BIA submission to Spring Budget 2023

January 2023

UK BioIndustry Association

Summary

The Prime Minister's and Chancellor's pro-innovation growth agenda and ambitions for the UK to be a science superpower are very welcome for the UK's innovative life science and biotech companies. However, recent announcements and ongoing reviews of R&D tax relief do not match this rhetoric. We are worried that the positive progress made by successive Conservative governments to grow UK life sciences and increase private investment in innovative sectors of the economy will be lost. We need urgent action to restore business and investor confidence in this administration's commitment to our sector and innovation-based growth.

Data published by BIA on 26 January 2023 showed a severe drop in equity investment into the biotech sector in 2022[1], reflecting and largely resulting from the global economic downturn. However, we also identified over £3.7 billion in new venture capital funds created in 2022 that could be brought to the UK if the fiscal and business environment is positioned to attract it.

Innovative companies are living through half a decade of instability due to successive and ongoing changes to the R&D tax relief at a time when the UK should be doing everything it can to support start-ups and scale-ups. The halving of the SME R&D tax relief at Autumn Statement has already negatively impacted investment decisions, resulted in cancelled hiring plans and movement of investment from the UK.

We welcome Treasury's work to create a simplified and more effective R&D tax relief regime but the piecemeal approach being taken is causing damage. We call on the government to delay, for R&D intensive businesses, the SME R&D relief rate cut announced at Autumn Statement 2022 and also delay the refocusing of relief to UK activity announced at Autumn Statement 2021. This will allow any changes to be made as part of the wider reforms currently being consulted and give businesses more time to plan and adapt their investments. We also call on the Chancellor to provide reassurance to entrepreneurs, innovators and investors that a future single R&D tax relief scheme will support R&D intensive life science and biotech companies to the same extent that they currently are.

Key messages on the SME rate cut

1. The halving of the SME R&D tax relief has already negatively impacted investment decisions, resulted in cancelled hiring plans and movement of investment from the UK.
2. A delay to the SME rate cut for R&D intensive businesses to allow for proper consultation as part of the merging process is our sector's preference. A de minimis threshold of £10,000 and anti-fraud measures could be brought in immediately if required.
3. If the "further support" is not via tax credits, it must be of equal value and low bureaucracy as the tax credits it is replacing. A grants scheme (via Innovate UK) is unlikely to be a quick and effective delivery mechanism due to lack of administrative capability at scale, the complexity and lack of certainty for businesses in the application process.
4. We welcome the Chancellor's commitment to provide further support for R&D intensive businesses, but we need details urgently to restore confidence.

[1] https://biotechfinance.org/

R&D policy instability is holding back investment, innovation and economic growth

In the past three years, the Government has implemented or proposed a series of changes to the SME R&D tax relief scheme that have progressively reduced the level its support to innovative small and medium-sized companies (SMEs) and created half a decade of instability in tax rules, with different rules needing to be followed each and every year (see table below). Each change has also been implemented more rapidly than the last, giving businesses less time to prepare and adapt.

These changes have successively introduced extra red tape, compliance costs and uncertainty for existing businesses, as well as disincentivizing new investment and reducing the UK's international competitiveness as a place to start and grow a science and technology business. This is contrary to the stated aims of successive Conservative governments.

Data published by BIA on 26 January 2023 showed a severe drop in equity investment into the biotech sector in 2022[2], reflecting and largely resulting from the global economic downturn. This difficult fundraising environment compounds the negative impact these tax changes are having and means the sector is less able to raise funds to compensate for the lower R&D cash payments.

In light of this instability, we urge the delay, for R&D intensive businesses, of the SME R&D relief rate cut announced at Autumn Statement 2022 and delay of the refocusing of relief to UK activity announced at Autumn Statement 2021. This will allow any changes to be made as part of the wider reforms currently being consulted and give businesses more time to plan and adapt their investments.

Five years of instability for SMEs due to compounded R&D tax credit changes	
Change	**Date of impact**
PAYE cap – cash payments capped to 3X the claimant's salary and national insurance costs, with limited exemptions	Announced October 2018, effective for accounting periods beginning on or after 1 April 2021.
Overseas activity restricted – subcontracted R&D not performed in the UK is no longer eligible for relief, with limited exemptions	Announced November 2021, for accounting periods beginning on or after 1 April 2023
SME relief rate cut – the cash payment loss-making SMEs receive was reduced from 33p per £1 of R&D spend to 18p.	Announced November 2022, for spend from 1April 2023 onwards
Merged scheme – the two existing SME and RDEC schemes will be merged into one. The design of the merged scheme is currently being consulted on. Innovative SMEs and their investors therefore have no predictability of what support they will receive; however, it appears the support will be significantly less than current levels	Announced January 2023, effective for accounting periods beginning on or after 1 April 2024
Combined impact As an example, a company with a 31 December year end will need to navigate the changes as follows: Year ended 31 December 2021 – old rules apply Year ended 31 December 2022 – PAYE cap applies	

[2] https://biotechfinance.org/

Year ended 31 December 2023 – PAYE cap applies for the whole year. SME rate cut applies to spend from 1 April 2023
Year ended 31 December 2024 - PAYE cap, SME rate cut and overseas activity restriction applies for the whole year
Year ended 31 December 2025 – Merged scheme applies, replacing all previous rules

The creation of a single R&D tax relief scheme

The BIA welcomes the consultation on the creation of a single R&D tax relief scheme. We agree that a more effective and efficient regime is desirable and achievable, and would like to continue to work constructively with HM Treasury and HMRC to ensure the new scheme can achieve our shared objective of driving economic growth by supporting innovation in the growth industries identified by the Chancellor at Autumn Statement 2022, including life sciences. We also strongly support measures to stamp out fraud in the system but not at the expense of genuine and non-fraudulent innovative companies, which is the effect of some of some of the measures currently being taken, such as the PAYE cap and reduced rate of relief.

Red lines for a single R&D tax relief scheme

R&D tax relief is a highly-effective and vital support for the UK's innovative start-ups and scale-ups, including life sciences. The single scheme consultation proposes a number of options, some of which would have a devastating impact on the life sciences sector. In the creation of a new single scheme for all companies, the Government must ensure:

1. R&D-intensive start-ups, spin-outs and scale-ups do not receive a lower cash credit payment than they do currently
2. Life science companies continue to be able to claim for the costs of R&D outsourced to specialist service providers, universities and hospitals.
3. The value of relief or cash payment is not capped by the company's headcount without exemptions for legitimate business models (such as the virtual biotech model where small highly-qualified teams manage outsourced R&D projects)

Objectives of a new single scheme

We welcome the opportunity to improve the UK's R&D tax relief regime. The new single scheme should achieve:

1. Simplification for claimants and HMRC
2. Reduced fraud, boundary pushing and spurious claims
3. Support targeted to strategically important growth industries identified in the Autumn Statement: digital technology, life sciences, green industries, financial services and advanced manufacturing
4. Raised UK Business Enterprise Research and Development expenditure and increased attractiveness to internationally-mobile R&D intensive businesses
5. Increased job and IP creation in the UK

Essentials of a merged scheme to meet these objectives

1. **Restricted to companies truly seeking to advance science and technology in their overall field**, not just in their own business. Currently, appreciable improvements in technology (BEIS Guidelines for R&D Paras 23 & 24) are hard for claimants and HMRC to assess, meaning that boundary pushing and spurious claims are not discouraged. This could be achieved by restricting eligible claimants to Knowledge Intensive Companies,

large enterprises with recognised R&D teams and meeting a minimum R&D spend threshold, and companies whose trade is to provide R&D services (see Point 3).

2. **Enhanced incentives for SME Knowledge Intensive Companies creating IP in the UK**. Such companies suffer from the greatest R&D investment market failure, but also exhibit exponential business and R&D investment growth (i.e. even higher future R&D) resulting from the R&D expenditure when successful. Current HMRC analysis of SME scheme effectiveness does not provide a full assessment of these benefits nor a sector-specific breakdown, which is needed. We have offered to work with HM Treasury and HMRC to produce the required evidence to inform policy development.
3. **Continued support for sub-contracted R&D as a legitimate R&D business activity.** In life sciences, a significant proportion of R&D needs to be outsourced to specialist R&D service providers (including Contract Research Organisations 'CRO's and Contract Development and Manufacturing Organisations 'CDMO's), which are a legitimate and vital part of the UK's life sciences ecosystem. Without the provision of relief for sub-contracted activity, awarded primarily to the IP owner unless they are not a UK taxpayer, in which case it should be awarded to the UK tax paying service provider, the R&D tax relief scheme will fail to support the UK's life sciences ecosystem.
4. **Continued support for overseas R&D activity that cannot reasonably be undertaken in the UK**. The draft HMRC guidance published 20 December 2022 rightly reflects a non-exhaustive set of reasons why R&D must be undertaken by necessity overseas. Other reasons exist and HMRC should work with industry to identify these within the guidance to provide clarity and assurance to claimants. Greater clarity on the evidence requirements for qualifying overseas expenditure is also required.
5. **Payable credits to loss-making companies.** Most start-ups and scale-ups in the identified growth industries are loss-making for many years due to their R&D spend. Payable credits are essential to support these companies.

Refocussing R&D tax relief on innovation in the UK

HM Treasury announced plans to restrict R&D tax relief for activity conducted overseas in November 2021. The life sciences industry is global and even the smallest companies in our sector must conduct R&D internationally to access the scientific and clinical expertise and patient populations required to achieve their clinical trial milestones in an internationally-competitive timeframe and sufficiently-high quality to obtain regulatory approval.

Some exemptions have been proposed by HM Treasury to permit claims for activity that it would be "wholly unreasonable" to expect companies to do in the UK, which will be legislated for in the yet-to-be published Finance Bill 2023-24.

We welcome these exemptions but there continues to be uncertainty on the interpretation of the rules and we still expect a significant negative and unfair impact on the life sciences sector. Moreover, this impact would be disproportionate to that suffered by other sectors. We therefore urge the Government to delay this reform and include it in the creation of the single scheme.

We will respond to the HMRC consultation on the draft guidance implementing the exemptions. However, we would like to make the following comments here:

1. The Life Sciences model works differently to other sectors and this fundamentally impacts where and how R&D is undertaken in a way that is unique. Specific guidance along akin to CIRD81920, a draft of which has been shared with the HMRC R&D policy team, would address much of the uncertainty that currently exists. Planning and implementing a trial is already very challenging and many clinical trials fail as a consequence of design and execution. If a company needs to undertake a full assessment of the extent to which it can be undertaken in the UK at this critical time, it will drain significant resource and increase

execution risk. While we recognise that clinical trials are not exempt from the restrictions but, allowing hindsight in adjusting to claim to limit QOE to expenditure that could not have been undertaken in the UK would be critical and time saving whilst still addressing the policy objective.

2. Under the draft guidance it is currently suggested that, where R&D undertaken overseas for regulatory purposes *clear, independent evidence* would be needed for example *correspondence from the regulatory body*. It would be very difficult, in practice, to obtain explicit documentation directly from the Regulator. We therefor suggest that this is revised to the need to provide '*clear evidence*' that can be provided by the company's own regulatory specialists.
3. Companies are currently negotiating contracts for work that'll be impacted by the new rules without knowing how those rules will be applied. Often these contracts can run for many years and be worth £millions if not hundreds of £millions. The timing of the introduction and the delayed release of guidance is unfair, detrimental and puts these early-stage research intensive companies at a disadvantage. We therefor call for a postponement for one year until the consultation on the merged scheme has concluded or, failing that, grandfathering such that contracts entered into on or before 1 April 2023 are not included in the new rules.

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