BIA policy submission

22 June 2023

Consultation: Stamp Taxes on Shares modernisation

About the BIA

The BioIndustry Association (BIA) is the voice of the innovative life sciences and biotech industry, enabling and connecting the UK ecosystem so that businesses can start, grow and deliver world-changing innovation.

Our members include start-ups, biotechnology and innovative life science companies, large pharmaceutical companies, universities, research centres, tech transfer offices, incubators and accelerators, and a wide range of life science service providers: investors, lawyers, IP consultants, and IR agencies. We promote an ecosystem that enables innovative life science companies to start and grow successfully and sustainably.

We are responding to this consultation on behalf of our members, who are primarily life science small and medium enterprises (SMEs). The current law creates considerable commercial problems and tension between buyers and sellers, as well as leading to conflicting views in the tax market. As such, we welcome this consultation as an opportunity to address these issues, but do not think the current proposals will do so.

Our assessment is that given the extended consideration timetables over many years and the contingent, but not uncertain, nature of milestone payments, the Government's proposals do not sufficiently account for the realities of the life science sector. This results in large stamp duty liabilities being crystallised on speculative potential consideration, which may never become payable.

We recommend, instead, that uncertain and unascertainable consideration should be assessed by reference to the present value of future contingent payments. This commonly undertaken and commercially useful assessment utilises discounted cashflow calculations, based upon publicly available large data sets of probabilities of future success in drug development. As this takes account of the uncertainty at the heart of the life science sector, and reflects true present value, we recommend determining the value of the consideration for stamp duty purposes on the same basis, at the time of sale.

Background: the UK biotechnology sector

The UK biotechnology industry is made up of over 6,000 businesses - 85% of which are SMEs - and employs 268,000 people. Approximately 770 of these businesses are active in "core biopharma" – focused on developing new medicines. The UK ranks third globally for life sciences equity

investment (£7bn in 2021), is responsible for 34% of all European life science start-ups since 2012 and attracts 40% of European VC investment. Pharmaceuticals is consistently the biggest R&D investor in the UK (c.£10bn pa).

UK biotechnology and life sciences is an internationally recognised success story. However, the path to successful development and commercialisation of pharmaceutical products is lengthy and uncertain, with time to market ranging from 10-15 years from exploratory R&D, through pre-clinical and clinical trials and regulatory approval, to eventual market access and commercial returns. The costs of this process for a successful product are in excess of $US1 billion on average (and often significantly more). Due to the complexity of the science involved, the innovation of competitor companies and research programmes, the rigour of clinical trials and regulatory processes, as well as changing demographic and market dynamics, the vast majority of potential products do not achieve regulatory approval and market access, meaning investors and innovators do not see a return on their investment[1].

Such high-risk market conditions, allied with high capital intensity, means that collaboration with other – usually larger – drug development companies is a routine occurrence in the industry as a means of spreading risk and combining investment. While companies seek funding from seed through to IPO, collaboration frequently takes place in the form of partnering and licensing deals, as well as innovators being the target in M&A transactions as larger companies seek to bring in innovation to bolster their own drug development pipelines.

Current impacts of Stamp Taxes on Shares regime in life science and biotechnology transactions

The structure of company transactions in the biotechnology sector reflects the complexity and uncertainty outlined above. Up-front cash payments represent only part of the typical consideration in early and mid-stage biotechnology transactions and licensing deals, which also frequently contain deferred contingent milestones linked to future development or sales. As such, the current Stamp Taxes on Shares framework – under which a sale of shares triggers a stamp duty liability at 0.5% of the value of the deal – does not take sufficient account of the business environment in which the UK's most innovative companies operate. Furthermore, the current regime requires that the sum of the value of all contingent milestones is included in the stamp duty calculation, without discounting for uncertainty or time. Liability is triggered on deal completion and so tax is charged on potential consideration that is often more likely than not never payable.

[1]Average success across indications from Phase 1 to approval: 13.8%*, declining to 3.4% for Oncology; Phase 2 to Phase 3 transition success at 48.6% (significant time and expense by that point). See Chi Heem Wong, Kien Wei Siah, Andrew W Lo, "Estimation of clinical trial success rates and related parameters" https://pubmed.ncbi.nlm.nih.gov/29394327/

Transactions typically have deferred consideration over many years in order to match the acquisition price to increases in value as the product in development progresses through pre-clinical and clinical trials. As noted, it can take between 10-15 years from initial discovery before a drug is fully developed and approved by the regulatory authorities. In the UK many very promising start-ups are spun out of universities and are generally unable to raise sufficient venture capital to complete the capital intensive research and development process alone. Consequently, the companies are often acquired by larger pharmaceutical companies after some of the initial risk has been addressed.

It would be typical for consideration for the shares to be an up-front sum, with potentially much larger sums contingent on the product meeting key development, regulatory or commercial milestones extending over 5-10 year of subsequent development and then payments economically equivalent to royalties on sales once the drug is approved. The current proposals for what happens at the 2 year point are reasonable in so far as uncertain amounts are subject to reasonable estimates (subject to correction when the actual amounts are known). The current proposals are that payments at the 2-year point would be on the basis that all of the contingent events occur, which is highly unlikely given the time periods outlined above.

For such transactions, that would mean assuming that all drugs will be successful - which as noted is very rarely the case (the average success across indications from Phase 1 to approval is 13.8% declining to 3.4% for Oncology). This would be very unfair and punitive, even if tax could eventually be reclaimed for those that fail.

Given the crystallization of large stamp duty costs with these types of consideration structures, we are aware that some tax advisers already argue for the use of consideration in the form of loan notes issued by the acquirer, to remove the liability. They consider that section 55(2) SA 1891 avoids a stamp duty charge, on the basis that the loan notes are non-marketable securities.

The current law therefore creates considerable commercial problems and tension between buyers and sellers, as well as leading to conflicting views in the tax market. As such, we welcome this consultation as an opportunity to address these issues, but do not think the current proposals will do so.

Below we address several of the consultation questions from the perspective of our member companies – predominantly SME companies whose core business is the research and development of innovative pharmaceutical products.

Question 32: Do you agree with the government's proposals for dealing with uncertain and unascertainable consideration?

For life science companies, given the extended consideration timetables over many years and the contingent, but not uncertain, nature of milestone payments, the Government's proposals

do not work. Two years after sale the same issues will remain and large stamp duty liabilities will be crystallised based upon highly speculative amounts.

Question 33: If not, how do you think we should deal with uncertain and unascertainable consideration for any single tax on securities?

Usefully, from a commercial point of view, life science companies already have a need to determine the present value of future contingent payments. They do so by making discounted cashflow calculations, based upon publicly available large data sets of probabilities of future success in drug development.

We would therefore favour the ability to determine the value of the consideration for stamp duty purposes on the same basis, at the time of sale. After all, this reflects the true present value. Conversely the current system attempts to charge the sum of all potential milestones in multiple therapeutic applications, for a drug which has not yet been developed, which is an illusory figure.

Obviously such a new stamp duty measure would be accompanied by suitable anti-avoidance safeguards.

For any further information on the contents of this submission please contact policy@bioindustry.org