22nd June 2018

The Rt Hon Philip Hammond, MP
Chancellor of the Exchequer
House of Commons
London
SW1A 0AA

Dear Mr Hammond

An Open Letter: Entrepreneurs' Relief

We are writing to you on behalf of the five major UK Life Science Membership Associations regarding Entrepreneur's Relief, which we do not believe in its current form represents the best interests of the UK industry, its employees or investors.

We have made some suggestions which we believe will greatly improve the effectiveness of the scheme, and lend further support to the sector, and its potential for growth going forward.

Background[i]

Entrepreneurs' Relief reduces the amount of Capital Gains Tax (CGT) on a disposal of qualifying business assets on or after 6 April 2008, as long as the qualifying conditions are met throughout a one-year qualifying period either up to the date of disposal or the date the business ceased. Qualifying capital gains for each individual are subject to a lifetime limit. The general rate of CGT on gains is 20%, while Entrepreneurs' Relief applies the reduced rate of 10%.

If the business is owned by a company in which the Entrepreneur disposes of the shares or securities, then throughout the qualifying period of 1 year the company must be:

- the Entrepreneur's Personal Company (see below)
- either a 'trading company' or the holding company of a 'trading group'

The Entrepreneur must be either an officer or employee of that company (or an officer or employee of one or more members of the trading group).

A company is a Personal Company if the Entrepreneur **holds at least 5% of the ordinary share capital and that holding gives the Entrepreneur at least 5% of the voting rights** in the company. It's possible for shares acquired under the Enterprise Management

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Incentive (EMI) share option scheme to qualify for Entrepreneurs' Relief where the Personal Company requirement isn't met (see guidance at CG64052), although in the case of shares derived from EMI share options, there is in fact no minimum 5% holding required.

Problem

The 5% qualifying threshold limit impacts different sectors in different ways. In particular, BioTech and MedTech companies often have to raise significant amounts of capital (many tens of millions) simply to pass the regulatory hurdles during the pre-revenue product development phase. The risks for investors during these development phases are high. Consequently, there are few investors willing to support such companies, and Entrepreneurs frequently find the value of their company does not increase at the rate that they had hoped (even though the valuations for the few companies that ultimately succeed can be exceptional). In addition, such BioTech or MedTech companies are often founded by more than one founder with founder shares being divided between them (with the university institutions often claiming a significant proportion of the founding shareholding). This means that Entrepreneurs behind these companies invariably have to accept that their shareholding will drop to below 5% (and loss of Entrepreneurs' Relief). As Entrepreneurs' shareholdings approach 5%, this dramatically affects behaviour (the founders retain influential voices on company strategy) and they will (understandably) allow personal and financial considerations drive company financing strategy in a way which may not be in the best interests of the company or the national economy as a whole.

Recently proposed changes to Entrepreneurs' Relief, whilst welcome, are unlikely to help significantly with respect to BioTech and MedTech companies. Under these proposed changes, where an Entrepreneur's shareholding drops below 5% as a result of a dilutative financing round, that Entrepreneur can 'crystallise' the gain up to that point with respect to the reduced rate of CGT (subject to the various other qualifying conditions).

However, for many BioTech and MedTech companies, the fall below 5% will happen <u>before</u> any meaningful gain in valuation has materialised (for all the reasons described above) and so the crystallisation of any gain is likely to have little effect in preserving the 10% Entrepreneurs' Relief rate.

Recommendation

Allow Entrepreneurs to retain their Relief so long as they have held at least 5% of the shares for at least one year during the period of their entire shareholding, and that such relief <u>permanently</u> applies to those shares acquired up to the point that they fall below 5%. That is, once they are below 5%, any <u>further shares</u> acquired do not automatically benefit from Entrepreneurs' Relief under this rule, but those held up to that point continue to qualify. This would be subject to all the other qualifying conditions.

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Likely Impact

This change should magnify the impact of Entrepreneurs' Relief in the BioTech and MedTech sectors, resulting in:

- an increase in the number of Entrepreneurs willing to take the personal risks in starting BioTech and MedTech companies;
- Entrepreneurs being incentivised to remain involved with those companies for the longer term;
- Entrepreneurs remaining supportive of future dilutative financing rounds, which in turn will ensure that more UK companies attract the scale of patient capital required to build large and sustainable BioTech and MedTech businesses, whilst resisting the urge to sell out early; and
- the consequential growth in these companies, which will further contribute to skilled employment in the life science sector and UK GVA.

This open letter has been drafted by OBN's Investment and Tax Special Interest Group (ITSIG), and is jointly agreed and signed by OBN, One Nucleus, BioNow, MediLink, MediWales, and ITSIG.

These signatories manage the major Not-for-Profit Life Sciences Membership organisations in the UK with both regional and national coverage and strength, which together directly represent around 2,000 active life sciences companies ranging through start-ups, SME's, Unicorns, and Big Pharma / MedTech. As such, we speak with a unified voice representing the interests of the majority of the Life Sciences business sector in the UK.

The UK has established a vibrant life sciences sector, but more needs to be done to secure its longer-term viability, to capitalise on the excellence of the UK life science research base, and to ensure the UK maintains its leading position in global healthcare.

We believe that rapid adoption of the measures we have outlined above will reaffirm a commitment to the UK life sciences sector, send an important message to investors, and ultimately make a significant contribution to UK health and wealth creation.

We look forward to receiving a detailed response to these suggested measures and to sharing Government plans for enhancing the investment environment for the UK's life sciences with our respective Members.

Yours sincerely,

OBN (UK) Ltd, 5F Park Square, Milton Park, Abingdon, Oxfordshire, OX14 4RR
T: +44 (0) 1235 420870 E: info@obn.org.uk W: www.obn.org.uk

Dr. John G Harris
CEO, OBN

Dr. Tony Jones
CEO, OneNucleus

Dr. Geoff Davison
CEO, BioNow

Dr. Shawn Manning
Chairman, ITSIG

Dr. Darren Clark
Director, MediLink Midlands

Mr. Gwyn Tudor
CEO, MediWales

Background information from: https://www.gov.uk/government/publications/entrepreneurs-relief-hs275-self-assessment-helpsheet/hs275-entrepreneurs-relief-2018

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