

# UK Spring Budget 2023 – A Hunt for Growth? HLS Insights

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## A view from the market

The 2023 Spring Budget has introduced a number of specific and more general tax measures designed to support growth and enterprise, particularly in the HLS sector. In its press notes, the government is keen to reassure SME and entrepreneurial businesses that measures have or will be put in place to counter the increase in corporation tax to 25% from April 2023. However, large HLS businesses will be impacted by both the corporation tax increase and the introduction of the “top-up tax” in line with OECD Pillar 2. So it seems that the winners are HLS businesses in start-up or investment mode, larger HLS businesses may not be feeling the love, to quite the same extent. This is perhaps hardly surprising given that the tax burden (tax receipts as percentage of GDP) is expected to rise to 37.3% in 2025 (a similar forecast was made in November), driven mainly by the increase in corporation tax.

Particular highlights for the HLS sector include:

- Enhanced R&D tax credits targeted specifically at loss making R&D intensive SMEs.
- Extension of VAT exemption for healthcare to include services carried out by staff directly supervised by registered pharmacists in the UK.
- Extension of zero rate of VAT on prescriptions for medicines supplied through Patient Group Directions.
- Full expensing for capital expenditure on e.g. computers, printers and office equipment, meaning that companies can deduct 100% of the cost from profits straight away.
- Changes to the Enterprise Management Incentives (EMI) scheme from April 2023 to simplify the process to grant options and reduce the administrative burden on participating companies.

- The development of 12 new Investment Zones clustered around universities and research centres, outside of London. The Zones will be designated as geographical areas where businesses can benefit from tax reliefs. These proposals may carry some political risk. Any incoming Labour government might seek to review Investment Zones given the Labour Party’s previous criticism of Freeports.

In addition to tax measures, there was a positive update for the HLS sector in that the government has announced that a total of £10 million has been awarded to the Medicines and Healthcare products Regulatory Agency (MHRA) to help bring innovative new medicines and medical technologies to UK patients more quickly, such as those with the greatest opportunity to meet the UK’s healthcare priorities, such as cancer vaccines and AI-based therapeutics for mental ill-health. It will also support the establishment of an international recognition framework, allowing the MHRA to capitalise on the expertise and decision-making of trusted regulatory partners and provide patients with fast-track access to best-in-class medical products that have been approved in other countries. Using the Agency’s pre-existing international partnerships, the first regulatory partners that the MHRA intends to build new recognition routes with are the FDA, in the USA, and with the PMDA, in Japan.

On the following pages we provide a broader summary of the tax changes that we think will be most relevant to the HLS sector.



## Tax rates and allowances

As previously announced, the headline rate of corporation tax will increase to 25% from April 2023 applying to profits over £250,000. The Finance Act 2021 introduced a small profits rate (SPR) of 19% for companies with profits of £50,000 or less from April 2023. Companies with profits between £50,000 and £250,000 will pay tax at the main rate reduced by a marginal relief providing a gradual increase in the effective corporation tax rate. The Spring Budget 2023 announced that legislation will be introduced in Spring Finance Bill 2023 to set the main rate at 25% and the small profits rate at 19% for the financial year beginning 1 April 2024 also.

## R&D tax credits

The government has confirmed that R&D Expenditure Credit (RDEC) rate will increase from 13% to 20%, the small and medium enterprise additional deduction rate will reduce from 130% to 86%, and the SME payable credit rate (for non-R&D intensive companies) will decrease from 14.5% to 10%. The possibility of merging these schemes is still on the table following the government's recent consultation which closed on 13 March 2023.

Importantly, the government has also released a 'Technical Note' with details of a new R&D scheme for qualifying 'R&D intensive' SMEs from 1 April 2023. This is an important and welcome development for many SMEs, following the rate changes announced during the Autumn Statement in 2022 which raised many questions on how the UK remains a competitive location for cutting edge research and innovation. Eligible R&D intensive SMEs will be able to claim an additional higher R&D payable credit rate of 14.5% instead of the 10% credit rate for non R&D intensive companies.

An 'R&D intensive' company is a "loss-making SME with an R&D intensity of at least 40%" (meaning that such company incurs at least 40% of its expenditure on R&D). Companies meeting this condition will be able to claim the additional support as part of their claim to SME credit, using the higher rate of credit for any expenditure on or after 1 April 2023, by delaying submission of their claim until the legislation is in place, or by amending their claim once the legislation is in place.

Alongside the above changes, the government announced that it will continue to review how the R&D reliefs are operating, including the possibility of merging the RDEC and SME schemes. The government is due to publish draft legislation on a merged scheme for technical consultation in Summer 2023, along with a summary of responses to the consultation. Any further changes as a part of the ongoing R&D tax reliefs review will be announced at a future fiscal event, including a final decision on whether to merge the RDEC and SME schemes (with possible implementation from April 2024).

## VAT and medicines and pharmacists

The government has announced that it will legislate to extend the VAT exemption for healthcare to include services carried out by staff directly supervised by registered pharmacists in the UK. The changes will take effect from 1 May 2023.

In addition, the government will extend the zero rate of VAT on prescriptions for medicines supplied through Patient Group Directions. This measure will be introduced in autumn 2023.



## Investment Zones

New measures will enable Investment Zones to be designated and recognised in law as geographical areas where businesses can benefit from tax and NICs reliefs. The intention is to incentivise investment in Investment Zones, in part, through tax reliefs and reducing the cost of hiring employees. The Investment Zones proposal was first put forwards by then Chancellor Kwasi Kwarteng in September 2022, but the current proposals align much more closely to the existing tax reliefs in Freeports, and suggest Chancellor Jeremy Hunt is taking a more cautious approach than his predecessor on his interpretation of Investment Zones. Nevertheless, given the relatively optimistic forecasts by the Office of Budget Responsibility since the Autumn Statement 2022, the “re-focus” on Investment Zones as a headline measure of the Spring Budget 2023 will likely be hailed by the Chancellor as a shift away from pragmatic cost-saving measures and towards a growth-oriented fiscal strategy.

Section 113 Finance Act 2021 currently allows HM Treasury to designate Freeport tax sites (a product of then Chancellor Rishi Sunak) which can provide a range of tax reliefs for businesses such as enhanced capital allowances, enhanced structures and buildings allowances and employer NICs relief. The new measures will extend these existing tax and NICs reliefs to special tax sites in or connected with Investment Zones.

On a political note, Investment Zones were first introduced by Kwasi Kwarteng in his otherwise ill-stared fiscal event last September. Even then people questioned their relationship to Freeports over which both the Labour Party and the EU have previously raised concerns. Those concerns may roll over to Investment Zones and attract the attention of an incoming Labour administration if it wins at the next General Election.



## Capital Allowances – Full Expensing

The Spring Budget introduces a new temporary form of capital allowances for plant and machinery in an attempt to drive business growth in the UK, termed “full expensing”.

Capital allowances are a type of tax relief for businesses that allow companies to deduct some, or all, of the cost of a capital item from their profits before paying tax. Various forms of capital allowances are already available in the UK which allow businesses to claim different amounts. These include annual investment allowances (“AIA”), writing down allowances, first-year allowances and structure and buildings allowances. If an item qualifies for more than one type of capital allowance, businesses can choose which one to use. They can claim 18 per cent tax relief per accounting period on all plant and machinery they buy which falls under the “main rate” pool, unless the items are required to be allocated to the “special rate” pool, or “single asset” pool. Items allocated to the “special rate” pool can benefit from the 50 per cent special rate first-year allowance for qualifying expenditure on plant and machinery incurred, subject to the same conditions that apply for full expensing. This means that a company can claim a deduction from taxable profits that is equal to 50 per cent of their qualifying expenditure in the year that expenditure is incurred. Capital allowances can be claimed on the balance of expenditure in subsequent accounting periods at the 6 per cent rate of writing down allowances for special rate expenditure.

Where full expensing is claimed, companies can claim 100 per cent capital allowances on qualifying plant and machinery in the first accounting period. This allows companies to write off the cost of investment in one go, rather than spreading it across a number of years. For every pound that a company invests, their taxes will be cut by up to 25p. For the full expensing to apply, companies must be subject to corporation tax; expenditure must be incurred on the provision of “main rate” plant or machinery; it must be claimed on plant and machinery which is new and unused; and full expensing cannot be claimed on cars, or items given to the company as a gift, or bought to lease to someone else.

Plant and machinery that may qualify for full expensing includes machines such as computers and printers; office equipment such as desks and chairs; vehicles such as vans, lorries and tractors; warehousing equipment such as forklift trucks, pallet trucks, shelving and stackers; tools such as ladders and drills; construction equipment such as excavators, compactors and bulldozers; some

fixtures such as kitchen and bathroom fittings; and fire alarm systems in non-residential properties.

Special rules will apply when a company sells an asset on which it has claimed full expensing, and companies will be required to bring in an immediate balancing charge equal to 100 per cent of the disposal value. In other words, if the company sold an asset for £10,000 on which they had claimed full expensing, they would be required to increase their taxable profits by £10,000.

Full expensing will be available for expenditure incurred on or after 1 April 2023 until 31 March 2026. The temporary extension of allowances is in line with the UK’s policy goal of promoting investment in UK businesses. It aims to build on the success of the 130% super-deduction, and follows a capital allowances consultation last year in which businesses showed a clear preference for full expensing over the other options under consideration.

The current £1 million AIA rate will continue to apply for any other qualifying purchases of used equipment. While the full expensing is only available to limited companies, the AIA remains available to all businesses, including unincorporated businesses and partnerships.

## Capital Allowances – Annual Investment Allowance

In addition the Government has announced that the increase to the limit of the AIA from £200,000 to £1,000,000 for qualifying expenditure on plant and machinery, which has applied temporarily to expenditure incurred on or after 1 January 2019, will be made permanent. This increase would otherwise have expired.

The permanent level of the AIA was set at £200,000 with effect from 1 January 2016. The AIA is a 100 per cent capital allowance for qualifying expenditure on plant and machinery up to a specified annual limit – i.e. it provides an equivalent benefit to full expensing for the expenditure covered. Businesses can claim the AIA in respect of expenditure which would otherwise be eligible for writing down allowances (“WDAs”). Given at either the main or special rates, WDAs provide relief for eligible capital expenditure over a number of tax periods. The AIA therefore accelerates relief, typically simplifying processes for businesses and aiding their cashflow. This measure will provide an incentive for businesses to increase their capital expenditure on plant and machinery.

The requirements to qualify for AIA are that (i) it is expenditure on the provision of plant or machinery wholly or partly for the purposes of a qualifying activity that the person incurring the expenditure carries on; and (ii) the person incurring the expenditure owns the plant or machinery as a result of incurring the expenditure. As AIA does not have the same requirements to qualify for relief as full expensing, items which could have benefited from full expensing but which fails on the relevant requirements, for instance, of being leased assets, cars, or second-hand expenditure items, or not being subject to Corporation Tax, can still benefit from AIA where it meets the requirements for an AIA above.

As indicated above, full expensing is available to companies subject to Corporation Tax only. Therefore, unincorporated businesses cannot claim, but such businesses are entitled to claim the AIA which offers the same benefits as full expensing for the investments it covers (up to £1 million per year).

The measure will have effect in relation to AIA qualifying expenditure incurred from 1 April 2023, and is in line with the UK's policy goal of incentivising investment in UK businesses.

## Capital Allowances – First year allowance for electric vehicle charge-points

The Spring Budget introduces a measure to extend the availability of a 100 per cent first-year allowance ("FYA") for qualifying expenditure on plant and machinery (equipment) for electric vehicle charge-points by two years.

The FYA was introduced for expenditure incurred from 23 November 2016 to support the UK transition to cleaner vehicles. This measure is designed to continue to incentivise the uptake of equipment for charging electric vehicles and aligns the period of its availability with the 100 per cent FYAs available for zero-emission cars and zero-emission goods vehicles.

The FYA will thus be extended to 31 March 2025 for corporation tax purposes, and to 5 April 2025 for income tax purposes. This measure aligns with the government's policy goal of incentivising businesses to install charging points, and therefore purchase zero emission vehicles to support the government's wider objective on climate policy to reduce greenhouse gas emissions to net zero by 2050.

## Tax advantaged employee share schemes

Those who haven't blocked out all memories of the first half of 2021 may recall that the Government

launched a review of the Enterprise Management Incentives (EMI) scheme during that period, with the stated intention of examining whether the scheme should be available to more companies. The EMI scheme is one of several tax-advantaged employee share schemes, and is intended to help SMEs recruit and retain talent through share incentives. There was a call for evidence that closed in May 2021 which had 48 respondents, and after some considerable delay a summary of response has now been published alongside the Budget.

In the interim it was announced in the Spring Statement 2022 that the EMI scheme was still "effective and appropriately targeted", followed in September 2022 by an announcement of an expansion of the Company Share Option Plans Scheme (CSOP) with the intention of ensuring that companies can graduate more smoothly from the EMI scheme to the CSOP scheme and continue to offer attractive share-based remuneration.

Accordingly, from 6 April 2023 the CSOP scheme rules will be amended to:

- Remove the restriction imposed on companies with more than one class of shares that the shares to be placed under CSOP options must either be open market shares or employee control shares.
- Double the employee option limit from £30,000 to £60,000.

In addition, some tweaks are being made to the EMI scheme with effect from 6 April 2023 in order to reduce the administrative burdens of compliance with the scheme:

- Removal of the requirement for the company to declare that that the employee has signed a working time declaration when they are granted an EMI option (NB the actual working time requirement is not removed).
- Removal of the requirement to set out in an option agreement restrictions on the shares to be acquired.

From 6 April 2024 there will also be an extension of the time within which companies must submit an EMI notification relating to the grant of an EMI option (currently within 92 days of option grant) to the 6 July that follows the end of the relevant tax year in which the EMI option is granted.

In addition, the government has announced that it will be launching a call for evidence on the Share Incentive Plan and Save As You Earn employee share schemes. The government will use the call for evidence to consider opportunities to improve and simplify the schemes.

## OECD Pillar Two

A multinational top-up tax and domestic top-up tax will be introduced for business groups with annual global revenues exceeding EUR 750m (in at least two of the previous four accounting periods) where they are conducting business activities in the UK. These top-up taxes form the first stage of the UK's implementation of the OECD's Pillar Two rules under the Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The objective of Pillar Two is to implement a global minimum level of taxation for corporate entities at an effective rate of 15%.

The multinational top-up tax will target UK parent companies within a multinational enterprise (MNE) group. The top-up tax will be triggered where (i) a UK parent company has an interest in entities overseas in a non-UK jurisdiction and (ii) the UK parent company's group has profits arising in such non-UK jurisdiction that are taxed below 15%.

The domestic top-up tax will target UK companies in either a domestic or MNE group. The top-up tax will be triggered where the group's profits arising in the UK are taxed below 15%. In essence, the UK government considers that if UK companies are to be subject to a top-up tax, the UK Exchequer should be the one to benefit from it.

Certain entities will be excluded from both the multinational top-up tax and domestic top-up tax, such as governmental entities, international organisations, non-profit organisations and pension funds. Investment funds and real estate investment vehicles will also be excluded where such entities are the ultimate parent of the group. The intention is to protect the status of certain investment funds/vehicles as tax neutral entities in order not to deter investment activity, but the exclusion will not extend to all fund arrangements and careful analysis will be required.

The multinational top-up tax and domestic top-up tax are intended to be the UK equivalent of the OECD's Income Inclusion Rule (IIR) and Qualifying Domestic Minimum Top-up Tax (QDMTT) respectively. The new measures do not yet provide for the OECD's Undertaxed Payments Rule (UTPR), which acts as a final resort to catch qualifying MNE groups that have not been subject to the IIR or QDMTT. However, under the UK government's consultation on Pillar Two, it is intended that the UTPR also be implemented in the UK, though most likely at a later date.

The measures will have effect in respect of a qualifying group's accounting periods beginning on or after 31 December 2023.

## Investment reliefs

It is seemingly a tradition that every Budget must include some tinkering with the terms of the UK's various venture capital schemes, and the Spring Budget 2023 does not disappoint. As previewed in September 2022, the Seed Enterprise Investment Scheme (SEIS) has received a boost in the form of relaxations of the rules on the size and age of companies that can raise SEIS-qualifying funding and the amounts on which investors can claim income and capital gains tax reliefs, in all cases with effect from 6 April 2023.

## Customs Advance Valuation Rulings

Measures will be introduced in the Spring Finance Bill 2023 which will enable HMRC to grant Advance Valuation Rulings (AVRs) to customers importing goods into the UK. AVRs are legally binding written decisions made by customs authorities such as HMRC, at the request of the trader, in order to provide certainty to traders on how they should arrive at the customs value for their goods (such value impacting the amount of customs duty that may be due). It is intended that any AVRs given will bind HMRC and the trader for a three year period in relation to the goods and importation scenario in respect of which it is given, subject to withdrawal of the ruling.

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