

Capital sums: receipt of compensation and insurance moneys not treated as a disposal in certain cases (S.536)

Manual Part 19-1-17

Document last reviewed May 2017

Capital sums: receipt of compensation and insurance moneys not treated as a disposal in certain cases (S.536)

7.1 Where a person receives a compensation, etc., payment within (a) of [Tax Instruction 19.1.6 Par. 1](#) in respect of an asset other than a wasting asset which is not lost or destroyed, he may claim by notice in writing that the receipt shall not be treated as a disposal of that asset in whole or in part (with the consequence that Capital Gains Tax would at that point become chargeable) but instead as reducing the cost of acquisition (before indexing) of the asset in question provided that -

(a) the capital sum is wholly applied in restoring the asset;

or

(b) the capital sum is so applied except for a part which is not reasonably required for that purpose and which is small (in practice not exceeding 5 per cent) in comparison with the amount of the capital sum as a whole.

Where the compensation is received in respect of damage to an asset which is part of a larger unit, the test of smallness in relation to the value of the asset should be applied to the smallest unit which could reasonably be sold as such. For example, if a cottage is damaged, the unit is the cottage and not the estate on which it stands.

Example 1

A person buys an asset for €10,000 and insures it. At a time when its value has increased to €12,000 it is damaged by fire. He receives compensation of €4,000 and spends the whole on restoring the asset. He then makes a claim under **Section 536**. The asset is eventually sold for €12,000.

The position is as follows:-

<u>Adjusted cost</u>	€	
Cost of asset	10,000	
<u>Deduct</u> recovery	<u>4,000</u>	(part disposal but Section 536 applies)
	6,000	
<u>Add</u> expenditure on reinstatement	<u>4,000</u>	(Section 536 (1) (a))
Adjusted cost	<u>10,000</u>	

<u>Chargeable gain on sale</u>	€
Sale proceeds	12,000
Less adjusted cost	<u>10,000</u>
Gain	2,000

Example 2

The facts are the same in Example 1 except that only €3,900 is spent on restoration.

The position is as follows:

<u>Adjusted cost</u>	€	
Cost of asset	10,000	
Deduct recovery	<u>4,000</u>	
	6,000	
<u>Add</u> expenditure on reinstatement	<u>3,900</u>	(Section 536(1)(b))
Adjusted cost	<u>9,900</u>	
 <u>Chargeable gain on sale</u>		
Sale proceeds	12,000	
Less adjusted cost	<u>9,900</u>	
Gain	<u>2,100</u>	

- 7.2** Where an asset other than a wasting asset is lost or destroyed and the owner of it applies the compensation in acquiring a replacement (see **Par.3**) asset within one year of receipt of the compensation (or such longer period as the Inspector may allow), **Section 536(2)** provides that he should be treated, if he so claims in writing, as if no gain or loss had accrued on the disposal of the old asset but as if the cost of the new asset were reduced by any chargeable gain which would have been taxed if the receipt of the compensation plus any scrap value of the old asset had been treated as a disposal of the old asset.

As regards - part disposals, see [Tax Instruction 19.1.4](#) **Par.1**.

Example 3

An asset which cost €2,000 in 2003 and was insured for "replacement value" is destroyed in 2005. There is an insurance receipt of €2,500 and the salvaged materials have a residual or scrap value of €50. The costs incurred in negotiating the settlement of the claim are €40.

<u>Computation</u>	€	€
The cost of the asset is	2,000	
Expenses of deemed disposal	<u>40</u>	
Allowable expenditure (Section 552)		2,040
Compensation received	2,500	
Scrap value (scrap not taken by insurance company)	50	<u>2,550</u>
Notional gain		510
Cost of new asset when completed		<u>2,750</u>
Deemed cost of new asset		<u>2,240</u>

7.3 The word "replacement" should be interpreted reasonably. If the new asset is of a similar functional type to the old asset, a claim under **Par. 2** may be admitted.

7.4 Where part only of the capital sum received as compensation for loss or destruction of the asset is applied in acquiring a new asset, a claim under **Section 536(2)** is not admissible. If, however, the part not so applied is less than the gain the owner may claim to be treated as if -

(a) the amount of the gain were reduced to the amount not applied in replacement and

(b) the cost of the new asset were reduced by the amount of that reduction of the chargeable gain.

Example 4

On 6 April 2000 a person purchased a piece of jewellery for €2,000. In 2005 it is stolen and in 2006, €5,600 compensation is received from the insurance company. The chargeable gain is:-

	€
Proceeds	5,600
cost €2,000 x 1.144 =	<u>2,288</u>
Gain	3,312

In 2007, the person buys a replacement for €4,500. As only part of the capital sum of €5,600 is used to purchase the new asset, the claim lies under **Section 536(3)** rather than **Section 536(2)**.

The part not applied to the new purchase is €5,600 less €4,500 = €1,100, which is less than the gain of €3,312. The chargeable gain is therefore reduced to €1,100. The acquisition price of the new asset is reduced by the amount by which the chargeable gain is reduced i.e. €3,312 - 1,100 = €2,212, giving a net acquisition price of €4,600 - €2,212 = €2,388.