CHAPTER 21

ROLLOVER RELIEF AND DEPRECIATING ASSETS

21.1 Depreciating assets

TCGA 1992, s. 154

A **depreciating** asset for CGT purposes is similar to a "wasting asset". A "wasting asset" is an asset with a useful life of not more than 50 years. A depreciating asset is either a wasting asset, or an asset which will become a wasting asset within the next 10 years. Therefore a depreciating asset is an asset with a **useful life not exceeding 60 years.**

TCGA 1992, s. 154(7)

Plant and machinery is always regarded as having a useful life of less than 60 years, and is therefore a depreciating asset. The other common type of depreciating asset, is a **lease of not more than 60 years** on land and buildings used in the business.

21.2 Purchase of a depreciating asset

As far as rollover relief is concerned, where the asset being purchased is a depreciating asset, we do not take the gain on the original asset and roll it over against the base cost of the replacement. If the **replacement asset** is a depreciating asset, **relief is given by freezing the gain on the old asset** for a certain period of time.

TCGA 1992, s. 154(2)

Illustration 1

A trader sells a building in July 2010. Proceeds are £200,000 giving rise to a gain of £80,000. The building is replaced with fixed plant and machinery bought in May 2010 for £180,000.

All of the conditions for rollover relief have been satisfied. Both assets are used in the trade, both assets are on the list of qualifying assets, and the reinvestment takes place within the four year time window.

However the way in which we defer the capital gain in this instance is slightly different, because the replacement asset – i.e. the asset purchased – is a depreciating asset. As not all of the sale proceeds have been reinvested in the replacement asset, the trader will have a gain of £20,000 which is immediately chargeable to capital gains tax, whilst the remaining £60,000 will be deferred.

	£
Proceeds	200,000
Less: cost	(120,000)
Gain	80,000
Less: deferred gain	(60,000)
Gain (200,000-180,000)	20,000

The way in which we defer the gain is not by rolling the £60,000 against the base cost of the plant and machinery. Instead this £60,000 is "frozen". This means that this amount will not be charged to capital gains tax until the happening of a certain future event. Where the replacement asset is a depreciating asset, the deferred gain is not rolled over. The base cost of the plant and machinery remains at £180,000.

At some point in the future, this frozen gain will crystallise and become chargeable. The **frozen gain crystallises on the earlier of three events:** TCGA 1992, s. 154(2)

(i) The frozen gain will become chargeable if the depreciating asset – i.e. the plant and machinery – is **sold** by the trader.

(ii) If the trader **stops using** the plant and machinery within his trade - for example the machine is used for a non-business purpose - this will also crystallise the frozen gain.

(iii) If neither of these two events happens, the frozen gain will automatically crystallise no later than **10 years after the acquisition** of the depreciating asset.

In the example, the plant and machinery was purchased in May 2010. Therefore the frozen gain of £60,000 will "unfreeze" in May 2020 at the very latest.

Illustration 2

In the previous illustration, the frozen gain was £60,000. This gain was frozen when the original building was sold in July 2010. The trader bought plant and machinery in May 2010 and the base cost of this plant and machinery is £180,000.

Assume that the trader sells the machinery in June 2011 for £195,000. A gain will arise on the sale as follows:

June 2011		£
	Proceeds	195,000
	Less: cost	(180,000)
	Gain	15,000

The sale of the depreciating asset will also lead to the crystallisation of the frozen gain.

The chargeable gain which crystallises in June 2011, is £60,000. We add this to the gain on the sale of the plant and machinery:

	£
Gain	15,000
Add: frozen gain crystallising	60,000
Total chargeable gains 2011/12	£75,000

21.3 "Parking"

There is one more slightly unusual point to cover with regard to depreciating assets, and this is something that many tax practitioners refer to as "parking". A special relief is available **if a gain is frozen** on a depreciating asset, **and before that gain crystallises**, the trader **purchases a non-depreciating asset.** A "non-depreciating" asset is an asset with a life of more than 60 years, such as land or buildings. In this instance, the **frozen gain can be rolled over** and set against the base cost of the new non-depreciating asset. TCGA 1992, s. 154(4) & (5)

This relief is known as "parking" because it effectively allows a trader to temporarily "park" a capital gain into a depreciating asset, until such time as a non-depreciating asset is purchased. The effect of this relief is to extend the reinvestment period for rollover relief.

Illustration 3

A trader sells a building used in his trade in July 1999 for £200,000 giving rise to a gain of £80,000. The trader uses the money to reinvest in a depreciating asset (such as fixed plant and machinery) which cost £180,000 in December 2000.

As the trader has retained cash of £20,000, this will be immediately chargeable to capital gains tax. The gain to be deferred is therefore £60,000. As the replacement asset is a depreciating asset, the £60,000 will not be rolled over, but will instead be frozen. This frozen gain will crystallise either when the depreciating asset is sold, or in December 2010 – i.e. 10 years after purchase.

It is now November 2010. You have noticed from your file, that a frozen gain of £60,000 is going to crystallise in one month's time. You therefore advise your client to purchase a non-depreciating asset – such as a building – which he does in November 2010. The building cost £500,000.

Because a non-depreciating asset has been acquired by the trader before the frozen gain becomes chargeable, HMRC allow the taxpayer to take the gain of £60,000, and roll it over against the base cost of the building.

	£
Cost	500,000
Rolled over gain	(60,000)
Base cost of new asset	£440,000

The £60,000 frozen gain is cancelled.

Effectively what this rule has allowed the trader to do, is to make a capital gain in July 1999, and have it rolled over against a building that he bought in November 2010 – i.e. over 11 years later.

21.4 Other points

We only use the depreciating assets rule, when the asset being **purchased** has a useful life of not more than 60 years. If this situation is the other way around – i.e. a trader sells a machine and uses the money to buy a non-depreciating asset such as a building – the normal rollover relief rules will apply.

Therefore if a trader makes a gain on the sale of a machine and reinvests the proceeds within 3 years in a shop, the gain on the machine will be rolled over and will reduce the base cost of the shop. There are no frozen gains in this example because the replacement asset is not depreciating.

If a trader reinvests into a depreciating asset and there is a frozen gain, if the **trader dies** before the frozen gain crystallises, the **gain does not become chargeable** at the point of death but is instead cancelled. This fits with the ESC D45 general principle that HMRC do not normally charge capital gains tax as a result of a disposal on death.

Example 1

Lance sold a freehold workshop in December 2010 for £400,000, making a gain of £150,000.

In May 2012 he reinvested £300,000 in buying a 30 year lease on a small shop.

In May 2013, due to a drop in business, he sold the lease for £280,000.

He made no other disposals in 2013/14.

Calculate Lance's gain/(loss) in 2013/14.

Answer 1

December 2010	£
Gain	150,000
Less: deferred gain	(50,000)
Gain	100,000

£50,000 frozen

Sale of lease May 2013:	£
Proceeds	280,000
Less: Cost x $\frac{S}{P}$ i.e. $\frac{29}{30}$	
£300,000 x $\frac{86.226}{87.330}$	(296,207)
Loss on sale of lease	£(16,207)

Sale of depreciating asset (lease)
Crystallises frozen gain

	£
Frozen gain	50,000
Less: Loss on lease	(16,207)
Gain	33,793