financial incentive provided to mining and quarrying companies to restore the mine site to its pre-mining condition. Its purpose was commercial, recognising that such capital expenditure was necessary to comply with state legislation but would not be tax deductible.

The land degradation provisions extend deductibility for expenditure incurred by primary producers, water irrigators and eligible rural businesses that undertake specified preventative and corrective measures to restore damaged land. Historically, these provisions did not always have an environmental purpose. However, following a series of amendments it can be inferred that the current provisions do reflect an environmental purpose.

The third set of provisions provides tax deductions for expenditure on environmental protection activities relating to pollution and waste. Originally introduced to provide a deduction for otherwise non-deductible capital expenditure, its use is predominantly confined to the removal of asbestos. As such, it could now be considered as having an environmental and social purpose. However, as a result of being prescriptive in their operation, qualifying for a tax deduction under these provisions is difficult. In addition they apply only in very narrowly defined situations.<sup>65</sup>

No reference to the PPP is made in any documentation accompanying the introduction of, or subsequent amendments to, the Australian tax provisions dealing with the rectification of ‘damaged’ or contaminated land. This does not necessarily imply that there was a conscious effort not to include the principle of polluter pays. Nevertheless, merely because it was not explicitly incorporated does not mean that its application cannot be assessed.

The first exception allows for financial assistance to be given in circumstances where introducing an environmental policy objective will result in socio-economic hardship. The second exception requires the aid be used to stimulate new technologies and/or abatement equipment. Neither of these exceptions applies to the mine site rehabilitation, the land degradation or the environmental protection tax expenditure provisions.

The third exception requires that there be predominantly a non-environmental purpose. However, it may be difficult to characterise an objective that is not explicitly environmental as ‘non-environmental’. This is because the environmental consequences are too interwoven in the analysis of the ‘non-environmental’ objectives.<sup>66</sup> This is certainly the case with the three

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<sup>61</sup> ITAA 1997 subdiv 40-H.

<sup>62</sup> ITAA 1997 subdiv 40-G.

<sup>63</sup> ITAA 1997 subdiv 40-H.

<sup>64</sup> For a detailed discussion on these, see Sally Joseph, ‘Income tax and environmental provisions –green gold or lead weight’ (2013) 8(1) *Journal of the Australasian Tax Teachers Association* 169.

<sup>65</sup> For more details on these provisions see Joseph, above n 56.

<sup>66</sup> Janet E. Milne, ‘Violating the Polluter-Pays Principle? Two Case Studies of United States Tax Incentives for Alternative Energy’ in K. Deketelaere, J. E. Milne, L. Kreiser and H. Ashiabor (eds) *Critical Issues in Environmental Taxation: International and Comparative Perspectives* (Oxford University Press, 2007) vol IV, 99.

Australian tax expenditures examined here. The third exception also requires that the incidental effect pertains to ‘pollution-control’ purposes. This is narrower than being for an environmental purpose. Thus, applying the third exception requires determining if there is, firstly, a socio-economic objective and, secondly, an incidental pollution-control effect.

It is arguable that the purpose behind the mine site rehabilitation tax expenditures was commercial rather than environmental.<sup>67</sup> This is not a ‘socio-economic’ objective with an incidental pollution-control effect. Indeed, the restricted application of the tax provision means that most environmentally induced damage that meets the definition of ‘pollution’ is outside scope. For example, tailings dams that store waste material from mineral processing at mine sites are often the most significant environmental liability yet these are specifically excluded from the tax expenditure.<sup>68</sup>

The land degradation provisions, as currently drafted, are essentially environmental. However, they were not always so, providing tax deductions for land clearing.<sup>69</sup> The third exception cannot apply as originally they had no incidental environmental benefit and currently their environmental benefit is not incidental. In any event the activities that constitute the tax deduction, while environmental, largely do not meet the definition of pollution.

A tax deduction for environmental protection activities was introduced for similar reasons to the mine site rehabilitation provisions – to provide a deduction for otherwise non-deductible capital expenditure. The clearing, removal and storage of pollution and waste could be seen as a socio-economic objective but is the pollution-control aspect only incidental?

It can therefore be deduced, with some reservations, that the third exception also does not apply. Based on this analysis, Australia’s land rehabilitation tax concessions do not comply with, or adhere to, the PPP.

#### IV EXCEPTIONS REVISITED

The UK’s approach to rectifying land contamination through tax deductions is ‘not considered to be inconsistent’ with the PPP. This is not the same as stating that it is consistent with the principle. It gets its qualified support only by meeting the third exception. However, the PPP was certainly considered in deriving the policy of the LRR and legislators endeavoured to ensure adherence to the principle, at least to the extent that the polluter should not benefit from the financial assistance. However, it is not impervious to misuse.

Australia’s tax expenditures with respect to contamination of the land, on the other hand, fail to meet the PPP criteria, including the exceptions. There is nothing to support the contention that the PPP was even considered.

The use of financial assistance in the form of tax expenditures (or subsidies) will generally violate the strict application of the PPP. The PPP implies a payment made by the polluter; tax expenditures are a credit-based system whereby taxpayers subsidise pollution rectification.

It is generally possible that the PPP is most violated when the polluter benefits from tax expenditures that are used to subsidise activities required by governmental regulations. By

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<sup>67</sup> For a detailed discussion on this, see Joseph, above n 64.

<sup>68</sup> Ibid.

<sup>69</sup> Ibid.

receiving financial assistance, regulatory compliance is subsidised with the cost shifted from the regulated entity as polluter to the broader taxpayer community.<sup>70</sup> This applies to the Australian mine site rehabilitation tax expenditures as the mining industry is required, under state and territory legislation, to provide non-tax-deductible bonds for the rectification of mine sites.

However, it is still possible to theoretically comply with the PPP if one of the exceptions applies. The first exception requires the policy to be environmental, the resulting problem to be socio-economic, the impact significant and the period short-term or transitional. However, by their nature, tax expenditures are not short-term. They require to be legislated for and, once implemented, are difficult to remove. It is possible for the legislature to put an expiration date in the tax expenditure provision, although these are frequently extended.

The second exception is designed to foster investment in pollution control technologies and abatement equipment. However, in the tax system, research and development provisions already serve this function. Nevertheless tax expenditures could be employed here to specifically target predetermined technologies and equipment. This, however, requires governments to 'pick winners', subsidising the development of particular technologies, and may result in old technologies being locked in and new technologies locked out.<sup>71</sup>

The third exception requires a socio-economic objective with an incidental pollution-control effect. This is narrower than requiring an incidental environmental effect. However, it is important to promote broader environmental land recovery and tax expenditures can be beneficial here.

As noted above, redistributive charging systems can be viewed as an additional exception in certain circumstances. It is now opportune to consider other situations as being worthy of exception. An obvious starting point is to extend the third exception to any incidental environmental effect rather than restricting it to a pollution-control effect.

Another exception could relate to a situation where the polluter cannot be identified. Degradation of the land should not be allowed to continue merely because a specific polluter can no longer be held to account. Indeed, there may not even be a polluter per se. For example, land degradation may be the result of climate change such as loss of vegetative cover, increased salinity and the inundation of seawater in delta areas.

A full formulation of the circumstances that warrant an exception to the PPP is beyond the scope of this paper. This would involve assessing a range of factors including an analysis of the incentive effect of the tax expenditure, competitive conditions and evaluating the types of activities and/or environmental issues to address.

## V CONCLUSION

An inquiry with respect to the consistency of tax expenditures with the PPP is not merely academic. It has very real implications from a policy perspective. It addresses the fundamental question of who should pay for the remediation of environmental damage – the polluters or the taxpayers. Is it permissible to expect taxpayers to bear the cost? Or, more pointedly, are there

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<sup>70</sup> Milne, above n 66.

<sup>71</sup> For more on this see Joseph, above n 15.

any circumstances when it is permissible to expect taxpayers to bear the cost? Environmental works can be expensive. Determining who should pay for them takes on increasing importance.

The environment is a public (or community) good that needs to be managed for the benefit of current and future generations. Decisions on how to share the burdens of environmental policy typically reflect a mixture of efficiency and equity criteria.<sup>72</sup> In most cases avenues that implement the PPP have both efficiency and equity advantages over other methods. Efficiency is gained by imposing the cost of environmental harm on those responsible for it, thereby providing an incentive for behavioural change, reducing the damage their actions cause. It is equitable to require those responsible for the damage to pay for it rather than those who are forced to live with the consequences. But generally only a strict interpretation of the PPP ensures this. It is lost with the effect of the exceptions.

It is expected that tax policies and environmental policies be mutually reinforcing.<sup>73</sup> This will require a linkage between environmental policy and the direct tax system. The effectiveness of the incentive or subsidy depends on how closely that tax measure is linked with the environmental damage to be remedied.<sup>74</sup> Specifically, the OECD stresses the importance of accurate targeting and the need to limit investment in direct tax incentives to those 'which will have a beneficial environmental impact'.<sup>75</sup> It is noted, however, that the extent of environmental damage cannot be objectively ascertained over the short to medium term.

It has been stated that the 'PPP does not have the force of law ... but it should have the force of sound policy'.<sup>76</sup> It has also been suggested that the PPP be applied to prevent a change to a more polluting activity but that a form of government funding be used to encourage a change to a more environmentally beneficial outcome.<sup>77</sup> Tax expenditures are one form of government funding. This calls into question whether the PPP is sound policy. Indeed, as shown in this paper, reality dictates that the PPP may not always be relevant, may not always be correct. It is also political. How a government balances the politics and the policy may well contribute to its environmental legacy.

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<sup>72</sup> Giles Atkinson, Fernando Machado and Susana Mourato, 'Balancing competing principles of environmental equity' (2000) 32(10) *Environment and Planning A* 1791.

<sup>73</sup> OECD above n 2.

<sup>74</sup> OECD, *Taxation and the Environment: Complimentary Policies* (OECD, 1993) 53.

<sup>75</sup> OECD, above n 2.

<sup>76</sup> Milne, above n 66, 126.

<sup>77</sup> David J. Pannell, 'Public Benefits, Private Benefits, and Policy Mechanism Choice for Land-Use Change for Environmental Benefits' (2008) 84(2) *Land Economics* 225.