



HM Revenue
& Customs

Legislating Extra Statutory Concession D33

Consultation document

Publication date: 31 July 2014

Closing date for comments: 15 September
2014

Subject of this consultation:	This is a consultation about introducing legislation to replace the long standing Extra Statutory Concession (ESC) D33.
Scope of this consultation:	<p>ESC D33 covers a number of circumstances where a capital sum is received from a right of action.</p> <p>The concession was amended in January 2014 so that only the first £500,000 of a capital sum where there is no underlying asset was exempt and exemption for amounts in excess of this had to be made in writing to HMRC.</p> <p>This consultation seeks views on introducing a limit of £1,000,000 exemption with amounts in excess of this liable to Capital Gains Tax (CGT).</p> <p>It also seeks views on legislating the relief given by ESC D33 for personal compensation or damages and indemnities.</p>
Who should read this:	We would like to hear from professional tax advisors, lawyers and consumer protection agencies.
Duration:	31 July 2014 to 15 September 2014
Lead official:	Tracy Gribble, HMRC
How to respond or enquire about this consultation:	<p>Responses or enquiries should be made:</p> <ul style="list-style-type: none"> • By post to: Tracy Gribble, HMRC, Room G/48, 100 Parliament Street, London SW1A 2BQ • By e-mail to: capitalgains.taxteam@hmrc.gsi.gov.uk <p>Representative groups may wish to give a summary of the people and organisations they represent and, where relevant, how they consulted in reaching their conclusions. You may wish to include contact details for follow-up (e.g. name, phone number, email address).</p>
Additional ways to be involved:	<p>As this is a largely technical issue we expect that this will be a purely written exercise.</p> <p>Any organisation that would like to discuss this document should contact Tracy Gribble (details above) who will arrange a meeting.</p>
After the consultation:	Following the period of consultation, HMRC will publish a summary of the responses to the consultation. We will then decide when it is most appropriate to introduce legislation.
Getting to this stage:	The part of the concession dealing with capital sums received where there is no underlying asset was amended in January 2014.
Previous engagement:	This is the first consultation on this topic.

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On request this document can be produced in Welsh and alternate formats including large print, audio and Braille formats

1. Introduction

HMRC's review of Extra Statutory Concessions (ESCs)

An ESC is a relaxation which gives taxpayers a reduction in tax liability to which they would not be entitled under the strict letter of the law. Most concessions are made to deal with what are usually minor or transitory anomalies under the legislation and to meet cases of hardship at the margins of the code where a statutory remedy would be difficult to devise or would run to a length which is disproportionate to the intrinsic importance of the matter.

ESCs have been a feature of the UK's tax system for decades but in 2005, the House of Lords' decision in the case of *HM Commissioners of Inland Revenue ex parte Wilkinson* [2005 UKHL 30] clarified the scope of HMRC's administrative discretion to make concessions that depart from the strict statutory position. HMRC is therefore reviewing all of its concessions.

In the course of this review some concessions have been identified as going beyond the scope of HMRC's discretion. This includes ESC D33.

Legislating ESCs

When HMRC identifies an ESC as going beyond the scope of HMRC's discretion a decision is taken whether to withdraw or legislate the concession. If the decision is to legislate, then a further decision is taken whether to legislate it with or without modification.

In addition to the option of using primary legislation, a power also exists to legislate ESCs by Treasury Order under section 160 of Finance Act 2008. If a Treasury Order is chosen then this is undertaken outside the usual tax legislation cycle of Budget, Autumn Statement and Finance Bill.

For most concessions, consultation takes place after publication of the draft legislation. This reflects the fact that the concessions have usually been in place for many years and their application is well understood.

We have decided to offer a separate consultation on D33 because changes were introduced to one part of the concession in January this year. We therefore wanted to highlight these changes and make sure that everyone had an opportunity to comment on them.

When we publish the consultation response document we will set out the timetable for legislating.

It is the government's intention to legislate ESC D33 through primary legislation and not through a Treasury Order.

Scope of consultation

ESC D33 covers a number of circumstances where a capital sum is received from a right of action and these are considered separately in this consultation document.

The definition of 'capital sum derived from assets' is not within the scope of this consultation.

HMRC considers certain parts of the concession – where the right of action can be linked to an underlying asset – are purposive interpretation of statute rather than concessionary treatment. These are not part of the consultation.

We have looked again at the amendment made in January 2014 for capital sums where there is no underlying asset. This introduced a limit of £500,000 to the amount of compensation that is automatically exempt from Capital Gains Tax (CGT) for individuals and Corporation Tax for companies. Any claims for amounts of compensation above this threshold to be exempt had to be made in writing to HMRC.

We are proposing that the limit of compensation should be £1 million but that it should be an absolute limit with amounts in excess of this liable to Capital Gains Tax (CGT). This consultation seeks views on this proposal.

2. Relevant legislation

Section 37(1) of Taxation of Chargeable Gains Act 1992 (TCGA) says that a sum that is charged to income tax is excluded from the consideration used in computing any gain. Where compensation or damages received are income in the hands of the recipient, they are chargeable to income tax. Where they are not income but capital, they are taxable to CGT.

Section 1 of TCGA charges CGT on gains accruing to a person on the disposal of assets. There is no statutory definition of 'disposal' so this has its ordinary meaning. There are specific events that are defined by the Act to be disposals.

Section 21 TCGA states that all forms of property are assets for the purposes of the act, including incorporeal property generally. 'Disposal' includes a part disposal.

Section 22(1) provides that for the purposes of TCGA there is a disposal by the owner of the asset where any capital sum is derived from the asset, notwithstanding that no asset is acquired by the person paying the capital sum. See [Annex A](#) for the full text of section 22.

'Capital sum' is defined in section 22(3) as any money or money's worth which is not excluded from the consideration taken into account in the computation of the gain.

There is a wealth of case law on the question of when a capital sum is 'derived from assets'. The principle which has emerged is that it is necessary to identify the underlying asset that is the source of the capital sum. The capital sum will be derived from the underlying asset rather than from a right of action. If there is no underlying asset then the capital sum will be derived from the right of action itself.

For example, a capital sum received as compensation for physical damage to an asset will be treated as deriving from the asset that was damaged and not from any statutory right to compensation or any other right of action that came into existence as a result of the damage.

The asset could be an intangible asset such as a person's 'rights'. For CGT purposes statutory rights, contractual rights or rights of action are intangible assets.

The definition of 'capital sum derived from assets' is not within the scope of this consultation.

Section 22 applies to:

- a) capital sums received by way of compensation for any kind of damage or injury to assets etc.;
- b) capital sums received under a policy of insurance;
- c) capital sums received in return for forfeiture or surrender of rights, or for refraining from exercising rights; and,
- d) capital sums received for use or exploitation of assets.

The receipt of a capital sum which is not within any of the categories above may still be treated as a deemed disposal if the general conditions of section 22(1) are satisfied.

In certain circumstances, a claim can be made under section 23 TCGA which prevents the receipt of a capital sum within section 22(1)(a) from being treated as a disposal where the compensation is applied in restoring a damaged asset or replacing an asset which has been lost or destroyed. A claim can also be made under section 23 TCGA to prevent the receipt of a capital sum within section 22(1)(b) from being treated as a disposal where the insurance receipt is applied in restoring a damaged asset or replacing an asset which has been lost or destroyed.

3. Background to concession

The full text of the concession is in [Annex B](#).

D33 deals only with capital sums received as compensation or damages for a right of action which are capital in the hands of the recipient so are taxable to CGT under section 22 TCGA. It does not apply where a capital sum has been derived from any other type of asset including statutory rights or contractual rights.

D33 was introduced following the High Court decision in the case of *Zim Properties Ltd v Proctor* [58 TC 371].

In this case Zim Properties were selling a property and engaged solicitors to complete the paperwork for the transaction. The solicitors did not complete the paperwork correctly which resulted in the property transaction failing to complete. Zim properties received a sum of money from its former solicitors in settlement of an action for negligence which it instituted against them. The High Court found that the property was unaffected by the actions of the solicitors so the property was not the source of the damages. The High Court held that the company's right to sue the solicitors was the source of the damages and also that it was an asset for CGT purposes. By receiving the damages the company had disposed of that asset.

This established that the right to take court action for compensation or damages is an asset in its own right for CGT purposes.

It is not necessary to take court action and have compensation awarded under a court order. The person with the right of action may agree to accept compensation because of arbitration or a negotiated settlement. The capital sum they receive will still be regarded as a disposal of the right of action.

In most cases, the person will not have incurred any expenditure in acquiring the right of action so the receipt of the damages will give rise to a capital gain. The strict application of this principle could give rise to some harsh results because a range of statutory reliefs and exemptions would not apply.

The purpose of the concession was to remove the anomalies resulting from the decision in Zim Properties and avoid difficulty in quantifying settlements because of uncertainty of the appropriate taxation treatment of damages.

4. ESC D33

This ESC was introduced with effect from 19 December 1988 following the Zim Property decision. D33 became widely known and well understood by accountants, lawyers, tax practitioners and HMRC staff.

However, the post-Wilkinson review of ESCs carried out by HMRC identified that parts of D33 exceeded HMRC's discretionary power of collection and management (in particular those in paragraphs 11 and 12). The Commissioners for HMRC were concerned at the potential for open-ended relief accessible by way of an *ultra vires* concession and took immediate action to limit the relief which could be given under paragraph 11.

The text of paragraph 11 was amended with effect from 27 January 2014.

5. Analysis of D33

ESC D33 paragraphs 2 to 7

D33 begins by setting out the strict position under the law. Paragraphs 2 to 7 are not concessionary but set out how the chargeable gain on receipt of a capital sum for a right of action will be calculated by reference to

- a. Cost of acquisition
- b. Date of acquisition
- c. Market value on acquisition
- d. Date of disposal
- e. Rebasing to 31 March 1982
- f. Reliefs and exemptions

We do not propose to legislate these parts of D33 but will ensure that the interpretation of statute which they contain is clearly set out in HMRC guidance.

Paragraph 8, 9 and 10 – treatment where there is an underlying asset

Paragraphs 8 to 10 set out an alternative to the strict position outlined in paragraphs 2 to 7 of the ESC where there is an underlying asset. The alternative depends on whether or not the right of action can be identified with an underlying asset.

Where the right of action arises from some damage to an underlying asset, the gain or loss on the disposal of the right of action may be treated as if it was a disposal or part disposal of the underlying asset rather than the right of action.

The effect of this alternative treatment is that a proportion of the cost of the underlying asset can be deducted in computing the gain or loss. Where it is necessary to time-apportion the gain or calculate relief, such as indexation, by reference to the date of acquisition, the date of acquisition will be that of the underlying asset.

Any reliefs or exemptions which would have been available on the disposal of the underlying asset will be available on the disposal of the right of action. D33 gives the example of compensation derived from a cause of action in respect of damage to a

building suffered by reason of professional negligence. If the compensation is applied in restoring the building, deferment relief under section 23 TCGA will be available as if the compensation derives from the building itself and not from the right of action.

This treatment follows the case law in *Zim Properties* and also in *Pennine Raceway Ltd v Kirklees Metropolitan Council (No 2)* [1989] STC122. *Pennine Raceway* held a licence to conduct drag racing on a disused airfield. The company applied to the Council for planning permission to build a racing circuit but the permission was revoked. The company acquired a statutory right to claim compensation under section 164(1) of the Town and Country Planning Act 1971 for loss of income and other costs incurred as a result of the revocation of planning permission. The Court of Appeal held that the compensation was a capital sum derived from the company's licence to conduct drag racing on the grounds that it had lost value when planning permission had been revoked. As the capital sum was derived from the company's license rather than the rights it held, part of the allowable costs of the license fell to be deducted in computing the gain. Had the court found that the capital sum derived from the rights held there would have been no allowable costs under section 38(1)(a) and (b) TCGA.

We believe it is therefore inaccurate to say that paragraphs 9 and 10 are a concession when they reflect the position in law as it stands after decided cases.

ESC D33 paragraphs 11 – No underlying asset

A right of action may be acquired in a situation where it is not possible to identify a separate underlying asset.

For example, where a professional adviser has given misleading advice on a tax or other financial matter, or in relation to private or domestic matters.

Zim Properties demonstrates that the right of action is a chargeable asset for CGT purposes even in the absence of an underlying asset.

Compensation for personal injury is exempt from CGT. We have set out later in this document what we are doing to make sure that where the statutory exemption is currently extended by a concession in other paragraphs of D33, it will still be given.

Broadly, when we are looking at capital sums without an underlying asset which fall within paragraph 11 of ESC D33 we are looking at a financial loss for example, compensation for poor professional advice or for mis-selling of financial products.

Prior to the amendment in January 2014, any gain accruing on the disposal of a right of action where there was no underlying asset was, by concession under paragraph 11, treated as entirely exempt.

When the concession was originally published in 1988 claims for compensation were far less common than they are now and the level of awards was much smaller. When we reviewed this concession we were concerned that the unlimited exemption of potentially large amounts could be outside the Commissioners of Revenue and Customs' discretionary powers, set out at section 5 of the Commissioners for Revenue and Customs Act 2005. Therefore the Commissioners amended the concession to limit automatic exemption to £500,000 of related compensation with the ability to submit a claim in writing to HMRC for amounts above the limit.

As an example of levels of compensation that can be awarded in government schemes, there is a limit of £150,000 for compensation paid through the Financial Ombudsman Service and £500,000 for the Criminal Injuries Compensation Scheme.

We do not think it would be practical to legislate the amended paragraph 11 concession as it does not provide sufficient certainty to anyone receiving compensation over £500,000.

We are therefore proposing that there is an absolute limit of £1 million exemption for compensation derived from a right of action where there is no underlying asset. Any amount above £1 million will be chargeable to CGT for individuals and Corporation Tax for companies.

Our research into the amounts of compensation which financial services businesses expect to pay to customers for mis-selling of financial products shows that the compensation they expect to pay to a customer will be less than this in the majority of cases.

By having an absolute limit we avoid adding complexity to the tax code and provide certainty of treatment to the recipient. In arriving at the amount of compensation, the Courts will be aware that any compensation awarded of more than £1 million in these circumstances will be subject to CGT for individuals and Corporation Tax for companies.

Where multiple payments are received, the exemption of £1 million will apply to the total of payments from a single right of action.

The statutory exemption for any wrong or injury suffered by an individual is already unlimited. We propose that where a compensation claim for the right to take action can be linked back to such a personal injury claim it should also be unlimited. For example, a child who suffers permanent, serious brain injuries in a road accident is awarded damages of £5 million. This is already exempt. If the solicitor advising on establishing a trust to manage the compensation and provide for the child was negligent in the advice he gave, he could be sued. Any compensation the solicitor had to pay as a result of this would also be exempt without limit.

Question 1

Is £1 million the right level of exemption? If not, what would be a more appropriate amount and why?

Question 2

Are you aware of any cases which would be taxable under the proposed changes which would result in hardship?

ESC D33 paragraph 12 – personal compensation or damages

Section 51(2) of TCGA exempts compensation from CGT paid to individuals (but not companies) if it is paid because of any wrong or injury suffered by the individual personally rather than because of any financial loss e.g. for physical injury, distress, embarrassment, loss of reputation or dignity, unfair or unlawful discrimination and for libel or slander (in Scotland, defamation).

By concession in paragraph 12, the exemption in section 51(2) also applies where the compensation is paid to someone other than the individual who suffered the wrong or injury such as relatives or personal representatives of a deceased person e.g. for compensation for emotional distress caused by the death of another person or for loss of financial support.

Section 51(2) exempts personal compensation paid to an individual (but not a company) for any wrong or injury suffered by someone in their **profession or vocation** e.g. unfair discrimination, libel or slander (in Scotland, defamation), breaches of contractual duties and torts (in Scotland, delicts).

By concession in paragraph 12, the exemption also applies for compensation paid for any wrong or injury suffered by an individual in their **trade or employment**.

We propose that the exemption in section 51(2) TCGA should be amended to include the wider class of qualifying individuals set out in ESC D33, paragraph 12.

Question 3

Should the exemption in section 51(2) TCGA include compensation paid for any wrong or injury suffered by an individual in their trade or employment?

Question 4

Should the exemption in section 51(2) TCGA include compensation paid:

- **to a person other than the individual who suffered the wrong or injury, such as relatives or personal representatives of a deceased person?**
- **to compensation for emotional distress caused by the death of another person?**
- **to compensation for loss of financial support?**

ESC D33 paragraph 13 – indemnity payments

Section 49 TCGA sets out the taxation position for CGT purposes on contingent liabilities. Under section 49(1)(c), no allowance is made in the computation of the gain for any contingent liability in respect of a warranty or representation made on a disposal by way of sale or lease of any property other than land.

If, after completion of the sale, a payment is made by the vendor to the purchaser under a warranty or representation, the purchaser's cost of acquisition in the event of a further disposal is reduced by the sum received and the sale proceeds of the vendor are adjusted under section 49(2).

Section 49(1)(c) does not apply to indemnities. The strict position is that the consideration is reduced by the value of the possibility that the vendor will need to make a payment to the purchaser under the indemnity.

The concession in paragraph 13 of D33 has the effect of broadening the scope of section 49(1)(c) to include an indemnity as well as a warranty or representation. This also extends the treatment in section 49(2) to indemnities.

Question 5

Do you agree that section 49(1)(c) TCGA should include indemnities?

6. Assessment of Impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18
	This measure is expected to have a negligible impact on the Exchequer. The final costing will be subject to scrutiny by the Office for Budget Responsibility.				
Economic impact	The measure is not expected to have any significant economic impacts.				
Impact on individuals and households	Minimal impact expected as the proposed legislation will replace an existing concession. A very few people who receive compensation of between £500,000 to £1 million in the period between January 2014 and the introduction of the increased limit may benefit by the proposed increase in the limit of the exemption. Individuals and businesses who have received compensation for mis-selling of financial products are unlikely to be impacted as their compensation is already exempt by concession.				
Equalities impact	No impacts identified. The proposed legislation will maintain the existing exemption for people receiving compensation for injuries leading to disabilities.				
Impact on businesses and third sector	There may be an impact on individuals and companies receiving compensation of more than £1 million.				
Operational impact (£m) – [HMRC or other]	None identified.				
Other impacts	None identified.				

Question 6

Do you have any comments on the assessment of equality and other impacts?

7. Summary of Consultation Questions

Question 1

Is £1 million the right level of exemption? If not, what would be a more appropriate amount and why?

Question 2

Are you aware of any cases which would be taxable under the proposed changes which would result in hardship?

Question 3

Should the exemption in section 51(2) TCGA include compensation paid for any wrong or injury suffered by an individual in their trade or employment?

Question 4

Should the exemption in section 51(2) TCGA include compensation paid

- **to a person other than the individual who suffered the wrong or injury, such as relatives or personal representatives of a deceased person?**
- **to compensation for emotional distressed caused by the death of another person**
- **to compensation for loss of financial support?**

Question 5

Do you agree that section 49(1)(c) TCGA should include indemnities?

Question 6

Do you have any comments on the assessment of equality and other impacts?

8. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.

How to respond

[Set a deadline for responses and make it clear who to respond to always include a name, address, telephone number and an e-mail address. In addition you should add a name and telephone number for enquiries]

A summary of the questions in this consultation is included at chapter 11.

Responses should be sent by 15 September 2014 by e-mail to tracy.gribble@hmrc.gsi.gov.uk or by post to: Tracy Gribble, HMRC, Room G/48, 100 Parliament Street, London SW1A 2BQ

Telephone enquiries to 03000 585169 (from a text phone prefix this number with 18001)

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC Inside Government](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles. This is largely a technical consultation which we think will principally be of interest to tax, accountancy and legal professionals. This is a long standing concession with which professionals are familiar. We are therefore running a slightly shortened consultation period of 6 weeks.

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

Oliver Toop, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

Annex A:

Section 22 TCGA 1992

Disposal where capital sums derived from assets

(1) Subject to sections 23 and 26(1), and to any other exceptions in this Act, there is for the purposes of this Act a disposal of assets by their owner where any capital sum is derived from assets notwithstanding that no asset is acquired by the person paying the capital sum, and this subsection applies in particular to—

(a) capital sums received by way of compensation for any kind of damage or injury to assets or for the loss, destruction or dissipation of assets or for any depreciation or risk of depreciation of an asset,

(b) capital sums received under a policy of insurance of the risk of any kind of damage or injury to, or the loss or depreciation of, assets,

(c) capital sums received in return for forfeiture or surrender of rights, or for refraining from exercising rights, and

(d) capital sums received as consideration for use or exploitation of assets.

(2) In the case of a disposal within paragraph (a), (b), (c) or (d) of subsection (1) above, the time of the disposal shall be the time when the capital sum is received as described in that subsection.

(3) In this section “capital sum” means any money or money’s worth which is not excluded from the consideration taken into account in the computation of the gain.

Annex B: ESC D33

D33. Capital Gains Tax on Compensation and Damages

Zim Properties Ltd - Compensation and Damages

1. Introduction

A person who receives a capital sum derived from an asset is treated for the purposes of capital gains tax as disposing of that asset. The case of *Zim Properties Ltd v Proctor* 58 TC 371 has established that the right to take court action for compensation or damages is an asset for capital gains tax purposes. It follows that a person who receives compensation or damages, whether by court order or arbitration or by negotiated settlement as a result of a cause of action may be regarded as disposing of the right of action. A capital gain may accrue as a result.

The strict position

2. Cost of acquisition

A capital gain will accrue if the capital sum received as compensation exceeds the amount which may be deducted as the cost of acquiring the right of action. A right of action will almost invariably be acquired otherwise than by way of bargain made at arm's length. Special rules for determining the cost of acquisition apply in these circumstances. Where the right of action was acquired on or before 9 March 1981, it is deemed to have been acquired for a sum equal to its market value on the date of acquisition. Where it was acquired on or after 10 March 1981 and there was no disposal of the right of action corresponding to the claimant's acquisition of it, then where - as is usually the case - the taxpayer gave no consideration to acquire it is treated as having been acquired without cost.

If the cause of action was held on 31 March 1982 and disposed of on or after 6 April 1988, it will, in accordance with the rebasing rules, be deemed to have been disposed of and immediately reacquired at its open market value on 31 March 1982.

If a right of action passes on the death of the claimant, it is treated as acquired at its open market value on the date of death.

In computing the gain or loss, a deduction may be made for any legal and professional fees incurred in pursuing the claim. If the action in respect of a claim of substance fails, or if the expenses exceed the compensation, a capital loss may accrue.

3. Date of acquisition

A right of action accrues and so is acquired by a person for capital gains tax purposes when, for example as a result of a breach of contract or the negligent actions of another person (tort) he or she suffers actual loss or damage.

4. Market value on acquisition

In practice, where relevant, the Board of Inland Revenue will be prepared to accept a valuation which gives rise to neither chargeable gain nor allowable loss.

5. Date of disposal

The right of action is treated as disposed of when a capital sum derived from it is received, and if a series of capital sums is received, each receipt is the occasion of a separate disposal.

6. Rebasing to 31 March 1982

If an asset which was held on 31 March 1982 is disposed of on or after 6 April 1988, the gain or loss is normally computed as if it had been disposed of and immediately reacquired at its open market value on 31 March 1982. If an underlying asset were held on 31 March 1982, but a right of action related to that asset were acquired after 31 March 1982, the rebasing provisions would apply on the disposal of the underlying asset but not on the disposal of the right of action.

7. Reliefs and exemptions

Some forms of compensation are specifically exempted from liability to capital gains tax (see paragraph 12 below) and these remain exempt despite the decision in *Zim Properties*. But other statutory reliefs and exemptions are not available where the receipt of the compensation is regarded as giving rise to a disposal of the right of action, not of any underlying asset to which the relief or exemption might apply. These include deferment relief for compensation applied in restoring or replacing an asset, roll-over relief for the replacement of business assets, retirement relief and private residence relief.

Relief by concession

Where a gain arises on the disposal of a right of action, the case may alternatively, by concession, be treated in accordance with the following paragraphs of this statement.

9. Underlying assets

Where the right of action arises by reason of the total or partial loss or destruction of or damage to a form of property which is an asset for capital gains tax purposes, or because the claimant suffered some loss or disadvantage in connection with such a form of property, any gain or loss on the disposal of the right of action may by concession be computed as if the compensation derived from that asset, and not from the right of action. As a result a proportion of the cost of the asset, determined in accordance with normal part-disposal rules, and indexation allowance, may be deducted in computing the gain. For example if compensation is paid by an estate agent because his negligence led to the sale of a building falling through, an appropriate part of the cost of the building may be deducted in computing any gain on the disposal of the right of action.

The gain may be computed by reference to the original cost of the underlying asset, with time-apportionment if appropriate if the asset was acquired before 6 April 1965, or by reference to its market value on 6 April 1965. For disposals on or after 6 April 1988, the gain may be computed in appropriate cases by reference to the value of the asset on 31 March 1982.

10. Other reliefs and exemptions

If the relief was or would have been available on the disposal of the relevant underlying asset, it will be available on the disposal of the right of action. For example, if compensation is derived from a cause of action in respect of damage to a building suffered by reason of professional negligence, and the compensation is applied in restoring the building, deferment relief under Section 23, TCGA 1992 will be available as if the compensation derives from the building itself and not from the right of action. Other reliefs which may become available in this way include private residence relief, retirement relief and roll-over relief. HMRC Board will be prepared to consider

extending time limits in cases where because of a delay in obtaining a capital sum in compensation, the normal time limit allowed for a relief has elapsed. If the right of action relates to an asset which is specifically exempt from capital gains tax, such as a motor car, any gain on the disposal of the right of action may be treated as exempt.

11. No underlying asset

A right of action may be acquired by a claimant in connection with some matter which does not involve a form of property which is an asset for capital gains tax purposes.

This may be the case where professional advisers are said to have given misleading advice in a tax or other financial matter, or to have failed to claim a tax relief within proper time. Actions may be brought in relation to private or domestic matters. Where the action does not concern loss of or damage to or loss in connection with a form of property which is an asset for capital gains tax purposes, the approach in paragraph 9 above of treating the compensation as deriving from the asset itself is not appropriate. In these circumstances any gain accruing on the disposal of the right of action will be exempt from capital gains tax up to a limit of £500,000 for any compensation awarded in a single set of legal proceedings.

Any awards of compensation above this threshold will need to be reviewed on a case-by-case basis to ensure that they remain within the Commissioners' collection and management powers. Therefore such claims will need to be notified to HM Revenue and Customs in writing.

Other points

12. Personal compensation or damages

Section 51(2), TCGA 1992 provides that 'sums obtained by way of compensation or damages for any wrong or injury suffered by an individual in his person or his profession or vocation' are not chargeable to capital gains tax. The words 'wrong or injury' include breaches of contractual duties and torts (in Scotland, delicts). If the exemption would have applied to damages received for any wrong or injury, it also applies to any compensation for professional negligence in relation to an action in respect of that wrong or injury.

The words 'in his person' are to be read in distinction to 'in his finances' but they embrace more than physical injury so that distress, embarrassment loss of reputation or dignity may all be suffered 'in the person'. Compensation or damages for unfair or unlawful discrimination suffered 'in the person' and for libel or slander (in Scotland defamation) would thus be included. Similarly the words 'in his profession or vocation' refer to compensation or damages suffered by an individual in his professional capacity such as unfair discrimination, libel or slander (in Scotland, defamation) as distinct from 'in his finances'. If the compensation is received by the members of a partnership, each member, in Scotland as elsewhere, is treated as receiving a share of the compensation. The exemption is extended by concession to such compensation received by an individual in his trade or employment.

The exemption also extends to compensation received by a person other than the individual who suffered the wrong or injury, such as relatives or personal representatives of a deceased person. It also extends to compensation for emotional

distress caused by the death of another person, and compensation for loss of financial support.

It does not apply to compensation for any other wrong or injury suffered by any person other than an individual.

13. Indemnity payments

The principle in *Zim Properties Ltd* is not regarded as applicable to payments made by the vendor to the purchaser of an asset under a warranty or indemnity included as one of the terms of a contract of purchase and sale.

Where such a contractual payment is made, then the cost of the asset to the person acquiring it will, on the occasion of a further disposal be reduced by the sum received. The sale proceeds of the person who makes (or is treated by Section 171A TCGA as making) the disposal of the asset are adjusted under Section 49, TCGA 1992 in respect of the sum received. Where a warranty or indemnity payment is not made in accordance with the terms of the contract, the principle in *Zim Properties* may apply and the sums received by the vendor or purchaser as appropriate may be identified as capital sums derived from the asset, or from the right of action, depending on the facts of the case.

14. Date of commencement

The concessions and practices set out in this Statement will apply to all open cases on the date of issue, 19 December 1988.