CHAPTER 20

ROLLOVER RELIEF

20.1 Introduction

You will sometimes see rollover relief referred to as "replacement of business assets" relief, for the simple reason that the legislation gives a trader relief when he **sells a business asset and replaces it with another**. Rollover relief is one of a number of ways in which a trader can **defer the payment of any capital gains tax**. TCGA 1992, s. 152

Illustration 1

A trader is using a building for the purposes of his trade. He sells the building for £200,000 making a capital gain – before any reliefs – of £80,000. The reason the trader has sold the old asset, is because he wishes to replace it with a new one. His business may be expanding and he needs larger premises.

The trader replaces his old office building with a new office building costing £250,000. Where a trader disposes of a business asset and reinvests his proceeds in buying another business asset, he can make a claim to defer the gain he has made. In this example, the trader sells his old asset for £200,000 and reinvests the whole of his proceeds in buying a new asset for £250,000. The trader has therefore not retained any of the sale proceeds.

As all proceeds are reinvested, full rollover relief is given as below. TCGA 1992, s. 152(1)

	£
Proceeds	200,000
Cost	(120,000)
Gain	80,000
Roll over relief	(80,000)
Gain	Nil

Rollover relief is a deferral relief as it pushes the capital gains back to a later period in time. The way rollover relief works, is that the amount of the **gain deferred** – in this instance £80,000 – is **rolled over and reduces the base cost of the new asset purchased.** TCGA 1992, s. 152(1)(b)

New building:

	£
Cost	250,000
Rolled over gain	(80,000)
Base cost of new asset	£170,000

Therefore when the trader comes to sell the second building, because its base cost has been reduced by £80,000, the capital gain on the sale of that building will be uplifted by £80,000. Therefore the **capital gain** of £80,000 on the sale of building number 1, has been **deferred until the sale of building number 2.** The advantage of making a rollover relief claim, is that the taxpayer can elect to pay capital gains tax on this £80,000 several years later, thereby obtaining a cash flow advantage.

20.2 Proceeds not fully reinvested

TCGA 1992, s.153

Illustration 2

Assume a trader sells a business asset for £200,000 realising a capital gain of £80,000. The trader uses the money to buy a replacement asset which costs £180,000. You will see therefore, that the trader has not fully reinvested his proceeds of sale.

Cash retained = £200,000 – 180,000 = £20,000

Where the taxpayer does not spend all of the sale proceeds, the amount of **cash retained** (£20,000) is **immediately chargeable** to capital gains tax. This amount is the gain. This means that having made a capital gain of £80,000, the taxpayer is immediately charged on £20,000. The **balance** – here being £60,000 – **is the rollover relief** that the trader can claim.

	£
Proceeds	200,000
Cost	(120,000)
Gain	80,000
Roll over relief	(60,000)
Gain (£200,000 – 180,000)	£20,000

The £60,000 will be rolled over and reduces the base cost of the new asset.

	£
Cost	180,000
Rolled over gain	(60,000)
Base cost of new asset	£120,000

Illustration 3

Assume a trader sells a business asset for £200,000, realising a capital gain of £80,000. He uses part of the sale proceeds to buy a replacement asset. The new building is considerably smaller and costs £110,000. Where a trader has not fully reinvested his proceeds of sale, we must identify the amount of cash retained.

Cash retained = £200,000 – 110,000 = £90,000

However it is not possible for HMRC to charge the trader on a gain of £90,000, as his actual gain is only £80,000. Therefore the whole of this gain of £80,000 will be immediately charged to tax, and no rollover relief will be available. The base cost of the new asset will remain at £110,000.

This demonstrates that when the **cash retained by the trader exceeds the capital gain**, the whole of the gain is chargeable and **no rollover relief can be claimed.**

	£
Proceeds	200,000
Cost	(120,000)
Gain	80,000
Roll over relief	Nil
Gain	80,000
Base cost of new asset	£110,000

20.3 Conditions for the relief

Rollover relief can only be claimed by **persons carrying on a trade.** Individuals trading as sole traders or within a partnership can claim rollover relief. Rollover relief can also be claimed if a **company** sells an asset and reinvests the proceeds in a replacement asset. TCGA 1992, s. 152(1)

The **old asset** – i.e. the asset being sold – must be **used for the purposes of a business** carried on by the trader. Rollover relief is also available where an individual owns an asset, but the asset is used by his personal company (i.e. where the individual owns at least 5% of the voting shares).

The **new asset** – i.e. the asset being acquired – must be **immediately taken into use for the purposes of the trade.** It is not possible for a trader to buy an asset, and use it for non-trading purposes if rollover relief is to be claimed. A trade in this context **can include furnished holiday lettings.** For example if a landlord sells a furnished holiday let and makes a capital gain, rollover relief will be available if the landlord reinvests all or part of the proceeds in acquiring a new furnished holiday let. TCGA 1992, s. 241

If an individual is carrying on two trades at the same time, these **two trades are regarded as one single trade** for rollover relief purposes. Therefore if an individual makes a capital gain on an asset used in trade "A", he can claim rollover relief by buying a business asset and using it for the purposes of trade "B". TCGA 1992, s. 152(8)

20.4 Qualifying assets

Rollover relief is only available to a trader who makes a disposal of a "qualifying asset", and who reinvests all or part of the proceeds in another "qualifying asset". The legislation contains a list of qualifying assets at s.155 TCGA 1992. TCGA 1992, s. 155

The most common type of qualifying assets is **land and buildings** used for the purposes of a trade. These will typically include shops, offices, factories, warehouses etc.

The **goodwill** of a business is also a qualifying asset. When a trader sells his business, a major part of the value of the business will often be the reputation of the business and the customer contacts. This is what we mean by "goodwill".

Fixed plant and machinery are qualifying assets for rollover relief. Note the word "fixed". Fixed means immovable, so assets such as tractors or combine harvesters used by a farmer, or vehicles used by traders, will not be eligible for rollover relief.

Ships, aircraft and hovercraft are qualifying assets as are satellites, space stations and spacecraft. Milk, potato and fish quotas will also qualify for rollover relief, as will ewe and cow suckler premiums.

The qualifying assets you are most likely to see in practice are land and buildings, goodwill, or fixed plant and machinery.

It is important to note that the **old and the new assets do <u>not</u> need to fall within the same category.** If a trader makes a gain on the sale of a building, he will obtain rollover relief if he purchases either another building, or any of the other qualifying assets. Therefore a dairy farmer who sells a milk quota and reinvests the proceeds in space travel, will obtain rollover relief.

One asset you will **not** find on the list of qualifying assets is **shares.** If an individual either **buys or sells shares, he will not be able to claim rollover relief.** Shares can never be used for the purposes of a trade. A share is simply an individual's stake in a company, and is not used for any specific purpose.

20.5 Statutory time limits

Rollover relief is only available if the new asset is acquired within a certain period of time. The **new asset must be acquired** within a four year time window, running **from 12 months before the sale of the old asset, to 36 months afterwards**. These time limits can be extended at the discretion of HMRC. TCGA 1992, s. 152(3)

Rollover **relief must be claimed** by the trader within a certain time limit. That time limit is four years from the end of the tax year in which the gain arises. For example, assume a trader sells the old asset in 2010/11. In the absence of a claim, the CGT will be due no later than 31 January 2012. A rollover relief claim should be made no later than 5 April 2015. TMA 1970, s. 43(1)

Provisional claims for rollover relief will be allowed. Therefore if the taxpayer sells an asset in 2010/11, but has not bought the new asset by 31 January 2012, but is intending to buy the asset before the three year reinvestment period has expired, HMRC will allow him to defer the capital gain, even though proper computations cannot be prepared. TCGA 1992, s. 153A

Rollover relief is not automatic, and if a trader does not wish to defer a capital gain, he will simply not make a rollover relief claim. This may be the case if the gain is covered either by losses or the annual exemption or is eligible for entrepreneurs' relief.

20.6 Interaction with entrepreneurs' relief

Where a taxpayer makes a **material disposal** of **business assets**, entrepreneurs' relief may be available to reduce the chargeable gain.

However, do remember that the disposal of a single asset will only qualify for entrepreneurs' relief if, when the asset is sold, either the whole or part of the business is also sold.

The most likely time when rollover relief and entrepreneurs' relief will interact is when the taxpayer is selling their old business with related assets and reinvesting in a new business and qualifying assets.

Where this is the case, entrepreneurs' relief will apply to any **gains remaining after rollover relief** has been claimed.

Example 1

Which of the below assets are qualifying assets for rollover relief purposes for an individual?

(a) Goodwill
(b) Freehold office
(c) Lease on a factory
(d) Tractor
(e) Shares in a personal company
(f) Painting

Example 2

Harry bought a shop in May 1994 for £180,000. He sold it in May 2010 for £250,000. In June 2009 Harry had bought a hovercraft for use in his trade for £230,000. He sold the hovercraft in March 2011 for £240,000.

Assuming all relevant claims are made calculate Harry's chargeable gains in 2010/11.

Answer 1

	Qualifying Asset? Yes	No
a) Goodwill	√	
b) Freehold office	√	
c) Lease on factory	√	
d) Tractor		X (Not fixed)
e) Shares in Personal Co.		X
f) Painting		X (Not used in trade)

Answer 2

May 2010	Shop:	£
	Proceeds	250,000
	Less: Cost	(180,000)
	Gain	70,000
	Rollover relief	(50,000)
	Gain (250,000-230,000)	20,000
	Hovercraft:	£
	Cost	230,000
	Rolled over gain	(50,000)
	Base cost of new asset	180,000
March 2011	Hovercraft:	£
	Proceeds	240,000
	Less: base cost (above)	(180,000)
	Gain	60,000
	Add:	
	Gain on shop	20,000
	Chargeable gains 2010/11	**£80,000**