HM TREASURY DWP Department for Work and Pensions HM Revenue & Customs

Autumn Statement 2011 policy costings

November 2011

HM TREASURY DWP Department for Work and Pensions HM Revenue & Customs

Autumn Statement 2011 policy costings

November 2011

Any queries regarding this publication should be sent to us at: public.enquiries@hm-treasury.gov.uk.

ISBN 978-1-84532-912-9
PU1229

Contents

		Page
Chapter 1	Introduction	3
Chapter 2	Policy costings	5
Chapter 3	Financial transactions	29
Annex A	Office for Budget Responsibility: certification of policy costings	33

1 Introduction

1.1 This document sets out the assumptions and methodologies underlying costings for tax and Annually Managed Expenditure (AME) policy decisions announced since the last Budget, that have a greater than negligible impact on the public finances. This continues the practice established at June Budget 2010 and the principles outlined in *'Tax policy making: a new approach'*, published alongside June Budget 2010[1]. This publication is part of the Government's wider commitment to increased transparency.

1.2 Chapter 2 presents detailed information on the key data and assumptions underpinning the costing of policies in the Autumn Statement. It also shows where long-term costs are expected to differ from those in the forecast period.

1.3 Chapter 3 covers the Business Finance Partnership, a significant financial transaction expected to impact on net debt. Table 2.4 of the main document shows the impact on the Central Government Net Cash Requirement (CGNCR). The National Loan Guarantee Scheme is not covered as it involves a guarantee and is not expected to impact on net debt in the same way. The note covers the methodology for estimating the impact of the Business Finance Partnership on both public sector net borrowing and net debt.

1.4 Annex A, by the OBR, provides commentary on the certification process and highlights areas of particular uncertainty. This is in line with the practice for previous policy costings documents.

[1] The Government's approach to policy costings is set out in Chapter 1 of *'Budget 2011 policy costings'*. This explains in detail what policy costings are, which measures they cover and their role in the public finance forecast. It gives further information on the methodology for producing costings, including estimating the static, behavioural and wider economy impacts.

2 Policy costings

The following policy decisions are included in this chapter:

- VAT: low value consignment relief
- Manufactured overseas dividends
- North Sea oil and gas – Ring Fenced Expenditure Supplement
- Air Passenger Duty for long haul departures from Northern Ireland
- Air Passenger Duty: Extension to business jets
- Housing Benefit changes
- JSA training
- Fuel duty
- Asset-backed pension contributions: tax treatment
- Bank Levy
- Freeze the Capital Gains Tax (CGT) Annual Exempt Amount (AEA) for 1 year
- 6 month extension of Small business rate relief holiday
- Business Rate Deferral Scheme 2012-13
- Climate Change Levy: relief for electricity
- Seed Enterprise Investment Scheme (SEIS): scheme and 2012 CGT Holiday
- VAT cost sharing exemption
- Capital Allowances: Enterprise Zones
- Gifts of pre-eminent objects
- Tax Credits
- Pension Credit uprating
- Public sector pay restraint

VAT: low value consignment relief

Measure description

Low value consignment relief (LVCR) exempts from import VAT commercial consignments imported into the UK from outside the EU, where the value of the goods is under £15. This measure withdraws LVCR on all low value imports from the Channel Islands with a proposed implementation date of April 2012.

The tax base

The tax base is the total expenditure on commercial consignments under £15 from the Channel Islands. This is estimated using sales data provided by the Channel Islands. The data covers the value and volume of items, below £15, sold to UK consumers. This is estimated to be £545 million in 2010-11 and this total is then projected forward in line with OBR's forecast for consumer expenditure.

Static costing

The static impact is calculated by multiplying the tax base by the current main rate of VAT (20 per cent). The results are shown below and presented on a National Accounts basis.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	+115	+120	+130	+135	+140

Post-behavioural costing

There is a behavioural effect in this costing, based on an assumed price elasticity of -1. The price elasticity measures the responsiveness of demand to a change in price. In this case, it is assumed that a 1 per cent increase in price will lead to a 1 per cent fall in the volume of consumption. We have also assumed a non-compliance rate of 5 per cent, which is consistent with the current VAT Gap.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	+90	+95	+95	+100	+110

Areas of uncertainty

There has been a recent drop in sales from the Channel Islands and there is some uncertainty whether expenditure within this market would continue to grow at the rate of overall consumer expenditure.

Manufactured overseas dividends

Measure description

Manufactured Overseas Dividends (MODs) are payments made under an arrangement for the transfer of overseas shares. This measure will prevent tax losses from a newly disclosed avoidance scheme that could result in companies using MODs to offset against Corporation Tax (CT) liabilities.

The measure took effect in September 2011.

The tax base

Information about the impact on receipts is derived from data about groups who have undertaken the scheme. The base is estimated by applying this to comparable groups who might be likely to undertake the scheme.

Costing

It is assumed that, without these changes, the scheme would be relatively straightforward to repeat. The scheme is unusual in that it can be used to generate a CT repayment even within a tax exhausted company, so no discount is made for losses. The costing is presented below combining both the cost of CT repayments and deductions made to the entities concerned.

The costing does not allow for any attrition; HMRC judge that there are unlikely to be further related avoidance routes available.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	+30	+40	+40	+40	+40

North Sea oil and gas - Ring Fence Expenditure Supplement

Measure description

Ring Fence Expenditure Supplement (RFES) assists companies that do not yet have sufficient taxable income against which to set their costs and capital allowances. RFES currently adds a 6 per cent per annum supplement to the amount of losses carried forward from one period to another for up to six accounting periods (not necessarily consecutively), to maintain the time value of exploration, appraisal and development costs.

This measure increases the rate of supplement from 6 per cent to 10 per cent for accounting periods beginning on or after January 2012.

The tax base

The tax base is estimated by extracting data for eligible loss-making companies to determine the extent of the losses available to carry forward and offset against taxable income. The analysis is based on 30 companies that are forecast to make losses up to the end of the forecast period. The tax impact of RFES at 6 per cent and 10 per cent was estimated by inflating net losses by the relevant rate for up to the maximum of 6 years for which the supplement can be claimed.

Costing

This measure can have the effect of delaying the point at which companies begin to pay tax and reduces the amount of tax due once a company becomes profitable. Taxable profits are subject to a 62 per cent tax rate, or 81 per cent for some older fields subject to Petroleum Revenue Tax. The table below shows the impact in the forecast period of this measure, on a National Accounts basis. Costs in some years beyond the forecast period are likely to be higher as specific projects come on-stream.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	-5	-5	-50	-10

Areas of uncertainty

There is considerable uncertainty in the timing of the costs to Government. As the costs will be incurred at the point that each company comes into profit, they are highly dependent on the timing of individual companies' investments and other factors that affect the levels of profits or losses oil and gas sector companies make, which change from year to year.

Air Passenger Duty for long-haul departures from Northern Ireland

Measure description

This measure reduces the rate of Air Passenger Duty (APD) charged on direct flights to Band B, C and D destinations from Northern Ireland. From November 2011, all direct flights from Northern Ireland to long haul destinations will be charged at the Band A rate of tax (currently £12 reduced rate and £24 standard rate per passenger).

The tax base

The tax base is all passengers flying on aircraft with a take-off weight of more than 10 tonnes or equipped to carry 20 or more passengers. In terms of direct long haul services, there is currently a scheduled service and two charter services flying directly from Northern Ireland to Band B destinations. Passenger numbers have been estimated using Civil Aviation Authority data, projected for future years using passenger growth forecasts.

Static costing

The static Exchequer impact is calculated by multiplying the difference between the economy Band A and Band B rates by the projected passenger numbers.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	Neg	Neg	-5	-5	-5	-5

Post-behavioural costing

This costing includes an increase in the number of passengers flying directly from Northern Ireland to Band B destinations in response to the policy. This has a negligible impact on the costing.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	Neg	Neg	-5	-5	-5	-5

Air Passenger Duty: Extension to business Jets

Measure description

Effective from April 2013, this policy extends Air Passenger Duty (APD) to all flights with an authorised take off weight of 5.7 tonnes or more. Additionally, all flights making use of aircraft with a certified authorised weight over 20 tonnes and fewer than 19 seats will be subject to a new premium rate of APD, set at twice the standard rate in each of the respective distance bands of the APD system.

Exemptions for certain passengers and flights will apply. These include, but are not restricted to, flights from the Scottish Highlands and Islands, as well as emergency, police and medical flights. Helicopters, and aircraft fuelled by aviation gasoline will also be excluded from the scope of the tax.

The Tax Base

The tax base is all flights which are currently exempt from APD either because they were outside the previous de minimis thresholds or because the passengers were not classified as being carried for reward.

Static costing

The static yield is estimated by calculating the number of passengers who will be brought into the scope of APD as a result of this change, and multiplying this by the relevant APD rate. For passengers on flights over 20 tonnes with fewer than 19 seats the rates are equal to twice the standard APD rate. Passengers on other flights captured by this extension are charged APD based on the current structure.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	+5	+5	+5	+5

Post-behavioural costing

The measure may generate a negligible behavioural effect. As this will not affect the Exchequer yield, the pre-behavioural costing has not been adjusted for behaviour.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	+5	+5	+5	+5

Areas of Uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, there is some uncertainty relating to the estimate of the number of passengers captured by this extension.

Housing Benefit: exemption from the shared room rate for former rough sleepers and ex-offenders

Measure description

From January 2012, the shared accommodation rate (SAR) will apply to single people aged under 35 living in the private rented sector who receive Housing Benefit under the local housing allowance rules, as announced at Spending Review 2010. This measure will exempt two groups from this change: former rough sleepers who have spent three months in a specialist homeless hostel (or hostels); and some ex-offenders who are subject to management by more than one agency under the Multi-Agency Public Protection Arrangements (MAPPA) and who are most likely to pose a risk of serious harm to others. The change will apply from January 2012.

The cost base

Estimates of the number of former rough sleepers potentially eligible for exemption from the shared accommodation rate were estimated using information from the Department for Communities and Local Government and research by the Economic and Social Research Council. Estimates of the number of ex-offenders eligible for exemption are derived from data on MAPPAs from the National Offender Management Service (NOMS).

Costing

The static Exchequer impact is calculated by multiplying the number of exempt individuals by the average loss for the extension of the shared room rate to those aged between 25 and 35. This loss is scaled in future years to reflect growth in rents and LHA rates.

This gives a total estimated cost of £15m in the steady state, reached in 2013/14. Costs are lower in 2012/13, as existing claimants will not be eligible for the exemption until the increased age threshold takes effect.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	neg	-10	-15	-15	-15	-15

Areas of uncertainty

The main area of uncertainty is around the precise number of those exempt.

JSA training

Measure description

This measure will allow people claiming Jobseekers Allowance (JSA) for six months or more to be referred to training of up to and including 30 hours per week and remain on JSA, rather than transferring to a training allowance, provided the training does not have a duration of over 8 weeks. Whilst on training, claimants will be required to remain actively engaged with the labour market. This measure will take effect from November 2011.

The cost base

The cost base will be JSA claimants who have been in receipt of JSA for 6 months or more who have been identified with a skills need. This is estimated to be around 9,000 people per year, based on internal forecasts of training starts (estimated based on historical proportions of starts/claimants, and forecasts of claimants).

Costing

The static costing is based on the estimated number of JSA claimants remaining in training and continuing to claim JSA who would otherwise not have received the benefit.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	neg	-5	-5	-5	-5	-5

Areas of uncertainty

The main area of uncertainty is over the number of individuals who will remain in training.

Fuel duty

Measure description

This measure defers the fuel duty increase that was planned for January 2012 to August 2012. The increase that was planned for August 2012 will be cancelled.

The tax base

The tax base for this policy is every litre of taxable fuel that is imported for use or produced in the UK and delivered for home use from relevant premises. In 2010-11 this amounted to nearly 52 billion litres of fuel. Estimates of the tax base over the costing period come directly from the fuel duty forecast.

Static costing

The static costing is calculated by multiplying the tax base by the change in rates.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	-375	-1,050	-900	-925	-975	-1,000

Post-behavioural costing

Behavioural responses were included to take into account the increase in consumption in response to lower fuel price increases. The behavioural impact is assumed to increase over time as people have time to adjust. For a 1 per cent reduction in pump prices, the model assumes an immediate 0.1 per cent increase in the quantity of fuel consumed, which increases to 0.16 as consumers react to the price change. These elasticities reflect only the impact upon kilometres driven, as changes in vehicle efficiency are largely driven by EU emissions standards

The impact will be to increase Exchequer yield, partially offsetting the reduction in static yield.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	-375	-975	-825	-850	-875	-925

Areas of uncertainty

The main uncertainty in this costing arises from the extent and the speed of the behavioural response.

Asset-backed pension contributions: tax treatment

Measure description

This measure prevents unintended excess tax relief arising for employers making asset-backed contributions (ABC) to their registered pension schemes. The changes will ensure tax relief accurately reflects the amount of payments made by an employer to their scheme, while preserving as much flexibility as possible for employers and pension schemes to continue to use these arrangements.

From November 2011, only those arrangements that fall within the structured finance legislation will be given upfront tax relief for the contribution paid under the arrangement. In such cases, no further relief will then be given on the instalments of the income stream paid to the pension scheme, except the interest element. In all other cases (those that do not fall under structured finance rules) relief will not be given upfront but on payments or amounts as they arise from the income stream. Transitional rules are also introduced.

The tax base

The tax base is a projection of asset-backed contributions made by employers sponsoring defined benefit pension schemes with more than 10,000 members, since this group are most likely to use these arrangements. Approximately half of the value of these employers' pension contributions in relation to deficits is expected to be funded by using asset-backed arrangements that can result in excess tax relief. A further adjustment is made to reflect the fact that not all employers will be profitable and therefore able to claim the upfront tax relief arising as a result of asset-backed arrangements.

Costing

The costing is based on the proportion of the tax base that would be denied upfront tax relief from November 2011 when the new tax rules take effect, i.e. those arrangements not falling within the structured finance legislation, multiplied by the prevailing corporation tax main rate. It is assumed that in future more employers will prefer to use ABC arrangements that fall within the structured finance legislation because of the benefits of upfront tax relief.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	+340	+450	+450	+450	+450	+450

Areas of uncertainty

The main uncertainty in this costing arises from the assumptions made on the tax base.

Bank Levy

Measure description

The Bank Levy was introduced from 1st January 2011. This measure increases the effective full rate of the Bank Levy from 1st January 2012 onwards from 0.078 per cent to 0.088 per cent.

The tax base

The estimated tax base is based on the latest receipts data collected and aggregated by HMRC, from banks liable to pay the Bank Levy. The receipts data for the year to date is used to derive an estimate of Bank Levy liabilities for the full year 2011 and the underlying total balance sheet. An estimate of banks' balance sheets is arrived at by applying changes in balance sheet growth and behavioural impacts. The tax base is expected to grow modestly over the forecast period.

Static costing

The static costing is calculated by applying the change in rate to the tax base data described above.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	+280	+310	+315	+320	+325

Post-behavioural costing

The costing assumes that behavioural changes expected to occur as a consequence of the increase in the rate from 2012 onwards are minimal and broadly in line with those assumed for the introduction of the Levy. These were described in the Budget 2010 policy costings publication. No additional increased avoidance activity is assumed to occur from this measure.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	+280	+310	+310	+315	+325

Areas of uncertainty

The main uncertainties in the costing arise from the forecast for the tax base and the extent of any behavioural response.

Freeze the Capital Gains Tax Annual Exempt Amount for One Year

Measure description

The Capital Gains Tax (CGT) Annual Exempt Amount (AEA) is the threshold below which no tax is paid on chargeable gains made on disposals. This measure freezes the AEA for 2012-13 at the 2011-12 level. Legislation will be introduced in Finance Bill 2012 to automatically increase the AEA in line with the consumer price index (CPI) thereafter.

The tax base

The current number of taxpayers is derived from tax data. Figures are available for 2009-10 and these are projected forward using equity price growth as historically this has proved to be a reasonable predictor. Freezing the AEA will also bring additional taxpayers into the CGT regime and this is estimated by inspecting the numbers likely to be in the vicinity of the affected threshold range. The tax base is then the total number of taxpayers multiplied by the change in the AEA allowable against their gains.

Static costing

The static yield is the tax base multiplied by the average tax rate. CGT is measured on a receipts basis in the National Accounts.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	+30	+30	+35	+35

Post-behavioural costing

A small behavioural effect is allowed for because it is expected that some taxpayers will rearrange their affairs in order to adjust to the revised allowance. The post-behavioural Exchequer impact is presented below.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	+25	+25	+25	+30

Areas of uncertainty

There is some uncertainty around the number of additional extra taxpayers for future years. There is also some uncertainty in the average tax rate for future years reflecting uncertainty in estimating how many taxpayers will pay at 10 per cent, 18 per cent and 28 per cent.

6 month extension of Small business rate relief holiday

Measure description

The small business rate relief (SBRR) holiday doubles the relief given to businesses eligible for SBRR. It offers 100 per cent relief up to a rateable value of £6,000, with relief tapering to the SBRR threshold of £12,000 rateable value. The base SBRR provides 50 per cent relief for eligible businesses, and is funded through the business rates system. This measure extends the SBRR holiday for a further six months from 1 October 2012.

The tax base

The tax base for this measure is the amount of relief given to businesses with hereditaments eligible for SBRR. The primary data source is the Valuation Office Agency's 2010 rating list of non-domestic properties.

Costing

The starting point for the costing is data on the number of non-domestic properties in England with a rateable value of less than £12,000. This figure is adjusted to account for empty properties and hereditaments ineligible for SBRR. These adjustments are based on VOA data on individual hereditaments, DCLG data from Local Authorities and survey results. The result is an estimated number of eligible properties of 520,000. Administrative data for the relief suggests that around 95% of the static yield will be claimed by businesses.

The costing for the measure accounts for the fact that business rates are deductible for Corporation Tax (for companies) and Income Tax Self Assessment (for the self-employed). To estimate this impact, an average effective business tax rate is assumed.

Although Barnett consequentials are not normally applied to taxes, increases in business rate relief in England lead to increased Exchequer (revenue support) grant, all else equal. The costing includes the Barnett consequentials, which are calculated as 19 per cent of the business rate cost at 95 per cent take-up, net of business tax adjustments.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	-210	+5	0	0	0

Business Rate Deferral Scheme 2012-13

Measure description

2012-13 business rates are to be uprated in line with September 2011 RPI at 5.6 per cent. The business rate deferral scheme 2012-13 allows businesses to choose to defer 60 per cent of this increase in their 2012-13 business rate bills, with half of the amount deferred to be repaid in 2013-14 and the final half in 2014-15.

The tax base

The tax base for this measure is the 2012-13 tax base figures, calculated by increasing the 2011-12 business rates return figure by the growth rate between March 2011 and September 2011 Valuation Office Agency (VOA) data. The primary data source is the VOA's 2010 rating list of non-domestic properties.

Costing

Experience of the deferral scheme in 2009 suggests take-up could be around 10%. The result is an estimated £80 million deferred business rates in 2012-13, repaid equally in the following two years. There is an adjustment made to reflect that some businesses that choose to defer their 2012-13 increase may default before repaying back in full.

The costing for the measure accounts for the fact that business rates are deductible for Corporation Tax. To estimate this impact an average effective corporation tax rate is assumed.

Although Barnett consequentials are not normally applied to taxes, changes in business rate receipts in England lead to adjusted Exchequer (revenue support) grant, all else equal. The post-behavioural costings include the Barnett consequentials, which are calculated as 19 per cent of the business rate impact at 10 per cent take-up, net of business tax and non-repayment adjustments.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	-85	+45	+40	0	0

Climate Change Levy: relief for electricity

Measure description

This measure amends the climate change levy (CCL) reduced rate on electricity, which is paid by participants in climate change agreements (CCAs), from 20 per cent to 10 per cent, with effect from April 2013.

The tax base

CCAs are available to up to 5,000 target units (a single industrial facility or group of facilities) across 54 energy intensive business sectors. The tax base affected is electricity consumption by these eligible units. This is estimated to be 38,400 GWh in 2013-14.

Costing

The costing is calculated by applying discounts of 80 and 90 per cent to the main rates of CCL for the tax base described above.

No significant behavioural responses are expected.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	-15	-20	-20	-20

Areas of uncertainty

The main uncertainty in this costing is the projection of energy consumption by eligible target units.

Seed Enterprise Investment Scheme (SEIS): scheme and 2012 CGT Holiday

Measure description

The Seed Enterprise Investment Scheme (SEIS) will be a new tax advantaged venture capital scheme similar to the existing Enterprise Investment Scheme (EIS). The existing EIS scheme gives an income tax relief rate of 30 per cent from April 2011. The SEIS would give a higher income tax relief rate of 50 per cent from April 2012. This would apply to a limited amount of investment, £150k, in a company whose total assets, before investment, are below £200k. In addition, there is a one year exemption from capital gains tax (CGT) where gains realised in 2012-13 are invested through SEIS in the same tax year.

The tax base

The measure applies to investments made in companies qualifying under SEIS. This is estimated by taking annual EIS investment totals and projecting them forward using relevant elements of the OBR's economic forecast. HMRC also has data from accounting records on the total assets of these companies which is used to identify qualifying companies.

Static costing

There are two elements to the static costing, the first relating to the income tax relief and the second to the CGT exemption.

i) The income tax element is calculated by taking the total amount of investment, which falls below £150k, in existing EIS qualifying companies whose gross assets are under £200k and then applying the additional 20 per cent tax relief to that. For companies whose investment is just over the £150k total investment limit it is assumed they would trim the amount of investment to enable investors to qualify for the extra relief.

ii) The capital gains tax element is based on the assumption that, in the absence of the CGT exemption, only a small percentage of SEIS investments would be made from reinvested capital gains. It is calculated by multiplying the tax base by the average CGT rate assumed for SEIS investors.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	-10	-10	-10	-10

Post-behavioural costing

This measure is expected to generate significant behavioural impacts as investors take advantage of the enhanced tax reliefs. There is more impact in 2012-13 affecting 2013-14 receipts due to both the enhanced income tax relief and the CGT exemption being available for investment through the SEIS in that year.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	0	-50	-25	-20	-20

Areas of uncertainty

In addition to the uncertainties surrounding the OBR's economic forecast, the main uncertainties in this costing relate to the likely increases in investment under SEIS in response to the tax reliefs because they relate to the commencement of a new scheme.

VAT cost sharing exemption

Measure description

This measure will allow, in certain circumstances, groups of organisations with VAT exempt and/or non-business activities to share costs between themselves on a non-profit basis without incurring a VAT charge.

The tax base

The measure has the potential to impact organisations in education, charities, housing associations and financial service sectors. It is expected that many uses of the exemption will not have an Exchequer impact. However if organisations restructure to transfer services which they currently buy in, into a cost sharing arrangement, the irrecoverable VAT that they incur will be reduced. The tax base for each sector is estimated using data obtained from consultation responses to derive total irrecoverable VAT that could be lost. The estimate takes into account various conditions that must be met to use the exemption, including services that are "directly necessary" to the exempt and/or non-taxable activity of the members. The total tax base, across all affected sectors is estimated at around £2,350 million for 2012-13. Costs associated with other sectors including health, gambling and sports clubs is expected to be negligible.

Static costing

The static costing is the tax base multiplied by the VAT fraction. This is before any further adjustment for the estimated take-up of the exemption – measured by the total value of services that could be replaced by a cost sharing arrangement. Static costs to the Exchequer (on a National Accounts basis) are presented below.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	-275	-400	-425	-425	-450

Post-behavioural costing

The behavioural element is captured by the extent to which services will be replaced by a cost sharing arrangement. Information obtained during the consultation has been used to provide a best estimate of take-up within each sector. The final costing also includes a small amount for the VAT that may be lost from existing cost sharing groups. Take up will depend on whether the supply received comes from an associated party or a third party.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	-25	-50	-75	-100	-125

Areas of uncertainty

There remains significant uncertainty as the rates of take-up are difficult to predict. The sample sizes are also relatively low.

Capital Allowances: Enterprise Zones

Measure description

This measure enables some companies to claim 100 per cent first-year capital allowances rather than the existing 18 per cent main rate capital allowances or the 8 per cent special rate capital allowance. This applies to qualifying expenditure on plant or machinery for use in designated assisted areas within enterprise zones, subject to a cap of €125 million euros per project. There are currently six projected designated assisted areas.

The tax base

Local Enterprise Partnerships have provided estimated levels of qualifying expenditure for each of the six designated assisted areas. It is estimated that the qualifying expenditure ranges from between £115 million to £410 million per annum over the next few years.

Costing

An adjustment is made to the tax base to disallow for any post-behavioural effects which exist in the tax base. The capital allowance rates and main rate for corporation tax are then applied to the estimated levels of qualifying expenditure.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	-25	-40	-25	-5	Neg.

Areas of uncertainty

It is assumed that the projected levels of expenditure that will qualify for the 100 per cent first-year capital allowance will take place. There is however some uncertainty around the qualifying expenditure as it is not yet certain which projects will go ahead within the designated areas. The Government is currently discussing Enterprise Zones with devolved administrations.

Gifts of pre-eminent objects

Measure description

This measure allows taxpayers to offset some or all of their tax liability against Income Tax, Corporation Tax and Capital Gains tax by giving pre-eminent objects to the nation. The scheme will be run in parallel with the current Acceptance in Lieu (AiL) scheme, in which an estate can offer pre-eminent objects against Inheritance Tax liabilities. This measure will take effect to allow for tax reductions in the tax year starting April 2012.

Under the scheme, individuals will be able to offset a percentage of the value of the donated assets against their liabilities for Income Tax, Corporation Tax and Capital Gains Tax. Total tax reductions under this scheme, and taxes offset under the current AiL scheme, will be subject to an annual limit of £30 million a year overall.

Post-behavioural costing

Responses to consultation on this measure suggest that taxpayers will be keen to take advantage of this measure, and that the total amount of tax offset under both schemes will reach the annual limit of £30 million a year. The cost is therefore the difference between the limit and the amount already being claimed under the existing AiL scheme (about £15 million a year).

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	-15	-15	-15	-15	-15

Areas of uncertainty

It is not clear at this stage how these gifts will be treated for National Accounts purposes. The Office for National Statistics (ONS) will decide this in due course. This costing assumes that the gift would be a capital grant to the Public Sector, and current receipts would be marginally lower to account for tax reductions granted. It is possible that the ONS will decide that a portion of the gift could be assumed to be pre-payment of taxes in which case the capital grant element would be reduced and there would be no negative current receipts element. Both treatments result in the same net borrowing impact.

Tax Credits

Measure description

This measure would freeze the couple and lone parent elements of the Working Tax Credit in 2012-13, and reverse the planned £110 increase in the child element of Child Tax Credit.

The cost base

For changes to the uprating or freezing of elements, the base affected can be taken directly from the tax credits forecast. The forecast is based on data for a sample of finalised 2009-10 awards, updated to reflect the latest estimates of expenditure and numbers of claims. For future years, changes in line with the latest OBR economic forecasts are accounted for, in particular growth in wages and salaries and trend in out-of-work claimants. In 2011-12, the total tax credits expenditure is projected to be £31.7 billion.

Costing

The static impact is calculated by applying the change in element rates to the base data described. There is also a further minor adjustment modelled by DWP to take into account the effect on Housing Benefit and Council Tax Benefit expenditure.

Exchequer impact (£m)

		2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Working Tax Credit: freeze the couple and lone parent elements for one year in 2012/13	AME	0	+220	+240	+230	+230	+235
	Negative Tax	0	+45	+45	+45	+45	+45
Child Tax Credit: reverse the £110 increase to the child element in 2012/13	AME	0	+840	+825	+880	+860	+865
	Negative Tax	0	+135	+130	+140	+130	+130

Areas of uncertainty

There is some uncertainty linked to the HMRC forecast methodology, specifically around the expected level of error and fraud, the assumptions about childcare cost and caseload growth, and the assumptions about the growth in caseload of tax credits recipients without children.

Pension Credit uprating

Measure description

This measure increases the Pension Credit standard minimum guarantee faster than earnings such that, for a single person, it increases by at least the cash increase in the basic State Pension. The Pension Credit savings credit threshold will be increased faster than indexation leading to reduced savings credit expenditure. Housing Benefit and Council Tax Benefit personal allowances for those over Pension Credit qualifying age will be adjusted accordingly.

The measure will take effect in April 2012.

The cost base

The cost base is the current pension credit caseload, based on DWP administrative data. Future benefit expenditure is estimated using DWP's forecasting models for Pension Credit, Housing Benefit and Council Tax Benefit.

Costing

The costing is calculated in two steps: the costs associated the Pension Credit changes; and the 'knock-on' costs due to Housing Benefit and Council Tax Benefit.

The values of the standard minimum guarantee and the savings credit threshold are calculated for each year under the base and reform scenarios. From these the 'typical' change in each recipient's Pension Credit as a result of the measure can be calculated. This is multiplied by the caseload to obtain an estimate of the change in Pension Credit expenditure.

The change in Housing Benefit and Council Tax Benefit is calculated in the same way as the Pension Credit costing.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Guarantee Credit	0	-190	-190	-190	-190	-185
Savings Credit	0	+190	+190	+185	+190	+190

Areas of uncertainty

The increase in benefit for those entitled to guarantee credit only could lead to an increase in take-up, increasing the cost of the measure. However, research on the barriers to claiming Pension Credit suggests that changes to the amount to which claimants are entitled has little impact on take-up.

Similarly, the increased benefit rates may lead to some people becoming newly entitled to Pension Credit, Housing Benefit and Council Tax Benefit. However, the amounts to which they are entitled will typically be small and research suggests that take-up of small amounts of benefit is low.

Public sector pay restraint

Measure description

Public sector pay awards will average one per cent for each of the two years following the end of the pay freeze. Departmental budgets will be adjusted in line with the policy, with the exception of health and schools, where savings will be recycled. The principal impact of the measure will therefore be to reduce public expenditure, through reduced departmental resource spending.

However, the pay policy will also generate an increase in public expenditure, via Annually Managed Expenditure (AME). This is because lower pay awards for public sector workers will also mean a decrease in the pension contributions paid by employees in unfunded public service pension schemes. As these contributions go towards paying out pension benefits, a reduction in contributions means that AME will need to rise to meet pension commitments.

The impact on Total Managed Expenditure (TME) is therefore equivalent to the total departmental savings, minus the impact on AME.

The cost base

The cost base is pension contributions in unfunded public service pension schemes.

Costing

A ratio between departmental and AME savings has been calculated, based on departmental savings from lower employer NICS and average pension contributions in unfunded public service schemes (excluding the NHS and teachers). This is estimated at 20% and has been applied to departmental savings, to calculate the impact on AME.

Exchequer impact (£m) (AME only)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Exchequer Impact	0	-20	-95	-160	-	-

3 Financial transactions

Business Finance Partnership

Measure description

The Government co-invests in a number of funds which provide loan funding to mid-sized businesses (broadly up to £500m turnover) in the UK. The Government receives a return from the funds net of administrative management costs. The Government's principal is repaid once the loans made by the funds expire.

The cost base

Both the costs and benefits incurred by the Government arise from the exposure to the companies that funds lend to. The total return will depend on the terms of the loans made by the funds, net of any losses incurred through default. In addition, the Government must finance its contribution through debt issuance.

HMT will commit a certain amount of funding to each fund manager, up to a total commitment of £1bn. This funding is likely to be allocated over a number of tranches. The Government's total exposure of £1bn is expected to remain at the end of 2016-17 but should be repaid once all loans made by the funds expire.

Static costing

This costing includes an assumption on net returns, which has been informed by discussions with fund managers and other stakeholders.

If a company defaults, Government will incur a loss if the outstanding loan amount is higher than the value of any assets recovered by the fund after the default. The losses on the loans are estimated using Moody's data on cumulative default and loss given default rates (which are broadly consistent with those used in the EBA stress tests).

The money invested in the fund will be financed by government debt issuance, and so the policy raises the level of PSND; impacts are given in the table below. The debt interest cost is calculated using the usual OBR methodology. The interest HMT receives, less the additional debt interest paid and expected losses from defaults, gives the Exchequer impact numbers shown in the table below. This is positive for all years; in the central case HMT expects that returns will be more than enough to cover associated funding costs and losses following loan defaults.

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
PSNB impact (£m)	0	Neg.	5	10	20	25
PSND impact (£m)	0	-150	-550	-900	-1,000	-1,000

Areas of uncertainty

The rate of default and loss given default of companies borrowing from the funds is uncertain and will be influenced by underlying economic conditions.

The exact return will depend on the terms of the individual loans agreed between the funds and the borrowers.

The Exchequer impact will also depend on gilt yields.

Office for
Budget Responsibility

Certification of policy costings

A Office for Budget Responsibility: certification of policy costings

Office for Budget Responsibility: certification of policy costings

A.1 The Office for Budget Responsibility (OBR), led by the Budget Responsibility Committee (BRC), has scrutinised and certified the costings of those policy decisions announced in the Autumn Statement and since the March 2011 Budget that affect the public finance forecasts.

A.2 Policy changes to tax and expenditure typically have a direct effect on public sector net borrowing (PSNB). Policy changes classified in the National Accounts as financial transactions typically involve loans and do not have a direct effect on PSNB, but may have a direct effect on Government cashflows and public sector net debt (PSND).

Policy costings

A.3 The OBR has certified that all of the costings with a direct effect on PSNB described in this document represent a reasonable and central view given the information currently available.

A.4 The OBR has not scrutinised the direct costings of policies where the total cost or yield is wholly determined by a Government policy decision. This includes, for example, policies that are set within Departmental Expenditure Limits (DELs), such as the 2012-13 Council Tax freeze and the Housing Strategy announcements; and the quantity of loans set directly by the Government for its Business Finance Partnership. Similarly, the OBR has only certified the consequences for Annually Managed Expenditure (AME) of the DEL measure on public sector pay restraint. These arise from its effect on public sector pensions contributions.

Methodology and process

A.5 All costings have been produced on the basis of the OBR's economic forecast published in the November 2011 *Economic and fiscal outlook*.

A.6 The OBR scrutinises the costings submitted by Government departments, which are produced using the methodologies set out earlier in this document. These costings take into account the direct effects of a policy on the component of taxes or spending to which the policy applies, and closely-related components. They do not take into account the indirect effect of policy measures on the wider economy. Any such effects are incorporated in the OBR's economic forecast. Measures with such effects in the Autumn Statement are set out from paragraph A.11.

A.7 Along with the officials responsible for producing each costing, the OBR attends a series of Star Chambers, at which the assumptions, judgements and methodology used in the costing are scrutinised by the BRC and OBR staff. The OBR was provided with detailed analysis and had full access to the information used in the costings. In the cases where the BRC felt that a different methodology or judgement was required, changes were made to the costing in line with BRC views, and a further set of discussions took place. Through this iterative process of scrutiny, the BRC was able independently to challenge the Government's costings in detail, and to ensure its views were fully reflected in the Treasury's final costings.

Uncertainty

A.8 The OBR emphasises the uncertainty that surrounds all forecasts of the public finances. Policy costings are subject to a similar, if not greater, degree of uncertainty for a number of reasons. In many cases, costings are highly sensitive to assumptions about the future behavioural responses of taxpayers or benefit recipients. So, for example, capital gains tax policy can have an unpredictable effect on individuals' decisions of when to dispose of assets. In addition, it is difficult to analyse the accuracy of previous policy costings to draw lessons for future costings, as it is not generally possible to separate the eventual cost or yield associated with a particular measure from other changes in total receipts and expenditure.

A.9 In respect of the specific policy costings at this statement, the OBR identified the following areas of particular uncertainty:

- **VAT cost sharing exemption:** this costing depends heavily on assumptions regarding take-up rates (i.e. the number of groups of organisations that will be formed to take advantage of the scheme) and the tax base, which is the total amount of VAT that can be recovered under the new rules; there is little evidence on which these assumptions can be based.
- **Ring fenced expenditure:** the profile of this costing depends on the timing of investment by the companies operating in the North Sea that are affected by this measure. The assumption that the costs will be incurred when each company comes into profit means that the costs are highly dependent on the timing of investments, which can change dramatically from year to year.
- **Seed Enterprise Investment Scheme 2012 CGT holiday:** the costing is very uncertain as it depends on the extent to which investors will decide to make additional investments, funded by proceeds from asset sales, in the new scheme.
- **Business rates deferral scheme:** the take-up assumed in this costing is low, in line with the experience of take-up of a similar scheme introduced two years ago. The uncertainty in this costing is whether take-up will be as low in response to this policy too.

A.10 It should be said that all these measures involve relatively modest sums of money, so even though there is considerable uncertainty around them, this does not imply a significant risk to the overall fiscal forecast, given the other uncertainties involved there.

Indirect effects on the economy forecast

A.11 Having considered the measures in the Autumn Statement, the BRC has concluded that the following would have indirect effects on the economy:

- The new build indemnity scheme (which is not included in this document as it is involves a guarantee rather than a loan) involves the Government contributing 5.5 per cent of the value of a new home to an indemnity fund to assist buyers in obtaining higher loan-to-value mortgages. The scheme is limited to 100,000 mortgages and we have assumed this will translate into around 30,000 more property transactions than would otherwise have taken place over the forecast period.
- The delay of the rise in fuel duty in January 2012 to August 2012 and the cancellation of the rise in fuel duty in August 2012 are estimated to reduce CPI inflation by around 0.1 percentage points in 2012.

A.12 The OBR has not adjusted its economic forecast at this time for the credit easing policies. Further information on the OBR's assessment of the potential indirect effects of the Autumn Statement policies is set out in Box 3.2 of the November 2011 *Economic and fiscal outlook*.

HM Treasury contacts

This document can be found in full on our website: http://www.hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000
Fax: 020 7270 4861

E-mail: public.enquiries@hm-treasury.gov.uk

ISBN 978-1-84532-912-9