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Buisness Asset Disposal Relief (BADR)

BADR, previously called Entrepreneurs' Relief, is a capital gains tax (CGT) relief intended to incentivise individuals to grow and invest in their businesses, representing a valuable source of relief for higher and additional rate taxpayers. There is some uncertainty as to whether BADR has achieved this aim and, despite having its benefits reduced and been under threat of removal in recent years, it has survived to date and continues to offer tax breaks to business owners.

BADR is available on disposals of business assets, reducing the rate of CGT on qualifying gains to 10% (compared to the current standard rate of CGT of 20%). The relief is subject to a £1 million lifetime limit on gains, with the current maximum potential tax saving under BADR therefore £100,000.

The relief is available to individuals disposing of their personal businesses or interests in a partnership, as well as directors and employees selling shares in the company (or group of companies) they work for. Trustees may also be eligible for BADR in certain circumstances, although this is not considered further within this factsheet.

Corporate bodies, such as companies, are not eligible for BADR and, as the relief is targeted at business assets, BADR will not be available to taxpayers on the disposal of investment assets.

Disposals qualifying for BADR

In order to qualify for BADR the disposal must fall within one of the following categories:

- A material disposal of business assets.
- A disposal which is associated with a material disposal.

A material disposal of business assets

This is the category that applies to most individuals when considering a claim for BADR. There are three types of 'business asset' which may qualify for relief, being:

- Whole or part of a sole trade or partnership business.
- An asset used in a business at the time the business ceases to be carried on.

- Shares or securities (for example loan stock) in a company.

Each of these categories then has associated conditions as to what will constitute a 'material disposal'.

Whole or part of a sole trade or partnership business

An individual carrying on a trade, either as a sole trader or through a partnership may qualify for BADR on disposing of their interest in the business. Relief will only be available in respect of assets used in the business at the time of the disposal.

In order to be a material disposal:

- The business must have been owned by the taxpayer throughout the two-year period ending with the date of disposal, and
- The disposal must represent either the whole of the business or, if only part of the business is disposed of, this part must represent a business capable of being carried on in its own right. As a consequence, the disposal of a single asset is unlikely to qualify for BADR.

Property businesses are not eligible for BADR with the exception of those which qualify as furnished holiday lettings businesses.

Assets used in a business at the time the business ceases to be carried on

In certain circumstances (often for sole traders), there is a delay between the cessation of a business and the disposal of the assets used within the business.

In this scenario, BADR may be available on the sale of the assets where the following material disposal conditions are met:

- The business must have been owned by the taxpayer throughout two-year period prior to its cessation, and
- The asset must be sold within three years of when the business ceased.

Note that, to qualify for relief, the asset only needs to have been in use by the business at time of cessation, not necessarily throughout the required two-year ownership period for the business.

Shares or securities in a company

BADR is available to directors and employees selling shares or securities in the company (or group of companies) they work for.

The relief is restricted to trading companies and groups, such that shares and securities in companies with substantial investment-related activities (such as most family investment companies) will not qualify for BADR.

In order to be a material disposal, the following conditions must be met throughout the two-year period ending with the date of disposal:

- The taxpayer must be an employee or director of the company or of another company within the same group. There is no minimum hours requirement, such that part-time employees can qualify for the relief.
- The company in which the shares (or securities) are held needs to be the taxpayer's 'personal company'. This means the taxpayer must hold at least 5% of both the ordinary share capital (based upon nominal value) and voting rights of the company, and either:
 - Be beneficially entitled to at least 5% of the company's distributable profits and 5% of the assets on a winding up available to equity holders, or
 - Be entitled to at least 5% of the proceeds on the sale of the company's entire ordinary share capital (in determining whether this test is met at any time during the requisite two-year period, the whole of the ordinary share capital is deemed to be sold at its market value on the last day of that two-year period).
- The company must be a trading company or holding company of a trading group.
 - The legislation defines a trading company as one which is 'carrying on trading activities whose activities do not include, to a substantial extent, activities other than trading activities'.
 - Activities other than trading activities will include any investment-related activities such as property businesses and investment portfolios.
 - HMRC consider a 'substantial extent' to mean 'more than 20%'. In practice, the 20% test is applied to various criteria and will depend on the facts and circumstances of each case. However, typically criteria such as turnover, asset base, management time and expenditure will be considered.

Additional considerations

- The above rules are relaxed in relation to individuals holding Enterprise Management Incentive (EMI) shares acquired on the exercise of a genuine EMI option. BADR is available for EMI shares where the company is not the taxpayers 'personal company' as long as the option was granted at least two years before the disposal (eg the taxpayer does not need to have either physically held the EMI shares for at least two years prior to disposal or meet the 5% personal company tests above). This means that exit-only EMI options, where the option is exercised and the EMI shares acquired just before a sale, can potentially qualify for BADR.
- A taxpayer may no longer qualify for BADR following certain share issues diluting their shareholding below 5%. In these circumstances it might be possible for the taxpayer to make an election preserving their right to BADR on the gain that has accrued up to that point in time, with the gain chargeable at the 10% BADR rate arising either at the date of the dilution or deferred until a subsequent disposal of the shares (or securities), assuming the other BADR qualifying conditions continue to be met.
- BADR may also be available in certain circumstances on shares (or securities) where the company has ceased to trade within the three years prior to the disposal. The shareholder needs to meet the various BADR qualifying conditions throughout the two-year period up to the date that trade ceased.
- Where a taxpayer exchanges their shares in one company for shares or securities in another company, there are special provisions which treat the exchange as not being a disposal of shares for CGT purposes, which defers any capital gain otherwise arising. If the new shares or securities acquired do not meet the BADR qualifying conditions, it may be beneficial for the individual to elect to disapply this 'no disposal' treatment to enable them to crystallise the gain and benefit from BADR on the share exchange.
- As referred to above, BADR can apply to shares and securities held in trading companies. As the 5% 'personal company' tests include rights attributable to ordinary share capital and voting rights then the holding of securities (eg loan stock) on their own would not normally be expected to qualify for BADR. However, where these securities are held alongside ordinary shares which meet do meet these 5% tests then the securities themselves might also qualify for BADR.

Associated disposals

A taxpayer who has made a 'material disposal' of business assets as part of their withdrawal from a business may qualify for BADR on a subsequent, linked disposal of assets used in the business (the 'associated disposal').

The relief is available to partners or individuals with shares (or securities) in a personal company. Although sole traders are unable to benefit under this condition, they may otherwise qualify for BADR on disposal of assets used in their business at the time they ceased to trade, as set out above.

There will be an associated disposal where:

- A taxpayer makes a material disposal of a business or shares/securities in a company. Although certain exceptions may apply, broadly this means there must be a significant reduction in the individual's ownership of the business:
 - Partners must dispose of at least 5% of the partnership's assets.
 - Shareholders (or security holders) must dispose of at least 5% of the company's share capital (or securities).
- The disposal is made as part of the individual's withdrawal from the business. HMRC view this as a withdrawal from the ownership of the business, therefore the individual can still continue to work for the business as long as their ownership interest has significantly reduced.
- The asset disposed of was used in the business for at least two years and owned by the individual for at least three years prior to its disposal.

There may be restrictions to the relief available if the asset was not used in the business for the full ownership period, or if rent was paid by the business for use of the asset.

Other considerations

Claiming BADR

BADR must be claimed by the first anniversary of the 31 January following the tax year of disposal. For example, if a disposal is made during the 2022-23 tax year a BADR claim must be made by 31 January 2025.

A claim for BADR is normally made by taxpayers as part of completing their self-assessment tax return.

Certainty on whether BADR conditions are met

It is not possible for individuals to apply to HMRC for clearance confirming BADR will apply to a disposal.

Planning for spouses and civil partners

Each spouse has their own £1 million lifetime gains limit under BADR. Where spouses or civil partners both have an interest in a company or asset where only one of them will qualify for BADR, there may be planning opportunities to maximise the available relief under BADR.

If you have any questions on BADR, please get in touch with your usual Saffery partner or contact Ian Harlock Smith:

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This factsheet is based on law and HMRC guidance at 1 May 2021.

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