BIA submission: Potential Reforms to UK's Capital Allowance Regime

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UK BioIndustry Association

Summary

We strongly support the Chancellor's view that more needs to be done to stimulate business capital investment, particularly in R&D and manufacturing activities. We also welcome the Government's commitment to ensure that the UK's tax regime remain up-to-date, internationally competitive, and well-targeted.

The long R&D timelines and capital-intensive nature of drug development means life science start-ups and scale-ups remain loss-making for 10-15 years. Investment incentives that only provide tax relief and not payable cash credits are therefore of no benefit or incentive for these companies. For this reason, R&D tax credits are the most effective lever to incentivise business investment within the life sciences sector and are also a crucial part of any company's consideration for where to locate themselves internationally, and therefore invest in R&D and IP creation in the UK. We therefore propose that capital expenditure is brought within scope of the R&D tax relief schemes (SME and RDEC).

Beyond this priority, and within the capital allowances regime, we propose:

- Have an additional FYA/Super deduction for Output - Maintain a super deduction for P&M used in enhanced production and service delivery (not refurbishment, back office etc).
- Maintain a fixed AIA of £500k as a simplification measure
- Otherwise, maintain current WDA rates as they are

Introduction

The UK's R&D-intensive life sciences sector is universally recognised as world-leading, and it delivers great benefits to the economy, the health of the nation, and it is key to the Government's net-zero agenda. From improving patients' lives through new treatments and digital healthcare, to the development of environmentally-sustainable technologies, such as biological fossil fuel substitutes and biodegradable bioplastics, our deep understanding of biology is helping to address humankind's greatest challenges.

The pandemic has highlighted the strategic importance of the life sciences industry to the UK's resilience. It is as a result of having a vibrant UK life sciences ecosystem that the UK has been able to play a leading role in the global response to the pandemic, putting the UK in a strong position to benefit rapidly from vaccines, diagnostics and therapies. The Oxford/AstraZeneca vaccine encapsulates this: the science came from one of our many world-leading universities, the technology was further developed by Oxford spin-out Vaccitech, the regulatory and global distribution capability was provided by the UK-based multinational giant AZ, and Oxford Biomedica and Cobra Biologics provided their existing UK-based manufacturing capabilities to rapidly scale up domestic production. This has been achieved through a public-private partnership that demonstrates the uniqueness of the UK life sciences ecosystem.

Figure 1: UK sites of COVID-19 vaccine manufacture

This is a growing sector of the future that poses a unique opportunity. The UK life sciences industry employs 268,000 people, with two-thirds of these jobs outside London and the South East.[1] High-value medicines manufacture is spread across the UK, a fact illustrated by the sites of COVID-19 vaccine production[2] (figure 1). There are over 6,300 life sciences businesses in the UK, 82% of which are SMEs, and combined they generate a turnover of £80.7bn. The average GVA per employee is over twice the UK average at £104,000[3] and the sector consistently invests more in R&D than any other (£5bn in 2020).[4] The sector is also attracting record levels of investment and overseas investors, who are in large part attracted to an ecosystem enjoying strong Government support.[5]

The role of investment incentives in UK life sciences

Companies within the life sciences sector benefit from a complementary set of government support schemes. R&D tax relief is widely seen as the most important and effective mechanism to promote innovation.

The research and development, and regulatory approval, of medicines and vaccines, and other biological products, takes 10 to 20 years and requires £500m to £1bn.[6] SMEs primarily finance this activity through successive venture capital fundraises and are typically not generating any revenue – and are thus loss-making – for the 10-20 year period until their product reaches the market.

Investment incentives that only provide tax relief and not payable cash credits are therefore of no benefit or incentive for these loss-making companies. For this reason, R&D tax credits are the most effective lever to incentivise business investment within the life sciences sector and are also a crucial part of any company's consideration for where to locate themselves internationally, and therefore invest in R&D and IP creation in

[1] UK Government (2021), *Bioscience and health technology sector statistics 2020*: https://www.gov.uk/government/statistics/bioscience-and-health-technology-sector-statistics-2020
[2] BEIS (2020), *UK Vaccine Taskforce 2020 Achievements and Future Strategy*: https://www.gov.uk/government/publications/uk-government-vaccines-taskforce-vtf-2020-achievements-and-future-strategy
[3] PwC (2017), The economic contribution of the UK life sciences sector: https://www.abpi.org.uk/media/1371/the_economic_contribution_of_the_uk_life_sciences_industry.pdf
[4] ONS (2021), *Business enterprise research and development, UK: 2020:* https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/researchanddevelopmentexpenditure/bulletins/businessenterpriseresearchanddevelopment/2020
[5] Radnor Capital Partners, commissioned by BIA (2021), *UK quoted biotech performance and investor base in 2020:* https://www.bioindustry.org/resource-listing/rcp-bia-2020-review-january-2021-final-pdf.html
[6] BIA (2020) *Opportunity on your doorstep: A guide to investing in the UK biotech sector: https://www.bioindustry.org/static/2552f01e-5b03-47ca-9794ba0d428a6cf5/Opportunity-on-your-doorstep-A-guide-to-investing-in-the-UK-biotech-sector.pdf*

the UK. Our members have reported that current rates of relief are such that the UK is still seen as competitive but there is increasing appeal in the regimes offered by other territories including France, Ireland and Australia. Furthermore, Ireland has increased the rate from 25% to 30% for SMEs. Australia has also increased the amount of depreciation for capital assets used in R&D that can be included as eligible expenditure. In the past the UK has been successful in attracting inward investment from the US and Europe although this may now be impacted by the rise in the rate of corporation tax.

However, there are of course profit-making companies within the UK life sciences sector, including companies that have products on the market, and also service and supply companies within the sector. For these companies, tax relief can be an extremely effective way to incentivise investment. Moreover, R&D tax relief only applies to capital investment related to R&D, whereas many life science companies will also be making non-R&D related capital investments.

This consultation therefore makes proposals that cover these different investment decisions.

Including capital expenditure within the R&D tax relief regimes

As described above, innovative life science companies are typically loss-making and are not incentivised by capital allowance or other tax reliefs that do not provide cash payments. We therefore propose the inclusion of capital expenditure within eligible costs for the UK's R&D tax relief regimes – both the SME scheme and Research Development Expenditure Credits (RDEC).

The UK has historically offered the lowest incentives for R&D capital expenditure out of all of the G7 countries[7]. A selected example of countries that allow capital expenditure to be claimed within its R&D tax credit system or inclusion of depreciation include: France, Ireland, Japan, the Netherlands, Australia, Belgium and Austria. These countries all have strong life sciences sectors and are direct competitors for UK companies and also the UK itself in attracting foreign direct investment.

This increases the possibility of outsourcing R&D and downstream manufacturing to other countries. As manufacturing is disproportionally prevalent in less developed regions of the UK, the inclusion of capital expenditure in the R&D tax regime would support the levelling up agenda and lead to the creation of more well-paid jobs in those areas. Moreover, it would help on-shore medicines manufacturing, which the pandemic has revealed is critical to ensure supply chain security. It would therefore support the Government's Vaccine Delivery Plan, which outlines the need for increasing manufacturing capacity permanently.[8]

Under the current regime, capital expenditure incurred for the purpose of R&D is only eligible for the Research and Development Allowance ("RDA"), therefore companies can claim 100% tax relief at the year of acquisition of the asset. As many UK research-intensive SMEs are loss-making already, accelerated tax relief is of little benefit. The inclusion of capital expenditure would likely provide an incentive for more companies to undertake capital-intensive R&D in the UK. Once this investment is made for R&D purposes, the company develops a significant amount of know-how around the manufacture of new medicines or biologics. This is difficult to move. As a consequence, there is a far greater likelihood that the new facility will be scaled up for commercial manufacture.

[7] ABPI, June 2020, Technical report: raising UK productivity by including capex in R&D tax credits
[8] UK Government (2021), UK COVID-19 vaccines delivery plan: https://www.gov.uk/government/publications/uk-covid-19-vaccines-delivery-plan

The depreciation of the assets could be included as qualifying expenditure as is the case in many territories. Alternatively, the relief can be provided in the form of an upfront incentive for SMEs, similar to costs capitalised as intangible assets whereby the company needs to make a section 1308 CTA 2009 claim in their tax computation for a current year deduction.

Where there is mixed use of R&D and non-R&D, an apportionment for the part used directly in R&D could be determined on a just and reasonable basis. There could be an avoidance opportunity where companies used facilities for R&D on a temporary basis with the long-term use being intended for different purposes. This could be addressed through a targeted anti-avoidance measure (TAAR) or by including a claw back if the use changed within a limited period somewhere between 2-5 years.

The inclusion of capital costs as a qualifying expenditure would also address the uncertainty around projects taken to capital on the balance sheet under CTA09/Ss 53; 1044(5), 1063(4), 1068(4) & 1074(7) (see CIRD81700).

Incentives for capital expenditure outside R&D

For incentivising capital investment outside R&D, we believe the capital allowance regime should do two things. It should provide tax relief for the cost over a period aligned with the economic life of the asset, and based on policy needs, create an incentive that will have a meaningful influence on investment decisions.

The BIA therefore proposes:

- an additional FYA/Super deduction for Output - Maintain a super deduction for P&M used in enhanced production and service delivery (not refurbishment, back office etc). There will be a much greater correlation between this type of investment and incremental jobs and GVA. This is where the capital allowance regime can be much more effective at attracting new investment to the UK. An incentive that creates a permanent benefit rather than accelerated tax relief can be easily valued and also has a beneficial impact in a company's financial statements. Use of a super deduction in this manner could enable to UK to have a much more innovative tax system to ensure that it is always on the shortlist of territories in scope for new investment as is currently the case for the likes of Ireland and Singapore.
- maintaining a fixed AIA of £500k as a simplification measure but otherwise, maintain current WDA rates as they are. The AIA is a very helpful simplification measure for small businesses who then only need to commit additional time and cost in analysing capital allowances for significant levels of investment where the exercise can then be an incidental cost of making that investment. We believe that the current WDA rates are probably in line with the average useful economic lives of assets classes that are generally included in the different pools. If they are not, then the WDA rates should be adjusted to ensure that the tax system is fair for the taxpayer. Otherwise, reducing the general WDA rates as a policy measure to act as an incentive is unlikely to accelerate or attract new investment and would be very costly.

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