



HOUSE OF LORDS

Economic Affairs Committee

Finance Bill Sub-Committee

Corrected oral evidence: Draft Finance Bill 2023-24

Monday 20 November 2023

4.10 pm

Watch the meeting

Members present: Lord Leigh of Hurley (The Chair); Lord Altrincham; Lord Palmer of Childs Hill; Lord Roborough; Lord Rooker; Lord Stevenson of Balmacara; Baroness Valentine.

Evidence Session No. 4

Heard in Public

Questions 46 - 59

Witnesses

[I](#): Colin Hailey, Chair, Finance and Tax Advisory Committee, UK BioIndustry Association; Dr Roger Barker, Director of Policy and Corporate Governance, Institute of Directors; Michael Moore, Chief Executive, British Private Equity and Venture Capital Association; Gillian Thomson, Group Tax Manager, Skanska.

Examination of witnesses

Colin Hailey, Dr Roger Barker, Michael Moore and Gillian Thomson.

Q46 The Chair: Good afternoon everybody, and welcome to this Finance Bill Sub-Committee meeting. We have a number of witnesses in front of us—three physically present and one online. To start, I invite the witnesses to give us a brief summary of who they are and why they have come forward.

Colin Hailey: I am chair of the finance and tax committee at the UK BioIndustry Association, which is the trade association for biotechnology companies in the UK. They are predominantly SMEs doing drug development, but there are also pharmaceutical companies and a number of other companies in the life science ecosystem.

Michael Moore: I am chief executive of the British Private Equity & Venture Capital Association, which represents fund managers, institutional investors and their professional advisers, from EIS and VCT-backed businesses all the way through to VC funds and the largest buyout firms. For this afternoon's purpose, of course, most of the focus is on VC and EIS/VCT-backed businesses.

Gillian Thomson: Good afternoon, everyone. I am the group tax manager at Skanska UK plc, one of the main construction contractors. I am here mainly to talk about the R&D legislative changes.

Dr Roger Barker: I am director of policy at the Institute of Directors. We represent directors across the board in the UK, but our 20,000 members are concentrated mainly in medium-sized companies. I am here to reflect their views on the reforms to the R&D tax credit system.

Q47 The Chair: Thank you. I am Lord Leigh of Hurley and I am chair of this sub-committee. We have about 10 questions to get through. To keep things moving along, if you feel that a colleague has answered a question satisfactorily, please do not feel any need to repeat the former answer.

I declare some interests. I cannot remember if I still am, but I certainly have been, a member of the BVCA and the Institute of Directors. I am probably behind in the subs for both, but I hope that will not count against me hereon in. None the less, I have been happy to be a member of both organisations.

What are your views on the Government's proposals, which they claim are a simplification of R&D relief? Do you agree with that and, if not, what more should be done to achieve such simplification?

Gillian Thomson: We do believe that a single scheme is a simplification, but, from a Skanska and a construction point of view, the legislation is currently drafted in a way that could mean the removal any future claims from the main contractors in construction. For an organisation that is involved in some of the UK's largest and most innovative construction projects, spending is in the tens of millions. We are slightly disappointed with the way the legislation is currently written, because it is certainly not

the way we believe government wanted to incentivise construction and get more growth in the UK.

Michael Moore: When the Chancellor originally made his announcements, we understood the challenges he was facing in needing to tackle whether the taxpayer's money was being put in the appropriate place and would reach properly innovative businesses that were doing genuine R&D. We are proud that we represent a huge number of those businesses. As others have said about their locus, 90% of the businesses that our members invest in are SMEs. So the principle of a targeted appropriate scheme is important to us.

We certainly recognise that the direction of travel is more straightforward and simple, but we slightly challenge the idea that this will create a simple scheme. It is a lot easier than before in certain respects, but there are still two schemes and there is the possibility of a cliff edge in terms of whether one hits the 40% mark in the intensive scheme. Looking at how you do it over multiple years, one after the other, is crucial to the planning of research and development expenditure and is particularly important for businesses that are burning their way through cash. Having a straightforward system that gives them predictability, as well as being simple, is really important, so we hope that there can be further refinements.

Colin Hailey: For SMEs, the merged scheme is a welcome simplification, provided that we remove the restriction on subsidised expenditure so that, if you are not R&D intensive, you have one set of rules for every project you work on. That is fine. The R&D-intensive aspect is complicated, and there remains huge uncertainty over which companies will be R&D intensive and which will not. In that sense, this is not a simplification: we still have two schemes.

Dr Roger Barker: The message from IoD members is that they do not support the idea of merging these existing schemes. There is recognition that there have been concerns about fraud in relation to the current SME scheme, but we think that would have been best addressed directly by trying to counter or improve compliance in the context of existing schemes. We think that changing the system will create a good deal of uncertainty and disruption to the overall R&D tax relief regime. If the Government are not very careful, there is a real risk that the net result will be less R&D investment.

For our members, the key fact behind whether the new regime will be successful will not be the format of the scheme but how generous the final scheme is in incentivising R&D expenditure. It is also incredibly important that start-up businesses can receive cash payments as well as potentially relief against their future corporation tax liability. Overall, when we asked our members, "Do you think this new merged scheme will result in more expenditure and investment in R&D?", 47% said that they thought it would not and that it could result in them spending less on R&D than in the past.

Q48 The Chair: How easy do you think it will be for SMEs to transfer to this new scheme—to join the RDEC scheme?

Colin Hailey: Our problem is that all SMEs and life sciences want to get into the R&D-intensive category, but it will be difficult to know whether you do. The reason is a simple calculation: if I am R&D intensive, 40% of my spend needs to be on R&D. Okay, that is easy, but there are all sorts of reasons why the bottom of the fraction can vary year on year, with share-based payment charges and other things that could expand the bottom of the fraction. The other thing is the top of the fraction: the R&D. The only R&D you can put at the top of the fraction is either spend on R&D done in the UK or what we will call qualifying overseas spend.

There is no life sciences-specific guidance and only one bit of guidance from the Revenue on what is qualifying overseas expenditure, which is that, if you are doing research into volcanos, you are allowed to do it outside the UK, and that is it. So all the complexities of complex supply chains, the life science industry and all of that are not captured; there is no guidance.

Currently, on balance, I think tax inspectors will say that any spend outside the UK does not go on the top of the fraction, so the chances are that I am not R&D intensive. Therefore, my rate of relief is 15% when it used to be 33%, so I am going somewhere else. Investment is already leaving the UK because of the rates of credit you can get elsewhere. We need guidance rapidly, and we need a more sophisticated test than looking at one year and saying, "Do we get to 40% or not?" Everywhere else in the tax rules you look at a year of grace, exceptional circumstances or three-year averaging, but, in this, you look at just one year and do the sum. People are doing that sum and saying, "It's too uncertain, and the chances are that I won't qualify".

The Chair: On the specific issue, how easy will it be for SMEs to transfer to this new scheme? Perhaps Dr Barker's members have said.

Dr Roger Barker: The message we have received from members is that, over the last five or six years, they have just about got ready for how the current scheme works, so they will find it difficult and onerous to get into a new scheme now. It will probably mean that they will need to turn to advisers and external specialists. Although in principle the single scheme is a more straightforward and less complex framework, the fact that it is new and will be set up on a completely different basis will create uncertainty for a lot of SMEs.

The fact that a lot of the support is focused on particular sectors or companies that are already quite R&D focused is, for our members, a negative aspect of the future scheme. There is a feeling that we should be trying to promote the R&D potential across the economy as a whole, across all types of companies. The fact that there is an exception for certain types of companies adds to the complexity.

The Chair: Do you want to add anything, Mr Moore?

Michael Moore: No.

- Q49 **Lord Rooker:** Sticking with the SMEs, do you think that an above-the-line credit for them would increase the additionality of research and development relief for them and, if so, why?

Colin Hailey: From the BIA's point of view, the studies that were originally done on additionality and R&D were not sector specific, so they are meaningless for the life sciences industry. You have a whole business that is designed to do R&D to create intellectual property, so the whole underlying rationale for that analysis that indicated that large companies will do more R&D than SMEs was just wrong. We are pushing to have the analysis redone; it does not reflect the reality. I do not think that the way they measured additionality is the right way to look at it for those research-intensive life science companies.

Michael Moore: It is a perfectly legitimate policy objective to want to be confident that you are getting additionality out of the scheme. The issue that has come back to us, as we have consulted our members, is that there are differences between what is above and below the line and between what will be counted into your profits before and after tax. Particularly because of that uncertainty about whether you will hit the 40% intensive criterion, there is then a problem about the fact that you are doing this one year at a time. If you are on a long research and development programme, which may be over many years, and you are raising your funding from venture backers and so on, that requires you to set out your cash runway for that period. This unpredictability—not knowing whether you are above or below the line, and where it hits you—is not helpful. Uncertainty appears to be getting structured into the scheme in a way that will not necessarily deter people but will not have the incentivising effect that surely lies behind the proposals.

- Q50 **Lord Palmer of Childs Hill:** Could you comment on the certification of the 40%? What concerns me, having thought about this in different industries in the past, is that there will be a whole group of professional people who will show how to certify to get it to 40%, or is this purely internal, and HMRC will just accept the internal certification?

Michael Moore: There are two distinct points here. I disclose that I am a chartered accountant by profession and worked for a large consultancy immediately before this role. There are a lot of consultants, and accountants will spot opportunities to assist. The bottom line—Gillian may have better insight on this than I do—is that, as things get more complex, given that these are often small teams that are trying to check their eligibility, they do not have the bandwidth, and it should not be where they are focusing most of their attention. You will naturally draw in others to do this, so it does matter that you get this.

Even this year, HMRC has produced what it calls its additional information form, which now demands a lot of detail from applicants. We have an example of an AI-focused business that has been asked for hundreds of documents and is spending hundreds of hours trying to define all of this.

When they get to the point of believing that they have done a knock-out proof that this is definitely research and development expenditure, they hit a second problem: there is not the technical expertise to assess what has gone in. There is a real danger that what starts with a really important principle—making sure that taxpayers' money is being targeted appropriately and used genuinely—quickly becomes a nightmare.

Colin Hailey: In terms of the stakeholders in all of this, there is a simple test—the 40% test—and you can exclude overseas expenditure. I sat here last year and talked about the number of problems in the existing system. All those rogue advisers are still out there and will be working hard to say, “How can we sway the fraction to make sure that people are R&D intensive, when you wouldn't think they were at first glance, by moving expenditure offshore and that kind of thing?” At the same time, there are companies that think they are R&D intensive, and are, but that will not meet the overseas expenditure requirement.

I have heard HMRC inspectors say that they will have a light touch with this rule and that you can include overseas expenditure in your R&D as long as it would derail your business plan to have done that work in the UK. I have heard other tax inspectors say, “No, the bar is set incredibly high. You'll need a letter from the US drug regulator, the FDA, proving that it asked you to do your clinical trial work in the US before we'll let you include it”.

So there is a swirling mass of uncertainty about what the HMRC's view will be, and there are rogue advisers who will play games with it. There is a simple test: year by year, divide one number by the other and see whether you get to 40%. So it is fraught with difficulty. We have no guidance from HMRC, and with a year-by-year test, as you rightly pointed out, the stage is set for an awful lot of uncertainty.

The problem currently is that people are saying, “The chances are that, if we're genuinely R&D intensive, we may not make that calculation and may not get to 40%. Let's just assume that we'll be at the 15% credit rate under the merged scheme and will not be an R&D intensive business”. They then say, “Where else can we get a better rate of credit if we move our business outside the UK?” That is real currently: jobs are being lost already because of the uncertainty about what an R&D-intensive company is.

The Chair: This might be an unfair question, but will an industry not develop to give advice on how to get around these rules? Specifically, could a company create a 100% R&D tax company that will be 100% R&D and then claim group relief?

Colin Hailey: The rules will include UK expenditure in the group but not non-UK expenditure. So it will absolutely be possible to structure it. Obviously, there are anti-avoidance rules, just as in the existing system, but I do not know how heavily that will be policed or how often those anti-avoidance rules will be used. There is no specific guidance from the Revenue saying, “We'd frown on, and look to rule out, the following

behaviour”—of exactly the kind you gave in your example. There is nothing out there like that to give taxpayers a steer on what will be acceptable and unacceptable behaviour.

Q51 Lord Stevenson of Balmacara: Another contentious area here is the changes to how you deal with subcontracting in the new merged schemes. Would you like to reflect on that? We will drill down deeper into the more specific areas later.

Gillian Thomson: The subcontracting part is the main issue in the construction industry. We never needed to consider subcontracting with the large scheme, and when the Government talked about merging the schemes there was talk about a lot of it falling within the large scheme, so it was not something that we tended to consult on at that point. When the draft legislation came out in July, we found that it was a complete change to the way we were dealing with subcontracting—the fact that we, as main contractors, are effectively having our work subcontracted to us by our customers.

We do not feel that the Government have looked at what they really mean by “subcontracted”. In our view, there are two layers here. There is the subcontracting of an R&D project, which is not what we are involved in in the construction industry. We are involved in R&D that is imbedded in a wider commercial project that we are brought on board to do. We are the ones who, with the contracts that we enter into with our customers, have the risk and reward.

As main contractors, we need to design and build what our customer wants, whether that is a film studio, an office building in a metropolitan area with a railway underneath and historic buildings that we are renovating, or rail or road infrastructure. We are the ones who need to come up with innovative ways of dealing with any engineering or uncertainty that we come across in those projects. We do not think that the Government, or HMRC, have really looked at the two different layers of subcontracting.

There is that subtle difference that we think needs to be looked at more and probably needs more consultation on.

Lord Stevenson of Balmacara: It does not just affect your industry.

Gillian Thomson: No, it does not. There will be others.

Lord Stevenson of Balmacara: Would you like to comment on the general principle of it?

Gillian Thomson: I am speaking from Skanska’s point of view here.

Michael Moore: In the generality, people are looking for a bit of clarity about where the relief can be claimed. Is it solely with the contractor, the customer, which is my understanding of the intent, or can the subcontractor do it? If the presumption is that it is on the customer, there are a couple of things there. As UK-based R&D, one would argue

that that should get the relief. But if it is a government entity, overseas company or charity, which do not qualify, there will be R&D that will not get the relief it ought to get.

There is also opportunity in the midst of all of this. It is hard to credit, but people might not realise who or where the relief is supposed to be claimed. A simple way of fixing it might be to introduce an election procedure whereby people can choose one or the other to act as the recipient, or to have a default provision that says that if there is no election it sits with the customer, or whatever. You can protect this every which way.

At the moment, it risks introducing another degree of uncertainty, which we do not think is the intent—we hope it is not the intent—but it is not helpful.

Colin Hailey: I differ slightly on that. The law as it is says that if you are the entity with the R&D project and you are contracting out to other people, you get to claim. That works perfectly from a life sciences point of view. I am a big fan of that. The other bit of the rules is to say, “Okay. I’m doing work as a subcontractor for a non-UK customer”, and you can claim there.

There are some awkward bits to do with things like fragmented R&D and some of the problems mentioned. I am unfortunately old enough to remember the 10-year review on the old R&D tax credit system where people talked about joint elections, things that fall through the cracks, and the absolutely legitimate concern of Treasury to avoid double-claiming on the same expenditure. It is a nightmarish situation. It is very hard to fix. The rules are trying to get there. It would certainly be good for the Treasury to keep this under review and keep trying to refine it if it can, but the fundamental principles are pretty good. As a UK taxpayer I think they get into the right place, and for the life sciences industry I think they get into a good place.

Dr Roger Barker: I agree that, ultimately, tax relief should apply to the customer, the organisation that is taking the risk, because ultimately that will encourage more R&D across the economy. If you are a company that wants to do R&D and you cannot do it in-house, should you be penalised for that? We do not think so. So the potential new merged scheme, which is applying the approach of the previous SME scheme whereby ultimately the customer obtains the relief, is the right approach.

- Q52 **Lord Palmer of Childs Hill:** In the normal contracting world, when the main customer, the supplier, costs the job, and when the subcontractor costs the job, which one has costed in the R&D relief? To my mind, when you cost something, you cost it according to the rules that are there. Maybe it is the main customer, in which case the main customer has to be up front with the subcontractor and say, “In this contract, we have built in the R&D relief”, or, if the subcontractor is only going for the work on the basis that they can claim the relief, maybe they should have the relief.

It comes to back to the comment one of you made about electing who it is, because, to my mind, having a draconian rule that it's one or t'other does not take into account who has costed it in. Does that make sense, Chair?

The Chair: Yes.

Colin Hailey: What that ignores is that a huge amount of this is contracting between non-UK and UK entities. In my experience, nobody factors in tax reliefs when pricing up a clinical trial. It just does not happen. It is not how it works. It is a competitive process. The level at which those procurement departments work has nothing to do with tax. People's individual tax position is just not taken into account.

Lord Palmer of Childs Hill: That does not sound like much of an incentive, does it?

The Chair: No. Just to elaborate the point, a UK company pitching for some work would not, in your opinion, price it to take account of the benefit it is getting from the R&D tax credit.

Colin Hailey: A UK company contracting out would say, "I'm contracting out. Where can I find the best science to take this work forward". A UK CRO doing work for other people would just say, "I'm in a competitive environment. I'm pitching against a Chinese company and a US company. What's my best chance of getting this work?" The R&D tax rate discussion is a separate discussion that tends to happen after the year-end: "We've done the following work. What R&D tax credit can we claim?"

The tax thinking is more from an investor and a shareholder point of view and is about where you set the company up and how you run the operations. Once you get into the nuts and bolts of the operations, I have never seen tax factored in like that.

Q53 **Lord Altrincham:** We have a question on subsidised expenditure. How should the new merged relief deal with subsidised expenditure?

Gillian Thomson: As I said before on the subcontractor bit, the subsidy part is very similar for the construction industry scheme. We were very surprised to hear about this coming in, albeit that it is still an area where the Government are saying that there is a bit more to be considered here.

From our point of view, as I said, we have contracts where we take the risk, and we undertake to do the R&D to reach a position that our customers want, so we believe that the subsidy part should be taken out altogether. There should not be any penalty for us for being able to claim the R&D purely because we are getting some income towards the project as a whole rather than the R&D itself specifically.

Colin Hailey: From a life sciences point of view, the commonest subsidy that we see is grant funding. The legacy scheme, the RDEC scheme, permitted that; you could have subsidy and still claim your credit. I am

very hopeful that we will get to the same place with this and delete the line about subsidy that is currently in square brackets—just take it out entirely—otherwise, we will have to start splitting between subsidised and non-subsidised projects.

Dr Roger Barker: I agree with the last speaker's comments.

Q54 **Lord Roborough:** I should disclose, as per the register, that I have some investments in R&D-intensive businesses. What are your views on the proposed relief for R&D-intensive SMEs? Is it appropriately targeted? Will it incentivise the types of innovation that the Government want to encourage?

Colin Hailey: It would be lovely if the rate of credit went back up to what it was. It was at 33%, but we are now down to 27% if you are R&D intensive. It would be fantastic if we could get that rate back up to what it was, to put us further up the international competitiveness tables.

I have already talked about some of the issues with proving that you are R&D intensive, and that remains challenging. To amplify that, the biggest issue here is overseas expenditure. You have a requirement to say, "The circumstances that I need to do my R&D work are not present in the UK but are present outside it, and it would have been wholly unreasonable for me to replicate those conditions in the UK". What does "wholly unreasonable" mean? Prove the negative.

We have had discussions with HMRC where we say, "There are five subject-matter experts in the world in this particular area of biology and they are all outside the UK, so we can use someone outside the UK and count that as R&D expenditure". That is fine, but what if one of them is in the UK but in the NHS and is completely sold out and busy working on lots of other things, we cannot get access to them for three years and it would wholly derail our business plan to wait for them? Can we include it then? If we are running a clinical trial at 10 sites, eight of them in the US, one in Europe and one in the UK, do you include all that cost, one-tenth of that cost or none of it? We just do not know, so at the moment people are concluding, "Given that I have overseas expenditure, I may not be R&D intensive and I have a problem".

Bear in mind that once you are not R&D intensive, two bad things happen. First, you get a lower rate of credit and, secondly, you cannot include the spend in the credit in the first place. That is a double whammy. Your R&D tax rate shrinks massively, all based on this difficult and nebulous test of whether you are R&D intensive based on your overseas expenditure.

Michael Moore: I echo Colin's comments there. I highlight that the rate is pretty important. The principle is the right one, but we have already rehearsed a lot of the concerns about how we will measure and show that it is intensive, and some of the complications with it, but there is now an international competitiveness issue: France is offering 30%, but we are sitting at a blended rate below that, while Australia, I think, is sitting at

45%. We are not signalling to businesses that need to take long-term decisions about where they want to do this research that this is the right place. We all get that there are budgetary pressures and the Chancellor has to make some fine judgments. Nevertheless, this is potentially a good principle if we can sort out some of the complexities and get the administration settled.

To move off the budgetary consideration, if we introduce an arrangement that is off-putting and does not allow people to invest or think it is worth their while jumping through the hoops, we could seriously undermine some very important parts of the economy. We have some great opportunities in the UK. We are globally competitive when it comes to our academic institutions and our financial and professional services infrastructure, not just here in London but across the UK. That gives us an amazing platform that bioscience and lots of others have taken advantage of and built great businesses on. We can ill afford a hiccup through introducing a system that is designed to simplify or focus stuff but does not do either.

Lord Roborough: I take your criticisms about the nature of the cliff edge at 40% and the uncertainty about qualifying overseas expenditure. Are there any examples from overseas of how this can be done better, or do you have any recommendations for that?

Colin Hailey: Look at the existing tax system; let us look at our own system before looking overseas. Are you an SME or not? There is the concept of a year of grace so that you do not flip in and out each year. One of the patent box rules is an exceptional circumstances rule, which says that if you have a one-off share option charge that would go in the bottom of your fraction and send you below 40%, you can ignore that. We need clear rules about what goes in the fraction and what does not.

In the EIS and VCT world, where there is the concept of a knowledge-intensive company, in various parts of that you do three-year averaging rather than looking at just one year. If you give a devious tax adviser the simple rule, "In this year, get me to 40% or above", they will come up with a million schemes to do it.

Dr Roger Barker: We do not agree with the principle of this approach. We have heard about how the policy increases the potential complexity of the new scheme, but that is a narrow issue. As a general principle, our members are very much of the view that the R&D regime should be encouraging R&D across the economy as a whole, not in certain sectors or certain types of company. We think that companies that are less research intensive could benefit hugely from doing more R&D.

We understand how this came about. There was obviously a great deal of pushback from business leading up to the Spring Budget. Business was concerned about the reforms to the regime previously announced by the Chancellor and its lower level of generosity. However, we feel that coming back with this policy proposal is now distorting the whole regime in the wrong direction.

Q55 Lord Palmer of Childs Hill: One thing that seems to have come out of this is the criteria to determine whether R&D-intensive business is there. If you are a big organisation, I presume you have a whole group of people working on this, but how easy will it be for SMEs to work on the criteria to decide whether R&D-intensive business is there? You are not HMRC, but presumably you talk to it, so what are its estimates of the cost of the relief? Will it be realistic? Are we talking about something that it can actually calculate?

Colin Hailey: As constructed, the test is intended to be easy. If you are considering total expenditure, you have to look at your profit/loss account, your R&D expenditure and the cost that you plan to put the claim. In theory, that is easy, but the practicalities on the overseas side make it very difficult.

It would be helpful if there were clear rules about what you would specifically exclude. Would you exclude financing expenses and costs? Are capital allowance costs in there? If we are going to continue allow full super-deduction, full expensing, on capital allowances, then—again, from a tax point of view—that goes in the bottom of the fraction, so what is a benefit on capital expenditure in one part of the tax system damages your ability to be R&D intensive in the other. It gets very complex very quickly.

Lord Palmer of Childs Hill: One suggestion in the forthcoming Autumn Statement is to allow all the investment to be treated in the profit/loss account.

Colin Hailey: Yes, absolutely. You can see that that would then drive fewer people to be R&D intensive.

The other point is that the 40% is the Treasury saying, “We believe in R&D-intensive businesses. Here’s how we will define them, and the limit is 40%”, which is great from a BIA point of view. We will have to see where that goes. Is 40% the right level? Should it be 50% or 30%? As businesses get bigger, grow and build other departments beyond the R&D department, you might find that lots of companies that you would think were R&D intensive all day long would fail to meet the criteria, so they should be lower. We do not know; it is currently an untested number.

Q56 Baroness Valentine: In your view, what will be the impact of the new scheme on R&D activity in the UK? Have the Government got R&D relief right by making these changes?

Colin Hailey: From my point of view, given where we were after last year’s Autumn Statement, the sooner this comes in, the better, because we get back to a rate of credit more like the old scheme. This has been damaging for confidence in R&D-intensive industries in the UK, particularly in the life sciences. It would be great to get this in and on track, get some proper HMRC guidance up and running, and get us back on the right lines.

Baroness Valentine: Are you saying that that just gets us back to

where we were before and does not make any progress?

Colin Hailey: I am saying that, in simple terms, beyond the tax advisers' world, biotech companies say, "We're loss-making. What's the cash credit rate?" It is 15% in the merged scheme and 27% under the R&D-intensive scheme, and that is what they will look at. They are doing cash flow statements to work out when they run out of money. The sooner we can get this in, the sooner they will look at it and say, "Okay, as long as we get some clarity on what overseas expenditure is, we can get back to somewhere close to where we used to be". It is about getting back to where we used to be. Obviously, depending on what happens with rates of credit in the future and other elements of the scheme, we could get somewhere better. But, as it is currently drafted, we are getting back to where we were before the Autumn Statement last year.

Gillian Thomson: I will jump in from the construction side. We are the opposite on how it is currently drafted. We believe that it is likely to disincentivise the construction industry to undertake R&D, due to the uncertainty about what is classed as subcontracted work. We already have domestic political uncertainty, and issues with Ukraine have hit us. This was an area that was stable for us: we could rely on it as a source of income.

To go back to the question about whether we considered it in our pricing, I think we did to an extent when we went out to be competitive. The construction industry has very low margins, so anything that we can get in to help that and make us more competitive will make things better. We believe that the way it is drafted at the moment will disincentivise us. We will probably not do as much as we would want to increase our knowledge and innovation if this stays as it is.

Michael Moore: Trying to avoid repeating any of the points or comments that have been made on this, if we scroll back to a year ago, the scale of the prospective change was a shock, notwithstanding the understanding that the Government have to focus on getting taxpayers' money focused in the right areas appropriately, and get value for money as they do so.

We are pleased about how some of the thinking has evolved since, but, for all the reasons set out this afternoon, there is still a lot of uncertainty. We are well into this financial year but are not yet at all clear about how this plays out into next year. We know that more questions are already being asked of people, which is entirely appropriate to a certain extent. But, for us, there is a need to get on with this and get clarity about it. If we can avoid a transitional arrangement and take a bit longer to get to the right outcome, people will then have more confidence in the system. We would like to see this resolved, and people will then have to adjust their expectations. We would clearly like the rates of intervention to remain where they were—that is a policy choice for the Chancellor, not us—but the speed at which this is done, the simplification of it and the ease of administration afterwards are critical criteria.

Q57 **Baroness Valentine:** You talked earlier about the direction of travel. If

the Government are successful in their direction of travel, do you think there will be more R&D activity across the UK?

Michael Moore: There is a distinction between the two things. Roger is shaking his head and probably wants to talk about the broader economy. In our wider membership, where there will be a range of other R&D activity in lots of different businesses, we are all, I think, committed to it being genuine. You can then have a discussion about what triggers it becoming intense and therefore getting you a higher level of intervention.

So much of government and politics is about the signalling as much as the practicality of it. We run the risk that this slightly jars with the direction of travel in lots of other places. We are delighted about the Chancellor's efforts with the Mansion House compact, which opens up new capital for investing in the very kinds of start-up and scale-up businesses that are also part of this world. We are delighted about how our industry has been able to respond to that, and we would like not to have this slightly unnecessary dispute on the side, which, when it comes to it, is critical to people getting capital and cash at critical stages in their evolution as businesses.

Colin Hailey: From a life sciences and BIA point of view, we have a great life sciences industry, and we just want to get back to where we were so that we can keep growing. That is what is important. I do not think that these changes will be transformative for the amount of life science investment in the UK, but if they do not come in soon, we will see a steady drain out of the UK.

Dr Roger Barker: We are at a delicate moment for business investment, and this reform will not help that. It is being driven primarily by concerns over fraud and error in the previous schemes. These are justifiable concerns, but we feel that they should have been addressed directly in the existing schemes.

To be honest, our reflection on this is that this has not been a productive way forward. As someone else said, it would be better to go back to how things were. The previous schemes were being relatively successful at driving additional investment in R&D. The new approach or regime will create a lot of uncertainty and disruption, and it will not help the cause of UK R&D and investment.

Q58 **The Chair:** Standing back a bit, can we get some feeling of what impact this has on businesses' ability to plan and make decisions about R&D? I am getting slightly mixed messages, because Mr Hailey is saying that people get on with life and work out how much tax they will get back at the end of the year, but Ms Thomson is saying, "No, we've got to price our very marginal contracts on the assumption that we get it or not, so it's very important". Are you able to elaborate on how significant the R&D tax credit is for businesses' decisions to plan and engage in R&D?

Colin Hailey: It is fundamental from a life sciences point of view. The point I was trying to make is that this does not affect individual items of procurement; it is much more fundamental than that. It is about where

to set up a company in the first place and, when people look at the overall strategic plan, it is about where they will add headcount in the future. It comes in at a strategic, not an operational, level, and R&D tax credits absolutely get taken into account there. We have had a year of turmoil in which a lot of overseas investors asked whether the UK is the right place any more. We need to get these rules in and get on with it so that they can then say, "We were right in the first place to set up in the UK, and we want to add headcount in the UK. If we start new companies, we can start them in the UK".

Michael Moore: If I may, I will draw attention to our colleagues at the Startup Coalition, who produced a report setting out various assumptions quite starkly. They calculate that the average start-up will see its R&D tax credit receipt reduced by £100,000, something like a 30% or 40% cut. At that moment in the life of the business—Lord Leigh will know better than most how challenging it can be to raise capital—that is a pretty significant chunk to take out on average from those businesses. Again, for some of them that 40% hurdle will seem pretty high. We would like there to be more time to get to a place where we have a smoother transition to the new regime that recognises some of the points that Colin, Gillian and Roger have emphasised.

Gillian Thomson: I would like to add that in the construction industry our projects last years. They are not short one-year or two-year projects; they are usually three to five years, or even 10-year projects. So far, we have had certainty with the R&D reliefs that we have been able to get, and they have been factored into our forecasting over the years. We have already done 2024 and 2025, but if this legislation comes in in April next year, that will hit us next year, let alone the years after that. Forecasting takes account of this relief, so having something change so quickly and at the pace that is planned to happen, along with everything else that has been going on with the additional information form that Michael mentioned, is causing a lot of headaches in the industry in trying to keep the business flowing in the way that we want it to flow, given the way the economy currently is.

Michael Moore: Another way to answer your question is to say that with both Colin and Gillian you have two different specific sectors, so I do not think there is a one-size-fits-all impact here. Even among our membership, which has a good cross-section of businesses backing biotech as well as other bits of tech, there are the concerns that I have set out. To Roger's points earlier and those that Gillian is making, the broader economy and specialist bits in it will have suffer big impacts as a result of this, which I imagine was not the intent of the original proposals.

Colin Hailey: I think it is simpler than that: Skanska builds a load of innovative lab space, we pack it full of biotech companies in the UK, funded by the UK taxpayer, and off we all go.

Gillian Thomson: Sounds good.

Dr Roger Barker: We have received a long list of submissions from members saying they have already reduced the amount that they are spending on R&D in the UK, while others are reconsidering whether the UK is the place to start up an R&D-intensive business. It really seems as though these changes have shot the UK in the foot. Especially at a time when there is a huge amount of potential investment subsidy present in the US through the Inflation Reduction Act, and coming through in the EU, to make life at difficult at this stage for companies that want to invest in R&D, especially SMEs, seems like an own goal.

The Chair: We come to a question from Lord Rooker, although I suspect it will have a brief answer.

Q59 **Lord Rooker:** The question I was going to ask has been more or less covered in previous answers. Given the other changes made earlier in the year to the R&D relief, what is your view about the proposed timing for these further reforms?

Colin Hailey: From my point of view, just get on with it. We have had huge uncertainty for the past five years and a lot of changes in the SME R&D tax credit. The sooner we get this done and get the revenue guidance out there, the sooner we can all say, "Right, that's now the system in the UK", and everyone can get familiar with it and start planning and forecasting. If we kick the can down the road for another 12 or 24 months, we are just prolonging the uncertainty and reducing the rate of credit while we mess about. That would be very unhelpful for the UK life sciences industry.

Michael Moore: I would love to end on a note of unanimity, but I am slightly more sceptical about the ability to introduce the scheme. To set aside all the policy issues and raise something else, the ability to make assessments of the claims is fundamental to whether or it will be creditable. I gave the AI example earlier: 120 days after the full technical submission was made, there has been no answer and no indication of when that answer is going to come. Hopefully, that will be dismissed as an isolated incident, but I slightly worry that it is not. We need to have the capacity and the capability to judge these claims as quickly as others. In the meantime, we and those on the government side need a bit more time to move from one scheme to the next.

Gillian Thomson: I agree wholeheartedly with Michael there. I think we need at least another 12 months to get particular areas of uncertainty clarified.

Dr Roger Barker: I agree.

Lord Rooker: Okay, that is three to one.

The Chair: Unless any colleagues have any further supplementaries, that concludes our session. I thank our witnesses for taking the time and trouble to come and talk to us. It is very much appreciated.