

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

Part 19-01-07

This document should be read in conjunction with section 536 of the Taxes Consolidation Act 1997

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Table of Contents

Introduction	3
7.1 Asset not wholly lost or destroyed.....	3
Example 1	4
Example 2	4
7.2 Compensation for loss or destruction of asset entirely reinvested	5
Example 3	5
7.3 Replacement	5
7.4 Compensation partially utilised acquiring a new asset	5
Example 4	6

Introduction

Section 535 of the Taxes Consolidation Act 1997 (“TCA 1997”) provides that capital sums derived from an asset may be treated as giving rise to a disposal of the asset.

Section 536 TCA 1997 provides for deferment of the charge on the receipt of compensation or insurance money for damage to or destruction of assets, or of sums for the forfeiture or surrender of rights or for the use or exploitation of assets, if the money received is used in restoring or replacing the asset. The amount received is treated as reducing the cost of the asset (or, in the case of the loss or destruction of the asset, the cost of replacing it), and the charge on the compensation money is not imposed until the asset or the asset replacing it has been disposed of. The relief must be claimed – it does not apply automatically.

7.1 Asset not wholly lost or destroyed

Where a person receives a compensation, etc., payment within **section 535(2)(a) TCA 1997** and described in [Tax and Duty Manual \(TDM\) Part 19-01-06](#) in respect of an asset **other than a wasting asset** which is **not** lost or destroyed, he or she 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 (“CGT”) 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 or she receives compensation of €4,000 and spends the whole compensation sum on reinstating the asset. He or she then makes a claim under **section 536 TCA 1997**. The asset is eventually sold for €12,000.

The position is as follows:

Adjusted cost

Cost of asset	€10,000
Deduct compensation (part disposal but section 536 TCA 1997 applies)	€4,000
	€6,000
Add expenditure on reinstatement (section 536(1)(a) TCA 1997)	€4,000
Adjusted cost	€10,000

Chargeable gain on sale

Sale proceeds	€12,000
Less adjusted cost	€10,000
Gain	€2,000

Example 2

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

The position is as follows:

Adjusted cost

Cost of asset	€10,000
Deduct compensation	€4,000
	€6,000
Add expenditure on reinstatement (section 536(1)(b) TCA 1997)	€3,900
Adjusted cost	€9,900

Chargeable gain on sale

Sale proceeds	€12,000
Less adjusted cost	€9,900
Gain	€2,100

7.2 Compensation for loss or destruction of asset entirely reinvested

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 **para 7.3**) asset within one year of receipt of the compensation (or such longer period as the Inspector may allow), **section 536(2) TCA 1997** provides that he or she should be treated, if he or she 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 [TDM Part 19-01-04](#).

Example 3

An asset which cost €2,000 in 2018 and was insured for "replacement value" is destroyed in 2020. 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. A replacement was purchased in 2020 for €2,750.

Computation

The cost of the asset is	€2,000	
Expenses of deemed disposal	€40	
Allowable expenditure (section 552 TCA 1997)		€2,040
Compensation received	€2,500	
Scrap value (scrap not taken by insurance company)	€50	€2,550
Notional gain		€510
Cost of new asset when completed		€2,750
Deemed cost of new asset (€2,750 - €510)		€2,240

7.3 Replacement

The word "replacement" should be interpreted reasonably. If the new asset is of a similar functional type to the old asset, a claim under **para 7.2** may be admitted.

7.4 Compensation partially utilised acquiring a new asset

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) TCA 1997** 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 2018 it is stolen and in 2019, €5,600 compensation is received from the insurance company.

The chargeable gain is:-

Proceeds					€5,600
Cost	€2,000	x	1.144	=	€2,288
Gain					€3,312

In 2020, 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) TCA 1997** rather than **section 536(2) TCA 1997**.

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 €4,500 - €2,212 = €2,288.