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

Budget 2011 policy costings

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Contents

1 Introduction

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 publication is part of the Government's wider commitment to increased transparency.

1.2 Chapter 1 explains the methodology and general principles for calculating the cost or yield of policy decisions and the interaction with the Office for Budget Responsibility's (OBR) public finances forecast. Chapter 2 includes detailed information on the key assumptions applied in all major policy costings in the Budget.

1.3 Annex A sets out the indexation assumptions included in the public finances forecast baseline, including all pre-announcements. Annex B, by the OBR, sets out the approach the OBR has taken to scrutiny and certification of the costings, and highlights areas of particular uncertainty.

What are policy costings?

1.4 The Budget policy decisions with a fiscal impact are summarised in Table 2.1 of the Budget. This shows estimates of the cost or yield of each policy decision for the years 2011-12 to 2015-16. It includes policies that are firm and final and are estimated to have an impact on Public Sector Net Borrowing (PSNB). The direct impact of tax measures on receipts is shown for all years. The direct impact of measures that affect the AME forecast is also shown in the same way.

1.5 Table 2.1 does not include:

- financial transactions such as student loans that impact Public Sector Net Debt (PSND) but have no impact on PSNB. These are captured in the final Budget forecast of PSND;
- changes to underlying economic assumptions, for example a change in the unemployment claimant count. These are captured in the public finance forecast; or
- decisions that simply re-allocate resources within a department or between departments.

1.6 For measures where a policy decision has been announced on the lead option for tax base and rate, but consultation is occurring on the details, the costing in Table 2.1 is for that lead option, with central assumptions made about features of the regime not yet finalised.

1.7 Policy costings show the Exchequer impacts of new policies against a baseline that assumes allowances, thresholds and specific tax and benefit rates will be increased in line with relevant price indices, or any pre-commitments (policies announced in previous Budgets). A full list of indexation assumptions and pre-commitments underlying the baseline forecast is shown in Annex A.

1.8 Where the costing of one policy change is affected by the implementation of others, the measures are costed in the order in which they appear in Table 2.1 of the Budget. So for example, increases to the rate of R&D tax credits for small and medium-sized enterprises (SMEs) are costed against the new corporation tax rates announced in the Budget.

1.9 Policy costings are produced by a number of different departments, based on the best available data. HM Revenue and Customs (HMRC) produces tax, tax credit and child benefit costings; the Department for Work and Pensions (DWP) produces most benefit costings; Communities and Local Government (CLG) typically produce business rate costings; and the respective spending department produces costings where DEL allocations are increased or decreased. HM Treasury oversees the costings as part of the Budget.

1.10 All costings are shown on a UK basis. Social security is devolved in Northern Ireland, so costings for social security measures are calculated on an England, Scotland and Wales basis and then adjusted to include equivalent cover for Northern Ireland. This is done by scaling the England, Scotland and Wales costing by 3.3 per cent, which is the average spend on social security in Northern Island over the past five years compared with similar spend in England, Scotland and Wales.

How do costings fit into the public finance forecast?

1.11 The OBR has scrutinised and certified the Government's assessment of the direct cost or yield of Budget policy decisions and has made an assessment of the indirect effects of Budget measures on the economy. These are included in the forecast.

1.12 The policy costings shown in Table 2.1 of the Budget reflect the direct cost or yield of Budget policy decisions. These take account of specific direct behavioural effects relating to the tax or benefit base the policy is applied to, or closely related bases. These direct effects are explained in more detail in each of the costing notes included in Chapter 2. Details of the OBR's certification of these direct effects are set out in Annex B.

1.13 The OBR's March forecast, published alongside the Budget, incorporates the direct effects of all policy measures set out in this document.

1.14 In addition to these direct effects a policy may have a wider indirect effect on the overall economic forecast. Further details of the indirect effects incorporated into the OBR's March economy forecast are provided in Annex B to this document.

Policy costing methodology

Static costing

1.15 Policy costings are estimated using purpose-built costing models, which are sufficiently detailed to take account of all relevant factors to the policy (e.g. policy parameters and behavioural effects).

1.16 Policy costings start with an estimate of the value of the economic activity or base that the policy applies to. For example, an income tax costing begins with estimates of wages and salaries and VAT starts with estimates of consumer expenditure. In many cases, these estimates have been taken directly from the March economic forecast produced by the OBR and published in the *Economic and fiscal outlook*. In other cases, forecast information is supplemented with data from other sources.

1.17 The static costing for a policy is the difference between applying the pre-Budget and Budget tax or benefit regimes to the relevant post-Budget base data. At this point, the costing does not take account of any expected change in behaviour as a result of the policy changes. The costing will take account of automatic changes in entitlement where this is as a result of the design of the tax and benefit rules, rather than behavioural change. For example, if qualification for one benefit counts as income for the purpose of the second benefit, both would be included.

1.18 Policy costings that relate to changes to existing rates or allowances are generally based on administrative data (e.g. data from tax returns on incomes). In other cases, for example the introduction of a new tax or the extension of a benefit base, administrative data may not exist and alternative sources with a wider range of estimates are used. In this instance, costings will apply central assumptions about the size of the tax or benefit base.

Behavioural effects

1.19 The policy costings take account of direct behavioural effects on the tax base itself or closely related taxes. They do not include economy-wide indirect behavioural effects on employment, wages and salaries or general consumption, for example. These indirect economic effects are included in the OBR's economic forecast.

1.20 Behavioural effects describe the way in which individuals and businesses change their actions as a result of a policy change. For example, an increase in tobacco duty will reduce the number of cigarettes sold because taxpayers will respond to the higher price by buying fewer cigarettes. In the case of benefits, changes in the rates or conditions may alter the take-up levels. Behavioural effects not only have an impact on the revenues from the tax or benefit base the policy is applied to, but also revenues and expenditure from close substitutes or complements. For example, an increase in beer duty could cause individuals to switch from drinking beer to drinking spirits, causing spirit duty revenues to increase.

1.21 Benefits in the social security system interact both with each other and with the tax credits system administered by HMRC. These interactions can be substantial and need to be allowed for in any social security policy costing. For example a change in Basic State Pension can lead to an offsetting change in Pension Credit entitlement and both can subsequently have an impact on entitlements to Housing Benefit and Council Tax Benefit.

1.22 The direct policy costings capture a number of behavioural effects specific to the relevant tax base or benefit itself, or closely associated taxes. These behavioural impacts are mainly micro-economic changes in behaviour modelled against precise changes in tax policy. For example, direct policy costings for capital gains tax include behavioural effects of individuals on the level and timing of realising the value of assets. They also involve behavioural effects on avoidance of the tax base itself.

1.23 However, the direct policy costings do not generally include indirect economic effects of the policy changes. These indirect economic impacts are included in the OBR's economic forecast. For example, they include any impact of measures on economy-wide wages and salaries, employment levels or consumer expenditure. So the direct policy costings on income tax and national insurance contributions (NICs) do not include any changes as a result of these indirect economic factors. The direct policy costings for these taxes are, therefore, different from the projections of receipts in the Budget which take these factors into account.

1.24 There is sometimes uncertainty around the size of the behavioural effects. Where possible, research evidence from academics or external bodies is used to inform judgement about the size of behavioural effects. In addition, there may be other behavioural effects which it is not possible to quantify.

Revenue protection and anti-avoidance measures

1.25 The Government is committed to strengthening the tax base against avoidance or evasion. Some anti-avoidance and anti-evasion measures result in yield being shown in Table 2.1.

1.26 Avoidance schemes that have been widely in use for some time will affect the receipts data. This effect is implicitly assumed to continue in the forecast. So measures that tackle these types of schemes will result in Exchequer yield. Conversely, where information suggests the avoidance activity is new and therefore not likely to be factored into recent receipts data, a measure to tackle this will protect revenue but not count as Exchequer yield.

1.27 For most taxes, forecasts are aligned to recent receipts data which will already include a degree of non-compliance. They do not, however, make explicit assumptions about losses through non-compliance: instead it is implicitly assumed that this level will remain constant in future.[1] One exception is VAT, where the OBR has approved an explicit assumption about the future VAT gap.

1.28 The evidence base for anti-avoidance costings draws on HMRC's operational expertise, such as the results of investigations, or the known behaviour of particular groups of taxpayers.

1.29 Where an anti-avoidance measure results in yield, the policy costing will need to take into account the sustainability of that yield over time. In general, yield resulting from closing down long standing avoidance schemes used by a wide group of people will be more sustainable than yield from tackling new schemes used by serial avoiders.

1.30 Policy costings do not usually include operational changes to the tax system, which are accounted for through changes to the underlying forecast. For example, a change to the allocation of HMRC resources to target a particular type of avoidance more aggressively would count as an operational change. Another example is where the outcome of a litigation case has an impact on Exchequer revenues, which is reflected in the forecast.

Benefit fraud and error

1.31 In the case of social security expenditure, the Government is seeking to reduce fraud and error. However, existing fraud and error rates are directly assessed and integrated into the expenditure forecasts. Where a new policy or administrative initiative is designed that will have a discernable and quantifiable impact in reducing fraud and error, the resulting savings will be shown in Table 2.1.

[1] Or that non-compliance will continue to increase/decrease at recent rates, where forecasts are based on receipts trends over time.

2 Policy costings: Budget decisions

2.1 The following policy decisions are included in this chapter:

- Main rate of corporation tax
- Interim Controlled Foreign Companies (CFC) rules
- Taxation of foreign branches
- Corporate capital gains rules for groups of companies
- Full CFC rules
- Bank Levy
- Enterprise Investment Scheme and Venture Capital Trusts
- Research and Development Tax Credits for SMEs
- Short life assets capital allowances
- Business Premises Renovation Allowance
- Enterprise Zones
- Small business rate relief
- Capital gains tax entrepreneurs' relief
- Stamp Duty Land Tax bulk purchasing
- Support for Mortgage Interest
- New Enterprise Allowance
- Income tax personal allowance
- Indexation of direct taxes
- Contracted out NICs rebates
- Taxation of non-domiciles
- Fuel duty
- Supplementary charge on North Sea oil and gas profits
- Rural fuel rebate
- Company car tax
- Vehicle Excise Duty for Heavy Goods Vehicles
- Approved Mileage Allowance Payments
- Carbon price floor

- Climate Change Agreements
- Climate Change Levy in Northern Ireland
- Air Passenger Duty
- Aggregates Levy
- VAT Low Value Consignment Relief
- Tobacco duty
- Disguised remuneration
- Functional currency for tax calculations
- VAT supply splitting
- Sale of lessor companies
- Plant and machinery leasing avoidance
- Stamp Duty Land Tax avoidance
- VAT fraud on imported road vehicles
- Protection life insurance
- Qualifying time deposits
- Security for Pay As You Earn and NICs
- Inheritance tax and charitable donations
- Gift Aid tax relief for micro donations
- Housing Benefit for long term jobseekers
- Mobility components of Disability Living Allowance for claimants in residential care
- Transitional protection for existing claimants of Local Housing Allowance
- Employment Support Allowance Youth
- Fraud sanctions regime in the benefits system and debt recovery
- Metal costs for coinage
- Pensions annual and lifetime allowances [2]

[2] A costing note is included for transparency around the revenue from the revised approach to restricting pensions tax relief set out in Table 2.4 of the Budget. As set out in Budget 2010, the total revenue for the revised approach over the costing period is slightly higher than the previous Government's policy.

Main rate of corporation tax

Measure description

This measure reduces the main rate of corporation tax by 1 per cent from April 2011. This is in addition to the rate reductions announced in the June Budget 2010. As a result of both of these measures the main rate of corporation tax will be reduced to 26 per cent in 2011-12, 25 per cent in 2012-13, 24 per cent in 2013-14, and 23 per cent in 2014-15 and subsequent years.

The tax base

Estimates of the tax base for the main rate of corporation tax are taken directly from the corporation tax revenue forecast of quarterly instalment payments by non-life assurance companies. This forecast is based on corporation tax data for 2008-09 calibrated to an estimate of 2010-11 accruals based on the latest tax receipts, and is then projected in line with relevant elements of the OBR's economic forecasts.

The resulting estimate of net taxable profits taxed at the main rate (and the main rate reduced by marginal relief) in 2011-12 is around £100 billion.

Static costing

The static Exchequer cost is calculated by applying the pre-Budget and post-Budget tax regimes to the tax based described above. This results in the following costing, presented on a National Accounts basis:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-525	-1,000	-1,130	-1,215	-1,290

Post-behavioural costing

The only behavioural response included in this costing is a change in the incentives for multinational companies to shift profits in and out of the UK. A reduction in the corporation tax rate makes the UK more attractive (relative to other locations) as a destination to locate profits.

To account for this, the portion of profits in the tax base that are mobile has been estimated at around 40 per cent. This estimate is based on data from corporation tax returns, by identifying sectors where profits are known to be most mobile, and the profit flows within those sectors that are most likely to be shifted. An elasticity of -2 has been applied to these mobile profits, so that this further 1 percentage point decrease in the corporation tax rate each year results in a 2 per cent increase in the size of the mobile profit base. The assumed elasticity is a central assumption, informed by multiple academic studies.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-425	-810	-910	-1,000	-1,075

Areas of uncertainty

The main uncertainties in this costing surround the corporation tax revenue forecast on which it is based, and the behavioural effects included.

Interim Controlled Foreign Companies rules

Measure description

The package of Controlled Foreign Companies (CFC) interim improvements makes the current CFC rules easier to operate and is designed to implement initial changes consistent with the direction of travel of full CFC reform, to be introduced in 2012. The interim changes will be introduced for accounting periods beginning on or after 1 January 2011 and will introduce:

- an exemption for certain intra-group trading transactions with little connection with the UK;
- an exemption for CFCs with a main business of intellectual property (IP) exploitation where the IP and the CFC have minimal connection with the UK;
- a statutory exemption (up to three years) for foreign subsidiaries that due to a reorganisation or change to UK ownership, come within the scope of the CFC regime;
- an alternative to the current de minimis exemption, which will increase the limit to £200,000 profits per annum, and replace the need to calculate chargeable tax profits with an accounts based measure; and
- an extension of transitional rules for certain holding companies until July 2012

The tax base

The aim of the CFC regime is to protect the corporation tax base against UK multinationals artificially diverting profits from the UK to low tax jurisdictions, by seeking to tax those profits in the UK. There is currently no accurate measure of the size of the CFC tax base.

Costing

The package of interim measures is designed to ease the compliance burden caused by the current CFC rules and provide increased certainty. Behavioural response is likely to be limited as many companies that could benefit already qualify for one of the existing exemptions.

The combined cost of the new intra-group trading exemption with limited UK connection and the new exemption for exploitation of IP with limited UK connection is estimated at £15 million but this is difficult to quantify. The extension of the transitional rule for superior and non local holding companies to July 2012 is estimated to cost £40 million for 2011-12 only, with no cost thereafter. The statutory exemption for foreign subsidiaries will cost £5 million in the first two years, and £10 million thereafter, based on an assessment of how many groups are likely to be affected. Other elements of the package are assumed to have a negligible effect.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-55	-15	-25	-25	-25

Areas of uncertainty

The main uncertainty in this costing relates to impact of the exemption of intra group trading activities with limited UK connection where the number of UK multinational businesses affected and the likely behavioural response are both uncertain.

Taxation of foreign branches

Measure description

The measure provides an opt-in exemption from Corporation Tax (CT) on the profits of foreign branches of UK resident companies. An election into the regime will be irrevocable. The measure will have effect for accounting periods commencing on or after Royal Assent. The exemption will be subject to an anti-avoidance rule to protect the Exchequer from the artificial diversion of UK profits to foreign branches in low tax jurisdictions.

The tax base

The tax base is the CT payable on profits of foreign branches of UK companies minus the relief given for taxes paid overseas on those profits. HMRC indentified the groups and companies which operate offshore through foreign branches. These are in four main sectors: Life Insurance, General Insurance, Banking and Oil & Gas. Information from the commercial accounts and tax computations for each relevant company and group, for the years 2007 and 2008 (and 2009 where available), was used to identify the profit (loss) for each branch, the CT payable and the credit relief given for foreign tax paid.

Static costing

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-30	-70	-95	-110

Post-behavioural costing

An anti-avoidance rule will protect the Exchequer from the artificial diversion of UK profits to foreign branches in low tax jurisdictions. There may be a limited amount of scope for businesses to use existing rules to channel some UK income to their branches in low tax jurisdictions. To reflect this, a 10 per cent increase in the cost has been applied for the most mobile business.

A transitional rule will apply to provide protection to the Exchequer. Companies with historic foreign branch losses which they have deducted against UK tax liabilities will be required to pay tax on foreign branch profits equal to the amount of historic losses.

The branch exemption regime does not provide relief for losses. A number of consultation respondents explained that some banks would not opt in to the exemption regime without some form of loss relief. A proportionate reduction in the cost to the Exchequer has therefore been applied to reflect the probability that not all banks will opt in to the regime.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-30	-70	-80	-80

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the costing assumes that anti-avoidance rules preventing companies from artificially diverting UK profits into exempt foreign branches are sufficiently robust. Due to the nature of avoidance and the uncertainty regarding behavioural responses, the data used to produce the costings may be subject to wider margins of error. Some uncertainty surrounds the behavioural response by those companies for whom loss relief within exemption was an important consideration.

Corporate capital gains rules for groups of companies

Measure description

These measures come into force in 2011-12 and simplify the rules on taxing corporate gains in two ways:

- by changing the treatment of capital losses after a change of ownership. Under previous rules, capital losses were 'locked in' to the existing group of companies at the time the losses were incurred. Under the new rules, when groups merge, capital losses can now be surrendered upwards from the acquired group to the group at the top of the corporate structure (subject to certain ownership criteria).

- by making changes to simplify the calculation of chargeable gains degrouping charges for companies. A degrouping charge is intended to prevent double non-taxation of gains on the disposal of assets, where no charge applies to either the company or its shareholders. This change will provide greater certainty to companies planning acquisitions and disposals, and ensure better alignment of economic and tax outcomes.

The tax base

The tax base for both of these measures is the amount of taxable losses that were previously 'locked in' to groups which have since been involved in a merger. The largest group acquisitions (by UK-owned groups) between 2003 and 2004 were identified from Office for National Statistics data. The full company structure for each group was obtained with the capital losses contained in the acquired group from corporation tax records.

Costing

The impact of changing the treatment of capital losses after a change of ownership was estimated by modelling the use of losses over a shorter period of time by companies given greater flexibility to surrender capital losses within a group. The resulting costs largely arise from a timing advantage, as the proposal will mean that relief for some capital losses will be given earlier than the current rules allow.

The impact of changing the rules around degrouping charges is modelled on a case study of a number of groups identified as having planned around the existing rules by creating double tax relief for a loss.

This measure is not expected to generate a significant behavioural response.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Capital losses	-5	-15	-25	-45	-65
Degrouping charges	+10	+10	+10	+10	+10
Total Exchequer impact	+5	-5	-15	-35	-55

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the extent to which groups are able to make use of these changes will depend on the amount of chargeable gains and also the extent to which capital losses are available to set against those gains. The position will be monitored closely by HMRC.

Full Controlled Foreign Companies rules

Measure description

Following interim changes to the existing Controlled Foreign Company (CFC) regime in 2011, this measure introduces a new CFC regime that will be included in Finance Bill 2012. The CFC rules are being redesigned to make them more competitive, while ensuring that the UK tax base is adequately protected, and to reduce compliance burdens where possible. The new regime will include:

- a finance company partial exemption, that in broad terms results in an effective UK tax rate of one-quarter of the main rate on profits derived from overseas group financing arrangements i.e. 5.75 per cent by 2014; and
- more targeted and competitive CFC rules for intellectual property by focusing the rules on artificially diverted UK profits, and exempting profits derived from intellectual property that relate to genuine overseas activity.

The Government has proposed a mainly entity-based system that operates in a targeted way by bringing within a CFC charge only the proportion of overseas profits that have been artificially diverted from the UK. A number of exemptions will therefore be included in the new regime to remove low risk entities and/or genuine overseas activities from the new rules. In addition, where needed, rules will be designed to address specific sectors including banking, insurance and property.

The tax base

The CFC regime protects the UK corporation tax base against UK multinationals artificially diverting profits from the UK to low tax jurisdictions, by seeking to tax these profits in the UK. There is currently no accurate measure of the size of the CFC tax base.

Costing

For the finance company partial exemption, the costing takes into account expected behavioural responses as businesses are likely to centralise their financing operations once this exemption is introduced. The overall Exchequer impact of making this change builds up to -£520 million in 2015-16.

This reflects the impact on the UK tax base (expected to have a negative impact on tax revenues) and the impact on financing income currently held overseas by UK groups (expected to have a positive impact on tax revenues). The purpose of this exemption is to provide a pragmatic way of protecting the UK tax base while giving UK multinationals greater freedom to manage their overseas financing operations. A consequential behavioural effect is the potential for relocation of external debt finance, over time, from elsewhere in the group to the UK.

Modernisation of the CFC rules for IP is expected to have an overall Exchequer impact of -£105 million by 2015-16. The new rules will exclude from a potential CFC charge foreign profits derived from IP that relate to genuine overseas activity. Currently many groups ensure that this income is not subject to a CFC charge, so the impact on overseas IP is expected to be minimal. The cost reflects any behavioural impact on movements of UK IP, although the new CFC rules will maintain CFC protection against IP currently held in the UK being moved overseas artificially to avoid a UK tax charge on the resulting profits.

The remainder of the cost arises from redesigning exemptions and from sector specific rules that will be included in the new regime. The overall Exchequer impact of making these changes is expected to be -£215 million by 2015-16. These changes aim to make the rules simpler to apply where possible and more competitive by exempting genuine foreign profits and targeting protection on artificially diverted UK profits. Assumptions have been made based on current thinking, although the policy is still being developed and proposals on these areas will be published for consultation in May 2011.

The Exchequer impact is on a National Accounts basis.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Total Exchequer impact	0	-210	-540	-770	-840

Areas of uncertainty

These costings are particularly uncertain because:

- consultation will take place between now and implementation of the new rules in Finance Bill 2012, which will impact on the final design of the regime;
- the costings are dependent on the behavioural response of UK groups; and
- the costings assume that the new rules will be effective in preventing avoidance activity that would erode the UK tax base (for example artificial upstream loans or artificial IP moves).

Bank Levy

Measure description

The Bank Levy was introduced from 1 January 2011. This measure increases (i) the effective full rate of the Bank Levy in 2011, from 0.05 per cent to 0.075 per cent; and (ii) the full rate of the Levy to 0.078 per cent from 2012 onwards.

The tax base

The estimated static tax base is based on data collected and aggregated by HMRC, following extensive engagement with industry over the consultation period. For this measure, the tax base is expected to grow modestly over the forecast period.

Static costing

The static costing is calculated by applying the pre measure tax regimes to the tax base data described above.

Static Exchequer impact (£m)

Fiscal year	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+670	+300	+110	+110	+110

The post-behavioural yield

The costing assumes that behavioural changes as a consequence of the increase in the rate for 2011 and beyond are proportionate to those assumed for the introduction of the Levy. The overall behavioural assumption is in line with that set out in the June 2010 Budget.

Post-behavioural yield (£m)

Fiscal year	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+630	+285	+100	+105	+100

Enterprise Investment Scheme and Venture Capital Trusts

Measure description

This measure increases the income tax relief available under the Enterprise Investment Scheme (EIS) from 20 per cent to 30 per cent, from 6 April 2011. Then, from 6 April 2012, the measure:

- increases the maximum annual amount an individual may invest (EIS only), the size of company that can qualify under either EIS or Venture Capital Trusts, and the maximum annual investment in any one company under the two schemes taken together; and
- refocuses both schemes on higher risk companies.

All changes are subject to State Aid approval.

The tax base

The rate increase applies to investments made in companies qualifying under EIS, which are monitored using annual returns. Historic annual investment totals are published as National Statistics, and projected using relevant elements of the OBR's economic forecast. In 2007-08 a total of £700 million was invested under EIS.

Static costing

The static Exchequer cost is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base described above. This results in the following costing, presented on a National Accounts basis.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	- 80	- 60	- 65	- 70

Post-behavioural costing

The costing builds in behavioural effects to take into account higher investment via the schemes stimulated by increasing the rate of relief, increasing the maximum annual investments allowed per individual and per company, and opening the schemes to larger companies. The costing also assumes an off-setting reduction in investment via the schemes as a result of restricting the relief to exclude certain lower risk companies.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	- 105	- 115	- 110	- 120

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainty in this costing relates to the assumptions made about the likely increase in investment under EIS and Venture Capital Trusts.

Research and Development Tax Credits for SMEs

Measure description

This measure increases the rate of the enhanced deduction against profits available for research and development expenditure by small and medium-sized firms. In 2011-12 the rate will increase from 175 per cent to 200 per cent and from 2012-13 it will increase further to 225 per cent.

The tax base

The tax base is the amount of eligible expenditure on research and development by small and medium-sized firms. The data on the number of claims and the cost to the Exchequer are available as HMRC National Statistics. In 2008-09, the latest year with complete data, the scheme benefited around 6,500 companies, costing £70 million for enhanced deductions and £160 million for payable credits.

Static costing

The static impact assumes that the costs of enhanced deductions increase in proportion to the increase in the deduction rate. The current deduction rate is 75 per cent on top of the 100 per cent normal R&D revenue expenditure deduction allowed without the schemes. Increasing this rate by 25 percentage points in 2011-12 is therefore expected to increase the costs of deductions by approximately one third. The further 25 percentage point increase in 2012-13 correspondingly leads to an overall increase in costs by two thirds. There is no change to the cost of payable credits.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-20	-50	-70	-80	-80

Post-behavioural costing

This measure will stimulate increased spending on research and development by companies. The costing assumes that for every pound foregone in tax revenue one extra pound is spent on research and development, leading to increased Exchequer cost.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-20	-75	-105	-105	-115

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainties in this costing surround the forecasted growth in research and development expenditure used to claim the tax relief, which has historically outpaced growth in overall UK research and development spending, and the magnitude of the behavioural change induced by the measure.

Short-life assets capital allowances

Measure description

The short-life assets (SLA) regime enables businesses to elect to have identified items of plant or machinery, (subject to certain exclusions) treated differently when claiming capital allowances. Under the regime, if the tax written-down value of the asset is greater than its value on a disposal within a four-year cut-off period, businesses can claim the difference as a balancing allowance, but if the disposal value is greater, then the business will be liable for a balancing charge (although business are unlikely to have elected for the SLA treatment if they could have predicted the latter event). From 2011-12 this measure will increase the time limit of the disposal period from four to eight years after the end of the chargeable period in which the asset was bought, more closely aligning tax and economic depreciation for a greater number of business assets.

The tax base

In broad terms, businesses may choose to put assets within the SLA regime if the expenditure is not on cars and is eligible for main rate capital allowances. In practice, businesses whose whole capital expenditure is covered by the Annual Investment Allowance may also be expected not to use the SLA facility.

Estimates of new expenditure that relate to assets businesses have the potential to put into the short life assets regime are calculated using data from tax returns for accounting periods ending in 2008-9 and, for future years, increasing this in line with OBR forecasts for growth in business investment. The estimated amount of new capital expenditure, excluding expenditure covered by the AIA and expenditure on cars, in 2011-12 is £80 billion rising to £130 billion in 2015-16.

Costing

The impact of this measure depends on the extent to which businesses will put more assets into the short life assets regime as a result of the increase in the time limit from four to eight years, as well as the length of time these assets are kept for before being disposed of and, if sold, their selling price. Assumptions have had to be made on the impact of all of these factors.

Once the change in the value and timing of disposals are established, this is compared to the value of the asset yet to be written down in tax calculations. The difference is then multiplied by estimated average effective tax rates, which will differ depending on whether the business is incorporated or not.

This results in the following costing, which is presented on a National Accounts basis.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-10	-40	-70	-100	-170

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainty in this costing arises because of the assumptions needed in establishing the value of assets that businesses chose to elect into the SLA regime, and the prices and timings of disposals of assets.

Business Premises Renovation Allowance

Measure description

The Business Premises Renovation Allowance (BPRA) provides 100% initial allowances for capital expenditure on the renovation of business properties that have been empty for at least a year in designated disadvantaged areas of the UK. This measure extends the scheme beyond the current end date of April 2012.

The tax base

The tax base is the amount of expenditure claimed under BPRA and is estimated from tax returns. In 2009-10 around 300 companies and 300 unincorporated businesses claimed the allowance, with total expenditure of around £90 million. The tax base is projected in line with the OBR's forecast for capital expenditure.

Costing

The static Exchequer impact is calculated by multiplying the tax base by the appropriate average effective tax rates. The measure continues an existing relief, and is not expected to have any significant behavioural effects.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	- 5	- 30	- 25	- 30

Enterprise Zones

Measure description

A new generation of 21 Enterprise Zones (EZs) will be launched from 2012-13. Budget 2011 announces ten locations, with a further eleven to be decided by competition, including one in London. Along with non-tax incentives, businesses moving into an EZ will be eligible for 100 per cent business rate discounts for five years, up to EU State Aid de minimis levels. These discounts will be funded by the Exchequer.

The tax base

The tax base is the 100 per cent business rate discounts provided to businesses. The primary data source is the Valuation Office Agency's 2010 rating list of non-domestic properties.

Costing

It is estimated there will be 200 properties per Enterprise Zone, with an average composition of 20 large industrial properties, 100 medium sized industrial properties and 80 offices. This reflects that Enterprise Zones will be targeted at promoting industrial activity.

A business rates bill is the result of multiplying the rateable value (the nominal rental value) of a property and the business rate multiplier (effectively the tax rate).

Valuation Office Agency statistics are used to estimate the average rateable value of each type of property in each region. It is assumed that rateable values are capped to ensure discounts are limited to around £55,000, in order to ensure compliance with State Aid rules. The average rateable values for an Enterprise Zone in a given region are then multiplied by the assumed number of each type of property to estimate the total rates liability of properties in the Enterprise Zone. For the sites to be decided by competition, the rateable values are aligned with the average rateable value across England for the different property types.

The business rates multiplier is increased each April by growth in RPI, in order to hold business rates yield constant in real terms. The costing accounts for this, using the forecast for RPI.

The costing assumes a rate of development for the sites from 2012-13, when discounts are available and the zones commence.

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 rates cost.

Exchequer impact

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-20	-40	-65	-80

Areas of uncertainty

There is some uncertainty in the costing given the precise locations of all 21 EZs are still to be finalised and the number and type of the population of occupying businesses will not be known until businesses begin to enter the EZs.

Small business rate relief

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. The base SBRR provides 50 per cent relief for eligible businesses, and is funded through the business rates system.

The holiday had been due to expire in October 2011. This measure extends the holiday until October 2012 at cost to the Exchequer.

The tax base

The tax base for the measure is the amount of relief given to businesses 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; occupying businesses receiving other reliefs; or businesses ineligible for relief. These adjustments are based on survey results and CLG data from local authorities. The result is an estimated number of eligible properties of 510,000.

It is assumed that ineligible properties are distributed evenly across the range of rateable values, and that take-up of the holiday is 95 per cent by value. The costing for the measure accounts for the fact that business rates are deductible for corporation tax (CT) (for companies) and Income Tax Self Assessment (for the self-employed). To estimate this impact, an average CT rate is assumed and applied both to companies and to self-employed businesses.

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 static and behavioural costings include the Barnett consequentials, which are calculated as 19 per cent of the business rates cost, gross of CT effects.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-190	-185	+5	0	0

Capital gains tax entrepreneur's relief

Measure description

From 2011-12 this measure raises to £10 million the lifetime limit for Entrepreneurs' Relief (ER) on capital gains tax (CGT). Currently, net gains that qualify for ER are taxed at a rate of 10 per cent. Any qualifying gains above the current £5 million lifetime ER limit are taxed at the individual's or trustees' specific CGT tax rate.

The tax base

The tax base is realised qualifying net gains for ER assets which are between the current limit of £5 million and the new limit of £10 million and is estimated using information on capital gains from tax returns from 2008-09 and 2009-10. The tax base is estimated to be around £325 million in 2011-12. The tax base has then been forecast to 2015-16 in line with the OBR's forecast for overall CGT accruals.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the forecast tax base described above and taking the differences. These are then converted into tax receipts by taking account of lags between the accrual (liabilities) and receipt of taxes, as CGT is measured on a receipts basis in the National Accounts. This results in the following costing:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-50	-70	-90	-100

Post-behavioural costing

Two behavioural effects are included: a reduction in the 'lock-in' effect;[3] and an allowance for a change in the composition of income between gains and other forms of income and other restructuring.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-50	-70	-90	-100

Areas of uncertainty

The size of the tax base has been estimated from Self Assessment returns for the years when the lifetime limit was £1 million (2008-10). Forecasting it over time is subject to similar uncertainties as the CGT revenue forecast. Both behavioural effects are also uncertain.

[3] The existence of a capital gains tax is widely acknowledged to discourage disposals of assets that have increased in value, thereby creating a 'lock-in' effect. In this case the reduction in the CGT rate for qualifying assets will lead to an increase in disposals of these assets.

Stamp Duty Land Tax bulk purchasing

Measure description

From 2011-12, this measure will offer an alternative way to calculate the stamp duty land tax (SDLT) charge on purchases involving more than one residential property, so that they are charged at a rate of tax based on the average (mean) property value, rather than the total value of the transaction. The rate applied to the mean value will normally be lower than the rate applied to the total. Where the mean value is below the starting threshold for the tax, a minimum 1 per cent rate of tax will apply.

The tax base

The tax base is the value of sales of residential properties where the sale consists of two or more properties and where the tax rate changes due to the measure, and is estimated from tax returns. The tax base is projected forward in line with the stamp duty land tax revenue forecast.

The size of the tax base in 2009-10 is estimated at around £5 billion of bulk property purchases.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget regimes to the tax base and taking the difference. 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
Exchequer impact	-70	-100	-130	-150	-160

Post-behavioural costing

The costing includes behavioural effects to take into account that reduced rates of SDLT will increase the overall volume of transactions. An elasticity of -2 is used for both prices and transactions, which is derived from HMRC estimates of price and volume responses to past increases in the SDLT threshold. This decreases the cost of the measure.

The costing also includes an impact on compliance, which has been assumed to increase the cost.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-70	-90	-120	-130	-150

Areas of uncertainty

In addition to uncertainties surrounding the quality of data on bulk purchases, OBR's economic forecasts and hence the tax base, the main uncertainty in this costing arises from the assumptions made on non-compliance and the price and volume elasticities.

Support for Mortgage Interest

Measure description

Since January 2009, new working age claims for Support for Mortgage Interest (SMI) have been subject to a 13 week waiting period and a limit on eligible mortgage capital of £200,000. The SMI scheme is due to revert to the pre-2009 rules (8, 26 and 39 week waiting periods and £100,000 capital limit) from January 2012. This measure extends the 13 week waiting period and £200,000 capital limit for a further year, until January 2013.

The cost base

The cost base is SMI awards to people of working age. This is established using data on historical SMI claims from the Quarterly Statistical Enquiry, historical and forecast rates of claimants remaining on benefit derived from DWP's Work and Pensions Longitudinal Study, and Bank of England projected mortgage interest rates.

Costing

The number of people receiving additional awards as a result of the reduced waiting period is derived from the forecast rates of claimants remaining on benefit and the estimated rate of new SMI claimants.

To estimate the Exchequer impact of additional SMI awards as a result of the increased capital limit, the proportion of claimants with eligible outstanding capital between the previous scored limit of £100,000 and the new limit of £200,000 is derived from the Quarterly Statistical Enquiry. This proportion is then applied to number of those receiving SMI under a 13 week waiting period.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer Impact	-10	-110	-15	0	0

No behavioural effects have been included in this costing.

Areas of uncertainty

The number of new SMI awards, particularly for those claiming through Jobseeker's Allowance, is sensitive to the OBR's economic forecasts

New Enterprise Allowance

Measure description

The Self Employment offer, ending on 31 March 2011, is presently available to Jobseeker's Allowance (JSA) recipients who have been unemployed for more than three months. It includes a Self-Employment Credit (SEC) which is payable for 16 weeks at £50 a week.

The New Enterprise Allowance (NEA) will be available for JSA recipients who are unemployed for six months or more. The NEA includes one-to-one business mentoring, a weekly allowance and a loan. The NEA will be rolled out from April 2011, initially in areas with a history of low private sector employment and then across the rest of Britain from the autumn.

The cost base

The costing assumes that there will be 15,000 participants in the scheme in 2011-12 and 25,000 in 2012-13.

Participants will receive a weekly allowance paid at £65 for three months and £33 for an additional three months.

Costing

The AME costing is calculated by assuming that on average participants receive the Allowance for an average of 23 out of a maximum possible 26 weeks. We also assume that participants would have spent an average of 10 out of a maximum possible 26 weeks on JSA, in the absence of the allowance, based on observed off-flows. Taking account of some time spent on benefit preparing for self employment, the net impact is that NEA participants would have spent an average of 8 weeks on benefit before leaving. All of these factors make for a net unit AME cost of £700.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-5	-15	-5	0	0

Income tax personal allowance

Measure description

This measure:

- increases the income tax personal allowance (PA) for those aged under 65 by £630 in cash terms, from £7,475 in 2011-12 to £8,105 in 2012-13; and
- reduces the basic rate limit (BRL) for income tax by £630 in cash terms, from £35,000 in 2011-12 to £34,370 in 2012-13. This leaves the higher rate threshold (the sum of the PA and BRL) unchanged so higher rate taxpayers benefit from the PA change by the same amount as basic rate taxpayers.

Given OBR forecasts for RPI inflation, this implies a £240 increase in the PA and £240 reduction in the BRL in 2012-13 compared with the baseline.

The tax base

The tax base is estimated using data on taxable incomes taken from the Survey of Personal Incomes (SPI), which is a weighted sample of tax records covering around 600,000 individuals. The latest available data is for the tax year 2007-08. To estimate the size of the tax base over the costings period, SPI cases are re-weighted to reflect expected changes in employment, and incomes for all individuals in the sample are projected for expected price and wage movements, in all cases in line with relevant elements of the OBR's economic forecasts.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base described above. This results in the following costings which are presented on a National Accounts basis:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-1,040	-1,200	-1,190	-1,220

Post-behavioural costing

The costing includes a small behavioural adjustment, because as the PA increases the range of incomes over which PAs are withdrawn above £100,000 also increases. A small number of individuals newly brought in to this withdrawal range will see an increase in their marginal tax rate.

Estimates of the behavioural effects of personal tax changes are generally based on Taxable Income Elasticities (TIEs), which show how taxable incomes change in response to changes in marginal tax rates. Assumed TIEs are informed by multiple academic studies, where findings vary widely but generally conclude that TIEs are much higher for those on high incomes. An elasticity weighted by income band is used, with a TIE of 0.35 for those on incomes over £150,000 and lower assumptions for those on lower incomes.

The resulting impact on this costing is around -£10 million per year.

The effect of this measure on the tax incentive to incorporate has also been considered, but is judged to be negligible.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-1,050	-1,210	-1,200	-1,230

Areas of uncertainty

Projections of income taxpayer numbers in the costings period are uncertain, in part reflecting uncertainties surrounding the OBR's economic forecasts. As the PA increase implies uniform gains for the large majority of income taxpayers with minimal behavioural effects, additional uncertainties are likely to be small.

Indexation of direct taxes

Measure description

From April 2012, the default indexation assumption for all direct tax thresholds will move from the Retail Prices Index (RPI) to the Consumer Prices Index (CPI). The change will apply for each year from 2012-13 except where there are specific policy commitments to increase the thresholds by a different amount.

The starting rate limit of savings income, income tax age related allowances, age-related income limits, married couples allowances, blind persons allowance and the NICs secondary threshold will continue to rise by the cash equivalent of RPI for the course of the Parliament. For forecast purposes this is assumed to be until April 2016. All other NICs thresholds will increase by CPI from April 2012. The personal allowance will increase from 2013-14 by at least the cash equivalent of RPI, until the Government's goal of reaching £10,000 is achieved. Future changes to the Basic Rate Limit will be linked to personal allowance increases, so it will also remain on the same baseline.

From April 2012, CPI will be used as the default indexation assumption for ISA limits and capital gains tax annual exempt amounts. The inheritance tax nil rate band is frozen until April 2015, after which point CPI will be used as the default indexation assumption.

The tax base

For all taxes, bases are projected to 2015-16 in line with relevant elements of the OBR's economic forecast.

For NICs the base is estimated using the NICs forecast model, which uses earnings and employment information from the Annual Survey of Hours and Earnings (ASHE).

For ISA limits, the base is an estimated value of income and capital gains tax relief in 2010-11 of £2.1 billion in respect of 20 million savers, as based on information supplied by ISA providers.

For capital gains tax Self Assessment data from 2008-09 is used, and for inheritance tax a sample of tax returns relating to deaths in 2008-09.

Static costing

Static costings are calculated by applying the pre-Budget and post-Budget tax regimes to the bases described above. This results in the following costing which is on a National Accounts basis:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	+105	+235	+625	+1070

Post-behavioural costing

Small behavioural effects are allowed for within capital gains tax and inheritance tax, because it is expected that some taxpayers will rearrange their affairs in order to adjust to the revised allowances and thresholds.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	+105	+230	+615	+1020

Contracted out NICs rebates

Measure description

This measure reduces the Class 1 NICs rebate on earnings between the lower earnings limit (LEL) and upper accruals point (UAP) available to employees (and their employers) who are active members of Defined Benefit pension schemes, and who contract out of the State Second Pension. The rebate will be reduced from 5.3 per cent to 4.8 per cent from April 2012, and will be split 3.4 per cent for employers and 1.4 per cent for employees.

The tax base

The tax base affected is estimated using the NICs forecast model. Class 1 NICs accruals are estimated using earnings and employment information from the Annual Survey of Hours and Earnings (ASHE), projected in line with relevant elements of the OBR's economic forecasts.

Class 1 rebates are estimated separately based on assumptions for the proportion of individuals contracting out of the State Second Pension. These are provided by the Government Actuary's Department and adjusted to reflect the OBR's economic forecasts. Numbers contracting out are expected to fall from 6.8 million in 2012-13 to 6.1 million individuals by 2015-16. Total rebates paid are also calibrated to a total estimated from HMRC administrative data of £7.3 billion for 2008-09.

Costing

The static Exchequer impact is calculated by applying the current and future rebate rates to the tax base described above. This results in the following costing which is presented on a National Accounts basis:

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	+640	+630	+620	+610

No direct behavioural effects are included in the costing. This measure applies to earnings below the UAP (currently £40,040 per annum), and taxable income elasticities are assumed to be zero below this level.

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainty in this costing surrounds future levels of Defined Benefit pension scheme membership, and the resulting level of contracting out. Expected changes in the composition of employment between the public and private sectors are also factored into the projections, based on the OBR's economic forecast.

Taxation of non-domiciles

Measure description

Subject to formal consultation, this measure will make the following changes to the tax treatment of individuals with non-domiciled status in the UK, from April 2012:

- The annual charge payable in order to benefit from the remittance basis of taxation will be increased for those non-domiciled individuals staying in the UK for the longest periods. The current charge of £30,000 per year for individuals resident for more than 7 of the past 9 years will increase to £50,000 for those resident for more than 12 of the past 15 years;
- For those individuals taxed on the remittance basis, income and gains remitted to the UK for commercial investment in UK businesses will be exempt from tax. This change will be accompanied by anti-avoidance rules to prevent funds remitted for other purposes being channelled through this route; and
- Some additional technical simplifications.

The tax base

The tax base for all of these changes is the foreign source income and gains of non-domiciled individuals resident in the UK, where those individuals are taxed on the remittance basis. Under the remittance basis, tax is only due on foreign source income and gains to the extent that they are remitted to the UK; funds remaining offshore are not taxed in the UK. Because taxpayers are not required to report their unremitted income and gains where they are not taxable in the UK, information held in this area is incomplete.

Since April 2008, non-domiciles who have been resident in the UK for more than 7 of the past 9 years have been required to pay an annual charge if they wish to continue benefiting from the remittance basis. In 2008-09, around 5,400 individuals paid this charge. Most taxpayers will only pay the charge where the level of their unremitted income and gains means that the tax benefit they receive under the remittance basis is greater than the cost of the charge. As a result, because income and gains increase over time in line with the OBR's economic forecasts more individuals are expected to pay the charge.

Static costing

The static costing of the increased remittance basis charge is calculated by estimating the number of those paying the existing £30,000 charge who are both UK resident for more than 12 of the past 15 years and expected to have sufficient foreign source income and gains to make paying the charge worthwhile. This figure is estimated to be around £70 million. A further £60 million of additional revenue is expected to result from individuals choosing to give up the remittance basis, and hence becoming taxable on their unremitted foreign source income and gains, rather than paying the increased charge.

Exempting income and gains remitted for business investment is expected to generate negligible Exchequer costs, since the current tax disincentive to remit foreign income and gains means it is unlikely that significant amounts are currently being remitted for this purpose.

Technical simplifications are expected to lead to a small Exchequer impact of -£5 million per year.

The costing below shows the total impact of all these measures and is presented on a National Accounts basis, which takes in to account time lags in payments being received via Self Assessment:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	+180	+150	+180

Post-behavioural costing

The costing assumes that a small number of individuals become non-resident in response to the £20,000 increase in the remittance basis charge for some residents. The effect of an individual leaving the UK is expected to reduce yield on foreign source income by up to £50,000 per individual from the static costing, as well as resulting in reduced tax on UK income and gains. This is estimated to reduce yield by around £80 million per year at steady state.

The costing has also been adjusted to allow for increased tax planning and avoidance in response to this measure, reducing Exchequer yield by around a further £10 million per year.

A small amount of behaviour is allowed for on tax free business investment, where individuals currently fund UK business investment out of UK income and gains and switch the source of investment to remitted foreign income and gains in response to the measure. This is estimated to lead to an Exchequer impact of -£20 million per year.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	+110	+70	+50

Areas of uncertainty

This costing is subject to significant uncertainties resulting from both incomplete data on the unremitted income and gains of the individuals affected, and the difficulty in predicting behavioural responses amongst this internationally mobile group.

Fuel Duty

Measure description

This measure removes the fuel duty escalator whereby fuel duties are raised by 1 penny per litre (ppl) each year over and above the rate rise needed to keep up with RPI inflation. Fuel duties will be increased by inflation only, at times of high oil prices, as part of a fair fuel stabiliser. This measure also reduces fuel duty by 1ppl as of 6pm on 23rd March 2011. The 2011-12 increase to keep rates in line with inflation will be deferred and implemented on 1 January 2012. The 2012-13 increase in fuel duty will also be deferred and will be implemented on 1 August 2012.

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 2009-10 this amounted to nearly 53 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
Exchequer impact	- 2000	- 1800	- 1900	- 2500	- 2550

Post-behavioural costing

Behavioural responses were included to take into account the increase in consumption in response to lower fuel price increases or in the case of 2011-12 a price reduction. 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 quantities of fuel consumed, steadily increasing over time to a 0.4 per cent increase in quantities consumed after five years.

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
Exchequer impact	- 1900	- 1600	- 1700	- 2100	- 2100

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainty in this costing arises from the extent and the speed of the behavioural response.

Supplementary charge on North Sea oil and gas profits

Measure description

This measure raises the supplementary charge (SC) that applies to profits generated from producing oil and gas in the UK or on the UK Continental Shelf (UKCS) at times of high oil prices, as part of the fair fuel stabiliser. It will also provide that where decommissioning costs are incurred, those costs do not have the effect of relieving the increase in the amount of the supplementary charge. The rate will increase from 20 per cent to 32 per cent from midnight on Budget Day.

The tax base

The tax base is profits generated from producing oil and gas in the UK or the UKCS. A forecast model projects tax revenues for each company involved in exploration and production of oil and gas within the UKCS. As well as company level data, the model incorporates forecasts of the growth in production and expenditure in the UKCS oil and gas sector from the Department of Energy and Climate Change. The model is consistent with that used for the Office of Budget Responsibility's published forecast of oil and gas tax revenues.

Costing

The static costing is calculated by running the forecast model on the pre-Budget and post-Budget tax regimes. An adjustment is then made to take into account companies with calendar year accounting periods where their tax is charged at different rates due to the timing of the implementation of this measure. The static costing also reflects the provision, effective Budget Day 2012, of relief for decommissioning costs against Supplementary Charge being available at the lower 20 per cent rate only.

This results in the following costing which is presented on a National Accounts basis.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+1,780	+2,240	+2,120	+2,090	+1,870

A number of possible behavioural impacts have been considered, including the potential for reduced production or investment in the UKCS. The conclusion is that no significant behavioural impact over the period is expected as a consequence of this change.

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainties in this costing relate to the accuracy of the revenue forecast model.

Rural fuel rebate

Measure description

This measure introduces a fuel duty rebate of 5 pence per litre for road petrol and road diesel fuels purchased in all islands in the Inner and Outer Hebrides, Northern Isles, the islands in the Clyde and the Isles of Scilly.

The tax base

The tax base is all road petrol and road diesel purchased in the affected islands. This has been estimated based on external research as approximately 50 million litres in 2007-08, and is projected to 2015-16 at the same rate of growth as consumption used in the UK fuel duty forecast. This results in an estimated volume of 60 million litres in 2012-13.

Costing

The costing is simply calculated by multiplying projected volumes by the rebate of 5 pence per litre. No behavioural effects are included. The costing below is presented on a National Accounts basis.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	neg	-5	-5	-5	-5

Company car tax

Measure description

When a company car is made available for the private use of an employee a 'benefit in kind' value is calculated in relation to the car, and in respect of fuel if that is also provided for private use. The benefit value is subject to income tax and employers' NICs. The car benefit value is calculated by multiplying the list price of the car by an 'appropriate percentage' determined by the vehicle's carbon dioxide emissions and fuel type, and the fuel benefit value is calculated by multiplying a fixed sum (£18,000 in the tax year 2010-11) by the same appropriate percentage. This measure increases the appropriate percentages by 1 percentage point for vehicles with emission levels between 95g and 220g, subject to a maximum value of 35 per cent.

The tax base

The tax base affected is the taxable value of company cars and fuel provided for employees' private use, determined by vehicle list prices and carbon dioxide emissions as described above. This base is estimated using benefit values reported to HMRC for the 2009-10 tax year, with a total value of around £5.5 billion. Values are projected forwards to 2015-16 assuming that list prices of the vehicles provided will increase in line with the OBR's forecast of the Retail Price Index, and that the carbon dioxide emissions from company cars will decrease in line with past trends at a rate of 2.7 per cent per year. This results in a total estimated taxable value of £6.3 billion by 2015-16, under the pre-Budget regime.

Costing

The costing is calculated by applying the pre-Budget and post-Budget company car tax regimes to the tax base described above. With regard to direct behavioural effects, the emissions trend allowed for in the baseline is in part a behavioural response to historic and expected changes in appropriate percentages. We do not consider that the increase announced in this measure will give rise to significant additional effects. The resulting costing which is presented on a National Accounts basis is as follows:

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	+125	+130	+135

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainties in this costing result from the possibility that employer provision of company cars may change in the future and the assumption that company car carbon dioxide emissions will continue to decrease in line with past trends.

Vehicle Excise Duty for Heavy Goods Vehicles

Measure description

This measure freezes Vehicle Excise Duties (VED) rates on Heavy Goods Vehicles (HGVs), and buses, while increasing the remaining VED rates for 2011-12 in line with RPI inflation. This measure comes into force on 1 April 2011.

The tax base

The tax base is made up of an estimate of all vehicles which are declared eligible for road use in the year 2011-12. This is derived using figures of the stock of vehicles from the Department for Transport and the Driver and Vehicle Licensing Agency (DVLA). This is projected forwards using historical estimates for the number of vehicles scrapped in each year and an estimate of the number of new vehicles sold each year, in line with the VED revenue forecast model.

Costing

The costing is calculated by applying the pre-budget and post-budget tax regimes to the tax base data. The pre-budget tax regime assumes that all VED rates are raised in line with RPI inflation. Freezing the VED rates on HGVs and buses therefore has an Exchequer impact. The policy costing does not include any behavioural effects.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-15	-15	-15	-20	-20

Approved Mileage Allowance Payments

Measure description

When employees use their own cars for business travel, employers can provide compensation payments to cover motoring costs up to the level of Approved Mileage Allowance Payments (AMAPs) tax and NICs free. Current AMAPs rates are 40 pence per mile for the first 10,000 miles driven in a tax year, and 25 pence per mile for any subsequent miles. This measure increases the 40 pence rate to 45 pence from 2011-12. Another part of the measure extends to volunteers the 5p per mile tax and NICs free passenger allowance which is currently only available to employees.

The tax base

The tax base affected is business mileage driven by employees and volunteers in their own vehicles, where compensation in excess of the current AMAPs rates is paid. This base is estimated using taxable mileage payment values reported to HM Revenue and Customs for the 2008-09 tax year, with a total value of around £225 million. It is assumed that this value is stable over time.

Static costing

The static costing is calculated by applying the change to a model of current payments derived from the taxable payment values mentioned above, and from information available on business mileage patterns from the National Travel Survey and actual mileage payment rates from a selection of employers. This gives an estimated reduction in taxable payments of £45 million and results in the following costing which is presented on a National Accounts basis:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-50	-50	-50	-50	-50

Post-behavioural costing

Many employers are known to have set their motoring compensation rates in accordance with AMAPs levels. It has been assumed that all such private sector employers will switch to the new AMAPs rates, while in the public sector only half will do so. Taking this into account results in the following costing, presented on a National Accounts basis:

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-35	-35	-35	-35	-35

Areas of uncertainty

The main uncertainties in this costing surround the mileage patterns estimated based on survey data, and incomplete information about the mileage compensation rates employers pay.

Carbon price floor

Measure description

From 2013-14, this measure removes existing exemptions from the climate change levy on fossil fuels used in electricity generation, and reduces the amount of fuel duty that can be reclaimed when oil is used in electricity generation to target a total carbon price of £30 per tonne of carbon dioxide (CO_2) by 2020 (in 2009 prices). The measure is intended to bring forward new low carbon electricity generation.

The tax base

The tax base for this measure is the consumption of fossil fuels used for electricity generation in the UK. This tax base is estimated using official energy demand projections from the Department for Energy and Climate Change (DECC) and resulting simulations of energy investment and generation commissioned by DECC from external providers. Total fossil fuel inputs to electricity generation are estimated at approximately 510,000GWh in 2013-14.

Static costing

The differential between baseline carbon prices and the target carbon price in real terms is converted into nominal future price differentials, in line with the OBR's inflation forecasts, and converted to a pence per KWh tax rate using standard DECC emission factors. The tax rates in 2013-14 would be equivalent to a carbon price of £4.94/tCO_2.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	+830	+1,240	+1,680

Post-behavioural costing

This measure will have behavioural impacts on electricity investment and generation decisions, by raising the prices of fossil fuels as an input for electricity generation and creating greater investor certainty about the carbon price. The change in generation mix (behavioural impact) leads to a smaller tax base. The costing does not take in to account any impact on electricity demand resulting from the measure feeding through to retail electricity prices. However, in practice this effect is not expected to be significant, due to very small expected changes in price and the inelastic nature of electricity demand.

The measure is intended to stimulate new low-carbon electricity generation in the longer term, in which case Exchequer yield would eventually decline.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	+740	+1,070	+1,410

Areas of uncertainty

There are some uncertainties involved in projecting energy demand, investment and generation decisions, both without this measure and in behavioural responses to it. There is some interaction between the EU Emissions Trading System (EU ETS) and carbon price support. Both policies work together to achieve the target price. The level of carbon price support required by this policy is dependent on market carbon prices within the EU ETS.

Climate Change Agreements

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 35 per cent to 20 per cent with effect from 1 April 2013.

The tax base

CCAs are available to 5,000 target units (single industrial facilities or groups of facilities) across 54 energy intensive business sectors. The tax base affected is electricity consumption by these eligible units. This is estimated to be 57,500 GWh in 2013-14.

Costing

The costing is calculated by applying discounts of 65 and 80 per cent to the main rate 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
Exchequer impact	0	0	-40	-50	-50

Areas of uncertainty

In addition to uncertainties surrounding the OBR’s economic forecasts, the main uncertainty in this costing is the projection of energy consumption by eligible target units.

Climate Change Levy in Northern Ireland

Measure description

This measure replaces the Climate Change Levy (CCL) exemption for relevant gas supplies in Northern Ireland with a lower rate during the period 1 April 2011 to 31 October 2013. The lower rate will be set at 35 per cent of the main rate of CCL on gas. From 1 November 2013, the full CCL rate for supplies of gas will apply. The measure comes into force on 1 April 2011.

The tax base

The tax base is the consumption of gas in Northern Ireland, minus that used for power generation (until 1 April 2013 when the carbon price support mechanism is due to be introduced) and domestic consumption. The data source for these estimates is the Northern Ireland Gas Pressure Report (2007). In 2011-12 the tax base is estimated to be 3,200Gwh.

Costing

The costing is derived by multiplying the tax base by the lower rate of 35 per cent of the full CCL rate for gas of £0.00169 per kilowatt hour.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	neg	neg	+5	+5	+5

Air Passenger Duty

Measure description

This measure defers the annual inflation increase in Air Passenger Duty (APD) for 2011-12 until April 2012-13.

The tax base

The tax base is all chargeable passengers flying on aircraft of more than 10 tonnes, equipped with more than 20 passenger seats, from a UK airport. Non-business passenger numbers are forecast using passenger numbers in previous years, forecasts of household disposable income from the OBR, and air fares (which are forecast using OBR inflation and oil price forecasts, and duty rates). Business passenger numbers are forecast using the number of passengers in previous years, and OBR forecasts for GDP. In 2009-10 there were around 97 million chargeable passengers and 95 per cent of these were reduced fare, economy class passengers.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base data described above. The result is shown below and is presented on a National Accounts basis.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-155	0	0	0	0

Post-behavioural costing

A behavioural response is included to take into account the increase in passenger numbers that will arise with a lower than expected price of flights. A range of elasticities are applied to the change in the post-tax price of flights. The elasticities vary by class of flights and types of passenger (business and non-business). These have been derived by HMRC, the International Air Transport Association, and Department for Transport and vary between -0.4 to -0.6 for non-business passengers and around -0.1 for business passengers.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-145	0	0	0	0

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, there is some uncertainty in this costing relating to the elasticity estimates, although this has a relatively limited effect on the overall Exchequer impact.

Aggregates Levy

Measure description

This measure reverses a decision to increase the UK standard rate of Aggregates Levy in 2011-12 to £2.10 a tonne from its current rate of £2.00 a tonne. The rate rise will instead take place on 1 April 2012.

The tax base

The tax base is the volume of primary aggregate commercially exploited in the UK and is estimated from historical tax returns, data for primary and recycled aggregates and ONS construction output. The tax base is projected using the OBR’s forecast of GDP.

Costing

The Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base and taking the difference. This results in the following costing which is presented on a National Accounts basis.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-15	-15	-20	-20	-20

VAT Low Value Consignment Relief

Measure description

From November 2011, this measure reduces the threshold for low value consignment relief (LVCR) from £18 to £15. LVCR exempts from import VAT commercial consignments imported into the UK from outside the EU where the value of the goods is under a certain threshold.

The tax base

The tax base is the expenditure on commercial consignments in between £18 and £15. This is calculated using data from the Channel Islands on items subject to LVCR, by volume and value, to UK, and HMRC operations data on what Channel Island sales are as a proportion of all sales outside of the EU. The total volume of worldwide sales under £18 is estimated to be around £935 million in 2009/10, of which £95 million lies between £15 and £18. This is projected forward by growing it in line with the OBR's forecast for overall consumers' 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
Exchequer impact	+5	+10	+10	+10	+15

Post-behavioural costing

Behavioural effects are included in the costing based on a price elasticity of demand of -1. The price elasticity measures the responsiveness of demand for a good to changes in price. An elasticity of -1 means that for a one per cent increase in price, the volume of consumption is expected to fall by one per cent.

The costing is also adjusted to allow for some non-compliance in these markets once the goods become subject to the standard rate of VAT; in common with VAT Gap projections and anticipating some further revenue loss.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+5	+10	+10	+10	+15

Tobacco duty

Measure description

This measure increases:

- the proportion of total **cigarette duty** that is received from specific duty and reduces the proportion that is received from ad valorem duty. Specific duty is a fixed rate, charged per 1000 cigarette sticks, whilst ad valorem is charged as a percentage of the retail price (of a packet). This measure reduces the tax differential between the lowest and highest priced packets of cigarettes; specific duty increases to £154.95 per 1000 cigarettes sticks and ad valorem duty decreases to 16.5 per cent; and
- the specific **duty on hand rolling tobacco** (HRT) to £151.90 per kilogram.

The tax base

Total duty receipts from all cigarettes cleared for sale in the UK (clearances), in 2010-11 are estimated at £8.3 billion. Total duty receipts from HRT in 2010-11 are estimated at £0.7 billion. Projected total clearances each year can be estimated from the tobacco duty revenue forecast. This takes into account previously announced duty changes, and trends such as reductions in smoking and the switching to lower priced cigarettes over time.

Static costing

The static costing is calculated by applying pre-Budget and post-Budget duty rates to the clearances described above. This results in the following costing which is presented on a National Accounts basis:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Cigarettes	+235	+260	+290	+315	+335
HRT	+75	+80	+90	+95	+105
Total Exchequer impact*	+310	+340	+375	+410	+440

* Columns do not add up due to rounding.

Post-behavioural costing

Smokers are expected to respond by reducing their consumption of duty paid cigarettes and duty paid HRT, and by switching to lower priced products. All of these have a negative impact on Exchequer yield.

For cigarettes, a long run price elasticity of demand of -1.05 is used, meaning that a 1 per cent increase in price is assumed to reduce clearances by 1.05 per cent. A short run price elasticity of -0.57 is used to estimate the behavioural response for the first three months. These elasticities are based on research published by HMRC which is available online at:

www.hmrc.gov.uk/research/cig-consumption-uk.pdf

For HRT, a price elasticity of demand of -1.17 is used, meaning that a 1 per cent increase in price is assumed to reduce the HRT clearances by 1.17 per cent. This elasticity is based on research by HMRC.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Cigarettes	+60	+40	+45	+50	+55
HRT	+20	+20	+20	+20	+25
Total Exchequer impact*	+80	+60	+65	+70	+80

* Columns do not add up due to rounding.

Areas of uncertainty

The elasticities used for this costing are based on extensive research but, inevitably, remain subject to some uncertainty. Exchequer impacts are sensitive to differences in the elasticities. A second uncertainty is how this measure will affect consumption across the different cigarette categories and HRT.

Disguised remuneration

Measure description

This measure tackles the use of trusts and other intermediaries in order to reduce or avoid tax or NICs on employment income. These schemes are also used to remunerate employees above the allowances for tax-privileged pension saving in registered schemes. The measure works by treating any funds allocated for the benefit of an employee in the same way as cash remuneration.

The tax base

The primary routes of avoidance being tackled involve Employer Benefit Trusts (EBTs) and Employer Financed Retirement Benefit Schemes (EFRBS), which are EBTs that are able to provide death and/or retirement benefits.

Static costing

Current Exchequer losses from these types of avoidance are estimated using HMRC data on known schemes, which suggest that Exchequer losses in 2008-09 were in the region of £1.1 billion. This value has been assumed to grow by 5 per cent per year up to the current year, and has then been projected forward to 2015-16 in line with wages and salaries growth in the OBR's economic forecasts.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+1,540	+1,590	+1,670	+1,760	+1,860

Post-behavioural costing

A number of behavioural responses have been allowed for in the costing. The intended outcome is that employers move to remunerating employees in cash (or equivalents) which is subject to tax and NICs in the normal way. However, the costing also allows for other behavioural responses. Assumptions are made (separately for public and private companies) for substitution to profit distribution, accumulation of capital gains and use of share schemes. Where these result in tax being charged at a different rate, in particular at the dividend tax rates or the capital gains tax rates, the costing is adjusted accordingly. In addition, an assumption is made for some attrition into new types of avoidance schemes, increasing during the scorecard period.

The costing is also adjusted to take into account the consequential impact on corporation tax (CT), which reduces any initial yield from the payment of cash and other taxable remuneration. This effect decreases Exchequer yield by approximately £300 million each year.

The overall effect of the behavioural responses is to reduce the yield by between 50% and 60%.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+750	+760	+730	+770	+760

In addition to the Exchequer yield generated, this measure is expected to protect future tax revenues. Importantly, the measure closes off opportunities to avoid restrictions to tax relief on pension contributions to registered pension schemes through the use of EFRBS.

Areas of uncertainty

The main uncertainties in this costing relate to the size of current tax losses, which are projected from 2008-09 data, and predicting the different ways in which employers will respond to the measure.

Functional currency for tax calculations

Measure description

This measure will ensure that companies cannot enter into schemes that abuse the current rules relating to foreign exchange in order to avoid tax. It will prevent companies from retrospectively choosing their functional currency to gain a tax advantage. It affects accounting periods beginning on or after 1 April 2011.

The tax base

The tax base for this measure is the taxable profits of companies within (typically large) international groups, who have the potential to retrospectively change the currency in which their accounts are drawn up.

Costing

Because foreign exchange based tax avoidance schemes are used by a relatively small number of corporate groups, the costing for this measure has been estimated from known past Exchequer losses due to these schemes.

No behavioural effects are included in the costing, as avoidance schemes involving changes in functional currency are seen as the last of a number of foreign exchange based avoidance schemes to be closed, and are used opportunistically by groups who can apply them relatively simply. As such it is not expected that groups will be able to shift easily to using alternative avoidance schemes.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+60	+60	+60	+60	+60

Areas of uncertainty

As the use of this type of foreign exchange avoidance schemes is opportunistic and entirely dependent upon global currency movements there is some uncertainty over behavioural change. Without this legislation, schemes would not necessarily occur every single year, but would tend to be of high value. As a result this costing is presented as an expected annual average value of yield to the Exchequer.

VAT supply splitting

Measure description

This measure withdraws VAT zero-rating from printed matter connected to the supply of services, where these are made by different suppliers in circumstances where, had there been a single supplier, these would have been treated as a single taxable (other than zero rated) or exempt supply. As a result the measure blocks VAT avoidance schemes based around this type of 'supply splitting'.

The tax base

This form of split supply is currently common in some sectors, and confidentially held HMRC taxpayer data and market data have been used to estimate the tax base in the affected sectors. The tax base relates to the value attributed to printed matter (and so subject to VAT at the zero rate) where this is supplied in connection with services supplied to consumers by separate companies.

Static costing

The static costing is calculated by applying the 20 per cent standard rate of VAT to the tax base described above. This results in the following costing which is presented on a National Accounts basis:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+40	+50	+60	+60	+60

Post-behavioural costing

The costing is adjusted for behaviour, because consumer demand for the affected printed matter is expected to fall. An elasticity of –2 is assumed, because printed matter is thought to be a non-essential component of the types of goods and services affected. After rounding Exchequer impacts to the nearest £10 million, this reduces the expected VAT yield by about £10 million in 2013-14 and 2014-15.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+40	+50	+50	+50	+60

Areas of uncertainty

There is some uncertainty surrounding the behavioural response to this measure.

The elasticity of –2 applied in this costing is illustrative and applies to the total price of the affected services or supplies. The VAT component of the change in that price is small, and so the behavioural impact on both turnover and tax receipts is also very small.

In a different scenario to the one assumed in this costing key suppliers could choose to cease supplying the printed matter in question. Ceasing to supply the printed matter could reduce the suppliers' costs which in turn could result in lower prices to consumers if passed on. This could result in no additional VAT yield in the case where the full cost reduction is passed on in the form of lower prices to consumers.

Sale of lessor companies

Measure description

This measure removes the option to elect out of the sale of lessors rules, an option which was introduced in December 2009 but is thought to have been subject to abuse.

The sale of lessors rules trigger a tax charge when a corporate group sells a subsidiary leasing company. Lessors often experience a timing mismatch between the profile of capital allowances deductions for an asset versus the profile of taxable income received for the lease of that asset. This mismatch can result in lessors not paying tax in the early years of a lease. In some cases this has been exploited by parent companies selling the lessor company when it is due to begin paying tax, and so avoiding the future tax liability. The tax charge triggered by the sale of lessors rules is intended to prevent this avoidance.

The option now being removed allowed companies to elect out of the sale of lessors rules, so that instead of an immediate tax charge being triggered, future profits from the lessor could be ring fenced and taxed as they arose. Removing the option to elect out means that an immediate tax charge may be triggered.

In addition, this measure makes changes to strengthen the sale of lessors rules in order to protect future revenues.

The tax base

The tax base affected is the future profits of lessor companies being sold, where the option to elect out of the sale of lessors rules could currently be exercised.

Costing

The costing is estimated based on an assessment by HMRC of the tax currently being deferred through use of the election in types of cases that may re-occur in future, around £325 million since December 2009. Because the deferred tax would instead have been paid gradually over time, the Exchequer impact of this measure is a timing change which unwinds over a number of years. The costing also takes into account that some sales of lessor companies will no longer go ahead in circumstances that would lead to tax yields arising at the times of the sales if the scope to elect out of the sale of lessors rules is removed.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+25	+20	+20	+15	+15

Areas of uncertainty

HMRC has only limited information on the use of the option to elect out of the sale of lessors rules to date. As a result the estimate of tax currently being deferred, which is the basis of this costing, is subject to significant uncertainty, as is the rate at which the timing effect on Exchequer revenues will unwind. Removing the option to elect out of the rules may deter sales of lessor companies that would otherwise have taken place or lead to them taking place in circumstances in which extra tax would not need to be paid at the time of the sales. However these effects are extremely difficult to estimate.

Plant and machinery leasing avoidance

Measure description

This measure makes changes to the long funding lease legislation within the corporation tax regime. The intention is to block abuse of the legislation, through which some lessees are currently claiming up to double capital allowances for the same expenditure on plant and machinery.

The tax base

The base affected by the long funding lease legislation is capital expenditure incurred on items of plant and machinery, which are then leased under arrangements similar to a finance agreement. However this measure will only impact on these arrangements where they are structured to allow up to double capital allowance deductions on the same expenditure.

Costing

The costing is estimated based on an assessment by HMRC of the tax currently being lost through this type of avoidance, around £300-350 million in 2010-11. This value has been projected to 2015-16 in line with investment growth in the OBR's economic forecasts. The Exchequer impact is then adjusted to control for the likelihood of alternative avoidance schemes causing attrition of the expected revenue gains. In addition to the costing below, which is presented on a National Accounts basis, this measure is also expected to protect future revenues from increasing use of this type of avoidance.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+80	+130	+130	+120	+120

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainty in this costing is the scale of the avoidance activity in question. It is possible that not all of the relevant cases of avoidance have yet been indentified and therefore that the Exchequer impact could be underestimated.

Stamp Duty Land Tax avoidance

Measure description

Legislation will be introduced in Finance Bill 2011 to ensure, and put beyond doubt, that certain Stamp Duty Land Tax (SDLT) avoidance schemes are ineffective.

This measure also strengthens SDLT in order to protect future revenues.

The tax base

The costing reflects two changes with an Exchequer impact. The first change covers situations in which it is claimed that the 'sub-sale' and alternative finance rules apply in such a way as to avoid any charge to SDLT. The second targets purchasers who acquire a consumer credit licence in order to qualify as 'financial institutions' for the purposes of the SDLT exemptions for alternative finance.

Costing

The costing estimate is based on an assessment by HMRC of the tax currently not collected because of these types of avoidance – around £40 million in 2009-10. Nearly all of the identified yield relates to the first change. The value of £40 million has been projected to 2015-16 in line with growth in the total SDLT forecast. In addition, expected Exchequer yield is reduced to allow for the possibility that alternative avoidance routes may be used in place of the schemes being blocked. This results in the costing below, which is presented on a National Accounts basis:

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	+30	+30	+40	+40	+50

Areas of uncertainty

The main uncertainties in this costing result from incomplete data on which the £40m estimate of current tax not collected is based, and the potential use of alternative avoidance routes which are inherently difficult to predict.

VAT fraud on imported road vehicles

Measure description

This measure creates a mandatory on-line notification requirement for road vehicles entering the UK for permanent use on UK roads, from 2013. This change will enable HMRC to determine whether payment of the VAT on the vehicle is secure, thus enabling the Driver and Vehicle Licensing Agency (DVLA) to refuse vehicle licensing and registration where the VAT is not shown as secure, preventing a known fraud route.

The tax base

The tax base affected is those vehicles brought into the UK by individuals and business which are then registered at a local DVLA office. The VAT is due on these imported vehicles, but where the fraud occurs the VAT is not paid. Exchequer losses for previous years are estimated using DVLA data and assumptions based on operational information. Estimated losses in 2009-10 were approximately £115 million. This figure is projected to 2015-16 in line with real economic growth from the OBR's economic forecasts, and applying the trend in new car prices.

Costing

The static costing is simply the value of projected Exchequer losses described above, amended to reflect changes in the VAT rate since 2009-10. Exchequer yield is also reduced to allow for the possibility that alternative tax avoidance or fraud routes may be used in place of the fraud being blocked, an effect which is expected to increase over time. This results in the costing below, which is presented on a National Accounts basis.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	+125	+110	+105

Areas of uncertainty

The main uncertainties in this costing result from imperfect data on which the £115 million estimate of past tax losses is based, and the potential use of alternative avoidance or fraud routes which are inherently difficult to predict.

Protection life insurance

Measure description

This measure removes life protection business from the (investment) category Basic Life Assurance and General Annuity Business (BLAGAB) to the Gross Roll-up Business (GRB) category. This means that this line of business will now be combined with: pension, life reinsurance, overseas life and individual savings business.

For historic reasons protection business, although very similar in character to general insurance (contingent) business, currently sits within BLAGAB business. This means that expenses attributable to protection business are deductible, but the underwriting profit generated (since this is not investment income as such) is not recognised under the I-E computation system.

The tax base

The tax base is taxable income net of deductions that are allowable under the tax regime that applies to the BLAGAB and GRB categories, which are estimated using the HMRC Life Assurance Survey. The survey extracts information from the computations underlying life companies' FSA returns. In a 'typical year' life companies pay approximately £1.5 billion in corporation tax'. BLAGAB and GRB account for 80 to 85 per cent of this.

Costing

The static costing is estimated by taking the difference in the tax treatment of protection life assurance under the pre-Budget and post-Budget tax regimes. This is done by examining detailed accounts data on a company by company basis based on the HMRC Life Assurance Survey, as well as referring to data from the Financial Services Authority; and taking advice from experts within HMRC and industry.

The costing has three stages. The first is to estimate the cost of protection expenses being deductible against BLAGAB income under the existing regime. The second is to estimate underwriting profits and tax arising on protection business that is not taxed by the existing I-E rules, but which will be taxed under the GRB rules. The third is to estimate the offsetting loss in yield from the first two stages that would result when underwriting profits and expenses are combined with companies' other income and losses that arise in the GRB category. This loss in the yield from taking protection business out of BLAGAB can arise because:

- Existing GRB profits can be offset by protection expenses removed from BLAGAB
- Previously untaxed underwriting profits from protection business could be offset by unused GRB expenses/losses.

The result is presented on a National Accounts basis. The costing assumes that there will be little opportunity for tax motivated behavioural effects in the wake of the changes. However the analyses have factored in some economic changes such as increased competitiveness in the market as the measure potentially opens up the market to an increased number of suppliers and takes account of potential pricing impacts on these policies.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	+60	+90	+120

Qualifying time deposits

Measure description

This measure will introduce basic rate tax deduction on interest from Qualifying Time Deposits (QTDs) in respect of investments made on or after 6 April 2012.

The tax base

An estimated £400 million was earned in interest from QTDs in 2007-08, and this has been projected using a growth assumption and OBR forecast interest rates.

Static costing

Under the pre-Budget regime, tax due on interest from QTDs is paid through Self Assessment (SA) or Pay As You Earn (PAYE) with an assumed 15 per cent tax gap. In the post-Budget regime, the basic rate element of the tax due is paid through the Tax Deduction Scheme for Interest (TDSI), with any higher and additional rate liability paid through SA or PAYE. The measure impacts on revenues because:

- TDSI is expected to reduce virtually to nil the tax gap on the basic rate element of liabilities, and
- this basic rate element of the tax due will now be paid quarterly and largely in the year in which the interest is paid, rather than in the following year through SA or PAYE adjustments. This creates an up-front timing gain for the Exchequer, spread out over a number of years.

This results in the following costing, presented on a National Accounts basis:

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	neg	+30	+35	+40

Post-behavioural costing

The costing assumes a narrowing of the tax gap, to 5 per cent, in respect of the remaining amount of tax paid by higher and additional rate tax payers through SA or PAYE, and some forestalling of the measure.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	neg	+35	+40	+40

Areas of uncertainty

In addition to uncertainties surrounding the future trend in interest rates, the main uncertainty relates to the estimated amount of interest arising from QTDs.

Security for Pay As You Earn and NICs

Measure description

This measure introduces a power to allow HMRC to require a security from employers, where the Pay As You Earn (PAYE) income tax or NICs that they owe or are likely to owe is seriously at risk.

The tax base

Securities will affect tax and NICs owed relating to employment income, but will only apply to employers where the amount they owe is seriously at risk.

Costing

Securities will help to ensure that payments owed are met, but the costing takes account of the fact that many such payments would otherwise have been paid at later dates, or received after recovery action from HMRC. The net Exchequer impact is therefore modest.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	neg	+5	+5	+5	+5

Inheritance tax and charitable donations

Measure description

This measure reduces the rate of inheritance tax (IHT) paid by estates which leave 10 per cent or more of their assets to charity. As at present, transfers to charities will continue to be exempt from IHT. The measure will apply from April 2012.

The tax base

The tax base is the value of assets of estates that are subject to IHT. The tax base is established through the IHT forecast model which contains details of a sample of estates left on death in 2008-09. The assets are projected forward using the OBR's economic forecasts for asset prices and other relevant variables. The model projects the use of charity relief by estates on an individual estate level, as well as all other aspects of their estate including their total tax liability (forecast to be £2.7 billion in 2011-12) and estate size.

Static costing

The static impact is calculated by applying the pre and post Budget tax regime to the tax base and taking the difference. The pre-Budget IHT rate was 40 per cent. The post Budget reduced rate for qualifying estates is 36 per cent. This results in the following costing which is presented on a National Accounts basis.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-10	-20	-20	-25

Post-behavioural costing

The measure is expected to have an impact on the amount that estates leave to charities. The main behavioural change assumed in the costing is that many of those that would have given under 10 per cent of their assets to charity will now donate 10 per cent or over.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-25	-75	-125	-170

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainty in this costing is associated with the level of take-up by estates, especially those that would not have given anything to charity in the absence of the measure

Gift Aid tax relief for micro donations

Measure description

This measure allows charities and Community and Amateur Sports Clubs (CASCs) that have been registered for Gift Aid for more than 3 years to apply for Gift Aid on small donations of £10 or less without the need for any Gift Aid declarations. Each qualifying charity or CASC will be able to claim up to a total value of £5,000 of donations per annum. The measure comes into operation in April 2013.

The tax base

The tax base is small donations below a certain limit (£10 or under) to charities that have been registered for Gift Aid for 3 years. Over 100,000 charities are registered for Gift Aid. HMRC records show that Gift Aid was repaid to over 70,000 parent charities and CASCs in 2009-10 and that this has been increasing over time.

Static costing

The static costing is estimated by making assumptions about the amount that will be claimed by different sizes of charities:

Charities and CASCs with higher incomes are assumed to claim the maximum available of £1,250 per annum and those with lower incomes a proportion of this.

The static costing assumes that the current profile of claims and repayments (proportions of claims/repayments made for current and previous years of donations) remains the same.

This results in the following costing which is on a National Accounts basis.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	-35	-65	-70

Post-behavioural costing

More charities are expected to register for Gift Aid as a result of this measure than under existing trends, and this will impact from 2014-15 onwards when newly registered charities can take advantage of this measure.

In addition, behavioural responses were included to take into account the fact that it is assumed that a higher proportion will be claimed and repaid in the same year in which the donation was made, than under the current Gift Aid system. The costing takes into account possible fraudulent claiming, but also that HMRC will monitor and respond to such activity.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	-50	-85	-105

Areas of uncertainty

The main uncertainties in this costing relate to the assumptions on the amounts claimed by charities and CASCs, the number of charities and CASCs that will take up the scheme, the fraud rate and the changing profile of claims.

Housing Benefit for long term jobseekers

Measure description

Reversal of the measure announced in the June 2010 Budget that from April 2013, there will be a 10 per cent reduction in Housing Benefit (HB) awards after one year for recipients of Jobseeker's Allowance (JSA). The measure was part of a wider package of proposed changes to HB, designed to address affordability, unfairness and poor work incentives in the benefit system.

The cost base

The cost base was established using data from local authorities' Housing Benefit administration systems (the Single Housing Benefit Extract). This was used to obtain information on the number of working age HB recipients also in receipt of JSA.

Costing

The costs of reversing the measure announced in the June 2010 Budget are costed against the baseline that they would have been introduced in April 2012, with the first HB recipients being affected twelve months later.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	0	-105	-115	-115

Mobility components of Disability Living Allowance for claimants in residential care

Measure description

At the 2010 Spending Review the Government announced it would remove the mobility component of Disability Living Allowance (DLA) from care home residents, to remove overlapping provision in the funding of mobility support. As set out in the 2010 Welfare Bill, this change will not take place in October 2012, and the Government is reviewing changes after 2013. The costing assumes the previous policy but with the implementation date moved to April 2013, so that the policy can be rolled into the design of the new Personal Independence Payment.

The cost base

The cost base includes those DLA claimants identified as claiming the mobility component but who are currently resident in a care home, estimated to be around 78,000 people. Quarterly data on DLA claimants indicates that the caseload for this group is static.

Costing

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	-75	0	0	0

Transitional protection for existing claimants of Local Housing Allowance

Measure description

The measure amends the Budget 2010 Local Housing Allowance (LHA) reforms which cap LHA rates and set them at the 30th percentile of local rents: by bringing forward the 30th percentile measure from October 2011, so that both measures start in April 2011; and providing nine months of transitional protection for claimants who are already in receipt of Local Housing Allowance in April 2011.

The cost base

The impact of the underlying reforms was estimated using the Single Housing Benefit Extract, a 100 per cent dataset extracted from local authorities' administrative systems, and the Market Evidence Database of rent information, compiled by the Valuation Office Agency in order to set Local Housing Allowance rates.

Costing

The costing is derived by updating the profile of the Budget 2010 costings to allow for new claims to be assessed at the 30th percentile six months earlier, and for existing claims to be paid at the lower LHA rates nine months later than was previously assumed.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact [4]	+20	-30	0	0	0

[4] The additional +£10m (rounded) Exchequer impact in 2011-12 shown in table 2.1 of the Budget arises from an adjustment to DEL

Employment Support Allowance Youth

Measure description

At present, special arrangements apply which allow certain young people to qualify for contributory Employment and Support Allowance (ESA) without having to satisfy the NI contribution conditions which apply to all other claimants. This scheme is known as ESA 'Youth'. From April 2012, all new claims for ESA 'Youth' will be subject to the same contributory conditions as other claimants.

The cost base

The costing is assessed against a baseline of the latest official DWP forecasts of ESA. These are not broken down to explicitly show ESA 'Youth' cases. The proportion of the total caseload comprising ESA 'Youth' cases is estimated by using the proportion of the Incapacity Benefit (IB) caseload comprising IB 'Youth' cases. This proportion is then applied to forecasts of inflows to create an ESA 'Youth' inflows forecast.

Costing

DWP's Policy Simulation Model (PSM) is used to assess the other income of these claimants and therefore how many would be able to claim income-related ESA, and the likely amount they would be able to claim. The PSM is based on the Family Resources Survey which does not include a flag to show that a claimant is an ESA 'Youth' case so all contributory IB/ESA claims by those aged under 25 are used as a proxy.

The Exchequer impact is estimated by taking account of the likely subsequent benefit destinations of those who no longer claim ESA 'Youth'.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	+10	+10	+15	+15

Fraud sanctions regime in the benefits system and debt recovery

Measure description

A new fraud sanctions regime for the benefit system from April 2012 will:

- increase financial penalties for those who commit benefit fraud between £350 and £2,000
- impose a 3 year loss of benefit for organised fraud
- impose a £350 penalty and 4 week loss of benefit for attempted fraud
- provide a range of loss of benefit punishment of between 4 weeks and 3 years
- impose a new civil penalty of £50 for customers who are negligent in maintaining their benefit claim

The cost base

The costing is based on the current volumes and overpayment levels for sanctions issued by DWP. The cost base takes into account the forecast of benefit expenditure, the rate at which debt is collected and the timing for introduction of the new legislation.

Costing

The Exchequer impact is calculated by taking the difference between the current volumes and overpayment levels for sanctions issued by DWP and the volumes and overpayment levels estimated for the new regime.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	0	+25	+45	+65	+65

Metal costs for coinage

Measure description

The Government has delayed the implementation of the change in metal composition of 5p and 10p coins. From 1 January 2012, 5p and 10p coins will be made from nickel-plated steel (NPS) rather than the current cupro-nickel alloy. The switch to NPS coins for these denominations was previously planned for introduction from 1 April 2011.

The cost base

The costing is based on the prices of copper, nickel and steel and demand for 5p and 10p coins in 2010-11.

Costing

The estimated savings of the switch to nickel-plated steel are calculated as the difference between the cost of the metals used to produce 5p and 10p cupro-nickel coins and the cost of the metals used to produce NPS 5p and 10p coins. The costing assumes constant prices of copper, nickel and steel, and no behavioural effects.

Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Exchequer impact	-10	0	0	0	0

Pensions annual and lifetime allowances

Measure description

The pension tax relief annual allowance (AA) will be reduced from £255,000 to £50,000 from April 2011. The lifetime allowance (LTA) will be reduced from £1.8 million to £1.5 million from April 2012. These measures replace the previously announced policy of restricting pensions relief for those with incomes of £150,000 and over. Table 2.4 of the Budget sets out the difference between this costing and the original costing of the previous Government's approach to restricting pensions tax relief.

The tax base

The tax base for the measure is pension contributions (both individual/employee and employer) and is largely derived from two data sources:

- data on individuals' contributions and incomes is taken from the HMRC Survey of Personal Incomes (SPI). The latest available SPI data is for the tax year 2007-08; and
- employer contributions are imputed to each individual using a distribution which results in aggregate pension contributions being consistent with total contributions reported in National Statistics.

To estimate the size of the tax base over the forecast period, pension contributions for all individuals in the sample are grown in line with relevant elements of the OBR's economic forecasts. Total pension contributions are estimated to be around £80 billion in 2011-12, rising to £100 billion by 2015-16.

The primary tax base for the LTA measure is individuals' pension wealth. This is largely estimated using the Wealth and Assets Survey, a comprehensive data source that provides a direct indication of the level of pension assets held on an individual basis. Estimates suggest that around 40,000 individuals have current pension assets that are worth more than £1.5 million, although the measure will also affect individuals that currently have pension assets below £1.5 million but expect to be above the lower LTA when they retire.

Static costing

The static costing for the annual allowance is derived by multiplying the total contributions above the proposed AA in each year of the forecasting period by a weighted average marginal income tax rate for those affected to produce the reduction in tax relief.

The costings are then adjusted to take account of the introduction of a three year carry forward rule that allows individuals to offset any unused allowances from the previous three years against any excessive contributions.

The static costing for the new lifetime allowance assumes that every individual will continue with their current pattern of pension contributions until they retire. At retirement these individuals will face an LTA tax charge of either 55 per cent or 25 per cent on any amounts over the LTA. Assumptions have to be made about the rate of return on investments and the average retirement age.

This results in the following costing, which is presented on a National Accounts basis.

Static Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Total Exchequer Impact	0	+2,800	+3,100	+3,400	+3,700

Post-behavioural costing

The main behavioural response expected as a result of the AA reduction is that a proportion of individuals will reduce their pension contributions to the AA to prevent annual allowance charges. This should have little impact on total tax liabilities as the reduction in AA charges will be offset by higher income tax and NICs liabilities, assuming that employees are compensated for any reduction in employer contributions by an increase in wages. There will however be a timing effect.

Some individuals, who cannot reduce their contributions to the annual allowance, are likely to take advantage of an option to meet the AA charge from their pension benefits. Again total receipts will not be affected, but the timing of receipts will be.

HMRC data indicates that only a small number of individuals have previously exceeded the LTA and thereby faced a LTA tax charge. People with pension pots that are expected to exceed the new lower LTA are therefore likely to either reduce their contributions or stop contributing entirely in order to avoid LTA charges. This produces yield of around £0.2 billion in 2011-12 as it reduces tax relief on contributions, rising to around £0.6 billion by 2015-16.

The post-behavioural Exchequer impact from the pensions changes is shown below. The changes also produce a yield (£0.2 billion) in 2010-11 as some individuals have pension input periods that began in 2010-11 that will be subject to the new lower annual allowance.

Post-behavioural Exchequer impact (£m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Total Exchequer Impact	+1,200	+2,300	+4,400	+4,400	+4,300

Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainties in this costing relate to the modelled distribution of employer pension contributions and the extent to which individuals reduce their contributions.

A Indexation in public finance forecast baseline

A.1 The following table shows the indexation assumptions that have been included in the public finance forecast baseline, including all pre-announcements, for Budget 2011 policy costings. Unless otherwise stated, changes are assumed to take place in April each year and tax rates are assumed to be fixed.

A.2 For policy costings in future, after the Budget, the baseline will reflect Budget announcements. In particular, the baseline will adjust for the transition to CPI for the indexation of direct taxes on the basis set out above in this document.

Forecast area	Element	Default indexation assumed in baseline	Pre-announced policy changes from 2011-12 onwards
Income tax	Personal allowances [1]	RPI,[3] increase rounded up to the nearest £10	Personal allowance for those aged under 65 increased by £1,000 in cash terms in 2011-12
	Basic rate limit	RPI,[3] increase rounded up to the nearest £100	Basic rate limit reduced by £2,400 in cash terms in 2011-12, higher rate threshold (sum of personal allowance and basic rate limit) will be held constant in 2012-13, basic rate limit will be held constant in 2013-14
	Starting rate limit	RPI,[3] increase rounded up to the nearest £10	
	Threshold for additional (50 per cent) rate	Fixed at £150,000	
	Threshold for tapered withdrawal of personal allowances [1]	Fixed at £100,000	
	Pensions tax relief annual allowance	Fixed at £50,000	
	Pensions tax relief lifetime allowance	Fixed at £1.5m	
	Individual Savings Accounts limits for cash and equities	Total limit fixed at £10,200, of which cash limit fixed at £5,100	Limits will increase with RPI [1] every year from 2011-12 onwards

Forecast area	Element	Default indexation assumed in baseline	Pre-announced policy changes from 2011-12 onwards
NICs	Lower earnings limit	RPI,[3] rounded down to the nearest £1	
	All other limits and thresholds	RPI,[3] rounded to the nearest £1	Primary threshold will be aligned with the personal allowance in 2011-12 (before June 2010 Budget £1,000 cash increase), and primary threshold will increase by an additional £570 (above RPI) in 2011-12
	Contribution rates	Fixed	Class 1 employers, Class 1 employees and Class 4 contributions will all increase by 1 percentage point in 2011-12
Capital gains tax	Main annual exempt amount	RPI,[3] rounded up to the nearest £100	
	Annual exempt amount for trustees	RPI,[3] rounded up to the nearest £50	
	Lifetime allowance for entrepreneurs' relief	Fixed at £5m	
Inheritance tax	Nil rate band allowance threshold	RPI,[3] rounded up to the nearest £1,000	Nil rate band threshold will be frozen until 2014-15 inclusive
Disability Benefits (Disability Living Allowance, Attendance Allowance, Carer's Allowance) and Maternity Benefits Income-related benefits (Jobseeker's Allowance, Income Support, Incapacity Benefit, Employment Support Allowance)	All elements and rates	CPI [4]	None
Basic State Pension	All categories	Higher of earnings, CPI or 2.5%	RPI will be applied in 2011-12
Additional State Pension	All elements	CPI [4]	None
Pension Credit	Guarantee Credit	Earnings	Uprated by the cash rise in a full basic State Pension in 2011-12

Forecast area	Element	Default indexation assumed in baseline	Pre-announced policy changes from 2011-12 onwards
	Savings Credit	Maximum Savings Credit award frozen in cash terms for 4 years from April 2011. It is then frozen in real terms.	None
Child Tax Credit	Family element	Fixed at £545 per year	
	Child element	CPI,[4] rounded up to the nearest £5	Rising by £180 above indexation in 2011-12 and a further £110 above indexation in 2012-13
	Disabled and enhanced disabled child elements	CPI,[4] rounded up to the nearest £5	
Working Tax Credit	All award elements	CPI,[4] rounded up to the nearest £5	Basic and 30 hour elements frozen for three years from 2011-12
	Maximum eligible childcare costs (for 1 and 2+ children)	Fixed at £175 and £300 per week	
Child Benefit	Eldest (or only) child and subsequent children amounts	CPI,[4] rounded to the nearest 5 pence	Frozen for three years from 2011-12
Corporation tax	Marginal relief lower limit	Fixed at £300,000 profit	
	Marginal relief upper limit	Fixed at £1.5m profit	
	Small profits rate	Fixed at latest announced rate	Small profits rate will decrease to 20 per cent in 2011-12
Stamp Duties	Stamp duty land tax thresholds	Fixed at £125,000, £250,000 and £500,000	New £1m threshold will be introduced for 5 per cent tax band from 2011-12
	Stamp duty land tax first time buyer threshold	Fixed at £125,000	First time buyer threshold temporarily increased to £250,000 until 2011-12 inclusive
Climate Change Levy	Levy amount	RPI [5]	
Aggregates Levy	Levy amount	RPI [5]	Aggregates levy will increase to £2.10 per tonne in 2011-12
Landfill Tax	Tax rates	RPI [6]	Landfill tax rates will increase by £8 per tonne until 2014-15
Vehicle Excise Duty	Duty rates	RPI [6], rounded to the nearest £1 or £5	
Amusement Machine Duty	Duty rates	RPI [6]	
Air Passenger Duty	Duty rates	RPI,[6] rounded to the nearest £1	

Forecast area	Element	Default indexation assumed in baseline	Pre-announced policy changes from 2011-12 onwards
Tobacco Duties	Duty rates on all tobacco products	RPI [6]	Duty rates will increase by an additional 2 percentage points above RPI every year until 2014-15 inclusive
Alcohol Duties	Duty rates on all alcohols	RPI [6]	Duty rates will increase by an additional 2 percentage points above RPI every year until 2014-15 inclusive
Fuel Duties	Duty rates on petrol and diesel [2]	RPI [6]	Duty rates will increase by an additional 1p per litre above RPI every year until 2014-15 inclusive
	Duty rate on liquefied petroleum gas (LPG)	In line with changes in petrol and diesel duty rates	LPG rate will increase by an additional 1p per litre above changes in petrol and diesel duty rates, every year until 2014-15 inclusive
VAT	VAT registration threshold	RPI,[7] rounded to the nearest £1,000	
Gaming Duty	Gross gaming yield bands	RPI,[7] rounded to the nearest £500	
Business Rates	Business rates multiplier	RPI,[3] rounded to the nearest 3 significant figures	

Notes

[1] and other allowances e.g. married couples allowance, blind persons allowance
[2] and consequential rates for other fuels e.g. rebated oils
[3] RPI is measured in the year to September prior to the respective change
[4] CPI is measured in the year to September prior to the respective change
[5] RPI is measured in the year to the third quarter prior to the respective change
[6] RPI is measured in the year to the third quarter following the respective change
[7] RPI is measured in the year to December prior to the respective change

Office for
Budget
Responsibility

Certification of policy costings

B Office for Budget Responsibility: certification of policy costings

B.1 The Office for Budget Responsibility (OBR), led by the Budget Responsibility Committee (BRC), has certified that all but one of the costings of Budget 2011 policies described in this document represent a reasonable and central view given the information currently available.

B.2 The OBR has not certified the costing of increasing the time limit in the short life assets regime from four to eight years because of insufficient evidence presented, and after the deadline which would have allowed adequate scrutiny. The BRC has asked HM Treasury to carry further analysis on the costing of this measure. Once HM Treasury has produced new evidence, the revised costings will be scrutinised by the OBR.

B.3 The OBR has not scrutinised the costings of policies within Departmental Expenditure Limits (DELs) where the total cost or yield is wholly determined by a Government policy decision. This includes, for example, the funding of Firstbuy Direct and the University Technology colleges.

Methodology

B.4 All costings have been produced on the basis of the OBR's economic forecast published in the March 2011 *Economic and fiscal outlook*.

B.5 The OBR scrutinises the costings submitted by Government departments that 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 this Budget are set out from paragraph B.12.

B.6 The Treasury's costings methodology starts from an initial static costing which reflects the impact of the difference between the pre-measure regime and the post-measure regime on the tax base.

B.7 Behavioural effects are then added to the static costing. These reflect the expected response of consumers and firms to the policy change. While behavioural effects on the tax base are included, indirect effects on the wider economic forecast are excluded. For example, following an increase in tobacco duties, taxpayers will respond to the higher price by buying fewer cigarettes, and some consumers may turn to the illicit and cross-border market. Such behavioural effects are included in the policy costings. However, any impact that such a measure could have on economic variable such as inflation would not be included in the policy costing, but would be captured in the OBR economy forecast.

B.8 The Treasury's approach to policy costings, where the static, behavioural and indirect effects are considered separately, can be contrasted with a fully dynamic approach where all costings and economic determinants interact simultaneously. Dynamic scoring has potential benefits since in theory it could fully incorporate the effects of all measures on each other and on the economic forecast. However, dynamic scoring is highly complex, involves a significant degree of uncertainty, and can make costings less transparent and harder to explain. The OBR will work with Government departments as they continue to develop their costings methodology in the future.

Scrutiny and challenge process

B.9 Along with the officials responsible for producing each costing, the OBR attended a series of Star Chambers, at which the assumptions, judgements and methodology used in the costing were 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 ensure its views were fully reflected in the Treasury's final costings.

Uncertainty

B.10 The OBR emphasises the uncertainty which surrounds forecasts of the public finances. Policy costings are subject to a similar, if not greater, level 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 the levels of error, fraud and avoidance in the tax system. 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.

B.11 In respect of the specific policy costings at this Budget, the OBR identified the following areas of particular uncertainty:

- Controlled Foreign Companies (CFC) reform: the overriding uncertainties surrounding the costing of this measure are the size of the CFC tax base (i.e. the number of UK companies that will be affected) and the behavioural response of large international companies.
- Entrepreneurs' relief: the estimate of the cost of this policy is dependent on the capital gains tax (CGT) forecast, which is subject to substantial uncertainties. These are due to the recent major changes to the CGT regime and the absence of relevant data. There is also significant uncertainty over the nature of the behavioural effects under a far higher lifetime limit than the £1 million limit which applied to 2009-10 liabilities, the latest period for which data is available. The behavioural response from the measure could be larger than estimated if entrepreneurs' relief asset disposals which did not take place at all within the old £1 million limit, do so once the limit is made more generous.
- Changes to duty on tobacco: an important component of the costing of this measure is the behavioural effect (i.e. how consumers will respond to the increased tobacco price), which is inevitably subject to uncertainty. Consumers are expected to respond by reducing the consumption of tobacco, switch to lower price products or turn to the illicit and cross-border markets. However, the extent of such behavioural responses is difficult to quantify.
- Review of non-domicile taxation: in this case the uncertainty is due to the narrow tax base and the difficulty in predicting behavioural responses amongst this internationally mobile group. The policy costing is therefore highly dependant on the decision of a limited number of individuals on whether to accept the higher charge or become non-residents as a result of the measure. For those becoming

non-resident, the Exchequer will lose all the tax and NICs currently paid by these individuals as well as the £30,000 per year each of them pays under the current regime.

- Avoidance measures: the main uncertainty associated with these measures is the sustainability of the yield over time. In general, the costings in this document assume that some individuals switch to other forms of tax avoidance. By its nature, this effect is subject to a wide margin of error.

Indirect effects on the economy forecast

B.12 Having considered the Budget measures in this document, the BRC have concluded that the only significant indirect effects are on the inflation forecast from the changes to fuel duty, air passenger duty and tobacco duty.

B.13 The OBR was notified of the change to corporation tax and the 1p cut in fuel duty from 1 April 2011 too late to incorporate any indirect effect of these measures in the economy forecast. However, we believe any such effects would have been minimal.

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

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