CHAPTER 32

ASSETS LOST OR DESTROYED

32.1 Introduction

As a general principle, if an individual receives a capital sum as **compensation** for the loss or destruction of an asset, this is a disposal for capital gains tax purposes. The detailed rules can be found at Section 22 to 24 TCGA 1992.

TCGA 1992, s. 22

The **date of disposal** for capital gains tax, is the **date that the capital sum is received**. The date of disposal is not the date that the asset was either lost or destroyed.

TCGA 1992, s. 22(2)

If an asset is physically **damaged** without being completely destroyed, and the individual receives a capital sum in compensation for the damage to the asset, we treat this as a **part disposal** for CGT purposes. As we shall see in the next chapter, because we have a part disposal we will use the "A over A plus B" formula to help us calculate the capital gain. In this chapter we shall concentrate on assets which have been completely lost or destroyed. Where an asset is lost or destroyed this is a full disposal for CGT purposes.

TCGA 1992, s. 23

32.2 Calculation of the gain

The sale proceeds for CGT purposes is the capital sum received by the individual. Typically this capital sum will be paid by an insurance company in settlement of a claim.

If an asset is lost or destroyed but no proceeds are received, the individual makes a capital loss. This will be the case, for example, where an asset is lost or destroyed but that asset has not been insured.

To calculate the capital gain we use normal CGT rules. We take the insurance money received, then deduct cost to arrive at a gain in the normal way.

Insurance money	X
Less: cost	(X)
Gain	X

32.3 "Rollover" relief

Section 23 allows a form of rollover relief to defer the capital gain when an asset is lost or destroyed. Assume an individual owns a painting which is stolen in a robbery. The painting is insured, so the insurance company pay a capital sum to the individual as compensation for the loss of the asset. We deduct cost from the insurance proceeds to arrive at a capital gain in the normal way.

TCGA 1992, s. 23(4)

If within 12 months of the receipt of the capital sum, the individual replaces his stolen asset with a new asset, the legislation allows the individual to make **a roll-over relief** claim, such that the capital gain on the loss of the original asset can be rolled over and **set against the base cost of the new asset**. To calculate the deferred gain, we apply normal roll-over relief principles.

Before a roll-over relief claim can be made, certain **conditions** must be satisfied. Firstly the **replacement asset must be acquired within 12 months** of the receipt of the capital sum. Note that this is different from the four year time window for normal roll-over relief.

The replacement asset does not necessarily need to be the same as the asset which has been lost or destroyed. All HMRC seem to insist on, is that the replacement asset **must be a chargeable asset** for CGT purposes. This means that an individual cannot make a roll-over relief claim if a painting is lost or destroyed and replaced with an exempt asset such as a car.

As with normal roll-over claims, if the individual retains some part of the insurance proceeds, the amount of **cash retained is immediately chargeable**.

When calculating the capital gain on the loss or destruction of the original asset, the proceeds of sale will consist of two elements. We take the **capital sum received** from the insurance company, and to it we must **add** any "residual" or **"scrap" value** of the old asset. For example, if an asset is destroyed in a fire or flood and some small part of the asset remains, that scrap value must be added to the capital sum received.

Relief must be formally **claimed** by the individual no later than **4 years** from the end of the tax year of disposal. This means that for disposals in 2010/2011, claims under Section 23 must be made on or before 5 April 2015.

Illustration 1

An individual owns a picture which cost £80,000 and which is destroyed in a fire in August 2010. The individual makes an insurance claim, and a capital sum of £200,000 is received in August 2010. After the fire, the picture frame is still intact and has a scrap value of £10,000. The sale proceeds for CGT purposes are therefore £210,000.

In March 2011, the individual uses part of the sale proceeds in purchasing a vase. The vase cost £160,000. As a replacement asset has been purchased in the 12 months following the date of receipt of the capital proceeds, a roll-over claim can be made under Section 23.

The first thing we do is identify the capital sum retained. The individual has received £200,000 from the insurance company, and has spent £160,000 of this capital sum in acquiring the new asset. The cash retained is therefore £40,000, and this will be immediately chargeable to capital gains tax. Thus £90,000 will be rolled over and reduces the base cost of the replacement asset.

	£
Capital sum	200,000
Scrap value	10,000
	210,000
Cost	(80,000)
Gain	130,000
Deferred gain	(90,000)
Gain chargeable now	
= Capital sum retained	
200,000 – 160,000	£40,000
Cost	160,000
Rolled over gain	(90,000)
Base cost	£70,000

32.4 Negligible value claims

A negligible value claim can be made by a taxpayer if an asset in his possession becomes **worthless** – i.e. its value becomes negligible.

TCGA 1992, s. 24(2)

This is most commonly applied to shares where the company goes into liquidation, but it could be applied to other assets which, for a variety of reasons, have no value.

If an individual owns an asset whose value has become negligible, the owner can make a claim under Section 24. The effect of the claim is that the owner can pretend that he has sold his asset, and that the **proceeds** of sale are equal to their **current market value** – in many instances the current market value of the asset will be zero. The individual is then deemed to have immediately reacquired the asset for the same price. This means the individual's base cost for CGT purposes will be nil.

The effect of this "pretend sale" is that a **capital loss will arise** at the date of this deemed disposal. Assuming that the asset is completely worthless, the capital loss will be equal to the original base cost.

Having made a claim under Section 24, the taxpayer must decide what he wishes to do with the resulting capital loss. The loss can be treated as a **current year loss** of the year in which the claim is made. Alternatively, the taxpayer can elect to treat this loss as a current year loss arising **in any of the two years immediately preceding the claim.** This option to effectively carry back the loss for two years, is only available if HMRC are satisfied that the asset in question was of negligible value in those two years.

TCGA 1992, s. 24(2)(b)

Illustration 2

Veronica bought some shares in Plughole Plc for £10,000 in 1998. Plughole Plc has been in liquidation since 2006, so it is unlikely that Veronica will see any return on her investment. Veronica can make a negligible value claim under Section 24, and duly does so in March 2011.

In March 2011, we pretend that Veronica sold the shares for their then market value, i.e. zero. The base cost of the shares was £10,000, leaving Veronica with a capital loss in March 2011 of £10,000.

At this point, the base cost of the Plughole Plc shares becomes zero. Therefore, if the company subsequently recovers and Veronica is able to sell the shares and realise some cash, this cash gain will become chargeable to CGT.

Veronica can treat the £10,000 as a loss arising in the year of the claim – i.e. 2010/11. Alternatively, Veronica can elect to treat the £10,000 capital loss as having arisen either in 2009/10 or in 2008/09. Once this capital loss has been allocated to a tax year, it is treated as a loss actually made in that tax year.

For example, if Veronica chooses to take the loss in 2009/10, that loss must first be set against other gains in that year, then any excess can be carried forward. Veronica's decision as to where to place the loss will depend on whether she has made any capital gains in those relevant tax years.

The reason behind the negligible value legislation, is to allow taxpayers to realise losses on assets which they would otherwise be unable to sell, simply because those assets have become worthless.

HMRC maintain a published list of companies whose shares have become of negligible value, and Section 24 claims in respect of those shares will be readily accepted.

32.5 Capital sums derived from assets

Finally, a brief discussion of the tax case of *Zim Properties Limited v Proctor.* Zim Properties Limited owned an investment property, which they had acquired in the 1960s. In 1973, the company decided to sell the property and duly found a purchaser. Contracts were signed and the intended completion date was set for July 1974. However, the transaction could not be completed because the solicitors had mislaid a conveyance document. As a result of this error, the sale fell through.

Zim Properties Limited duly **sued their solicitors for negligence**. In settlement of this claim, the solicitors agreed to pay Zim Properties Limited damages totalling £69,000. The question then arose as to whether this capital sum was chargeable to corporation tax as a capital gain.

In order for a chargeable gain to arise, a chargeable person – in this case Zim Properties Limited – must be disposing of a capital asset. As the investment property had not been sold, Zim Properties argued there was no disposal of an asset and as such the £69,000 could not be a chargeable gain. HMRC argued that the £69,000 was a **capital sum deriving from an asset**, and that asset in question was the **right** for Zim Properties **to take legal action** against their solicitors. Effectively the company had given up their right to sue, in return for £69,000.

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The right to receive a future capital sum is also known as a **"chose in action".** You will already have come across this term in the chapter on "earn outs" in which a right to receive future proceeds was held to be an asset in itself.

The High Court agreed with the Revenue, and the payment of £69,000 was a chargeable gain and was subsequently charged to corporation tax.

If you come across this point in practice, it is worth looking at Extra Statutory Concession D33. Under the Concession, HMRC have said that if the **underlying asset is exempt** from CGT, any **damages** payments arising in connection with that asset will **also be exempt** from tax. This may apply, for example, if an individual obtains a payment of damages as a result of an abortive sale of his principal private residence. Because one's PPR is exempt, any damages paid to the owner in connection with that property are also exempt from CGT.

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Example 1

Seamus bought 10,000 shares in Beta-Max plc in 1990 for £8,000. The company ceased trading in December 2008 and in June 2010 Seamus was officially informed that the company had gone into liquidation and no funds were available to distribute to the shareholders.

Seamus has capital gains in recent years as follows.

	2008/09	*2009/10*	*2010/11*
Gains	£3,500	nil	£12,000

Advise Seamus on his most appropriate claim.

Example 2

Mark's valuable 1940s record collection was destroyed in a flood in November 2010. It had cost £5,000 in March 1982 and had an insurance value of £30,000. This was received in November 2010. Mark rescued some of the record sleeves from the flood. These were worth £1,000.

In January 2011, Mark bought an antique chest for £27,000 with the insurance proceeds. He sold it in March 2011 for £32,000.

Calculate Mark's chargeable gain in 2010/11.

Answer 1

Seamus should make a negligible value claim under s.24 TCGA 1992. This will generate a capital loss of £(8,000). As the shares became of negligible value in 2008/09, Seamus can claim the loss as a current year loss in either 2008/09, 2009/10 or 2010/11.

Seamus's most efficient claim is to **take relief in 2009/10** He will then have a capital loss of £(8,000) in 2009/10 which can be carried forward against gains in 2010/11 as follows:

	2009/10
	£
Gains	12,000
Less: capital loss b/f from 2009/10	(1,900)
Net gains (covered by AE)	10,100
Loss c/f to 2011/12: £8,000 – £1,900	£6,100

Note: if relief is taken in 2010/11, the full loss would have to be set against the 2010/11 gains leaving no remaining losses to be c/fwd.

Answer 2

Compensation received (November 2010)	£
Insurance proceeds	30,000
Residual value of asset	1,000
Total disposal proceeds	31,000
Less: cost	(5,000)
Gain	26,000
Less: gain deferred	(23,000)
Gain	
Proceeds retained	
30,000 – 27,000	£3,000
Antique chest (January 2011)	
Cost	27,000
Less: rolled over gain	(23,000)
Base cost	£4,000
Sale of antique chest (March 2011)	
Proceeds	32,000
Less: base cost	(4,000)
Gain	**£28,000**