EYE ON BIO

UK TAX RELIEF

A LURE TO BIOTECH BUSINESSES AND INVESTORS

The tax landscape is shifting, in many ways rather attractively, for biotechnology initiatives in the United Kingdom. The UK's research and development tax credits and reliefs available to biotech companies, combined with recent recommendations for reforms to the international tax system, have given companies much to consider regarding where to set up shop.

With that in mind, Will Smith, a transactional and advisory tax lawyer, together with Mark Thompson, who advises clients on international corporate and private equity transactions, hosted a recent roundtable discussion in Sidley's London office with guests in the pharmaceuticals, biotech and tax sectors. In the meeting, they highlighted the various tax incentives and other benefits available to biotech businesses operating in the UK, while simultaneously being mindful of the greater international tax and regulatory systems.

"The thing people should already be thinking about is the Organisation for Economic Co-operation and Development's (OECD) final recommendations on the range of 15 principal international tax issues and risks," Smith said. This was in reference to the OECD's Base Erosion and Profit Shifting initiative, designed to eliminate "harmful tax practices." There are two aspects of this initiative that are likely to be of particular interest to those in the biotechnology industry. The first centres on proposed revisions to bilateral double tax treaties, which may, for example, be currently used to extract income streams without suffering local withholding taxes. The other involves the significant changes to the way in which transfer pricing will operate with respect to where and how intellectual property-related income will be taxed.

In response to the OECD initiatives, Smith said, "The question will be, 'Do I need to be doing something about it?' The answer is, yes. There are companies, both large and small, which are already actively working towards rearranging aspects of their group arrangements to ensure they are compliant with what they broadly expect the new tax world order will become."

Those heavily invested in the IP arena, such as biotech companies, for example, need to be especially proactive with monitoring and evaluating the potential impact. Such entities will have arrangements in place particularly in relation to the location and licensing of the IP. "You may have royalties or license fees being paid through to, or legally owned by, entities in jurisdictions that may not be justifiable from an international tax perspective going forward," Smith cautioned.

EYES ON UK TAX INCENTIVES

Businesses are increasingly looking to the UK for the combination of its stable environment, solid reputation and comparatively attractive tax regime, including, for the duration of this Parliament, a "tax lock," which prevents certain UK taxes from increasing. Other potential attractions include the UK dividend exemption, which allows UK companies to receive the majority of dividend payments tax free, and certain revisions to the UK anti-avoidance legislation to allow for a more "user-friendly" approach.

The UK tax system is designed to encourage and promote R&D activity and investment. Smith and Thompson discussed three key types of tax incentives in the UK that every biotech company should be aware of that can have a material impact on their business: preferential tax breaks for R&D expenditure (so-called "super deductions"); tax relief on investments in early-stage enterprises; and a patent box regime allowing companies to monetise their IP.

Benefits aimed at the biotechnology industry include "super deductions" for costs and expenses incurred in connection with R&D. The goal of these deductions is to actively encourage UK situs expenditure on R&D, and can be significant in managing an entity's effective tax rate. In particular, smaller entities, such as start-ups, can utilise the regimes in order to manage cash flow by virtue of being able to effectively "cash in" part of their "super deduction" entitlement in the period before they become profitable.

The UK system is also designed to encourage investment in early-stage and start-up enterprises in the biotechnology industry. This is achieved through, for example, offering certain investors relief against income tax for funds that are used to subscribe for shares issued by qualifying companies. Indeed, the UK government has recently announced increased reliefs and benefits that could arise for investments in so-called "knowledge-intensive companies."

For a number of years, the UK has operated a regime, called the patent box, which enables companies to apply a lower rate of UK corporation tax to certain profits earned from the monetisation of certain patented inventions. Such regimes have come under significant scrutiny from organisations such as the OECD. As a result, the UK has announced that it will be revising the current patent box regime to ensure that it remains fit for purpose in light of the forthcoming international tax developments. This is an important development, as it ensures the patent box will continue to operate as an effective and attractive element of the UK tax regime for those in the biotechnology industry.

"Given the incentives offered in the UK, all biotech companies, regardless of size, need to be well advised as to the various tax benefits available," Thompson said. The UK government is currently trumpeting the country's business-friendly environment, citing that it intends to cut corporation tax to 19 percent in 2017 and 18 percent by 2020. These are important developments that will benefit every industry. "If you look at it from a multinational perspective and ask, 'Do I want to come to the UK or do I want to buy a company here?' then yes, you may actually have a slightly different view these days and find the UK a very attractive location for investment," Smith said.

Contacts

Mark E. Thompson
London
+44 20 7360 3730
methompson@sidley.com

Will Smith
London
+44 20 7360 2076
will.smith@sidley.com

SIDLEY AUSTIN LLP
SIDLEY

sidley.com

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