HM TREASURY

HM Revenue & Customs

Department for Work & Pensions

# Autumn Statement 2012 policy costings

December 2012

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# 1 Introduction

1.1 This document sets out the assumptions and methodologies underlying costings for tax and Annually Managed Expenditure (AME) policy decisions announced since Budget 2012, where those policies have a greater than negligible impact on the public finances. This continues the practice established at June Budget 2010 and the principles outlined in '*Tax policy making: a new approach*', published alongside June Budget 2010[1]. This publication is part of the Government's wider commitment to increased transparency.

1.2 Chapter 2 presents detailed information on the key data and assumptions underpinning the costing of policies in Autumn Statement 2012. Each note sets out a description of the measure, the base, the methodology for the costing (including relevant adjustments for behavioural responses) and highlights any areas of additional uncertainty, beyond those inherent in the OBR's forecast. All costings are presented on a National Accounts basis.

1.3 Costings for AME measures do not have a direct effect on borrowing after 2014-15 as they are contained within the overall spending envelope for Totally Managed Expenditure (TME).

1.4 Annex A sets out assumptions and methodologies underpinning the costing of Universal Credit. This was announced at Budget 2012 but has now been through a more detailed modelling process to provide an updated costing for the OBR's forecast. The annex also covers decisions announced at the Autumn Statement.

1.5 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.

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

# 2 Policy costings

The following policy decisions are included in this chapter:

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# Personal allowance increase

## Measure description

Budget 2012 announced that the income tax personal allowance will increase to £9,205. This measure increases the personal allowance (PA) by a further £235 to £9,440 in 2013-14.

The basic rate limit (BRL) will also be decreased to ensure that the higher rate threshold (HRT) remains at £41,450 in 2013-14, ensuring equal gains to higher rate tax payers. The national insurance contributions (NICs) upper earnings and profits limits (UEL/UPL) will remain aligned to the HRT.

## The tax base

The tax base is estimated using two data sources:

- For income tax; data on taxable incomes is taken from the Survey of Personal Incomes (SPI), comprising a sample around 675,000 tax records, weighted to be representative of all taxpayers. The latest available data is for the tax year 2009-10.
- For national insurance; data on incomes subject to NICs are estimated using the Annual Survey of Hours and Earnings (ASHE), calibrated to NICs receipts outturns.

The income tax base, including taxpayer numbers and incomes, is grown over the forecast period in line with the relevant OBR forecast determinants. The NICs base is also grown in line with relevant OBR forecast determinants.

## Static costing

The static Exchequer impact is calculated by applying the pre- and post-measure tax regimes to the tax base described above, and taking the difference. The costing also takes account of the direct impact of this measure on DWP spending on income-related benefits calculated after tax income. This results in the following static costing:

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -1,000 | -1,105 | -1,105 | -655 | -575 |

## Post-behavioural costing

The costing includes small behavioural adjustments to account for changes in the HRT in years after 2013-14. These estimates are based on an assumed Taxable Income Elasticity (TIE) of 0.03 around the HRT.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -1,000 | -1,110 | -1,110 | -660 | -580 |

## Areas of uncertainty

The main uncertainties in this costing relate to the projection of SPI survey data from 2009-10, which in particular affects the number of baseline taxpayers who will benefit from the measure.

# Higher rate threshold

## Measure description

This measure increases the higher rate threshold (HRT) from £41,450 in 2013-14 to £41,865 in 2014-15 and £42,285 in 2015-16. The HRT is the sum of the Personal Allowance (PA) and the basic rate limit (BRL).

The costing assumes that the PA will rise by RPI indexation in 2014-15 and 2015-16. The national insurance contributions (NICs) upper earnings and profits limits (UEL/UPL) will also rise so that they remain aligned with the HRT.

## The tax base

The tax base is estimated using two data sources:

- For income tax; data on taxable incomes is taken from the Survey of Personal Incomes (SPI). The latest available data is for the tax year 2009-10.
- For national insurance; data on incomes subject to NICs are estimated using the Annual Survey of Hours and Earnings (ASHE), calibrated to NICs receipts outturns.

The income tax base, including taxpayer numbers and incomes, and the NICs base, are grown over the forecast period in line with the relevant OBR forecast determinants.

## Static costing

The static costing is calculated by applying the pre- and post-measure tax regimes to the base described above, and taking the difference. The pre-measure tax regime assumes that the HRT rises by indexation, using the OBR forecast for RPI in 2014-15 and 2015-16, and CPI thereafter.

**Static Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | +315 | +920 | +1,155 | +1,130 |

## Post-behavioural costing

A behavioural adjustment is made to account for individuals adjusting their taxable incomes in response to changes to marginal tax rates. This can arise through changes in work effort, increased tax planning, avoidance, evasion or migration.

Behavioural effects are estimated using Taxable Income Elasticities (TIEs), which show how individuals' taxable incomes change in response to changes in marginal tax rates. These elasticities are derived from a range of evidence including academic studies; although precise results vary, there is a consensus that TIEs are greater for those on high incomes. The TIE used in this costing is 0.03.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | +295 | +875 | +1,105 | +1,085 |

## Areas of uncertainty

The main uncertainties in this costing relate to the projection of SPI survey data from 2009-10, which in particular affects the number of higher rate taxpayers who will be affected.

# Inheritance tax nil rate band

## Measure description

This measure increases the inheritance tax (IHT) nil rate band by one per cent in 2015-16. The threshold was frozen at March Budget 2010 until 2014-15.

## The tax base

The tax base is estimated from a sample of 2010-11 IHT returns, which contain details and values of estates left on death, as well as any reliefs that they are entitled to. The tax base is projected forward using OBR forecast determinants and the Government Actuary Department's mortality forecasts.

## Costing

The Exchequer impact is calculated by applying the pre- and post-measure tax regimes to the tax base described above. A small behavioural impact has been included in the costing to take into account tax planning. This results in the following costing:

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | 0 | +15 | +30 | +35 |

# Capital gains tax annual exempt amount

## Measure description

The Capital Gains Tax (CGT) Annual Exempt Amount (AEA) is the threshold below which no tax is paid on chargeable gains made on disposals. This measure sets the annual increase in the AEA for 2014-15 and 2015-16 at 1 per cent. The 2014-15 increase of 1 per cent is applied to the threshold for 2013-14.

## The tax base

The tax base is estimated using 2010-11 tax data and is projected forward using equity price growth. The measure brings additional taxpayers into the CGT regime and this is estimated by inspecting the numbers likely to be in the affected threshold range.

## Static costing

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

### Static Exchequer impact (£m)

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | 0 | +5 | +10 | +10 |

## Post-behavioural costing

A behavioural adjustment is made to allow for the reduction in disposals from a lower increase in the AEA.

### Post-behavioural Exchequer impact (£m)

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | 0 | +5 | +5 | +5 |

## Areas of uncertainty

There is some uncertainty around the number of additional taxpayers in future years as a consequence of reducing the increase in the AEA to 1 per cent.

# Fuel duty

## Measure description

This measure cancels the January 2013 increase in fuel duty which was deferred from August 2012 and defers all future fuel duty increases in this Parliament from April until September of each year.

## 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 2011-12 this amounted to just over 50 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)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -910 | -1,725 | -1,720 | -1,820 | -1,510 | -1,555 |

## Post-behavioural costing

Behavioural responses were included to take into account the increase in consumption in response to lower fuel price increases. The behavioural impact is assumed to increase over time as people have time to adjust. For a 1 per cent reduction in pump prices, the model assumes a short-term 0.07 per cent increase in the quantity of fuel consumed, which increases to 0.13 as consumers react to the price change. These elasticities reflect only the impact upon kilometres driven, as changes in vehicle efficiency are largely driven by EU emissions standards. This increases Exchequer yield, partially offsetting the reduction in static yield.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -890 | -1,640 | -1,625 | -1,715 | -1,420 | -1,465 |

## Areas of uncertainty

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

# Bank Levy increase

## Measure description

The Bank Levy was introduced with effect from 1 January 2011. This measure increases the effective full rate of the Bank Levy from 1 January 2013 onwards from 0.105 per cent to 0.130 per cent. A proportionate increase will be made to the half rate, also with effect from 1 January 2013. The full rates are shown in the table below.

**Bank Levy rate (per cent)**

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|
| Bank Levy rate | 0.088% | 0.130% | 0.130% | 0.130% | 0.130% | 0.130% |

## The tax base

The tax base is estimated from the latest receipts data collected by HMRC from those banks liable to pay the Bank Levy. The tax base is projected forward across the forecast period using assumptions about future underlying balance sheet growth as well as behavioural impacts (as assumed for the introduction of the Bank Levy and updated according to more recent research).

## Static costing

The static costing is calculated by applying the change in rate to the tax base described above. Most banks are likely to start paying the extra tax arising from the additional rate as part of their July 2013 quarterly instalment payment.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | +515 | +550 | +545 | +545 | +545 |

## Post-behavioural costing

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 Budget 2010.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | +515 | +545 | +540 | +545 | +545 |

## Areas of uncertainty

The main uncertainties in this costing are around the Bank Levy tax revenue forecast on which it is based and the behavioural effects.

# Main rate of corporation tax reduction

## Measure description

This measure reduces the main rate of Corporation Tax (CT) by a further 1 per cent from April 2014. As a result of the measures announced by this Government, the main rate of CT will be reduced to 23 per cent in 2013-14 and 21 per cent from 2014-15 onwards.

## The tax base

Estimates of the tax base for the main rate of CT are taken directly from the CT revenue forecast of quarterly instalment payments by non-life assurance companies. This forecast is based on CT data for 2010-11, calibrated to an estimate of 2012-13 accruals based on the latest tax receipts. This is then projected in line with relevant determinants from the OBR's economic forecast.

The resulting estimate of net taxable profits taxed at the main rate (and the main rate reduced by marginal relief) in 2012-13 is around £80 billion.

## Static costing

The static Exchequer impact is calculated by applying the pre- and post-measure tax regimes to the tax base described above. This results in the following static costing:

**Static Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -10 | -505 | -935 | -1,040 | -1,035 |

## Post-behavioural costing

The costing includes a behavioural response to account for changes in the incentives for multinational companies to shift profits in and out of the UK. A reduction in the CT rate makes the UK more attractive, relative to other locations, as a destination to locate profits.

The proportion of profits in the tax base that are mobile has been estimated at around 40 per cent, based on data from CT returns. Within this data, the sectors where profits are known to be most mobile are examined and the profit flows for these sectors that are most likely to be shifted are identified. An elasticity of -2 has been applied to these mobile profits; a 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 elasticity used is a central assumption, informed by multiple academic studies.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -10 | -415 | -785 | -875 | -875 |

## Areas of uncertainty

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

# Pensions lifetime and annual allowances

## Measure description

This measure reduces the pensions tax relief lifetime allowance (LTA) from £1.5 million to £1.25 million for tax year 2014-15 onwards.

It also reduces the annual allowance (AA) from £50,000 to £40,000 for tax year 2014-15 onwards.

## The tax base

The tax base for the AA is individual and employer contributions to pension schemes. Estimates are taken from the Annual Survey of Hours and Earnings for contributions to occupational pensions and HMRC records for contributions to personal pensions, reported by pension providers.

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 the OBR's forecast for average earning. Total pension contributions are estimated to be around £90 billion in 2012-13, rising to £110 billion by 2017-18.

The tax base for the reduction in the LTA is all contributions and pension wealth from individuals that expect to have pension wealth above the new lower LTA when they retire.

Private pension wealth is estimated using the Wealth and Assets Survey and is projected forward using assumed pension contributions, and estimates of the real rate of return on pensions savings taken from the OECD and the Government Actuary's Department. Estimates suggest that around 30,000 individuals have pension assets that are worth between £1.5 million and £1.25 million in 2014-15. The measure will also potentially impact on further individuals who could have pension wealth between the new and the old LTAs in future years when they retire.

## Static costing

The static costing for the decrease in the AA is derived by multiplying the total contributions above the new AA and up to the old AA threshold in each year of the forecast period by a weighted average marginal income tax rate for those affected to produce the reduction in tax relief. The costing is then adjusted to take account of the three year carry forward rule that allows individuals to offset any unused allowances from the previous three years against any excessive contributions.

This results in the following static costing for the reduction in the AA, which is presented on a National Accounts basis. The LTA static costing is not included here as it does not factor into the final costing.

**Static Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | 0 | 350 | 400 | 425 |

## Post-behavioural costing

The main expected behavioural response for the decrease in the AA is that a proportion of individuals will reduce their pension contributions to the new level to prevent charges. These effects will have little impact on total tax liabilities as the reduction in AA charges are likely to be offset by higher income tax and NICs liabilities. 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.

The costing for the LTA assumes that some individuals will reduce their pension contributions to avoid LTA charges. This produces a small yield of around £50 million in 2012-13, as it is assumed that individuals will start adjusting their contributions after announcement of the lower LTA, with greater responses in the following years.

The costing is also adjusted to account for some public sector workers near retirement choosing to opt out of their pensions to protect any current pension wealth above the new LTA, thereby reducing the value of pension contributions the Government receives from public sector workers.

Small adjustments have also been made to account for the introduction of lower annual allowances and possible forestalling.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | +50 | +200 | +300 | +600 | +1,000 | +1,125 |

## Areas of uncertainty

In addition to uncertainties surrounding the OBR's economic forecasts, the main uncertainties in this costing relate to assumptions on the real rates of return on pension savings, the retirement age, pensions contributions as a proportion of gross pay and behavioural impacts.

# Tax repatriation from Switzerland

## Measure description

This measure provides for bilateral co-operation to ensure effective taxation in the UK of individuals with financial assets in Switzerland. It is expected to come into force on 1 January 2013. The measure has four main elements:

- A one-off levy applied to existing Swiss assets owned by UK residents; the rate will range from 21 per cent to 41 per cent;
- A withholding tax on future income and gains with rates ranging from 27 per cent to 43 per cent, based on income type;
- A 40 per cent inheritance levy applied to Swiss assets for UK investors and an enhanced exchange of information.

Alternatively individuals can make a disclosure, either to HMRC or through the Lichtenstein Disclosure Facility (LDF). This is captured in the costing.

## The tax base

An estimated £40 billion of funds held by UK residents in Switzerland are affected by this measure; this provides the tax base for the one-off levy. The base for the future elements will be smaller, due to the deduction of the levy and the movement of assets. The tax base is £24.7 billion at the outset and grows in line with Swiss GDP and bank deposit growth.

## Costing

The behavioural aspects of this measure have been captured in the tax base and an adjustment has also been made to account for identification failure. The past element of this measure is expected to generate the bulk of the costing, and most of this will be captured in the earlier years; this includes an upfront payment of CHF 500 million in February 2013 as part of the agreement.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | +330 | +3,120 | +610 | +920 | +180 | +150 |

## Areas of uncertainty

There are significant uncertainties around tax base and behavioural effects.

# High-end television tax relief

## Measure description

This measure will provide a corporation tax relief for expenditure on high-end television production, following a similar approach to the Film Tax Relief. The relief will provide eligible companies with a choice between an additional deduction set at 100 per cent of qualifying core expenditure and a payable tax credit at 25 per cent of losses surrendered and will be introduced from April 2013.

## The tax base

The tax base is the amount of qualifying expenditure on high-end television productions in the UK, which is based on industry estimates.

## Static costing

The static costing is calculated by applying the appropriate rates of tax relief to the tax bases described above.

**Static Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -5 | -10 | -10 | -10 | -10 |

## Post-behavioural costing

There is a significant behavioural element to this costing as it is expected that the introduction of the relief will encourage increased levels of eligible production expenditure within the UK. Estimates have been guided by industry discussions.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -5 | -25 | -45 | -60 | -70 |

## Areas of uncertainty

There is uncertainty around the size of the tax base and the extent of the behavioural effect.

# 12 month extension of small business rates relief scheme

## Measure description

The Small Business Rate Relief (SBRR) scheme provides 50 per cent relief for eligible businesses, and is funded through the business rates system. This measure doubles the relief given to businesses eligible for SBRR for a further 12 months from 1 April 2013, at Exchequer cost. It offers 100 per cent relief up to a rateable value of £6,000, with relief tapering to the SBRR threshold of £12,000 rateable value.

## The tax base

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

## Costing

The starting point for the costing is data on the number of non-domestic properties in England with a rateable value of less than £12,000. This figure is adjusted to account for empty properties and hereditaments ineligible for SBRR. These adjustments are based on VOA data on individual hereditaments, DCLG data from Local Authorities and survey results. The result is an estimated number of eligible properties of 530,000.

Administrative data for the relief suggests that around 95 per cent of the static yield will be claimed by businesses.

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

The costing includes the Barnett consequentials, which are calculated as 19 per cent of the business rate cost at 95 per cent take-up, net of business tax adjustments.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -475 | +50 | 0 | 0 | 0 |

# Empty property rates relief for newly built commercial property

## Measure description

Subject to consultation, this measure introduces an 18 month empty property rates exemption for newly built commercial property completed between October 2013 and September 2016, up to state aid limits, at Exchequer cost.

## The tax base

The tax base for this measure is the total rateable value from newly built non-domestic property eligible for this relief. It is estimated that the number of eligible properties will be 25,000 per annum. The primary data source is the Valuation Office Agency's 2010 rating list of non-domestic properties.

## Costing

The costing is estimated by applying the value of the relief to the tax base. An adjustment is made for the value of the existing empty property rates relief. This exempts storage and industrial property for the first 6 months. All other non-domestic property is exempt for the first 3 months.

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

The costing includes the Barnett consequentials, which are calculated as 19 per cent of the business rate cost pre business tax adjustments.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -10 | -55 | -50 | -30 | -5 |

# Introducing a cash basis for small businesses in self-assessment

## Measure description

This measure introduces a cash basis for calculating tax due for self-assessment (SA) for qualifying small firms under certain turnover thresholds, depending on their circumstances. The measure takes effect from April 2013.

## The tax base

The tax base is the tax paid by qualifying small firms, within the receipts limit, for whom there would be a timing benefit in tax payments when using the cash basis. The number of qualifying small firms benefiting is estimated using information from 2010-11 tax returns to be around 270,000.

## Costing

In estimating the Exchequer impact, adjustments are made to take into account that not every business who would benefit from this measure will take advantage of it, nor would they do so straight away. The take-up rate is assumed to be around 40 percent, of which around 80 per cent are assumed to do so in the first year of this measure taking effect. The Exchequer impact is calculated by applying the pre-and post-measure tax regimes to the adjusted tax base described above and taking the difference. This results in the following costing.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | -165 | +25 | -5 | neg. |

## Areas of uncertainty

The main area of uncertainty in this costing is the assumptions around the take up rate.

## Gift aid on small donations

Budget 2011 announced a measure to allow certain charities and community and amateur sports clubs (CASCs) to apply for Gift Aid style payments on small donations without the need for any Gift Aid (GA) declarations, up to a total value of £5,000 of donations a year. Since Budget 2011 the following changes have been made to the measure:

- The maximum size of a small donation is increased from £10 to £20.
- Introduction of the "community buildings" rule to allow a charity to claim top up payments on an additional amount of donations up to a value of £5,000 for each of its local groups.
- The requirement for charities to match each pound of Gift Aid small donations scheme (GASDS) with 10 pence of GA donations (the 10 percent rule).
- Charities must have been registered and claiming GA for at least two years prior to the scheme rather than three as originally announced.

### The tax base

The tax base is small cash donations below a certain limit (£20 or under) to charities, CASCs and their eligible local groups, that have registered for GA for two years. This is estimated using information from 2011-12 claims and projected forward using information from historic growth trends.

Assumptions are also made about new charities and charities currently registered but claiming GA intermittently who would do so without this measure.

### Costing

The costing is estimated by making assumptions about the amounts that will be claimed by different sizes of charities, CASCs and qualifying local groups that will now be eligible to claim as a result of this measure.

Including the local groups that will now qualify, the above changes to the scheme will have a positive effect on the amounts claimed, which is reflected in the costing below. Changes have been made to estimates of fraud as a result of the 10 percent rule.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -10 | -15 | -10 | -20 | -30 |

### Areas of uncertainty

The main areas of uncertainty in this costing are around take-up numbers, amounts claimed, underlying levels of giving and the fraud rate.

# Increase in annual investment allowance

## Measure description

This measure temporarily increases the annual investment allowance (AIA) for qualifying expenditure on plant and machinery from £25,000 to £250,000 from 1 January 2013 for two years.

## The tax base

The tax base is qualifying expenditure made by businesses above the current AIA allowance and up to the new AIA. The tax base is estimated using tax returns data for accounting periods ending in the 2010-11 tax year. The tax base is projected forward using the OBR forecast for total business investment.

## Costing

The profile of higher allowances claimed is estimated from the increase in the tax base, with adjustments made for the reduction in other capital allowances now claimed and the fact that not all businesses will be able to make use of the higher AIA in all years. The relevant main and small profits rates of corporation tax will apply to incorporated businesses, and an average combined marginal income tax and National Insurance rate of 29 per cent is assumed for unincorporated businesses.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -305 | -670 | -910 | -400 | +300 | +235 |

## Areas of uncertainty

As well as uncertainties around the OBR's forecast for investment, the main uncertainty in this costing is due to estimates of eligible investment from unincorporated businesses.

# Amendments to cap on income tax reliefs

## Measure description

This measure excludes charitable reliefs from the cap on currently unlimited income tax reliefs. This cap will limit the total amount of income tax relief an individual can claim through currently uncapped income tax reliefs. The cap was announced at Budget 2012 and will be effective from April 2013.

## The tax base

The tax base is estimated using data on reliefs from self assessment (SA) tax returns for 2008-09. These are projected forward in line with the OBR's forecast for earnings growth.

## Static costing

The static Exchequer impact is calculated by applying the pre-and post-measure tax regimes to the tax base described above. This results in the following costing.

**Static Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | -90 | -65 | -70 | -75 |

## Post-behavioural costing

The costing makes allowance for behavioural responses that impact on the yield from the reliefs cap.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | -80 | -60 | -65 | -65 |

## Areas of uncertainty

There are some uncertainties around the use of reliefs going forward and also around the extent of the behavioural impact.

# Value added tax: amendments

## Measure description

At Budget 2012 the Government announced that static holiday caravans, alterations to listed buildings, all self storage and hot take-away food would be subject to the standard rate of VAT as of October 2012. This measure makes the following changes:

- Static holiday caravans: apply a reduced rate of VAT of 5 per cent to static holiday caravans and large touring caravans from 6 April 2013;
- Hot food and premises: clarification of the scope of this measure;
- Approved alterations to listed buildings: extend transitional arrangements to make them more generous; and
- Self storage: amend the Capital Goods Scheme for providers of self storage so that small firms are able to benefit from the scheme in the same way as their larger competitors.

## The tax base

The tax base is consumer expenditure on the affected products. This is estimated using data from a range of sources; including commercial and trade association reports, the Office for National Statistics and the Department for Communities and Local Government.

## Static costing

The costing is calculated by applying the difference between the pre and post measures tax regimes to the tax base described above. For self storage, an adjustment is made for input tax that is reclaimable by self storage suppliers.

**Static Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -45 | -90 | -100 | -100 | -105 | -105 |

## Post-behavioural costing

A behavioural response is included to take into account the change in demand in response to a change in price. Elasticities of demand were applied to the products affected of -0.5 for self storage, -0.4 for alterations to listed buildings, -1.5 for static caravans and -0.8 for hot take-away food. A compliance adjustment is also made.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -35 | -65 | -70 | -70 | -80 | -80 |

## Areas of uncertainty

The main uncertainties in this costing relate to the exact size of the tax base and the behavioural response of consumers to the change in prices.

# North Sea oil and gas allowances

## Measure description

This summer the Government announced two new categories of allowances that can be offset against the supplementary charge on profits from oil and gas production. The two new categories are:

- a brown field allowance of £50 per tonne of reserves, for expected capital costs of £80/tonne or over and tapering to no allowance for costs of £60/tonne. The maximum available allowance for a project or projects forming part of a wider development will be £250 million, or £500 million where companies are paying PRT.
- a £500 million allowance for qualifying large shallow-water gas field projects, with estimated reserves of between 10 billion and 20 billion cubic metres, tapering to no allowance at 25 billion cubic meters.

## The tax base

The tax base comprises the profits that would be eligible for the supplementary charge if no field allowances were available, including profits arising from additional investment. This is calculated using estimates of oil and gas prices, production and expenditure for projects in fields qualifying for the allowances, which are also used in the OBR's economic forecast.

## Static costing

The static costing is calculated by applying the relevant rates of supplementary charge and ring fence expenditure supplement to the tax base described above.

**Static Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | -20 | -45 | -80 | -85 | -90 |

## Post-behavioural costing

An adjustment has been made to account for the measure increasing the probability that relevant oil and gas fields will be developed or redeveloped, as these fields will be more profitable after the reform. This initially increases the Exchequer cost of the measure, due to extra field allowance and capital allowances; in subsequent years beyond the forecast period, the additional production and profits arising from this extra investment are expected to increase the Exchequer yield.

**Post-behavioural Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -10 | -60 | -120 | -175 | -145 | -75 |

## Areas of uncertainty

The main uncertainties in this costing result from incomplete information about the oil and gas fields affected by the measure, the behavioural responses of companies, and future oil and gas prices.

# Carbon reduction commitment

## Measure description

Autumn Statement 2012 announces two changes to the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme:

- a number of simplifications to the CRC;
- increases in the price of permits after 2014-15 in line with the retail price index measure of inflation.

## The tax base

The tax base is emissions of $CO_2$ covered by the CRC, estimated by the Department of Energy and Climate Change (DECC). These are derived from 2010-11 participant reports to DECC and grown in line with DECC's projections for energy demand. To estimate the post measure tax base, an adjustment is made to take into account the impact on $CO_2$ emissions of the simplifications to the CRC. This decreases the level of emissions covered by CRC.

## Costing

The costing is arrived at by applying the appropriate rates to the relevant tax base, under a pre-and post measures tax regime. A small behavioural effect is included to take into account the reduction in demand as a result of the increase in the price of permits, using a price elasticity of -0.2.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -25 | -25 | -25 | 0 | +30 | +65 |

## Areas of uncertainty

The main area of uncertainty in this costing relate to the forecasts of the tax base.

# Capital gains tax: employee shareholder status

## Measure description

This measure exempts any capital gains arising on the first £50,000 worth of shares acquired by an employee through the adoption of the 'employee shareholder' employment status from capital gains tax (CGT).

## The tax base

The tax base is the value of chargeable gains made by employees who would have held employee shares without the measure and who enter the scheme. The tax base is estimated by looking at 2010-11 tax returns and statistics on the numbers of employees currently receiving shares and share options in unapproved schemes. Assumptions are made on the value of employee shares that are transferred into the scheme and gains are estimated after assuming some restrictions on the timing of disposals of shares.

## Costing

The Exchequer impact is estimated by multiplying CGT tax rates by the tax base described above. This costing allows for some tax planning.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | 0 | neg. | -20 | -80 |

## Areas of uncertainty

The main uncertainties are around assumptions on take up rates, the average value of shares that are entered into the scheme, the extent of tax planning and the timing of disposals.

# HMRC: compliance (evasion, avoidance and debt)

## Measure description

HMRC is increasing its capacity to tackle avoidance and evasion in a number of areas. This is underpinned by additional new funding announced at Autumn Statement 2012. This funding will, in part, underpin:

- an extension of HMRC's affluent unit. It will now tackle taxpayers with a net worth of £1 million (previously £2.5 million), increasing the target population from 300,000 to 500,000;
- additional staff to target offshore evasion and avoidance of inheritance tax (IHT) and other duties using offshore trusts;
- tackling partnerships which have entered into structures to avoid tax suffered by the partners on non-partnership income;
- an increase in HMRC's transfer pricing specialist resources to accelerate the identification, challenge and resolution of transfer pricing issues; and
- an extension of HMRC's debt collection capacity through the recruitment of 500 temporary fixed-term appointments for a period of 15 months.

## The tax base

The tax base for the extension of the affluent unit and targeting of offshore trusts relates to the number of additional cases generated by the increased resources, estimated using historical departmental performance data. It is estimated that an additional 1,600 to 1,700 affluent cases and 200-400 offshore avoidance cases will be generated each year.

The costing for partnerships and transfer pricing is based on the litigation and compliance activity generated from additional compliance staff plus additional legal resources. The costing excludes compliance yield HMRC expects to generate in the absence of the measure.

The cost base for debt collection capacity is formed of the additional debt cases that can be worked by the new recruits.

## Costing

The static exchequer impact for the affluent unit and offshore trusts is calculated by applying the average yield per case to the tax base described above. An adjustment is made for cases that do not generate any revenue. An increase in cases is expected to have a positive behavioural effect on the non compliant minority. An adjustment has been made to account for an increase in the future compliance of taxpayers.

Exchequer yield from tackling partnership losses is expected through two routes: an increased number of people agreeing to settlement offers and accelerated litigation. For transfer pricing, the costing is based on the estimated compliance yield from each additional recruit. An allowance is made for the training of new recruits. The measure is also expected to protect significant future revenue.

The costing for HMRC's debt collection capacity assumes that some debts clear within a year without HMRC intervention and that, initially, new recruits will not be as effective as existing staff. Recruitment, training and set up costs are deducted from the costing. There is not expected to be any behavioural effect. The final costing is presented on a national accounts basis.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | +15 | +200 | +95 | +325 | +330 | +330 |

## Areas of uncertainty

There are significant uncertainties around the tax base and estimates of the yield generated by these additional cases.

# US foreign accounts information powers

## Measure description

The US Foreign Account Tax Compliance Provisions (FATCA) is US legislation that requires financial institutions outside the US to report information on the accounts held by US persons. A 30 per cent withholding tax is applied to the US source income of any financial institution that fails to comply.

On 12 September 2012 the UK signed a Treaty to implement FATCA with the US. This Treaty and the legislation introduced to enact it will remove some of the implementation problems of the US regulations. In addition the US have agreed to provide reciprocal data on the US accounts of UK persons. The information provided to HMRC (both by the UK banks and by the US) is expected to generate additional compliance cases. Financial institutions will be required to begin collecting data in 2013, with HMRC receiving the data from 2015-16.

## The tax base

This tax base is derived from an estimate of the total number of records that the UK will receive and a further estimation around the number of those generating compliance cases. An allowance is made for cases where there is no yield due to double tax agreements.

## Costing

The costing is derived by estimating the additional revenue HMRC will raise from its compliance activity. This uses assumptions around the expected level of yield from a typical new case identified by this arrangement, and that of a typical existing case.

An adjustment has been made to account for individuals affected moving funds to other jurisdictions.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | neg. | neg. | +5 | +55 | +25 |

## Areas of uncertainty

This costing is subject to significant uncertainty.

# Tax credits: error and fraud

## Measure description

This measure gives HMRC more information from tax credits (TC) claimants under the following circumstances:

- certain people claiming childcare costs as part of their tax credits
- young people (16 to 19 year olds) who are in qualifying education or training

The measure will be in operation from 2014-15 to 2016-17.

## The cost base

The cost base is the amount of residual error and fraud in finalised awards that is estimated using the results of a TC random enquiry programme. In 2010-11, error and fraud relating to the childcare element of TC was around £265 million and around £500 million was due to the incorrect reporting of young people in qualifying education or training. The tax base is grown in line with entitlements' growth from the tax credit forecast. Adjustments are made to also include overpayments and the impact of migration to Universal Credit.

## Costing

The Exchequer impact derives from HMRC's ability to reduce error and fraud in year by either stopping or reducing payments. In some cases, a debt will arise which will need to be recovered. The costing is estimated by taking the additional proportion of error and fraud that HMRC expects to be able to tackle based on past operational performance data.

Adjustments are made to take into account:

- that some of the resource needed to work on these cases will be taken away from other error and fraud cases; and
- that some error and fraud will re-enter claims after the cases have been worked due to some customers failing to report changes to their circumstances or subsequently reporting changes incorrectly.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | +315 | +185 | +85 | neg. |

# Tax credits: recovering debt

## Measure description

This measure enables HMRC to recover more tax credits (TC) debt by:

- outsourcing TC debt to debt collection agencies (DCAs). This is due to be introduced from January 2013 and run for 6 months;
- introducing changes to the TC IT system to enable recovery of debts that accrued from a customer's previous TC award from payments being made for a customer's current TC award.

## The cost base

HMRC plan to transfer TC debt to DCAs each month for six months.

The cost base for changes to the TC IT system is the recoverable outstanding TC debt. This is estimated from individual administrative records of debt owed by past TC customers, and of current TC awards.

## Costing

The costing is based on estimating the likely debt recovery rates. For DCAs this have been guided by the results of a previous HMRC DCA programme and the results of a commissioned study. An adjustment is made to account for those debts that would have been recovered in the absence of intervention.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | +5 | +80 | +205 | +125 | +105 | +90 |

## Areas of uncertainty

The main areas are the rates of recovery and self-clearance.

# Working age discretionary benefits and tax credits

## Measure description

The following benefits, tax credits and payments will be up-rated by 1 per cent for 3 years from 2013-14:

- The main elements of Jobseeker's Allowance, Employment and Support Allowance (ESA), Income Support, applicable amounts for Housing Benefit;
- Maternity Allowance, Statutory Sick Pay, Statutory Maternity Pay, Statutory Paternity Pay, Statutory Adoption Pay; and
- The couple and lone parent elements of Working Tax Credit (WTC), and the child element of Child Tax Credit. The basic and 30 hour elements will be frozen in 2013-14 as previously announced, and will be uprated by 1 per cent in 2014-15 and 2015-16.

It will not apply to the premia within these benefits relating to disability, pensioners, and caring responsibilities, the support group component of ESA, or the disability elements in tax credits, which will be uprated as usual.

## The cost base

The cost base is estimated using DWP's statistical and accounting data and HMRC's Tax Credit forecasts data and assumes that announced policy for 2013-14 on WTC basic and 30 hour elements are frozen remains in place.

## Costing

The costing is calculated by applying baseline and post-measure rates to the cost base set out above.

The tax credit savings have been calculated independently of the income related benefit savings, so an adjustment has been made to reflect the estimated effect of the interaction between tax credits and other benefits.

The total estimate is then adjusted to account for the additional savings from the introduction of Universal Credit.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | +505 | +1,430 | +2,280 | +2,445 | +2,555 |

## Areas of uncertainty

The main uncertainty in the costing arises from the forecast of CPI.

# Child Benefit

## Measure description

This measure will increase Child Benefit (CB) rates by 1 per cent in both 2014-15 and 2015-16.

## The cost base

The cost base is estimated using HMRC administrative data on the number of children for which CB is currently claimed. This data is projected forward using ONS population projections.

## Costing

The Exchequer cost is calculated by applying the pre- and post-measure tax regimes to the tax based described above, and taking the difference. An adjustment is made to account for the fact that some of the savings allocated to the High Income Benefit charge will no longer be realised. No behavioural responses are expected. This results in the following costing, presented on a National Accounts basis.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | +175 | +285 | +310 | +330 |

# Local Housing Allowance rates

## Measure description

Local Housing Allowance (LHA) rates are used to determine the maximum amount of Housing Benefit (HB) payable to people who have started a tenancy in the private rented sector since April 2008, and will apply to all private sector tenants under Universal Credit (UC). Under this measure LHA rates will be uprated by current policy, subject to a 1 per cent cap in 2014-15 and 2015-16, with exemptions for rates in those areas in which rent increases are highest. 30 per cent of the potential savings from the 1 per cent cap in 2014-15 and 2015-16 will be used to fund these exemptions.

## The cost base

The cost base is people receiving HB who have started a tenancy in the private rented sector since April 2008. This is estimated using the DWP Housing Benefit Forecasting model, the latest OBR economic assumptions and the latest estimates of LHA uprating in April 2013.

The baseline assumes that LHA uprating reverts to current policy from 2015-16.

## Costing

The costing is calculated by applying baseline and post-measure LHA rates to the cost base described above.

The estimate is adjusted to account for the introduction of UC in line with the methodology described in costing for UC in Annex A. Savings from LHA changes under UC are around 35 per cent higher than under HB because of the higher numbers of people who are eligible for some housing support under UC.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | +105 | +225 | +245 | +260 |

## Areas of uncertainty

The main uncertainty in the costing arises from the forecast of CPI.

# Support for Mortgage Interest

## Measure description

Under current SMI rules, new working age claims are subject to a 13 week waiting period and a capital limit of £200,000. Funding for the current rules is due to expire in December 2012, and from January 2013 the system would revert to the old rules of a 39 week waiting period and a £100,000 capital limit. This measure extends the current rules until 31 March 2015.

## The cost base

The cost base is estimated from historical SMI claims from the Quarterly Statistical Enquiry, historical and forecast new awards, and survival rate data provided by the Department for Work and Pensions Forecasting Division. OBR assumptions on the future average mortgage rate are also used.

## Costing

The costing is calculated using the estimated number of people to receive additional/higher awards (and the value of these awards) compared to the pre-measure base.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | -10 | -95 | -90 | -20 | 0 | 0 |

## Areas of uncertainty

The main uncertainties are related to assumptions around using the overall survival rates for the underlying benefits and proportion of those with SMI and capital above £100,000.

# New Enterprise Allowance: day one access

## Measure description

The New Enterprise Allowance (NEA) was rolled out from April 2011 for JSA recipients who have been unemployed for six months or more. The NEA includes one-to-one business mentoring, a weekly allowance and a loan.

From 2 July 2012, claimants were able to access business mentoring support from 13 weeks into their JSA claim. Subsequently, from 22 October 2012, the support offered through the NEA was moved to day one of a JSA claim.

## The cost base

The original costing assumed that there would be 15,000 participants in the scheme in 2011-12 and 25,000 in 2012-13. Participants would receive a weekly allowance paid at £65 for three months and £33 for an additional three months.

The revised costing assumes that there will be 19,000 participants in 2012-13 and 15,000 in 2013-14. Participants would receive the same weekly allowance as above.

## Costing

The costing is estimated by calculating the difference between the pre- and post-measure costings.

The AME costing in Budget 2011 was calculated by assuming that on average participants receive the Allowance for an average of 23 out of a maximum possible 26 weeks and that participants would have spent an average of 8 out of a maximum possible 26 weeks on JSA in the absence of the allowance. All of these factors made for a net unit AME cost of £700.

The revised AME costing maintains that on average participants receive the Allowance for an average of 23 out of 26 weeks. In the absence of the scheme it is assumed that participants would have spent an average of 6 weeks out of a maximum possible 26 weeks in JSA, based on observed off-flows. This is shorter than the Budget 2011 costing due to earlier eligibility. This makes for a net unit AME cost of £700 in 2011-12, £760 in 2012-13, and £820 in 2013-14.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | +5 | -10 | 0 | 0 | 0 | 0 |

# 4G spectrum sale

## Measure description

In February/March 2013, Ofcom is expected to complete a commercial auction of 800Mhz and 2.6Ghz spectrum to enable delivery of fourth generation (4G) mobile services. Receipts from this auction will return to the Exchequer in a lump sum.

## Costing

The OBR's forecast includes an estimate of the value of receipts from the auction of £3.5 billion. This costing is based upon independent analysis of revenues from comparable spectrum auctions outside the UK[1], and the increasing economic value of spectrum[2] underpinned by the high level of anticipated competition in the commercial marketplace.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | +3,500 | 0 | 0 | 0 | 0 | 0 |

## Areas of uncertainty

The actual value of auction receipts will be known on completion of the spectrum auction.

[1] DotEcon and Aetha Report for Ofcom, "*Spectrum value of 800MHz, 1800MHz and 2.6GHz*", July 2012
PWC, "Timing is Everything: Releasing the Value of Spectrum", 2010
[2] Analysys Mason, "*Impact of radio spectrum on the UK economy and factors influencing future spectrum demand*", November 2012. The report estimates that the overall the economic value of commercial spectrum use has increased significantly since 2006, from £35bn to £52bn.

# Public Works Loan Board project rate discount

## Measure description

This measure introduces a Public Works Loan Board (PWLB) project rate at 40bps below the PWLB standard rate. The rate will be available to one strategic priority project identified in each of the Local Enterprise Partnership (LEP) areas up to an aggregate total of £2.5 billion in England (consisting of £1.5 billion for LEPs outside London and £1 billion for the Northern Line extension (NLE) in London).

## Costing

The costing assumed that LEPs outside London will take up the project rate to 90 per cent of the full £1.5 billion cap, with some of the borrowing in 2013-14 and the remainder in 2014-15. Each LEP will specify which Local Authorities will undertake the borrowing for their preferred project, in line with the requirements of the PWLB which can only lend to Local Authorities. It is assumed that those LAs borrowing would previously have borrowed at the PWLB certainty rate. Additionally, it assumes that the full £1 billion for the NLE is taken up.

The Exchequer impact represents the value of interest payments on LA borrowing which would previously have been at the certainty rate but are now at the lower project rate. It is assumed that 10 per cent of the interest saving outside the NLE is applied to local reserves and the remaining 90 per cent to delivering local authority current expenditure. In the case of the NLE, all the interest saving has been applied to local expenditure.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | neg. | neg. | - | - | - |

## Areas of uncertainty

The main uncertainty relates to the assumed take up of borrowing within the £1.5 billion cap for LEPs outside London.

# Northern Line extension

## Measure description

This measure provides for funding for an extension of the Northern Line from Kennington to Battersea, by allowing the Mayor of London and partner authorities to borrow the funds required to finance its construction.

## Costing

Original cost estimates for the NLE were prepared in Q1 2010 prices by Corderoy, a consulting firm, for Treasury Holdings (UK), the previous owners of the Battersea Power Station site. These were based on RIBA Stage C designs. These cost estimates were then updated by KPMG in 2011 and 2012, following a review of the estimates by EC Harris, a technical adviser. Major changes included allowances for optimism bias, risk, capital cost inflation, a delayed construction profile and additional project management costs reflecting the transfer in responsibility for delivering the scheme to Transport for London.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | +5 | +20 | +10 | - | - | - |

## Areas of uncertainty

The main uncertainty relates to the estimates of the project costs, although allowance has been made for risk, contingency and optimism bias.

# Business rates retention

## Measure description

At present, business rates are collected by local authorities (LAs), pooled centrally by government and then redistributed to LAs as part of formula grant. From April 2013, the local government rate retention scheme will reform the way in which LAs are funded by central government by allowing LAs to retain a proportion of the business rates they collect, known as the "local share", and then continuing to top this up with central government grants as relevant. There will be a system of tariffs and top ups within the local share which ensure a fair starting point within the system.

## The cost base

The main business rates forecast is based on 2012-13 data on business rates submitted to the Department for Communities and Local Government (DCLG) by billing authorities. Most components are projected forward using the Office for Budget Responsibility's (OBR) RPI forecast and the central forecast of growth in the rateable value of businesses.

## Static costing

For the purposes of the rate retention scheme, the total business rates that English LAs will collect in 2013-14 has been estimated to provide the starting point for determining individual authority business rates baselines and the calculation of each authority's tariffs and top-ups. This figure has been defined as the Estimated Business Rates Aggregate (EBRA) and starts from the main business rate forecast then applies appropriate adjustments to reflect elements such as outstanding appeals and transitional relief. This measure is fiscally neutral, but results in a reclassification of 50 per cent of EBRA, from central Government DEL to Non-Departmental AME to reflect the nature of the local share.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | 0 | 0 | 0 | 0 |

# A Universal Credit

## Measure description

This annex describes the methodology for estimating the additional costs of Universal Credit (UC) as reflected in the OBR forecast and on the scorecard.

UC is a major reform of the benefit system that will:

- replace the current system of means tested out-of-work benefits:  Income Support (IS), Employment and Support Allowance (ESA) (income based) and Jobseeker's Allowance (JSA) (income based); Working Tax Credit (WTC); Child Tax Credit (CTC); Housing Benefit (HB); and Support for Mortgage Interest (SMI);
- withdraw benefits at a single rate (the taper) once households exceed a specific level of earnings (the disregard);
- create a simple system that tracks earnings in real time; and,
- be phased in over a number of years, starting in October 2013 (Pathfinder from April 2013).

This annex sets out the impact on Annually Managed Expenditure that arises from these changes. It reflects the structural changes to the benefit system under UC, some changes to the rules around eligibility and the introduction of transitional protection for households whose move to UC is initiated by DWP.

The key policy assumptions underpinning the UC costing are set out in high level terms below. The full details of the new arrangements will be published in the Universal Credit Regulations on 10 December[1]. Other measures announced at the Autumn Statement that have an impact on Universal Credit are not included in this costing note. Details of interactions are set out in the individual costing notes where relevant.

## The cost base

The households that will be affected by the introduction of UC are:

- Existing working age claimants of tax credits and income related benefits;
- Other households on relatively low income, who, due to the differences between UC and the current system, have no underlying entitlement to income related benefits and tax credits prior to the introduction of UC but become entitled to UC;
- Households with an unclaimed entitlement to the current system of means tested benefits and tax credit. Due to the relative simplicity and integrated nature of UC, take-up is expected to increase under UC;

[1] See www.dwp.gov.uk for more information.

- Couples with one partner under and one partner over the single qualifying age for pension credit will no longer be entitled to make a new claim to Pension Credit (PC), but will be considered for UC;
- Claimants currently receiving incorrect amounts of benefits or tax credits due to fraud or error. Reductions in fraud and error are expected through the simplification of policy and delivery and through more accurate and up-to-date earnings information; and
- Tax credit claimants with in-year earnings fluctuations, who benefit from the tax credit income change disregard. No such disregards will exist in UC.

Benefit claimants who choose to move into work or those in work who choose to change their hours in response to improved work incentives will also be affected, but these effects are not incorporated in the costs presented here.

Finally, with the introduction of UC and the abolition of Housing Benefit and Tax Credits, households above pension age may be impacted by a change in the way support is paid for rent and for children.

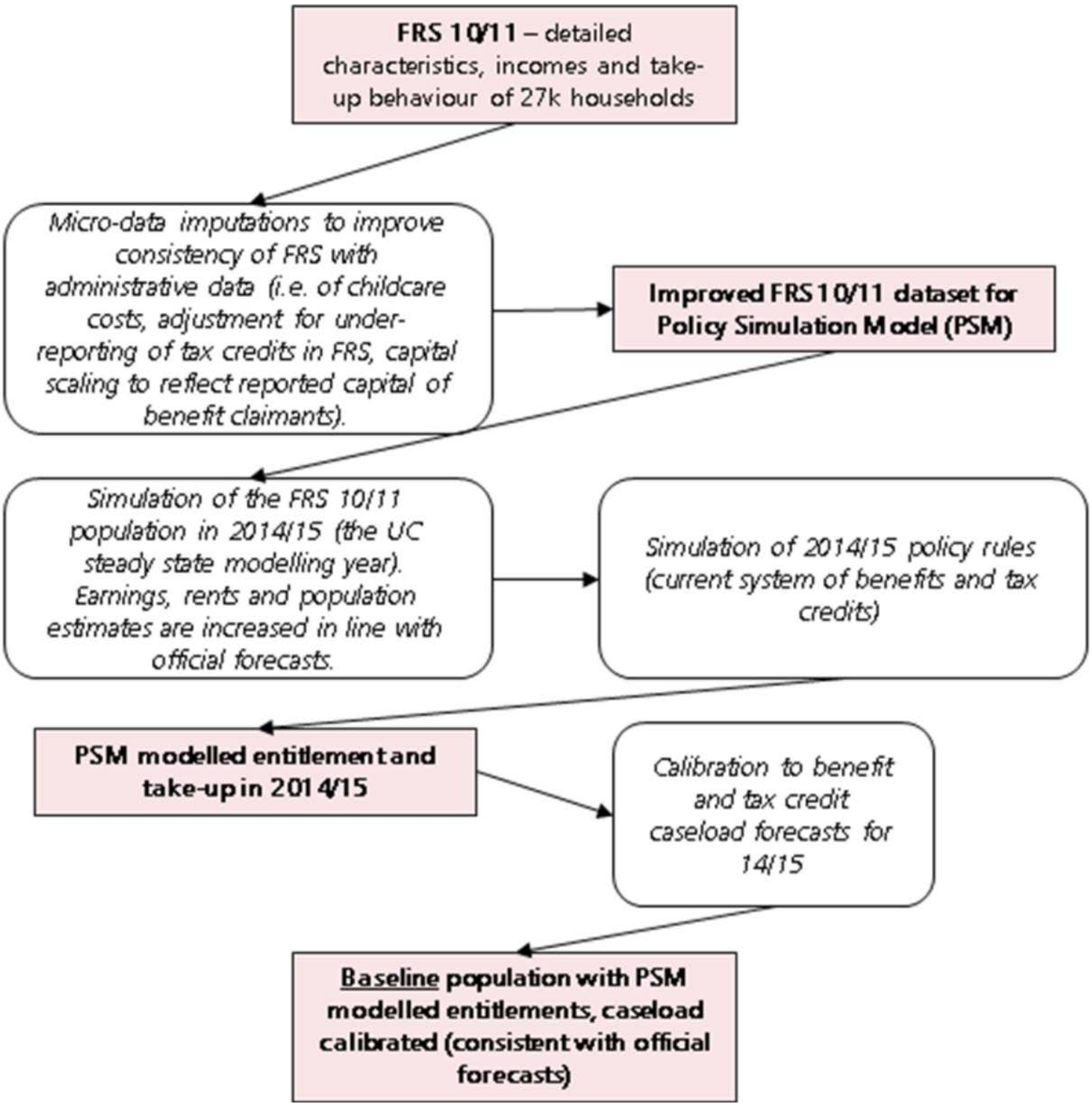
In the costing, the Policy Simulation Model (PSM) [2] is the primary tool for modelling entitlement rules and take-up (see chart A.1 below).

Following the simulation of the baseline, the policy rules in the PSM are altered to reflect policy and expected take-up to UC. The impacts of entitlement and take-up changes in UC are derived by comparing the simulations of UC against the simulation of the baseline.

The key data sources used in the costing are the Family Resources Survey (FRS), official benefit and tax credit caseload forecasts, and administrative benefit and tax credit data. The costing also draws on DWP and HMRC National Fraud and Error Statistics and HMRC administrative forecasts of Tax Credit expenditure and overpayment debt levels.

[2] For tractability 2014-15 was chosen as a year to simulate the 'steady state' impact of Universal Credit. In practice, Universal Credit will be introduced gradually over a number of years. The transition modelling (set out in section 3) explains how the steady state costs are profiled during build up of Universal Credit.

**Chart A.1: Simulating the baseline in the Policy Simulation Model**




## The costing methodology and assumptions

### Establishing the maximum UC award

UC entitlement is based on a maximum award comprised of a number of elements. This is equivalent to the amount of UC a claimant would be eligible to receive if they had zero earnings. These elements are:

- The standard allowance, which replaces the JSA, IS and ESA personal allowances and also determine the maximum award for in-work (e.g. previously WTC) claimants;
- The additional limited capability for work and limited capability for work related activity elements for disabled adults;
- The carer element, which replaces the carer premium in income related benefits;

- The child element, disabled child element (lower and higher rate), which replace CTC and its elements;
- The childcare element for in-work claimants; and
- The housing element to support claimants with rent and support for mortgage interest.

### Impact of earnings and capital on UC awards

UC will inherit capital rules from existing out-of-work income related benefits. So households with capital of more than £16,000 will not be able to receive UC and those with capital of over £6,000 will have their UC reduced by £4.35 per month for every £250 of capital holdings over £6,000.

Earnings will reduce UC awards at a rate of 65p to the pound once earnings disregards are exhausted. The earnings disregards vary by household composition; the proposed rates for 2013-14 are set out later in this note.

Other income is generally assumed to result in a pound-for-pound deduction of UC. There are exceptions to this which will be published in Regulations.

To stop claimants from under reporting their earnings and receiving high benefit awards, as can happen in tax credits, new rules will include a Minimum Income Floor (MIF) that assumes self-employed claimants are earning at least a minimum level of income. Genuine self-employed people will benefit from the support provided by Universal Credit.

The MIF will be set at the minimum level of earnings, which will be set out in regulations, required to exempt UC claimants from actively seeking employment or increased employment. This varies by family composition and the age of the youngest child. New self-employed claimants will be exempt from the MIF for 12 months to allow them time to build up their business. Full details of the policy will be published in Regulations.

### Take-up assumptions

The costing assumes that existing claimants who remain entitled under UC will continue to take-up their entitlement. In addition, it is expected that take up will increase for some groups:

- Those only partially taking up their entitlement to existing benefits and tax credits are assumed to take up their full UC entitlement.
- Some claimants who currently completely fail to take up their entitlement are assumed to take-up UC. The take-up assumptions made for this group of claimants vary by employment status:
  - Amongst the employed, it is assumed that 20 percent of those currently not taking up any entitlement will take-up UC;
  - Amongst the self-employed, it is assumed that 10 percent of those currently not taking up any entitlement will take up UC; and
  - Take-up rates amongst out-of-work claimants are not expected to change.

These assumptions are based on take up rates in the current benefit system and analysis of survey data.

### Modelling fraud, error and the abolition of tax credit income change disregards

The impacts on fraud and error have been modelled through careful consideration of how the design of UC differs, both in terms of policy and in terms of delivery, from the system it replaces.

UC is expected to result in a net saving from reduced fraud and error. The savings accrue over time from the designing out of known sources of fraud and error in the current benefit and tax credit system through simplification and changes to claimants' reporting requirements.

For example, the merging of in-work tax credits and out-of-work benefits means that overpayments that currently occur when in-work claimants are wrongly paid out-of-work benefits will be reduced, whilst the provision of monthly updates about earnings and childcare will help reduce the errors, which currently occur as a result of using out-dated information.

As UC will link to Real Time PAYE Information, entitlement can be accurately calculated each month. This means that payments will become sensitive to income fluctuations, unlike the current tax credit system which has a disregard for income changes.

### Other assumptions and policies captured in modelling

Further changes introduced with UC include:

- the abolition of tax credit (TC) and HB run-ons;
- the abolition of measures designed to improve work incentives in the short term: Job Grant, In-work Credit, Return-to-Work Credit, (as work incentives are instead central to the design of Universal Credit);
- changes that have a small impact on expenditure on Cold Weather Payment, the Sure Start Maternity Grant and Funeral Payments; and
- For claimants of Pension Credit (PC) age, the move from HB and CTC to support for rent and children within PC.

### Modelling the transition

The four year process to stop claims to the benefits replaced by UC and to migrate existing claimants from the old system to the new will begin in October 2013 and be completed by the end of 2017.

The exact timing and sequence of the migration process will be adjusted in the light of experience, not least from operating the pathfinder service in the Greater Manchester area from April 2013.

For the purpose of the costing, we have assumed:

- new claims to UC in place of JSA start from October 2013;
- new claims to UC in place of TC and IS start from May 2014;
- new claims to UC in place of ESA and HB start from October 2014; and
- managed changes start in September 2014, initially for JSA cases, and then the other benefits and tax credits in the same order as new claims.

Throughout this migration period households will move onto UC through 3 routes:

- New Claims – These claims will be received from households who would otherwise have claimed one of the old working age benefits or tax credits;
- Natural Changes – These claims to UC occur when someone undergoes a change of circumstances that would lead to a new benefit claim (for example, the birth of a first child or an individual losing their job). As UC is a household benefit, this would also trigger the closure of any old entitlements for others in the household; and

- **Managed Changes** – Managed changes occur where there has been no change of circumstances and DWP initiates the transfer of an entire household from legacy benefits to one UC entitlement.

Managed changes will be eligible for transitional protection. An adjustment to the UC cost profile is made to account for the costs of providing transitional protection.

## Costing

Since the Budget 2012 several Universal Credit policy decisions have been finalised on including for example on occupational pensions disregards, on war pensions, on simplifying housing policy and on advances policy within UC. The OBR forecast has been updated to incorporate the latest data sources, economic assumptions and caseload forecasts as well as the wider policy environment e.g. updates to tax allowances and other benefits and tax credits. The public finances now also include the proposed disregard levels and the plans for uprating them in 2014-15 and 2015-16, as set out in the *Setting disregards* section of the annex.

**Exchequer impact (£m)**

| | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|
| Exchequer impact | +70 | -140 | -945 | -1,770 | -2,230 |

## Areas of uncertainty

Uncertainties arise from changes to behavioural impacts, such as different take-up rates; changes to the rate that UC builds up; or, changes to fraud and error assumptions. The additional cost of UC could also change in response to differences between turnout of wider economic parameters[3], such as CPI and earnings growth, and the underlying forecasts of the benefits and tax credits that UC replaces.

**Table A.1: Sensitivity analysis**

| Uncertainty | Central scenario | Alternative scenario | Approximate impact |
|---|---|---|---|
| UC take up | Take-up rates for newly entitled to UC are based on existing take-up rates | 2 percentage points higher or lower (newly entitled taking up) than central scenario | Plus or minus £30 million in 2017-18 |
| Build up of additional take-up | The rate at which additional take-up to UC builds up is assumed to be linked to the size of the award | Doubling or halving the rate at which additional take-up builds up | £130 million higher cost (doubling the rate) to £450 million saving (halving rate) in 2017-18 |
| Fraud and error (F&E) | Baseline levels of F&E are equivalent to central estimates of F&E in published National Statistics | Accounting for confidence intervals in the published National Statistics reports and further models | Plus or minus £250 million in 2017-18 |
| Transitional Protection | Costing assumes that changes in circumstances will occur at the same frequency as in current system | Doubling or halving the rate at which changes in circumstances occur | Plus or minus £100 million in 2017-18 |

[3] For the purpose of the costing, it is assumed that standard allowances, child elements and other components that make up individual awards are uprated by CPI each year. Earnings disregards are also assumed uprated in the costing. These are working assumptions and do not necessary reflect policy.

## Setting disregards

The Autumn Statement sets out the parameters for Universal Credit, including setting the disregard levels for April 2013.

The proposed rates for 2013-14 are set out below. It is proposed that all the Universal Credit earnings disregards will be up-rated by 1 per cent in 2014-15 and 2015-16 and from 2016-17 onwards they are assumed to be up-rated by CPI.

**Table 2.A: Disregard levels to be used in April 2013 (£ per year)**

| | | |
|---|---|---|
| Lower Work Allowance for households with rental costs (taking the highest of whichever of the following amounts in applicable)— | | |
| Single claimant— | | |
| | not responsible for a child or qualifying young person | £1,330 |
| | responsible for one or more children or qualifying young persons | £3,159 |
| | has limited capability to work | £2,306 |
| Joint claimants— | | |
| | neither responsible for a child or qualifying young person | £1,330 |
| | responsible for one or more children or qualifying young persons | £2,660 |
| | one or both have limited capability to work | £2,306 |
| Higher Work Allowance for households with no rental costs (taking the highest of whichever of the following amounts in applicable)— | | |
| Single claimant— | | |
| | not responsible for a child or qualifying young person | £1,330 |
| | responsible for one or more children or qualifying young persons | £8,812 |
| | has limited capability to work | £7,759 |
| Joint claimants— | | |
| | neither responsible for a child or qualifying young person | £1,330 |
| | responsible for one or more children or qualifying young persons | £6,429 |
| | one or both have limited capability to work | £7,759 |

Please note: these are annual rates which will be converted into monthly rates

## The cost base

The cost base is estimated using the methodology described in the costing for UC above. This assumes that disregards are set in 2010-11 prices and uprated by the CPI each year.

For this measure the levels in the table above are put into the model in April 2013 and increased by 1 per cent rather than the CPI for both 2014-15 and 2015-16. This generates the post measure costing.

This costing uses information from DWP's Policy Simulation Model (PSM), a static micro-simulation model which uses 2010-11 Family Resources Survey data and which was used to model the baseline UC costs.

## Costing

The costing is calculated by comparing the difference between the pre- and post–measure disregards. The detailed methodology behind this is described in the costing for UC above.

**Exchequer impact (£m)**

| | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
|---|---|---|---|---|---|---|
| Exchequer impact | 0 | 0 | +170 | +640 | +1,000 | +1,235 |

## Areas of uncertainty

The main uncertainty relates to the future level of the CPI.

# B Office for Budget Responsibility: certification of policy costings

## 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 of the costings of Autumn Statement 2012 policies described in this document represent a reasonable and central view given the information currently available. We have also certified the costing of Universal Credit, and our assessment of the specific uncertainties around the cost of this policy is set out at the end of this Annex.

B.2 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 additional capital expenditure announced since the Budget on housing and science and the extra capital DEL spending announced at the Autumn Statement.

## Methodology

B.3 All costings have been produced on the basis of the OBR's economic forecast published in the December 2012 *Economic and fiscal outlook* (*EFO*).

B.4 The OBR scrutinises the costings submitted by Government departments that are produced using the methodologies set out 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 Autumn Statement are set out from paragraph B.8.

## Scrutiny and challenge process

B.5 Along with the officials responsible for producing each costing, the OBR attended a series of Star Chamber meetings, at which the assumptions, judgements and methodology used in costings 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 costings 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.6 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 analytically complex to separate the eventual cost or yield associated with a particular measure from other changes in total receipts and expenditure and requires a suitable counterfactual.

B.7 In respect of the specific policy costings at this Autumn Statement the OBR identified the following areas of particular uncertainty:

- HMRC operational changes: we have certified the costings included in the Treasury's policy decisions table for HMRC operational measures – HMRC: compliance (evasion, avoidance and debt), US foreign accounts information powers, tax credits: error and fraud, and tax credits: recovering debt – in isolation. However, we note that there have been, and will continue to be, wider operational changes within HMRC and across government that are likely to affect the public finances. For example, reductions in administrative spending in other areas of HMRC could lead to less tax revenue being collected. We have not been presented with costings for such broader changes. Therefore, taken in isolation the costings for the specific operational changes in the Treasury's policy decision table are potentially unrepresentative of the impact of wider operational changes across Government.
- Capital gains tax: employee shareholder status: there are a number of uncertainties in this costing. The static cost is uncertain in part because of a lack of information about the current amount of CGT arising from gains on shares through their employer. The behavioural element of the costing is also uncertain for two main reasons. First, it is difficult to estimate how quickly the relief will be taken up; this could make a significant difference as the cost is expected to rise towards £1 billion beyond the end of the forecast horizon. Second, it is hard to predict how quickly the increased scope for tax planning will be exploited; again this could be quantitatively significant as a quarter of the costing already arises from tax planning.
- Interactions with Universal Credit: the social security measures in the Autumn Statement are costed on the basis that Universal Credit, including its transitional profile, is in the baseline forecasts. As discussed in the final section of this Annex, there are a number of uncertainties around the Universal Credit estimates, and changes to the Universal Credit estimates will have a knock-on impact on the estimates of the social security measures presented in this document.
- 4G spectrum sale: given the final details of the auction have now been announced we have been able to certify an estimate of the proceeds. However, even at this stage there remain a number of uncertainties. The estimate is based on the value of comparable spectrum auctions outside the UK, but as was the experience with the 3G auction in 2000, they may not necessarily offer a good guide for the UK. Views on future demand for mobile products and the required costs to meet this will differ between individual participants in the auction.
- Tax repatriation from Switzerland: this has been included on the scorecard on the basis that it has passed through the Swiss and UK Parliaments and is due to come into force on 1 January 2013. The final stage of the ratification process is expected to be concluded shortly, but there remains a possibility that the Swiss government will have to hold a referendum on the agreement. This is therefore a significant fiscal risk to the forecast. The estimated revenue raised by this measure is also highly uncertain as there is little hard information about the value of UK individuals' financial assets in Switzerland, and how these individuals will respond to the policy.

## Indirect effects on the economy forecast

B.8 The overall impact of the measures in the Autumn Statement on our economy forecast is relatively small. Further details are provided in Chapter 3 of the *EFO*. There is a small positive impact from increased capital spending, the reduction in the main rate of corporation tax in 2014-15, and the Annual Investment Allowance, which is partly offset by policies which reduce welfare payments and current departmental spending. Taken together these measures are forecast to increase the level of GDP by the end of the forecast period by 0.1 per cent. We have also taken into account the potential impact of the Funding for Lending scheme and measures aimed at supporting the housing market.

B.9 The OBR's inflation forecast has been adjusted to reflect the decision to cancel the April 2012 fuel duty increase, which had been postponed to January 2013, and to move the April 2013 increase to September 2013. These measures reduce our inflation forecast by around 0.1 percentage points by the end of 2013.

## Universal Credit

B.10 The OBR has certified that the additional costs of Universal Credit described in this document represent a reasonable and central estimate of the additional AME costs of Universal Credit. The OBR has not scrutinised the costs of Universal Credit which fall within DELs – where the total cost or yield is wholly determined by a Government policy decision. This includes, for example, the additional costs of developing a new computer system for Universal Credit.

B.11 This costing has been produced on the basis of the OBR's economic forecast published in the December 2012 *EFO*. The costing takes into account the direct effects of the policy on tax and spending, and closely-related components. They do not take into account the indirect effect of the Universal Credit on the wider economy. Any such effects would be incorporated in the OBR's economic forecast.

### Scrutiny and challenge process

B.12 Along with officials from DWP, HM Revenue and Customs, and HM Treasury, the OBR attended a series of challenge meetings, at which the assumptions, judgements and methodology used to produce this costing were scrutinised by the BRC and OBR staff.

B.13 The OBR was provided with a detailed Universal Credit policy costing note, produced by DWP, which explained the methodologies and all key assumptions used to produce the costing, and we 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 costings 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 costings in detail, and ensure its views were fully reflected in the final costing.

### Uncertainties

B.14 All policy costings are subject to change ahead of implementation of the policy, for example due to changes in the forecasts of the underlying economic determinants and caseloads, and as final operational details are finalised. However, in the case of Universal Credit there are particular risks of the estimates changing ahead of implementation:

- we have agreed the costing on the basis of the policy and operational assumptions set out in the detailed notes that accompanied the costing. If any details of these assumptions change when the policy is implemented then they will affect the costs.

A particular example is the policy on the timing of managed migration, as this is intricately connected to the costs of transitional protection; and

- DWP intend to incorporate Universal Credit into their main social security forecast model by Budget 2013. Given the size and complexity of this policy, and the uncertainties related to the current modelling approach set out below, this could potentially lead to significant further changes in the estimated costs.

B.15 The costing of a policy change of this significance and complexity, affecting some £60 billion of social security expenditure, is inevitably subject to large uncertainties. We would highlight the following areas of the current Universal Credit costing as particularly uncertain:

- it is particularly difficult to draw lessons from previous policy costings for Universal Credit, as its structure represents a significant departure from the existing social security system. Assumptions on certain factors, including take-up and inflows, are based on the behaviour and characteristics of existing social security recipients who will migrate to Universal Credit in the future;
- the assumptions on error and fraud savings are also subject to further uncertainty, particularly during the transition period. It is inherently difficult to anticipate new opportunities for fraud and error that a policy change of this scale may create. We believe the estimated savings are reasonable on the basis of DWP's view that the new Real Time Information system can be delivered on time, is immediately effective, and will also improve in effectiveness over time. If this was not achieved then substantial savings would likely be lost;
- the current modelling approach requires an extensive calibration exercise to ensure that the total caseload and expenditure baseline for the costing is consistent with our latest social security forecast. Information on the composition of households is taken from the 2010-11 Family Resources Survey, adjusted for known inaccuracies, projected out to 2014-15, and then scaled up to calibrate to our latest forecast baseline. The scaling factors involved are large and so the costing is likely to be sensitive to the pre-calibration composition of households in 2010-11. There are therefore significant uncertainties involved particularly given that 2010-11 to 2014-15 covers a period in which the economy is recovering from a unique and deep recession;
- a related issue is that the additional cost is also sensitive to assumptions made on the take-up of Universal Credit, in particular for households currently not claiming or eligible for any existing benefits. It is also very sensitive to the number of households taking up entitlement to legacy benefits, as these affect the overall composition and therefore interact with the calibration exercise;
- the costings are highly sensitive to assumptions about the future behavioural responses of social security recipients, so for example, the policy of creating a minimum income floor for the self employed is sensitive to the behavioural assumption for the self-employed. We believe the estimate presented is a reasonable estimate but there is significant uncertainty around the extent to which the policy would incentivise fraudulent claims and the extent to which DWP could combat such claims; and
- the overall Universal Credit costing is sensitive to changes in the macroeconomic forecast of inflation and earnings. The latest estimate suggests that a change in the level of CPI in 2014-15 of 1 per cent in the December *EFO* would lead to an increase in the additional cost of £170 million. However, this was a relatively small change in the context of the uncertainty around any forecast of inflation.

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

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