

Rollover relief (Lecture P1359 – 13.56 minutes)

Rollover relief is available where a trader sells an asset and then buys a replacement. The basic idea is that a trader does not have to suffer the tax on a sale which might then reduce the amount of proceeds available to buy a new asset.

To qualify for relief, both the old and new assets must be 'relevant' business assets and the required reinvestment must take place within a given time frame.

Relief is only available if both the original asset and the new asset fall within specified classes. It is not, however, a requirement that they should both fall within the same class.

The classes specified are:

- Class 1:
 - (1) Head A:
 - (a) Buildings, parts of buildings and structures in the nature of buildings;
 - (b) Land.
 - (2) Head B: Fixed plant or fixed machinery.
- Class 2: Ships, aircraft and hovercraft.
- Class 3: Satellites, space stations and spacecraft.

The remaining classes are only applicable to individuals and trustees. For corporation tax purposes, the assets within these classes are taken outside the scope of chargeable gains and dealt with under the intangible assets regime:

- Class 4: Goodwill.
- Class 5: Milk and potato quotas
- Class 6: Ewe and suckler cow premium quotas
- Class 7: Fish quota
- Class 7A: Entitlements under the Single Payment Scheme and the Basic Payment Scheme
- Class 8:
 - (1) Head A: Syndicate rights of an underwriting member of Lloyd's.
 - (2) Head B: Syndicate rights held through a members' agent pooling arrangement

There is no requirement to ensure that the actual sale proceeds of the old asset are used for the purchase of the new asset. Indeed, as the new asset may be purchased before the disposal of the old asset, this would be impossible in such a case. All that is required is that an amount equal to the disposal proceeds is expended on the acquisition of the new asset.

HMRC accept that the comparison to be made is between the net disposal proceeds (after allowable costs of disposal) and the cost of acquisition (including incidental costs).

In this context, the disposal proceeds include any consideration deemed to have been received on the disposal, e.g. the market value of the asset in the case of a disposal to a connected person and the market value of any non-monetary consideration. This reinforces the fact that there is no actual matching of the sale proceeds to the purchase cost.

The relief works by reducing the allowable cost of acquisition and other expenditure of the new asset by the amount of the gain on the old asset. Thus, on a disposal of the new asset an enhanced gain arises which comprises the gains on both assets.

The way the relief works is to reduce the disposal consideration to an amount which produces no gain/no loss. The amount by which the consideration is reduced is then knocked off the purchase price for capital gains purposes for the new asset.

In a simple example, an asset is sold for £450,000 and crystallises a gain of £73,223. A new asset is purchased for £500,000. The notional sale price is reduced to £376,777 so that no gain and no loss arises on the disposal. The purchase price for the new asset is reduced by the same amount so becomes £426,777.

Where the amount reinvested in the new asset is less than the disposal proceeds, then partial rollover relief may be available as long as the amount not reinvested is less than the gain.

In that case, the chargeable gain on the old asset is reduced to the amount by which the amount reinvested falls short of the disposal proceeds and the cost of acquisition is again reduced by the amount by which the gain is reduced. In effect, the amount not reinvested comes back into charge as the gain on disposal.

In the above example, if the new asset had cost £400,000, then a gain of £50,000 would have come into charge on the sale. If it had cost less than £376,777 then no rollover relief would have been available. It should be noted that this does not affect the purchaser of the old asset or the vendor of the new asset.

There are two different forms of relief: 'roll-over relief' and 'hold-over relief'. Roll-over relief is the title given to the principal relieving section but is not otherwise a statutory term as the headings do not strictly form part of the legislation. It implies that the gain being relieved is 'rolled-over' onto the new asset. Hold-over relief is a variant of roll-over relief where the new asset is one which depreciates. In this instance, if the gain was deducted from the allowable cost of the new asset, it would gradually waste away under the rules relating to such assets.

Instead, the gain is held in abeyance and becomes chargeable on certain specified events. Those events are the earlier of:

- The date of sale
- The date the asset ceases to be used for the business
- 10 years

There is no specified time limit for the making of a claim and therefore the normal time limits apply. Individuals and trustees must claim within four years of the end of the year of assessment to which the claim relates and companies must claim within four years of the end of the accounting period to which the claim relates. Because a claim cannot be made until both a qualifying disposal and a

qualifying reinvestment has occurred, the relevant tax year or accounting period is that in which the later of the acquisition or disposal occurs. As a consequence of the fact that a reinvestment may be up to three years after the disposal, a claim could be made up to seven years after the disposal.

Under the power granted by TMA 1970, Sch. 1A, para. 2(3), HMRC have determined the format of a valid claim to roll-over relief. It must be in writing and identify the following:

- the claimant;
- the assets which were the subject of the disposal giving rise to the gains;
- the date of disposal of each of those assets;
- the consideration received for each of those assets;
- the new assets which have been acquired;
- the dates of acquisition, or the dates of the unconditional contracts for the acquisition, of each of those new assets;
- the consideration given for each of those new assets; and
- the amount of the consideration received for the disposal of each of the specified assets that has been applied in the acquisition of each new asset.

Because a claim cannot be made before the reinvestment has occurred, taxpayers could be faced with having to pay the tax due on disposal and reclaim that tax once the reinvestment has occurred. Moreover, payment of the tax could actually prejudice the taxpayer's ability to fund the reinvestment. To overcome this problem, the statute gives relief on a provisional basis. If the reinvestment does not take place, then additional interest will apply on unpaid tax and HMRC will potentially levy penalties if they believe the return was incorrectly completed.

Individuals and trustees may make a declaration in the self-assessment return for the chargeable period in which the disposal takes place, to the effect that:

- all or a specified part of the consideration will be applied in acquiring new assets which will be used and used only for the purposes of the trade;
- the acquisition will take place within the time limit specified; and
- the new assets will fall within the qualifying classes.

It is a basic requirement for relief that the old asset must be used and used only for the purposes of a trade. It must be in use at the time of disposal which can cause some issues with achieving the relief. For example, trading property where planning permission has been obtained so it can be sold to a developer might not be available for rollover relief if HMRC can argue that the use for the purposes of the trade has ceased before the sale.

It is important to make sure that the activities undertaken are, in fact, trading. This would be judged in accordance with the normal badges of trading. A recent case focussed on whether land used for glamping on a farm as part of a diversification away from agriculture would prejudice the ability to claim rollover relief if the property was sold.

The asset which is the subject of the disposal must be used for the purposes of a trade or other business activity throughout the claimant's period of ownership, in order for full relief to be available. However, restricted relief is available if this condition is not fulfilled.

Where the asset has only been partially used for the purposes of a trade during the whole or any substantial part of the period of ownership, the part which has been used for the trade is treated as being a separate asset from that which has not. Thus the gain on the disposal is to be apportioned to the two notional assets on a 'just and reasonable' basis and only that attributable to the notional asset used for trade purposes is eligible to be rolled-over.

It is important that this apportionment only applies where the asset is still in use for the purposes of the trade at the date of disposal. If it is not, then no rollover is available at all even if there has been previous business use.

The new asset must be brought into use in the new trade on purchase or as soon as possible afterwards. Delays due to refurbishment or adaptation may be acceptable but it is important to ensure any delay in bringing the asset into use in the trade must be avoided. Trade in this context include furnished holiday lettings businesses. This can lead to a useful planning opportunities although the availability of business asset disposal relief has meant that rolling over into FHL has become less common.

All trades carried on by the same person either concurrently or successively are treated, for these purposes only, as a single trade. Thus it is possible for an individual or company to sell an asset used in one trade and acquire an asset used in a different trade.

Relief is also extended to situations where an asset is held by an individual in a personal capacity but used for the purposes of a trade carried on by his 'personal' company; that is, a company in which he is able to exercise not less than 5% of the voting power. It should be noted that there is no requirement that the individual must be a director of that company. To qualify for relief, the company must be the individual's personal company both at the date of the disposal of the old asset and at the date of the acquisition of the new one. The old and new assets must be used in the same company.

The receipt of rent by the individual from his personal company for the use of the asset does not prejudice roll-over relief. This is in contrast to the entrepreneurs' relief, applicable from 6 April 2008, where the receipt of rent will restrict relief.

Contributed by Ros Martin