MADE IN BRITAIN

STIMULATING GROWTH AND INVESTMENT IN UK MANUFACTURING

A TAX POLICY PROPOSAL

SPRING 2021

IDEAS | PEOPLE | TRUST

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UK MANUFACTURING IS A CRUCIAL SECTOR FOR THE ECONOMY, ACCOUNTING FOR £191BN OF OUTPUT AND EMPLOYING 2.7 MILLION PEOPLE[1]

But it is a sector that has been hit hard by the uncertainty of the Brexit trade negotiations over the past four years, as well as reduction in demand caused by the COVID-19 pandemic.

Dealing with COVID-19 of course continues to be a major focus for the Government.

However, with the Trade and Cooperation Agreement in place with the European Union (EU), and COVID-19 vaccines being rolled out in the UK, it is time for the Government to provide a clear strategy to support manufacturing in the years to come.

As manufacturing is a major focus at BDO, we have been thinking hard about what tax changes could most benefit the sector.

For now, we advocate a clear strategy for overcoming the COVID-19 emergency including the continuation of policies such as the job retention scheme that can support business through to full recovery.

But once the emergency is over, we believe the UK manufacturing sector will need new ideas to remain competitive. This manifesto distils our thinking-and will hopefully serve as a useful model for policymakers going forward.

A FOREWORD

FROM RICHARD AUSTIN AND SIMON BIRD

INVESTMENT IN OUR MANUFACTURING SECTOR IS CRUCIAL TO OUR ECONOMY. IT HAS A SIGNIFICANT MULTIPLIER EFFECT FOR EVERY POUND INVESTED AND CREATES SKILLED, HIGH-QUALITY JOBS, AS WELL AS FURTHER OPPORTUNITIES THROUGHOUT EXTENDED SUPPLY CHAINS.

It also helps to drive innovation, leveraging the talent and knowledge within our world-class university system. This is why we believe it is a sector that should be supported through a clear Government strategy.

The manufacturing sector can play a pivotal role in achieving many of the UK government's stated goals for the post-COVID-19 recovery, including creating a green economy, driving digital innovation and improvements in productivity, and levelling up the north-south economic divide.

A clear industrial strategy for the sector could take many forms and tax is only one of a number of policy areas that can make the UK an attractive place to manufacture.

However, tax can play a vital role in stimulating the economy, creating jobs and driving desired economic outcomes-and it is a simple policy instrument for the Government to apply. That said, no one tax measure provides a panacea for the challenge that lies ahead.

Instead, we believe the Government should look at all the building blocks within the tax system and establish a clear, targeted, balanced and long-term policy for the manufacturing sector. This will give manufacturing businesses and entrepreneurs a clear signal that the UK is a great place to invest in and assist the Government in meeting its goals for the country.

In this paper, we set out what we see as the main levers within the tax system and highlight the changes we would make to stimulate investment in the sector.

Some might argue for greater change in certain areas. Others might think now is not the right time, given the need to repay the COVID stimulus. However, we believe these clear, targeted and balanced changes to tax would ultimately pay for themselves in the years to come. We encourage the Government to consider these changes in the upcoming Budget and beyond, to create an environment where UK manufacturing can thrive.

We hope you find this paper interesting and thought provoking. If you would like to discuss any of the issues raised, then please get in touch with one of us or your usual BDO contact.

RICHARD AUSTIN
National Head of Manufacturing

SIMON BIRD
Tax Lead for Manufacturing Sector

WHY MANUFACTURING IS KEY FOR THE UK

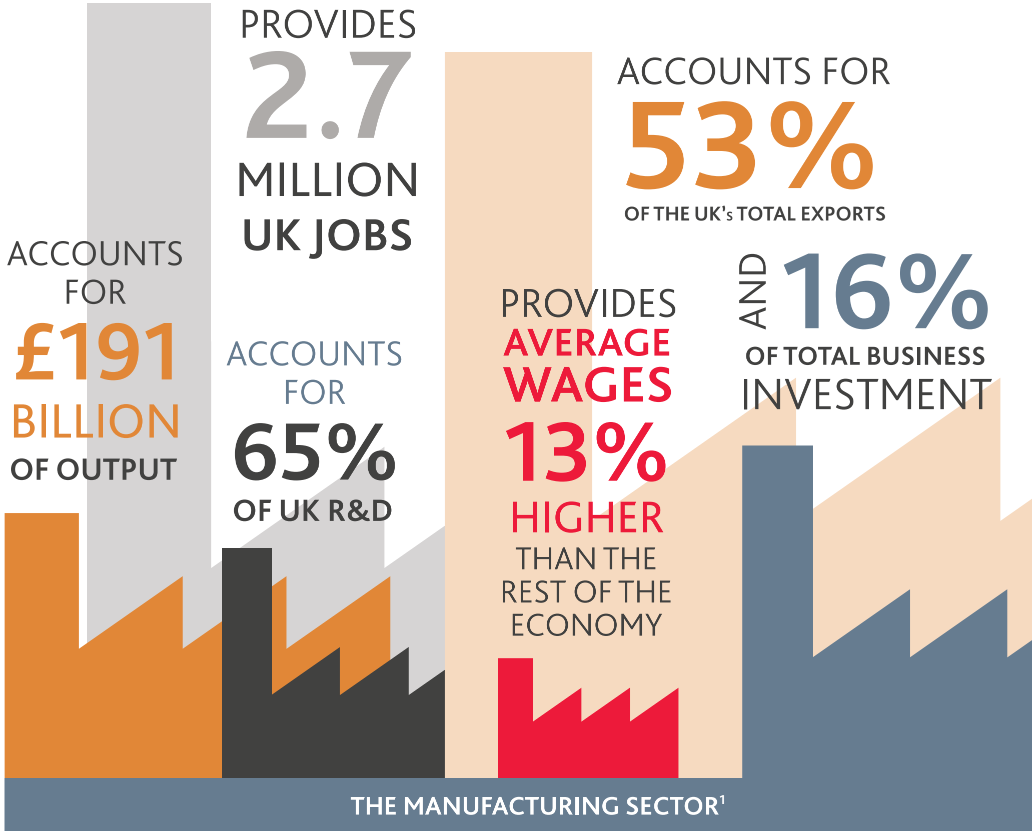
WHY CREATE INCENTIVES SPECIFICALLY FOR MANUFACTURING?

WITHOUT WISHING TO BELITTLE OTHER SECTORS THAT ARE ALSO VITAL FOR THE UK ECONOMY, MANUFACTURING HAS AN OUTSIZE IMPACT ON EXPORTS, WAGES AND RESEARCH AND DEVELOPMENT (R&D) SPENDING WHICH ARE ALL CRITICAL MEASURES FOR OUR PROSPERITY AS A NATION.

Manufacturing underpins other sectors, such as construction and services, and will be central in driving forward the Ten Point Plan for a Green Industrial Revolution announced by the Government in November 2020.

Alongside this, Boris Johnson was clear in stating that the Ten Point Plan should also target levelling-up objectives across the country - with a clear reference to manufacturing capacity throughout.

"Our green industrial revolution will be powered by the wind turbines of Scotland and the North East, propelled by the electric vehicles made in the Midlands and advanced by the latest technologies developed in Wales, so we can look ahead to a more prosperous, greener future," he said.



Manufacturing is a broad church, and by its nature has a wide range of ownership models. Mid-market manufacturers, including those that are listed or backed by private equity, are a major part of the UK's economy but are often overlooked in government policy.

In contrast, Germany takes great pride in the Mittelstand. It is seen as the backbone to not only the economy but the country as a whole – providing innovation, investment, exports, social cohesion and sustainable growth.

Boosting the productivity of the UK's 5.9 million small and medium-sized businesses to match that of Germany could add up to £100bn to our economy and improve the competitiveness of UK business[2].

This is a potentially enormous prize. But it is one that we risk missing out on unless manufacturing is carefully nurtured through a clear, targeted, balanced and long-term government policy.

THE CASE FOR A COMPETITIVE TAX POLICY

BEFORE DELVING INTO OUR DETAILED TAX PROPOSALS FOR THE MANUFACTURING SECTOR, WE FEEL IT IS IMPORTANT TO FOCUS BRIEFLY ON TAX IN THE WIDER ECONOMY.

We recognise that after borrowing more than at any other time outside wartime, the Government will be under significant pressure to recoup the costs of fighting COVID-19 and delivering post-COVID stimulus packages.

We also sense that tax increases, particularly those borne by large corporates and wealthy business owners, could be seen as an easy way of refilling the Government coffers.

The Conservatives have previously ruled out raising income tax, national insurance or VAT, but could argue that a few extra percentage points on the corporation tax rate would allow companies to help shoulder some of the COVID-19 burden without affecting the average citizen. This could be seen as a compelling argument when the rate of UK corporation tax is significantly lower than in countries such as Germany, France or Spain.

But we think that would be a mistake, for two reasons.

The first is that corporation tax is not a particularly large earner for the Exchequer, accounting for only around 8% of tax revenues in the last financial year[3]. And when we consider that HMRC estimates the latest “tax gap” to be £31bn in unpaid taxes, with £8.5bn being down to avoidable mistakes, it is clear that simplifying the UK tax system to close the “tax gap” could have a far bigger impact on government revenues than tax increases.

The second is that any corporation tax rises could have a significant impact on business investment.

The UK’s reputation as a great place to do business has already suffered from the loss of access to European markets caused by leaving the EU.

Increasing corporation tax will only add to the impression that the Government doesn’t care much for business. In addition, with tax increases in a number of other countries expected in the near future, most notably the USA, maintaining the corporation tax rate in the UK is likely to significantly increase the UK’s attractiveness relative to other jurisdictions.

Of course, if there is overwhelming public pressure to raise the headline rate of corporation tax, then the hike should be as low as possible, certainly no more than 1% or 2%, and be time limited with a clear route back to more competitive rates.

But, most importantly, the Government should ensure any increase in the headline rate of tax is combined with a set of clear and targeted incentive regimes.

These should have the aim of supercharging investment in key areas of the economy, so that the whole of the UK can build back as a green, sustainable and digitally advanced economy.

There is promise for such a plan through the ‘corporate tax roadmap’ and we hope the Government follows through on this.

45% of manufacturers said an increase in the headline rate of UK corporate tax would negatively impact decisions to invest in the UK[4]

A TAX MANIFESTO FOR MANUFACTURING

THERE ARE MANY WAYS TO SUPPORT UK MANUFACTURING. FROM A POLICY PERSPECTIVE, PERHAPS ONE OF THE EASIEST IS THROUGH TAX INCENTIVES. AFTER ALL, TAXATION IS AN IMPORTANT CONSIDERATION FOR INVESTMENT DECISIONS AND BENEFICIAL TAX REGIMES CAN HELP TO STIMULATE SECTOR GROWTH AND EVOLUTION.

Any tax policy should be considered in light of the current Government consultation for a new subsidy control regime post-Brexit. However, it is important for policymakers to bear in mind that manufacturing has very different capital and incentive requirements to other sectors. An R&D credit that might be relatively worthless to a service sector business, for example, could be a lifeline for a manufacturing small-to-medium sized enterprise (SME). This is why manufacturing tax policy needs to be carefully considered from the viewpoint of the industry rather than being lumped into broad-brush measures aimed at businesses in general.

Furthermore, this manufacturing-centric view needs to encompass the wide range of companies that make up the industry and the equally wide range of life-cycle stages and requirements they are experiencing.

Thus, a holistic manufacturing tax policy needs to work just as well for a research-driven urban start-up as it does for a global automotive or aviation parts supplier.

Finding tax levers that support this focused but wide set of industry characteristics is not easy, but we believe there are tools that could be used to address six key requirements common to almost all UK manufacturers:

- Access to skilled workforces
- Access to finance for investments
- Reductions in the cost of manufacturing premises and assets
- Realising the benefits of clustering
- Incentives for entrepreneurs and owner managers
- Support for trading and moving goods globally post-Brexit.

Some of these requirements are being partially met through current tax measures. But in most cases, we think the taxation regimes in place could be improved to better support the sector. What follows are our recommendations for each area.

THE SIX MANUFACTURING TAXATION LEVERS

EMPLOYING SKILLED WORKERS

THERE IS WIDESPREAD AGREEMENT BETWEEN THE MANUFACTURING SECTOR AND WHITEHALL THAT THE INDUSTRY NEEDS TO BE FUTURE PROOFED WITH A SKILLED, HIGHLY PRODUCTIVE WORKFORCE.

The Department for Business, Energy and Industrial Strategy has tried to address this issue with a Business Productivity Review announced back in 2018 and the release of a Skills for Jobs White Paper as recently as January 2021.

However, we believe there is still scope to remove some of the tax barriers manufacturers' face, particularly in deciding whether to hire someone, invest in an apprentice or re-train and upskill existing teams. Done well, policies in these areas could lead to higher-paid jobs, improving and levelling up the economy.

MANUFACTURING PROVIDES **AVERAGE WAGES** **13%** **HIGHER** THAN THE REST OF THE ECONOMY[1]

OUR PROPOSALS

A SKILLED WORKFORCE

CHANGES TO NIC

The cost of employer National Insurance Contributions (NIC) is ultimately borne by a company's shareholders, finance providers and, somewhat counter-intuitively, employees as the additional cost of employment is not reinvested in staff.

In fact, an EU agency report[5] found that strong positive employment impacts were more likely with policies based on reducing employer social security costs than with other supply-side measures such as hiring subsidies.

Therefore, we consider it is important the Government considers ways to reduce the non-wage cost of employment for employers by implementing the following proposals:

- NIC holiday schemes: Businesses were able to claim up to £5,000 as a deduction from the employer NICs due for each of the first 10 employees they employed during 2010 to 2013. We encourage the Government to re-introduce a similar scheme, with consideration given to larger payments creating more than 100 jobs. This would give employers a motive to invest in the workforce.
- NIC thresholds: Aligning primary and secondary Class 1 NIC thresholds would cut payroll administration time and costs, helping employers in challenging economic circumstances. The Government should also review the specialist NIC upper secondary threshold for those under 21 and apprentices under 25.
- A targeted NIC allowance: In April 2020, the Government reduced the eligibility criteria for the employment NIC allowance. Given that this decision was made at the early stages of the COVID-19 pandemic, we encourage the Government to reconsider. It should either increase the eligibility threshold (currently up to £100,000 of annual NIC costs) so that more employers can benefit or increase the benefit itself, for example by increasing the current £4,000 allowance to £10,000 for the next two years.

EMPLOYING SKILLED WORKERS

OUR PROPOSALS

A SKILLED WORKFORCE

NATIONAL MINIMUM WAGE (NMW)

The Government has announced increases to NMW from 1 April 2021. We acknowledge it is important that wages represent the real cost of living and support the Government in its attempt to close this gap.

However, the Government should consider the knock-on impact of these costs (such as employers NIC) have on employers. This cost can have a detrimental effect on employment when the NMW is increased.

Therefore, we encourage the Government to introduce a temporary concession so that employers only pay the increased wage and not the increased taxes for employing NMW personnel, leaving companies with additional cash to reinvest.

This should be reviewed in the future alongside the next Low Pay Commission review and NMW increase. We anticipate it would help to protect employment at a time when employers are looking carefully at the costs of retaining their workforce, particularly in the manufacturing sector.

INCENTIVES FOR TRAINING AND THE APPRENTICESHIP LEVY

Providing tax incentives that align education or training with the specific skills - such as STEM subjects or robotics and automation - required by most advanced manufacturers could give the UK a skills advantage and put it in a strong position to attract investment.

There are different ways this could be achieved. We believe the key is to ensure incentives achieve the desired results and as Hone-All Precision Director Andrea Wilson points out, they need to be suitable for all businesses, including SMEs.

A tax incentive relief similar to the R&D credit regime is one option. But the Government has recently paid businesses for Brexit-related customs training, so why not do something similar to help retrain staff within the manufacturing sector?

We would also encourage the Government to review of the current Apprenticeship Levy scheme to explore how the funding could be better utilised to drive job creation across the manufacturing industry, and in particular support SMEs. This could include removing the current 5% contribution towards apprenticeship training for SMEs so that the training costs are fully funded by the Government.

"There needs to be a change in attitude and approach by Government. The current funding model is based on suiting larger businesses, but the majority of UK manufacturing and engineering businesses are SMEs. Therefore, tax breaks for training, similar to R&D relief, and focused specifically on SMEs would be hugely beneficial."

ANDREA WILSON, Director at **Hone-All Precision Ltd**

FINANCING INVESTMENTS

MANUFACTURING IS CAPITAL INTENSIVE. THERE IS PROPERTY TO BE BOUGHT OR RENTED, MACHINERY TO MAINTAIN AND PEOPLE TO BE PAID TO MAKE IT ALL TICK.

A 21st century tax system should factor this in so manufacturing is not hindered compared to less capital-intensive sectors, such as digital technology.

Manufacturing businesses understand this, and tools such as the R&D tax relief have helped many businesses, particularly SMEs and mid-market manufacturers, to invest. There is still more that can be done to support the manufacturing sector, however.

61%

OF MANUFACTURERS SAID THAT **AN INCREASE OR SIMPLIFICATION OF R&D RELIEF** WOULD MAKE THEM **MORE LIKELY TO INVEST IN THE UK**[4]

OUR PROPOSALS

ACCESS TO FINANCE

R&D TAX RELIEF

For two decades, the UK R&D tax scheme has provided an incentive for companies to innovate. R&D spend has increased every year. But in uncertain times, such as we face now with COVID-19 and the UK leaving the EU, businesses generally tend to reduce R&D spend.

This may put UK companies at a disadvantage compared to their peers if other governments increase innovation support. Now that the UK is no longer part of the EU, the Government should take a more bullish stance on supporting local innovation.

Furthermore, R&D tax relief can help the UK manufacturing sector to address key areas of the economy, such as digitalisation and sustainability. Therefore we suggest:

- Revamping the SME regime in the same way the large company regime was changed to a R&D expenditure credit. This would allow SMEs to consider credits above the line, improving valuations and attracting greater levels of investment.
- Expanding qualifying R&D cost categories to include the rent of essential facilities and equipment.
- Allowing companies that get preapproval to submit R&D claims on a quarterly basis, to improve cashflow and drive more innovation.

Studies show that on average for every £1 of R&D incentive a government provides it generates an additional £1.40 of spend by businesses[6]

FINANCING INVESTMENTS

ACCESS TO FINANCE

OUR PROPOSALS

GRANT FUNDING

With a post-Brexit era allowing the Government to move away from EU state-aid restrictions and re-write its subsidy control mechanisms, there may be scope for the Government to significantly increase grant funding to companies.

On one hand, this could take the form of increased grant funding and availability for industries most impacted by COVID-19 and the UK leaving the EU, including a simplified process and new capital and innovation grants encouraging businesses to invest in their UK facilities and technical expertise.

On the other, it could also involve introducing non-competitive grants, so companies have access to funding in growth sectors such as cleantech or robotics. These grants should be based on a predefined set of criteria, demonstrated via an application and paid out in arrears.

PATENT BOX

The patent box regime was introduced under a previous administration to attract investment to the UK. It encourages businesses to own or hold exclusive licenses over patented intellectual property in the UK, by taxing profits generated from those patents at a rate of 10%.

Subsequent changes mean that associated R&D activity must also be carried out in the UK in order to access the regime. We suggest now is the time for the Government to consider expanding the scope of the patent box regime to include a broader selection of intellectual property, for example software, or allowing productivity increases from patented processes to more easily benefit from the regime.

Compared to other territories, this change could help increase the UK's attractiveness as a place to own and develop intellectual property. Given that R&D activity should also be carried out in the UK, we would expect it to drive significant benefit for the economy as a whole.

Expanding the scope of intellectual property which falls within the regime may also help a significant number of smaller UK businesses for which the cost of patent protection is seen as prohibitive. In addition, the complexity of the regime's various tracking and tracing requirements is too great an administrative burden for most small business, leading to them not taking advantage of the regime. This may be seen by the fact that 92% of patent box relief is currently claimed by large companies[7].

92%
OF PATENT BOX RELIEF **IS CLAIMED BY LARGE COMPANIES**[7]

56%
OF RELIEF **CLAIMS WERE MADE BY MANUFACTURING COMPANIES...**

...ACCOUNTING **FOR 30% OF THE RELIEF CLAIMED**[7]

FINANCING INVESTMENTS

OUR PROPOSALS

ACCESS TO FINANCE

NEW INCENTIVES TO PROMOTE THE CIRCULAR ECONOMY

As we have noted before, the Government has stated it wants to build back the UK as a green economy following the COVID-19 pandemic. With the UK hosting the United Nations Climate Change Conference in November 2021, now is the time to set out clear incentives to drive business investment. We believe this approach is widely supported by business.

Manufacturers can play a key part in this drive for a green economy, so we encourage the Government to think carefully about measures such as:

- Tax credits for manufacturers that invest in reducing carbon emissions.
- Enhanced R&D relief for manufacturers that re-engineer products to allow for disassembly or easier recycling.
- Industry partnerships to design new ways of using waste from one manufacturing process as a resource for another.

These are just a few ways in which the manufacturing sector can be at the forefront of helping the UK to build back as a green economy.

Despite the current fiscal climate, it is time for the Government to invest in this crucial area through a comprehensive set of tax incentives. Any delay is only going to increase the overall cost to the Government if it is meet its stated goals on climate change.

51%

IF YOU WERE CHANCELLOR HOW WOULD YOU USE THE POST-BREXIT FREEDOMS TO INCREASE BUSINESS INNOVATION IN THE UK? THE TOP OPTION **PICKED BY 51% OF MANUFACTURERS** WAS SUPPORTING CO_2 REDUCTIONS BY GIVING TAX RELIEFS WHERE COMPANIES INNOVATE TO MEET ENVIRONMENTAL STANDARDS[8]

REDUCING THE COST OF CAPITAL

STARTING AND GROWING A MANUFACTURING BUSINESS IS NOT CHEAP. COMPARED TO A DIGITAL BUSINESS, WHERE CAPITAL COSTS MAY BE LIMITED TO LAPTOPS AND OFFICE FURNITURE, MANUFACTURERS OFTEN HAVE TO FOOT SIGNIFICANT BILLS FOR PLANT, MACHINERY, BUILDINGS AND SO ON.

Thus, if we want increased investment in our manufacturing sector, the Government needs to help reduce the cost of capital. It does this in a few ways already, but we believe it could go further.

THE MANUFACTURING SECTOR CLAIMS THE **GREATEST AMOUNT OF CAPITAL ALLOWANCES,**

ACCOUNTING FOR **12%**

OR **£12.2 BILLION**, OF THE TOTAL AMOUNT CLAIMED[8]

OUR PROPOSALS

LOWER THE COST OF CAPITAL

ANNUAL INVESTMENT ALLOWANCE

The Annual Investment Allowance (AIA) is a valuable tool for the sector in helping to reduce the post-tax cost of capital investment. It encourages investment by allowing all businesses to write off the cost of qualifying plant and machinery in the year in which expenditure is incurred, up to an annual limit. Currently this limit is £1m per annum until 1 January 2022.

But history shows that the AIA limit has been chopped and changed at almost every Budget, providing manufacturing businesses with no certainty as to the cost of medium to long-term investment plans.

In our New Economy Report we called for the AIA limit to be increased to £5m for 5 years.

This would be a welcome expansion to the scheme and would help to stimulate significant medium and long-term investment by manufacturing businesses.

But in the current climate, it may be harder to justify an increase in the limit above the current level, especially when the increased limit will benefit a small number of the largest taxpayers. So if the fiscal climate does not allow for an increase in the current AIA limit, the most crucial factor is to provide certainty for businesses.

Therefore we would encourage the Government to commit to maintain the current AIA limit at £1m for at least for the full term of the current parliament to 2024.

65%

OF MANUFACTURERS SAID THAT AN INCREASE IN TAX INCENTIVES FOR CAPITAL EXPENDITURE WOULD PROMPT THEM TO MAKE INVESTMENTS IN THE UK THEY WOULDN'T OTHERWISE HAVE MADE[4]

HMRC's statistics state that the number of AIA claims increased by 12% between FY/17/18 to FY18/19, driven by the increase in AIA from 1 Jan 2019 to the current threshold of £1m[9]

REDUCING THE COST OF CAPITAL

OUR PROPOSALS

LOWER THE COST OF CAPITAL

ENHANCED ALLOWANCES FOR CUTTING-EDGE MANUFACTURING TECHNOLOGY

Existing manufacturing is a capital-intensive business. And investing in new-generation manufacturing technology requires even more investment. But it's important that the UK makes these investments to close the productivity gap and keep pace with competitors around the world.

There are a number of reasons for the UK productivity gap, but one consistently quoted is the low rate of capital investment in cutting-edge manufacturing technology.

We would like the Government to focus on this issue by helping business finance investment in new manufacturing technology through a scheme of enhanced capital allowances. This could be via an increase in the AIA or by a special pool for capital allowances where a deduction can be claimed in respect of qualifying expenditure over four years (as opposed to 15 years under the general pool).

STRUCTURES AND BUILDINGS ALLOWANCE

The reintroduction of the Structures and Buildings Allowance (SBA) was a welcome change. But to encourage investment in the construction or renovation of buildings or structures, the Government should consider providing an enhanced SBA to certain sectors or areas which align with its stated priorities.

This could be targeted at carbon-neutral buildings or the Government's bidding prospectus for UK freeports. Here it intends to offer an enhanced SBA rate allowing businesses to reduce taxable profits by 10% of the cost of an investment every year for 10 years, compared with the standard 3% per annum over 33.3 years.

BUSINESS RATES

Business rates are crippling to a lot of industry sectors, including manufacturers, and provide a significant disincentive for capital investment. We consider their focus is wrong, as it is based on the rateable value of a building or land - which can be significant for factories and manufacturing sites.

Thus, the business rates system needs a complete reform to ensure it works fairly and equally for manufacturers and other capital intensive sectors compared to online technology businesses. In our view, this reform should focus on taxing the activity within a building rather than the value of the land on which it sits, meaning that business rate liabilities are not a fixed cost but instead are proportional to the revenues and profits of a business as is the case with other taxes.

In the short-term we want the Government to do more to support manufacturing businesses. This could be in the form of discounts or holidays for manufacturers, as companies have in the hospitality sector, to put manufacturing businesses on a level playing field with technology-driven ones.

At the very least, the Government should offer rates reductions for businesses making investments that align to stated policies, such as capital expenditure which increases the productivity of a site or increases the energy efficiency of factories, or investments in enterprise zones (see next section). The Government wants businesses to make these investments, but at present, where such investments increase the rateable value of a building, the additional business rates that arise act as a significant disincentive to investment.

STAMP DUTY LAND TAX

Stamp Duty Land Tax (SDLT) can be a major cost for manufacturing businesses, preventing investment in new factories and land. The Government should consider reducing this cost via a specific discount on SDLT rates for the manufacturing sectors the UK wants to incentivise, or where investment is made in specific locations (see next section).

Alternatively, policymakers could consider giving manufacturers the option of spreading the cost of SDLT over a number of years and align payment to the revenue generated from the manufacturing investment.

REALISING THE BENEFITS OF CLUSTERING

MANUFACTURING IS OFTEN THOUGHT OF AS A TIME-DEPENDENT INDUSTRY, BUT LOCATION MATTERS TOO.

Take the positive effect that clustering can have on the wider supply chain, for example for technology in Silicon Valley or blockchain companies in Zug, Switzerland, over the past few years.

UK examples include London's Tech City for technology companies and the City of London and Canary Wharf for financial services. These clusters attract foreign direct investment, foster innovation, draw in skilled staff and lead to the cross-pollination of ideas. These 'spill-over effects' all make significant contributions to economic growth.

In manufacturing, it is noteworthy that Welsh businesses have the highest turnover in the sector, in part driven by the clustering of manufacturers around aerospace and other technology-driven initiatives. And for manufacturers, location isn't just about having access to suppliers, but also workers and distribution routes.

MIRA Technology Park Enterprise Zone celebrating a decade in business[10]

- National centre of excellence for UK automotive development
- Home to over 35 global OEMs and Tier 1s
- Created and safeguarded over 600 high value jobs in specialist areas
- It has become a global technology cluster bringing companies from around the world to the UK
- International companies account for over 70% of the parks total revenue

OUR PROPOSAL

CLUSTER IN SUITABLE LOCATIONS

ENTERPRISE ZONES

There has been much talk about freeports recently, but enterprise zones can deliver clustering effects that can be particularly valuable if linked to government priorities. Clustering the specific reliefs and incentives into a specific area or manufacturing base should help to attract more manufacturing to the area and build on the economic multiplier effect.

There are already several enterprise zones in local areas, but the number and scale of these should be significantly increased to realise the benefits of clustering.

An alternative could be to empower regional growth funds to target manufacturing sectors that are strongest in particular regions, such as automotive in the Midlands, aerospace in Wales or chemicals in the North East.

Not only would this help to drive investment in the manufacturing sector but it would also align with the Government's levelling-up agenda.

PROVIDING INCENTIVES FOR ENTREPRENEURS AND OWNERS

THE UK IS BLESSED WITH A VIBRANT MANUFACTURING START-UP SCENE AND THE GOVERNMENT GENERALLY RECOGNISES THE NEED TO PROVIDE INCENTIVES FOR ENTREPRENEURIAL ACTIVITY.

One example of this is Employee Ownership Trusts (EOTs), introduced in 2014 to facilitate employee ownership.

Incentives include tax breaks to encourage employee-ownership models. However, to qualify for the tax incentives the employee ownership needs to be structured in a complex way.

Simplifying EOTs is just one of our recommendations to reward entrepreneurship and owner managers and one that we expect would lead to additional entrepreneurial investment in UK manufacturing.

455

MANUFACTURING COMPANIES RAISED

£186M

OF INVESTMENT THROUGH THE ENTERPRISE INVESTMENT SCHEME IN 2017-2018[11]

OUR PROPOSALS

INCENTIVISED OWNER MANAGERS

EMPLOYEE OWNERSHIP TRUSTS

We encourage the Government to widen the eligibility criteria of EOTs. Beside the financial incentives, there are practical benefits associated with being owned by an EOT, such as greater staff engagement, commitment and performance, reduced absenteeism and a greater drive for innovation.

BUSINESS PROPERTY RELIEF

Business Property Relief (BPR) allows shares in unquoted manufacturing businesses to be wholly or partly sheltered from inheritance tax. This means family businesses can be passed down through the generations without having to be sold or stripped of assets to pay for inheritance tax bills.

We believe it is vital this relief is maintained, or the long-term viability of family-owned manufacturing businesses would be severely jeopardised.

ENTERPRISE INVESTMENT RELIEF AND SEED ENTERPRISE INVESTMENT RELIEF

The tax breaks afforded to Enterprise Investment Scheme and Seed Enterprise Investment Scheme investors are an important incentive for investment in higher-risk start-ups. And with the UK leaving the EU, decarbonisation and technological advances, the need to fund early-stage businesses is likely to grow.

These reliefs drive significant investment in the manufacturing sector. Therefore we encourage the Government to retain these important reliefs and use the opportunity of leaving the EU to simplify the current overly complex rules.

CAPITAL GAINS TAX RATES FOR ENTREPRENEURS

The tax system should reward entrepreneurs who take on personal risk, create value, deliver tax streams and provide employment. We consider that investors of all ages should be rewarded for their efforts through generous Capital Gains Tax (CGT) rates, as effort in building value should be rewarded irrespective of the age of the entrepreneur.

We strongly argue for retaining low CGT rates for business disposals to encourage entrepreneurs to reinvest company profits to build their business, which is particularly critical to capital-intensive sectors such as manufacturing.

DEEMED INCOME ON RETAINED PROFITS

There have been proposals for taxing retained profits in closely held SME businesses at a higher corporation tax rate or applying dividend rates when profits are realised on a share sale.

As above for CGT rates, such a policy could discourage entrepreneurs from retaining profits in their companies as a buffer against uncertain times and to fund future investment. Now more than ever, manufacturing needs a stable environment to allow for capital investment.

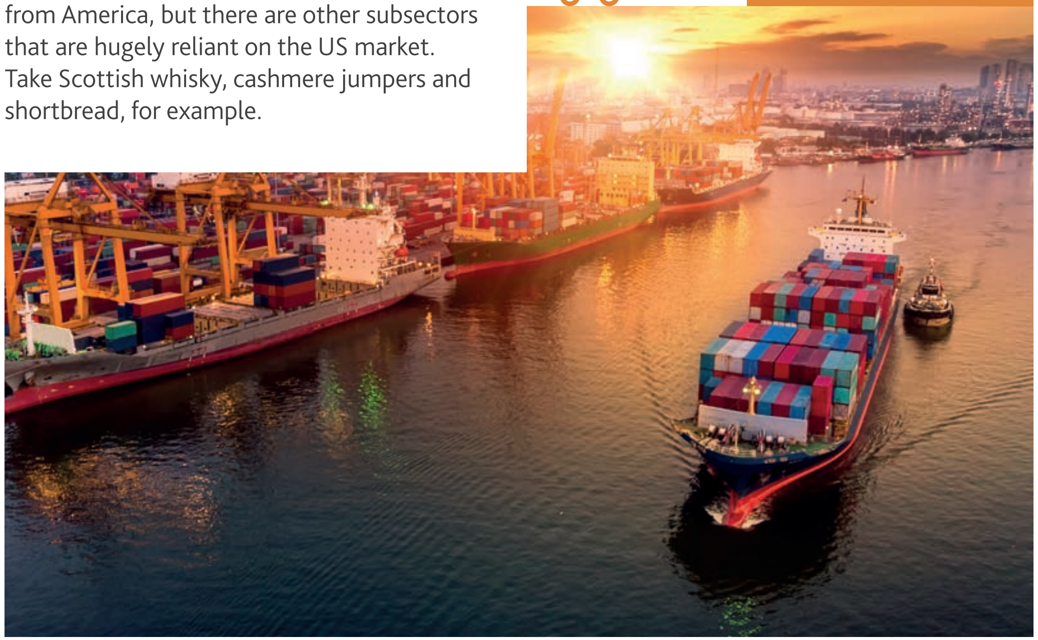
TRADING AROUND THE WORLD

MORE THAN 85% OF NET FOREIGN DIRECT INVESTMENT INTO UK MANUFACTURING HAS TYPICALLY COME FROM EUROPE AND THE AMERICAS, OUR CLOSEST TRADING PARTNERS[12].

Taking away the EU as a single trading bloc, the US represents the UK's largest export market to a single territory, accounting for £54.4bn of sales[1].

Automotive and pharmaceutical exports are the largest sources of manufacturing revenue from America, but there are other subsectors that are hugely reliant on the US market. Take Scottish whisky, cashmere jumpers and shortbread, for example.

MANUFACTURING ACCOUNTS FOR
53%
OF THE UK's TOTAL EXPORTS[1]



OUR PROPOSALS

AGENCY AND PARTNERSHIP SUPPORT

In June 2020, the Government announced strategic interventions to help boost digital trade and help turn the UK into a global tech powerhouse.

The measures announced included the creation of a new Digital Trade Network for Asia-Pacific, to support UK SMEs in breaking into the Asian market.

They also included the launch of a new Tech Exporting Academy to provide expert advice to UK companies on areas essential to expansion, including regulation, intellectual property and tax compliance overseas.

Given the importance of the manufacturing sector to the UK economy, we see no reason why a similar intervention could not be made to support the export of goods.

As the UK strikes more free trade agreements, the ability of business to maximise the potential opportunities these agreements provide will be key to the economy building back from the current COVID-19 pandemic.

GLOBAL TRADE

PRIORITISING TRADE DEALS

We salute the Government's intention to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPATPP) and build trade links with Asian, Australasian and American partners.

However, the CPTPP territories only represent around 9% of UK exports[13], so ministers shouldn't lose sight of the importance of markets closer to home. In particular, having signed a deal with the EU, the UK Government must now focus on a free trade agreement with the USA to support UK businesses that export to America.

THE UK EXPORTS
£54.4bn
OF MANUFACTURED GOODS
TO **THE USA**

AND **£18.3bn**
OF MANUFACTURED GOODS
TO **CHINA**[1]

CONCLUSION

YES, THESE ARE TRYING TIMES.

YES, THE GOVERNMENT HAS A LOT ON ITS PLATE.

AND YES, THE MASSIVE LEVEL OF SPENDING INCURRED DURING AND AFTER THE COVID-19 PANDEMIC WILL PUT PRESSURE ON MINISTERS TO RAISE TAXES WHEREVER POSSIBLE.

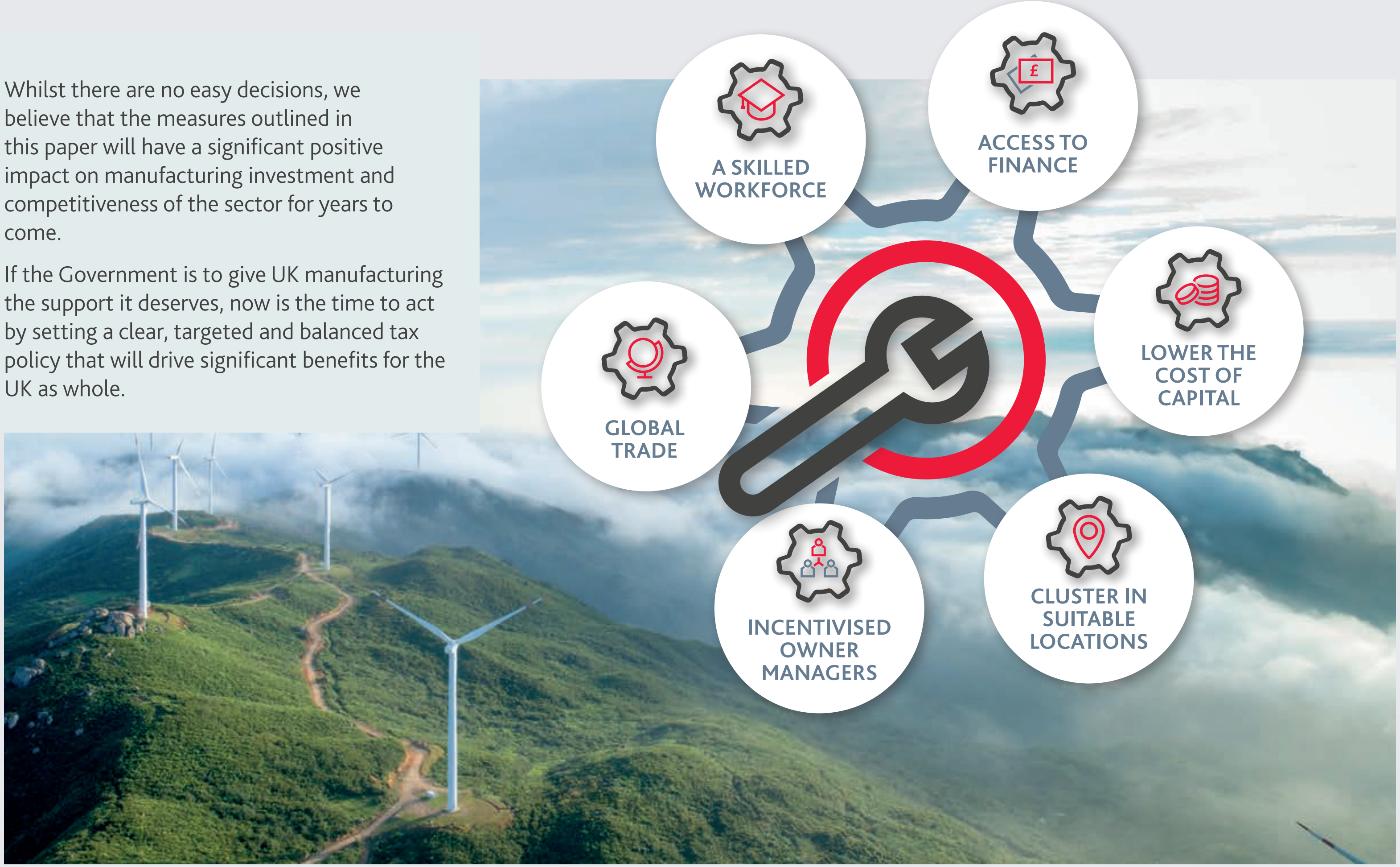
But neglecting the UK's manufacturing industry could have long-lasting impacts on our nation's ability to compete on a global stage. And increasing taxes carelessly could have adverse knock-on effects for this critical sector.

Where possible, the Government should maintain investment in manufacturing and leverage its huge potential to support building back a green economy, improving digitalisation and productivity and levelling up the regions.

Failure to set out a clear strategy and invest in these policy areas now is only going to increase the costs in the future if the Government is to meet its stated goals.

Whilst there are no easy decisions, we believe that the measures outlined in this paper will have a significant positive impact on manufacturing investment and competitiveness of the sector for years to come.

If the Government is to give UK manufacturing the support it deserves, now is the time to act by setting a clear, targeted and balanced tax policy that will drive significant benefits for the UK as whole.



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