HM TREASURY

HM Revenue & Customs

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1 Policy costings methodology

Introduction

1.1 This document is published for the first time alongside the Budget. It reflects the Government's commitment to increase transparency around the public finances forecast by publishing the assumptions and methodologies underlying policy costings. This follows the establishment of the Office for Budget Responsibility (OBR), which provides independent forecasts of the public finances and the economy to inform fiscal policy decisions. These changes are part of the Government's wider commitment to increased transparency in public life.

1.2 The Government is committed more generally to improving tax policy making to increase the predictability, stability and simplicity of the tax system. To be effective, better tax policy making needs to be underpinned by greater transparency. The Government has published a discussion document alongside the Budget '*Tax policy making: a new approach*', setting out its proposed approach to tax policy making. As a general principle, the Government will provide more information on the underlying rationale for tax policy changes, accompanied by supporting analysis and assumptions, including more information on tax policy costings.

1.3 Chapter 1 explains the methodology and general principles for calculating the cost or yield of policy decisions and the relationship with the OBR's overall public finances forecast. Chapter 2 includes detailed information on the key assumptions applied in all major policy costings in the Budget. Annex A sets out the indexation assumptions included in the public finances forecast baseline, including all pre-announcements.

What are policy costings?

1.4 The Budget policy decisions with a fiscal impact are summarised in Table 2.1 of the Budget. This shows estimates of the cost or yield of each policy decision for the years 2010-11 to 2014-15. It includes policies that are firm and final and are estimated to have an impact on Public Sector Net Borrowing (PSNB). The direct impact of tax measures on receipts is shown for all years. The direct impact of welfare measures on the AME forecast is also shown in the same way. The Budget also sets out changes to overall current and capital spending from 2011-12. Specific departmental policies and allocations will be determined in the Spending Review.

1.5 Table 2.1 does not include:

- financial transactions such as student loans that impact Public Sector Net Debt (PSND) but have no impact on PSNB. These are captured in the final Budget forecast of PSND;
- changes to underlying economic assumptions, for example a change in the unemployment claimant count. These are captured in the public finance forecast;
- policy options that are subject to consultation. Where a firm and final decision has been taken but the Government is consulting on detailed design or implementation options that do not significantly affect the costing, a costing will be included; or

- decisions that simply re-allocate resources within a department or between departments.

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

1.7 Where the costing of one policy change is affected by the implementation of others, the measures are costed in the order in which they appear in Table 2.1 of the Budget. So for example, the changes in capital allowances are costed against the new corporation tax rates announced in the Budget.

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

How do costings fit into the public finance forecast?

1.9 On 14 June, the OBR published an independent forecast of the public finances and the economy, incorporating all policy measures the Government inherited. Alongside the Budget, the OBR have published a further forecast incorporating policy measures announced at Budget.

1.10 The policy costings shown in Table 2.1 of the Budget reflect the direct cost or yield of Budget policy decisions. These take account of specific direct behavioural effects relating to the tax or benefit base the policy is applied to, or closely related bases. These direct effects are explained in more detail in each of the costing notes included in Chapter 2.

1.11 The indirect economic effects of Budget policies are incorporated into the final Budget public finance forecasts, through their impact on the economic forecast. To produce the Budget forecast, the OBR has scrutinised and certified the Government's assessment of the direct cost or yield of Budget policy decisions that affect the economy and public finance forecasts and has made an assessment of the indirect effects of Budget measures on the economy.

Policy costing methodology

Static costing

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

1.13 Policy costings start with an estimate of the value of the economic activity or base that the policy applies to. For example, income tax rate costings begin with estimates of wages and salaries and VAT rate changes start with estimates of consumer expenditure. In many cases, these estimates have been taken directly from the Budget economic forecast produced by the OBR. In other cases, forecast information is supplemented with data from other sources.

1.14 The static costing for a policy is the difference between applying the pre-Budget and Budget tax or benefit regimes to the relevant post-Budget base data. At this point, the costing does not take account of any expected change in behaviour as a result of the policy changes.

The costing will take account of automatic changes in entitlement where this is as a result of the design of the tax and benefit rules, rather than behavioural change[1]. For example, if qualification for one benefit counts as income for the purpose of the second benefit, both would be included.

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

Behavioural effects

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

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

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

1.19 The direct policy costings capture a number of behavioural effects specific to the relevant tax base or benefit itself, or closely associated taxes. These behavioural impacts are mainly micro-economic changes in behaviour modelled against precise changes in tax policy. For example, the direct policy costings for corporation tax include behavioural changes by firms or individuals that affect the CT base itself. Similarly, direct policy costings for Capital Gains Tax include behavioural effects of individuals on the level and timing of realising the value of assets. Both also involve behavioural effects on avoidance of the tax base itself.

1.20 However, the direct policy costings do not include any indirect economic effects of the policy changes. These indirect economic impacts are captured in the OBR's economic forecast. For example they include any impact of measures on economy-wide wages and salaries, on employment levels, or on consumer expenditure. So the direct policy costings on income tax, national insurance and VAT do not include any changes as a result of these indirect economic factors. The direct policy costings for these taxes are, therefore, different from the projections of receipts in the Budget (Table C.13), which take these factors into account.

1.21 There is sometimes uncertainty around the size of the behavioural effects. Where possible, research evidence from academics or external bodies is available and used to inform judgement

[1] DWP social security measures have been costed on a GB basis, and then adjusted by a standard factor of 3.3 per cent (based on average outturn data) to account for Northern Ireland (where social security policy is devolved) to arrive at final estimates for UK expenditure.

about the size of behavioural effects. In addition, there may be other behavioural effects the scale of which it is not possible to estimate.

Revenue protection

1.22 The Government is always looking to strengthen measures against avoidance or evasion. However, in projecting tax receipts HMRC estimate tax losses resulting from new forms of tax avoidance or evasion. These losses are deducted from the forecast at fiscal events. Where a policy announcement is made to prevent this loss of tax, the revenue protected by the announcement is not deducted from the forecast.

1.23 Some avoidance or evasion measures result in yield being shown in Table 2.1. This happens when announcements reduce losses that have already been deducted from the forecast in previous fiscal events.

1.24 Due to the nature of avoidance and evasion, and the uncertainty regarding behavioural responses, the data used to produce the costings is subject to wider margins of error.

Benefit fraud and error

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

2 Policy costings: Budget decisions

2.1 This chapter includes short notes explaining the calculation of the policy costings for all tax, tax credit and welfare policy decisions in Table 2.1 of the Budget. The public finances baseline for these costings assumes allowances, thresholds and specific tax and benefit rates will be increased in line with relevant price indices, or any pre-commitments (policies announced in previous Budgets). A full list of indexation assumptions and pre-commitments underlying the baseline forecast is shown in Annex A.

2.2 The following policy decisions are included in this chapter:

- Increasing the standard rate of Value Added Tax
- Increasing the standard and higher rate of Insurance Premium Tax
- Reducing the main rate of corporation tax
- Reducing the small profits rate of corporation tax
- Changes to the Annual Investment Allowance and capital allowances
- Not introducing the video games tax relief
- Introducing the Bank Levy
- Waiver of back-dated business rate bills
- Employers National Insurance Contributions relief for new businesses in targeted regions
- Increase in employer National Insurance Contributions threshold
- Increasing the income tax personal allowance
- Increase in capital gains tax
- Freeze income tax basic rate limit in 2013-14
- Freeze council tax for one year
- Not introducing fixed landline duty
- Reverse increase in cider duty rates
- Reforms to furnished holiday lettings
- Defer introduction of HMRC managed payment plans
- CPI indexation for all benefits, tax credits and public sector pensions
- Reforming Disability Living Allowance
- Extend conditionality to lone parents with children aged five and above
- Housing Benefit reform

- Tax credit and child benefit reforms
- Abolish Health in Pregnancy Grant
- Reduce Sure Start Maternity Grant
- Reform Support for Mortgage Interest
- Abolish Savings Gateway

Value Added Tax

Measure description

From 4 January 2011, the standard rate of Value Added Tax (VAT) will increase from 17.5 per cent to 20 per cent.

The tax base

The estimate of the tax base for the standard rate of VAT is taken directly from the VAT forecast, and consists of expenditure on standard rated goods and services broken down between the following sectors:

- household current consumption (around £460 billion);
- business supplying goods and services that are exempt from VAT, input tax blocks and private non-profit making bodies (around £110 billion);
- central government (around £90 billion); and
- housing related transactions, e.g. capital expenditure and transfer costs (around £30 billion).

This expenditure is then adjusted to take account of the VAT tax gap (around 13 per cent of the tax base) and VAT deductions such as VAT refunds to local authorities (around 8 per cent of the tax base).

The primary data sources for estimating the size of the tax base are detailed expenditure statistics from the Office for National Statistics (ONS) and HMRC. To estimate the size of the tax base over the costings period, the different components of the tax base are grown in line with relevant components of the post Budget economic forecasts, which take account of all measures announced in this and previous Budgets and Pre-Budget reports, including this VAT rate change.

Static costing

The static costing is the difference between the revenues from a 17.5 per cent and a 20 per cent standard rate of VAT applied to the post Budget forecast tax base (that is, the tax base which takes into account the effect of all Budget measures). For the purpose of the static costing, the volume of goods and services is held constant at the levels implied by the post-Budget forecast tax base.

The VAT rate also has a direct impact on cigarette revenues, as cigarette duty has an ad valorem element, which is dependant on the price of cigarettes. The costing assumes an increase in the VAT rate gets passed on in full and therefore raises the price of cigarettes, increasing tobacco duty revenues. The size of this impact is estimated to be around £50 million per annum.

The resulting static costing, presented on a National Accounts basis, is shown below:

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	+2,900	+12,250	+12,600	+13,050	+13,550

Post-behavioural costing

The static costing estimates the revenue gain from applying the change in VAT rates to the post-Budget volume of goods and services. It does not account for the revenue lost at the original 17.5 per cent rate of VAT from any reduction in the VAT base resulting from the rate increase. As in the static costing, the aggregate volume of expenditure on goods and services is held constant. But there are compositional changes: the share of expenditure subject to the standard rate will fall because of the change in relative prices between standard rated and reduced or zero rated goods and services. This needs to be subtracted to arrive at the post-behaviour costing.

This revenue loss effect is estimated via an elasticity that measures the change in the consumer durables' share of total household expenditure in response to a change in the relative prices of durable and non-durable goods. The estimated value of this elasticity is -0.128, which is taken from HM Treasury macroeconomic modelling. HMRC analysis then estimates that a 1 percentage point change in this share is associated with a 1.4 percentage point change in the household standard rated share. The result is that a 2.5 percentage point increase in the standard rate of VAT that is passed on in full to final consumers is estimated to lead to a decrease in the overall standard rated share of 0.07 percentage points, which reduces the overall yield by around £100 million per annum. The post-behavioural yield from the VAT rate change is shown in Table 2 below.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	+2,850	+12,100	+12,500	+12,950	+13,450

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Insurance Premium Tax

Measure description

From 4 January 2011, the standard rate of insurance premium tax (IPT) will be increased to 6 per cent, and the higher rate to 20 per cent.

The tax base

The tax base for IPT is taken directly from the IPT forecasting model, and is apportioned between two components:

- premiums subject to the standard rate of IPT (£43 billion in 2011-12); and
- premiums subject to the higher rate of IPT (£1billion in 2011-12).

Static costing

The static costing is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base data described above. In order to exclude any behavioural effects, expenditure on insurance (excluding IPT) is held constant. This results in the following costing which is presented on a National Accounts basis:

Table 1 – Static impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Standard Rate change	+110	+430	+420	+430	+430
Higher Rate change	+5	+25	+25	+25	+25

Post-behavioural costing

Insurance is relatively inelastic with assumed elasticities of -0.19 to -0.25 for different categories of insurance. For the higher rate the elasticity is -0.25. These elasticities are based on HMRC analysis.

The costings assume that total volume of goods and services is held constant at the levels implied by the post-Budget forecast tax base. Thus any reduction in expenditure on insurance is assumed to be offset by increased expenditure on other goods and services. The overall result is that the change in consumption patterns by households and business has negligible impact on the costing.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Standard Rate change	+110	+430	+420	+430	+430
Higher Rate change	+5	+25	+25	+25	+25

Reducing the main rate of corporation tax

Measure description

From 5 April 2011, the main rate of corporation tax will decrease from 28 per cent to 27 per cent, and thereafter fall to 26 per cent in 2012-13, 25 per cent in 2013-14 and 24 per cent in 2014-15.

The tax base

Estimates of the tax base for the main rate of corporation tax are taken directly from the corporation tax forecast for the quarterly instalment payments of non-life assurance companies. This forecast is based on corporation tax return data for 2006-07, calibrated to an estimate of 2009-10 accruals based on latest tax receipts, and then projected in line with economic determinants from the Budget economic forecasts.

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

Static costing

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

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-10	-500	-1,500	-2,700	-3,500

Post-behavioural costing

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

To account for this, the portion of profits in the tax base that are mobile has been estimated at around 40 per cent. This estimate is based on data from corporation tax returns, by identifying sectors where profits are known to be most mobile and the profit flows within those sectors that are most likely to be shifted.

In the costing, an elasticity of 2 has been applied to these mobile profits, so that for every 1 percentage point decrease in the corporation tax rate the result is a 2 per cent increase in the size of the mobile profit base. The assumed elasticity of 2 is a central assumption, informed by multiple academic studies of varying findings on the true value of the elasticity.

This behavioural response reduces the Exchequer costs of the measure by around £800 million per year by 2014-15.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-10	-400	-1,200	-2,100	-2,700

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Reducing the small profits rate of corporation tax

Measure description

From 1st April 2011 the small profits rate of corporation tax will decrease to 20 per cent, compared to the pre-announced rate of 22 per cent.

The tax base

The primary data source for estimating the size of the tax base the measure applies to is published National Statistics estimates of 2006-07 chargeable profits by tax band.

To estimate the size of the tax base over the costings period, profits are assumed to grow in line with the forecasts of corporation tax accruals from companies which do not pay by quarterly instalments. This forecast is calibrated to an estimate of 2008-09 accruals based on latest tax receipts and then projected in line with economic determinants from the emergency Budget economic forecasts.

Static costing

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

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	-30	-800	-1,100	-1,200

Post-behavioural costing

The only behavioural response included in this direct costing allows for an increase in the tax incentive to incorporate. The effect of the policy measure on the number of incorporations is difficult to quantify. An estimate for the effect of this measure is an increase in Exchequer costs rising to around £200 million per year from 2012-13.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	-100	-1,000	-1,300	-1,400

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Changes to the Annual Investment Allowance and capital allowances

Measure description

This measure makes the following changes to the corporation tax and personal tax regimes from 2012-13:

- reduces the rate of writing-down allowance on the general pool of plant and machinery, from 20 per cent to 18 per cent;
- reduces the rate of writing-down allowance on the special rate pool of plant and machinery, from 10 per cent to 8 per cent; and
- reduces the Annual Investment Allowance (AIA), from £100,000 to £25,000.

The tax base

The primary data source for estimating the size of the tax base for the above allowances is published National Accounts data on various types of qualifying investment. To estimate the size of this base over the costing period, changes in line with the Budget economic forecasts are accounted for. In particular for this measure, qualifying investment is assumed to grow in line with total business investment.

Capital allowance claims from companies form part of the corporation tax forecast, so estimated claims from companies are calibrated to that forecast to ensure consistency.

The total amount of expenditure that can be relieved under capital allowances under the existing regime in 2011-12 is projected to be around £100bn.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base data described above. The main and small profits rates of corporation tax announced in the emergency Budget will apply to incorporated businesses, and an average marginal income tax rate of 28 per cent is assumed for unincorporated businesses. This results in the following costing which is presented on a National Accounts basis:

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact – reduce capital allowances rates to 18 per cent and 8 per cent	0	0	+1,000	+1,900	+1,800
Exchequer impact – reduce Annual Investment Allowance to £25,000	0	0	+100	+1,200	+1,000

Post-behavioural costing

The policy costing includes behavioural effects on tax planning and avoidance relating to the AIA. Some businesses may arrange their affairs in an attempt to circumvent existing anti-avoidance legislation with the aim of benefiting from more than one AIA and previously published costings took this possibility into account. However, with the allowance set at a lower value it is more likely that the costs of seeking to do this would outweigh any potential benefits. A reduction in this type of activity is therefore estimated to result in increased Exchequer yield of around £40 million per year. After rounding, this does not change the pre-behavioural estimates.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact – reduce capital allowances rates to 18 per cent and 8 per cent	0	0	+1,000	+1,900	+1,800
Exchequer impact – reduce Annual Investment Allowance to £25,000	0	0	+100	+1,200	+1,000

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Video games tax relief

Measure description

The March 2010 Budget announced that a tax relief for the UK's video games industry would be introduced in 2011-12, subject to consultation on design and state aid approval from the European Commission. This relief is now not being introduced.

The tax base

The primary data source for estimating the size of the tax base is the 'Games up' industry publication from Games Investor Consulting. From this the amount of development expenditure in the industry was estimated to be £460m in 2009, falling to £380m in 2013.

Costing

The static Exchequer impact was calculated by applying the pre- and post-measure tax regimes to the tax base data described above. The cancellation of this relief will result in an increase in Exchequer yield, as in the following costing that is presented on a National Accounts basis:

Table 1 –Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	+40	+50	+50	+50

Bank Levy

Measure description

The Bank Levy is a new tax, to be introduced from 1 January 2011. It applies to:

- the consolidated balance sheet of UK banking groups and building societies[1];
- the aggregated subsidiary and branch balance sheets of foreign banks and banking groups operating in the UK; and
- the balance sheets of UK banks in non-banking groups.

Those institutions and groups listed above will only be liable for the levy where their aggregate liabilities that are subject to the levy amount to £20 billion or more.

The levy will be based on banks' total liabilities excluding:

- tier 1 capital;
- insured retail deposits;
- repos secured on sovereign debt; and
- policyholder liabilities of retail insurance businesses within banking groups.

The Government proposes that any derivative liabilities will only be taken into account where they are net derivative positions, but will consider the technical details of this and other aspects of the levy design in consultation with industry.

It is proposed that the levy will be set at 0.07 per cent with the aim of raising approximately £2½ billion annually. However, there will be a lower rate of 0.04 per cent in 2011. The rate of the levy is scheduled to be set as follows:

Table 1 – Levy rates

Year	2010	2011	2012	2013	2014
Rate	0%	0.04%	0.07%	0.07%	0.07%

A reduced rate will apply for longer-maturity (i.e. greater than one year remaining to maturity) wholesale funding, this will be at half the main rate, i.e. 0.02 per cent in 2011 and 0.035 per cent thereafter. The Government will consult over the summer. Final details of the levy will be published later this year, following this consultation.

The tax base

The tax base has been estimated over the forecast period by considering publicly available accounts. For this measure, the size of the tax base is assumed to contract due to deleveraging across the sector, i.e. a reduction in the overall size of banks' balance sheet liabilities.

[1] Throughout the remainder of this note, references to the application to banks also assume application to building societies.

Static costing

Table 2 – Static Exchequer impact (£m)

Fiscal year	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	1,210	2,500	2,770	2,735

The static costing is calculated by applying the pre measure tax regimes to the tax base data described above. Beyond 2011 we forecast a further small reduction in the base due to de-leveraging. In addition, we assume that UK banks will increase both their longer-term funding and eligible capital due to regulatory requirements and economic conditions, with a subsequent decrease in their short-term funding. Given the limited amount of retail deposits available, we have assumed the switch to retail deposits from wholesale funding is negligible.

The post-behavioural yield

Table 3 – Post-behavioural yield (£m)

Fiscal year	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	1,150	2,320	2,500	2,400

The table above sets out our forecasts for the post-behavioural yield across fiscal years. The key behavioural changes that we have assumed will impact on the yield forecasts beyond the pre-behavioural effects are:

- a reduction in the tax base as a result of the potential incentive for banks to remove liabilities from the levy base;
- a further switch towards longer-term funding at a similar magnitude to pre-behavioural estimates;
- the levy will further reinforce existing incentives for banks to increase their capital positions in anticipation of expected regulatory reforms, but in the forecast period we expect any additional increase in capital as a result of the levy to be small. Likewise, given the current significant competitive pressures for banks to increase their share of retail deposits, it is assumed the post-behavioural effect of the levy would be marginal over the forecast period; and
- in terms of avoidance behaviour we have assumed avoidance activity will decrease the yield by 5 per cent in each year of operation. This assumption is made to allow for appropriate margin in the public finances and does not represent an official estimate of avoidance. Anti-avoidance measures will be introduced by HMRC to counter avoidance activity.

Waiver of backdated business rates bills

Measure description

The Government will waive backdated business rates bills eligible for the 8-year schedule of payments scheme in England introduced at the 2008 Pre-Budget Report where the bill was the result of a property having been split from another rateable property.

The current freeze on all repayments of backdated rates on the 8-year schedule will be extended until the end of 2011-12, with the waiver of bills that are the result of a 'split' taking place once legislation is passed during 2011-12.

The tax base

The tax base is the properties in receipt of relevant backdated business rates bills. The primary data source to estimate the size of the backdated liability is a series of reports on new assessments to the Rating List supplied by the Valuation Office Agency (VOA).

The costings assume that:

- on average, when an existing property is split into two or more for rating purposes, half the rateable value is attributed to the 'old' property (not eligible for waiver), and half to the 'new' (waived);
- on average, the backdated period in the year of identification of a property is six months; and
- liabilities began between 1 April 2005 and 33 months before the date the VOA recorded them.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base data described above, with the following assumptions:

- the higher business rate multiplier is used;
- gross revenue is reduced to take account of the reduction in yield due to reliefs;
- responses from local authorities are used to estimate the proportion of backdated liability paid off up-front;
- estimates take account of the deductibility of business rates from corporation and income tax, and Barnett consequentials paid to the devolved administrations; and
- these costs are in addition to the £60m announced and allocated on 24 May 2010.

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

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	+30	-70	-15	-15	-15

Post-behavioural costing

This measure is not expected to generate any significant or calculable behavioural response.

Employer NICs relief for new businesses in targeted regions

Measure description

The measure will mean that new businesses set up in certain regions in a three year period will be eligible for a holiday from Employer National Insurance Contributions. The costings assume the regions included are Scotland, Wales, Northern Ireland, the North East, Yorkshire and The Humber, the North West, the East Midlands, the West Midlands and the South West, and that the scheme will run from September 2010. The holiday applies to the first ten employees hired in the first 12 months of the business and for a maximum of 12 months from the time the individual is hired. A cap of £5,000 per employee is placed on employer relief available through the holiday.

The tax base

The primary data sources for estimating the size of the tax base relate to new business volumes and wages:

- the latest complete Corporation Tax returns data (2007-08) showing the number of companies incorporating and active in 2006-07, and IDBR data showing the numbers of sole traders and partnerships with employees who set up PAYE schemes in 2007-08;
- IDBR data showing the number of employees associated with new businesses for the above periods; and
- estimates of mean salaries paid to employees in new businesses informed by Annual Survey of Hours and Earnings data and analysis of PAYE year end data for new PAYE schemes in 2006-07.

To estimate the size of the tax base over the costings period, numbers of new businesses and employees are assumed to grow in line with recent trends in Companies House incorporation statistics, with a separate adjustment to exclude incorporations of existing businesses. Salaries of employees are assumed to grow in line with the Budget economic forecasts for average earnings.

Static costing

The static Exchequer impact is calculated by estimating new UK business employer NICs that would have been due under the pre measure tax regime to the tax base data described above. The share of such costs relating to the countries and regions included in the holiday is estimated using Survey of Personal Incomes data for 2007-08, projected using emergency Budget economic forecasts. A separate adjustment is made to take account of estimated pre measure per employee liabilities above the £5,000 cap. This results in the following costing which is presented on a National Accounts basis:

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-50	-310	-370	-170	0

Post-behavioural costing

Behavioural effects are included on general changes to the structure of businesses in response to the measure.

These behavioural responses are difficult to quantify, but the costing allows for additional Exchequer costs of around £40 million across the costings period.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-50	-320	-390	-180	0

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Secondary threshold for employer NICs

Measure description

This measure raises the threshold for employer National Insurance Contributions by £21 per week in 2011-12, compared to the indexed baseline set out in Annex A.

From 2012-13 indexation is assumed to continue as described in Annex A.

The tax base

The primary data sources for estimating the size of the tax base the measure applies to are:

- outturn data for Workforce jobs (employees and self-employed), and wages and salaries;
- Annual Survey of Hours and Earnings (ASHE) data on the earnings distribution; and
- modelled employer NIC liabilities are calibrated to HMRC data on receipts.

To estimate the size of the tax base over the costings period, changes in line with the Budget economic forecasts are accounted for. In particular for this measure, incomes subject to employer NICs are assumed to grow in line with the growth rate of wages and salaries.

Static costing

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

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	-3,130	-3,150	-3,510	-3,720

Post-behavioural costing

It is assumed that the impact of an increase in the tax incentive to incorporate though the effect of policy measures on the number of incorporations is negligible

The post and pre-behavioural Exchequer impacts are therefore assumed to be the same.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	-3,130	-3,150	-3,510	-3,720

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Increase in income tax personal allowance

Measure description

This measure involves the following changes to the income tax and national insurance regimes in 2011-12:

- a £1,000 cash increase in the income tax Personal Allowance (PA) for those aged under 65. This takes the PA from £6,475 in 2010-11 to £7,475 in 2011-12;
- the Basic Rate Limit (BRL) for tax and the National Insurance Upper Earnings/Profits Limit (UEL/UPL) will be decreased to leave the majority of higher rate taxpayers paying the same total amount of tax and National Insurance Contributions as under the indexed baseline. Given Budget forecasts for RPI, this means a BRL decrease of £2,500 and a UEL/UPL decrease of £1,650, relative to the baseline. These figures will be confirmed when actual September 2010 RPI figures are known; and
- the higher rate tax threshold (HRT), which equals the sum of the PA and BRL, will decrease by £1,650 and will therefore continue to be aligned with the UEL/UPL.

The resulting allowances, limits, and thresholds are all assumed to be indexed as normal from 2012-13 except the BRL, which is assumed to fall by £100 in 2012-13 as described in the indexed baseline.

The tax base

There are two primary data sources for estimating the size of the tax base the measure applies to:

- for income tax, data on taxable incomes is taken from the Survey of Personal Incomes (SPI) from tax records which covers around 600,000 individuals, weighted to be representative of all taxpayers. The latest available data is for the tax year 2007-08; and
- for national insurance, data on incomes subject to NICs are assessed via Annual Survey of Hours and Earnings (ASHE) data for employment and the earnings distribution, and controlled to NIC receipts outturns.

To estimate the size of the tax base over the costings period, income components for all individuals included in the sample are grown in line with relevant economic determinants included in the Budget economic forecasts.

Static costing

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

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	-3,440	-3,650	-3,730	-3,870

Post-behavioural costing

The costings build in behavioural effects for individuals with the following incomes:

- employed individuals with income between the baseline and reduced HRT under the measure (Group I) that will face an increase in their combined marginal income tax and employee NICs rates from 32 per cent to 42 per cent; and
- the range of incomes over which PAs are withdrawn from £100,000 will increase with the higher PA.

Estimates of the behavioural effects of these individuals are based on Taxable Income Elasticities (TIEs), which show how taxable incomes change in response to changes in marginal tax rates. Assumed TIEs are informed by multiple academic studies, where findings vary widely but generally conclude that TIEs are much higher for those on high incomes. A weighted average TIE of 0.35 is assumed for those on incomes above £150,000. TIEs for Group I and Group II individuals described above are assumed to be much lower, consistent with evidence, with small responses assumed for those around the HRT. As a result the behavioural response increases the Exchequer cost by around £80 million per year.

The costing also allows for a decrease in the tax incentive to incorporate. The effect of policy measures on the number of incorporations is difficult to quantify. An indicative estimate for this measure suggests an reduction in Exchequer costs of around £20 million in 2011-12 rising to £40million in 2014-15.

The post-behavioural yields are shown in table 2 below.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	-3,490	-3,700	-3,770	-3,910

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Increase in capital gains tax

Measure description

This measure increases the main rate of capital gains tax (CGT) from 18 per cent to 28 per cent for higher rate taxpayers, trustees and personal representatives. Other taxpayers will continue to pay 18 per cent. Increase the lifetime limit for Entrepreneurs' Relief from £2 million to £5 million - qualifying gains continue to be taxed at 10 per cent.

The tax base

The tax base for CGT is realised gains from relevant asset disposals by individuals, trustees and personal representatives. Estimates of the tax base used in the costing are taken directly from the CGT revenue forecasting model. This forecasts from a base year of tax return data (currently 2008-09) in line with components of the Budget economic forecasts, including equity and property prices and the volume of sales. It also allows for taxpayers making disposals earlier in 2010-11 (i.e. before the Budget rather than afterwards) in anticipation of an increase in CGT. The forecast gains in 2011-12 are £5.2 billion for gains qualifying for Entrepreneurs' Relief and £11 billion for other taxable gains.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the forecast tax base described above allowing for implementation part way through 2010-11. These are then converted into tax receipts by taking account of lags between the accrual (liabilities) and receipt of taxes as CGT is measured on a receipts basis in the National Accounts. Estimates of the pre-behavioural impacts on accruals and receipts are shown in table 1 below.

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	+925	+900	+1,100	+1,325

Post-behavioural costing

Two behavioural effects from increasing the CGT rate have been incorporated into the costing:

- an increase in the 'lock-in' effect; and
- a change in the composition of income between gains and other forms of income.

Lock-in effects

Gains accrue through changes in asset value but they are only liable to CGT when they are realised. Consequently, it is widely accepted that CGT has the effect of discouraging asset disposals or 'locking-in' gains. There is a substantial body of econometric evidence on the size of this effect, predominantly from the US. Based on this evidence, the costing assumes that a 1 percentage point increase in the CGT rate would reduce gains realised in the UK on average by 2.75 per cent. As a result, the 10 percentage points increase in the CGT rate for higher rate taxpayers is estimated to reduce their gains realised by 27.5 per cent. It is assumed that this reduces the pre-behavioural yield by around £800 million in 2011-12 rising with forecast gains over the period.

The composition of income

The current difference between CGT and income tax rates gives taxpayers an incentive to prefer income in the form of capital growth (from investment returns, equity-based remuneration etc) rather than dividends, wages and salaries, rent etc. Bringing CGT more in line with income tax rates will therefore reduce the income to gains shifting built into the tax forecasts based on the historical position (and forecast to increase following the introduction of the 50 per cent higher rate of income tax in 2010-11). The costing assumes that for every 1 percentage point reduction in the gap between the CGT rate and the 40 per cent, 50 per cent and trustees' rates of income tax, there is an increase in income tax yield in 2011-12 of about £60 million. This adds around £600 million in 2011-12 rising with income growth over the period.

The yield from the measure after taking account of these behavioural responses and the timing of income tax receipts is shown in table 2 below.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	+725	+825	+850	+925

Freeze income tax basic rate limit in 2013-14

Measure description

The measure involves the following changes to the income tax and national insurance regimes in 2013-14.

- A freeze in the Basic Rate Limit (BRL) in 2013-14. Given current projections of RPI, this means that the BRL would remain at its 2012-13 level of £34,700;
- Freezing the BRL in 2013/14 will have an impact on the level of the Higher Rate Threshold (HRT) which is the sum of the personal allowance (PA) and the BRL. Under current projections for RPI, this is forecast to increase from £42,435 in 2012-13 to £42,675 in 2013-14;
- The HRT is currently aligned with the National Insurance Upper Earnings/Profits Limit (UEL/UPL). Under this measure this alignment will remain, and the UEL/UPL on an annual basis is projected to increase from £42,435 in 2012-13 to £42,675 in 2013/14; and
- These figures all include previous plans to freeze the HRT in 2012-13 which are in the baseline forecast.

The tax base

There are two primary data sources for estimating the size of the tax base the measure applies to:

- for income tax, data on taxable incomes is taken from a survey of personal incomes (SPI) from tax records which covers around 600,000 individuals, weighted to be representative of all taxpayers. The latest available data is for the tax year 2007-08; and
- for national insurance, data on taxable incomes subject to NICs are assessed via an annual survey of hours and earnings (ASHE) data for employment and the earnings distribution, and controlled to NIC receipts outturns.

To estimate the size of the tax base over the costings period, income components for all individuals included in the sample are grown in line with relevant economic determinants included in the Budget economic forecasts.

Static costing

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

Table 1 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	0	0	+340	+770

Post-behavioural costing

The costings build in behavioural effects for individuals with income between £42,675 and £43,775 who will face an increase in their combined marginal income tax and employee NICs rates from 32 per cent to 42 per cent.

Estimates of the behavioural effects of these individuals are based on Taxable Income Elasticities (TIEs) which show how taxable incomes change in response to changes in marginal tax rates. Assumed TIEs are informed by multiple academic studies, where findings vary widely but generally conclude that TIEs are much higher for those on high incomes. A weighted average TIE of 0.35 is assumed for those on incomes above £150,000. TIEs for the individuals described above are assumed to be much lower consistent with evidence.

As a result the behavioural response reduces the costing by around £20 million per year.

The costing also allows for an increase in the tax incentive to incorporate. The effect of policy measures on the number of incorporations is difficult to quantify. An indicative estimate for this measure suggests an increase in exchequer costs of around £10 million in each year.

The post-behavioural yields are shown in table 2 below.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	0	0	+320	+740

Freeze council tax receipts for one year

Measure description

The Government has announced that it will work in partnership with local authorities in England to freeze council tax in 2011-12. To account for this, the Government is reducing its Budget forecast for the increase in council tax receipts in England in 2011-12 to zero per cent and reflecting this reduction in the tax base in future years.

Local taxation is a devolved matter and this measure only applies to council tax in England. The forecast for Scotland, Wales and Northern Ireland is assumed to be unaffected.

The tax base

Council tax levels are a matter for individual local authorities. For the purpose of the fiscal forecasts we assume that council tax bills in England rise by the geometric mean of the annual average increase of the last three years. For 2011-12 this is 2.9 per cent.

It is assumed that the council tax base will increase by 0.8 per cent between 2010-11 and 2011-12 and in future years. This is in line with the assumption in the pre-Budget forecast, and is based on historical data on the number of Band D equivalent dwellings liable for council tax derived from the Budget Requirement (BR) return collected from all local authorities in England annually.

Costing

Lower council tax will lead to lower council tax benefit payments than forecast in 2011-12. This has been taken into account in the costings. To calculate the reduction in receipts, it was assumed that increases to band D council tax bills in all local authorities in England would be zero in 2011-12.

The loss in council tax receipts is assumed to be a permanent loss to the council tax base in future years and the reduced council tax benefit payments are assumed to have a permanent effect on the costing.

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

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	-625	-630	-635	-640

Fixed landline duty

Measure description

The Government has decided not to proceed with the landline duty which was to have been introduced in October 2010.

The tax base

The primary data source for the number of fixed telephone lines is OFCOM. Their latest estimate is that there were 33.2 million fixed lines in 2008. The future number of fixed lines was estimated by assuming that the declining trend since 2003 continues over the forecast period, so that by 2014-15 there are 30.7 million fixed lines.

Lines used for social tariffs were to be exempt from the tax and these lines (around 850,000) were subtracted so as to arrive at an estimate of the projected tax base.

Costing

The Exchequer impact is calculated by applying the pre-Budget and post-Budget tax regimes to the tax base data described above.

An analysis of the nature of fixed line contracts as well as the behaviour of fixed line telephony users, indicated that there would be little behavioural impact (an own-price elasticity of -0.25) as a result of this measure. As a result of this measure no longer being implemented, there will be a decrease in Exchequer yield. This results in the following costing which is presented on a National Accounts basis:

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-90	-175	-175	-175	-175

Reverse increase in cider duty rates

Measure description

This measure reverses the increase in cider duty made at the March Budget. From 29 March cider duty increased by ten per cent above inflation. From 30 June 2010, this increase will be reduced to two per cent above inflation. The duty change applies to all still ciders and sparkling cider of 5.5 per cent alcohol by volume and below.

The tax base

The tax base affected is the projected volume of UK duty paid cider. This comes directly from the alcohol forecasting model.

Static costing

The static Exchequer impact was calculated by applying the pre and post measure tax regimes to the tax base data described above. The impact of reversing this measure is to reduce Exchequer yields, resulting in the following costing which is presented on a National Accounts basis:

Table 2 – Static Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-20	-30	-30	-30	-35

Post-behavioural costing

In addition, behavioural responses were included to take into account a reduction in consumption of cider in response to a price rise and changes in consumption of other types of alcohol. The impact of the behavioural response reduced the Exchequer yield by around 50 per cent. So similarly, reversing this measure will result in a smaller reduction in Exchequer yields than the pre-behavioural costing. The post behavioural impact is presented in table 3.

Table 3 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-10	-15	-15	-15	-20

Furnished holiday lettings

Measure description

The furnished holiday lettings rules (FHL) will not be withdrawn from 6 April 2010 (1 April 2010 for companies), as had been announced at Budget 2009. Instead, the Government will consult over the summer on a proposal to change the tax treatment of furnished holiday lettings from April 2011.

This measure therefore:

- reverses the previously announced repeal of the UK rules; and
- continues the extension to properties in the EEA area.

Costings are presented relative to a baseline of the policy announced at Budget 2009, i.e. repeal of the entire scheme.

The tax base

The primary data source for estimating the size of the tax base the measure applies to is income tax self-assessment data from 2007-08. The main impact of the current FHL rules is that they allow losses for FHLs to be offset against other forms of income, and such losses for UK property are estimated as £75 million per year. Corresponding losses for EEA area properties are estimated as £50 million per year.

Costing

The Exchequer impact is calculated by applying the pre- and post-measure tax regimes to the tax base data described above.

This results in the following costing relative to the baseline of the announced policy to repeal the FHL rules from April 2010 and is presented on a National Accounts basis:

Table 1 – Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	-5	-30	-15	-10	-10

Defer introduction of Managed Payment Plans

Measure description

Budget 2009 announced legislation for Managed Payment Plans, which would allow taxpayers to pay self assessed income tax and corporation tax in a series of monthly instalments either side of the theoretical due date. These were due to be introduced from April 2011. Their introduction has now been deferred.

The tax base

Managed Payment Plans would have been open to people paying self assessed income tax or corporation tax. This costing relates to those taxpayers expected to have taken them up.

Costing

Exchequer savings from this measure are simply the reverse of the forecast costs of introducing the Managed Payment Plans from April 2011. These forecast costs had been based upon an assumption that 10 per cent of eligible taxpayers will have taken up a Managed Payment Plan and spread their tax payments.

The impact is almost entirely on self assessed income tax as we expect greater numbers of these taxpayers to take them up and that more payments will have been shifted into the following year. Corporation tax payments are spread more evenly throughout a year and thus the impact of payment plans on these payments is much smaller and have been estimated as negligible. The original costing was based on projections that £140m of self-assessed income tax receipts would shift to the following year. This has a one-off timing effect in the first year. The main impact of the decision to defer implementation now is that the expected shifting of the payments from 2011-12 into 2012-13 will not happen. This results in the following costing in the current Budget:

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	+140	0	0	0

CPI indexation for all benefits, tax credits and public sector pensions

Measure description

This note covers three measures affecting the indexation of benefits, tax credits and public service pensions:

- switching to the Consumer Price Index for the price indexation of all benefits, tax credits and public service pensions from April 2011. Basic state pension remains indexed by RPI in 2011-12;
- introducing a triple guarantee that the basic State Pension (BSP) will be uprated by the higher of prices, earnings or 2.5 per cent from April 2011 (with CPI used to define inflation, but with an increase equivalent to RPI provided in 2011-12); and
- over-indexing the standard minimum income guarantee of Pension Credit to match the cash increase provided for the basic state pension in April 2011.

The cost base

The base for these costings is taken from the same data used for the social security, tax credit and public service pensions forecasts.

Costing

The Exchequer impact of these measures is calculated by replacing the uprating assumptions used in the baseline AME forecasts with the new policies outlined above, using the OBR's forecasts for growth in prices and earnings.

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact:					
Switch to CPI	0	+1,170	+2,240	+3,900	+5,840
Triple guarantee for BSP	0	0	-195	-420	-450
Increase in Guarantee Credit of Pension Credit	0	-415	-535	-535	-535

The policy costings do not include indirect behavioural effects, which are captured in the OBR's economic forecast.

Reforming Disability Living Allowance

Measure description

This measure will introduce an objective medical assessment and revised eligibility criteria for both new and existing working-age claims for Disability Living Allowance, to be rolled out from 2013/14. The assessment will follow a similar process to the Work Capability Assessment (WCA) used for claims to Employment and Support Allowance, with a points based system to assess eligibility to the different rates of the benefit.

The cost base

This costing uses the same caseload and expenditure projections used in the main social security forecast.

Costing

Drawing on the evidence of the impact of the WCA, the central assumption for this policy is that it will result in a 20 per cent reduction in caseload and expenditure once fully rolled out. It is assumed that existing claimants would be reassessed over three years, with 25 per cent of the caseload reassessed in the first year, 75 per cent by the end of the second year and 100 per cent by the end of the third year.

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact:	0	0	0	+360	+1,075

Extend conditionality to lone parents

Measure description

Income Support (IS) for lone parents only requires six-monthly attendance at a Jobcentre, in contrast to the more active job search requirements for Jobseeker's Allowance (JSA). The age of the youngest child for which a lone parent may claim IS was lowered from 15 to 9 in November 2008, and will be further reduced to 7 from October 2010. Once that age is reached, lone parents without other income may claim JSA, or Employment and Support Allowance (ESA) if they are disabled, subject to medical assessment. This measure further lowers the age limit for IS to 5, from October 2011 for new claims and April 2012 for existing cases.

The cost base

There are around 100,000 lone parents claiming IS with a youngest child aged 5 or 6 (Work and Pensions Longitudinal Study, November 2009). Based on evidence of historic benefit flows the policy option is expected to affect around 75,000 lone parents per year following the stock transfer.

Estimates are calculated using DWP benefits stock-flow model, based on 2006-2009 data from the Work and Pensions Longitudinal Study, Family and Children's Study, New Deal for Lone Parents statistics, and the DWP Destinations Survey.

Costing

This costing assumes that:

- the majority of lone parents affected (90 per cent) remain on one of the income-related benefits, with the remainder moving directly into employment or off benefits for another reason, representing a saving for the Exchequer. This assumption draws on evidence from the previous tightening of eligibility for lone parent benefits, adjusted to take account of the risk that those with younger children might be less work ready;
- 60 per cent of lone parents who immediately or subsequently leave an income related benefit go into paid employment, based on analysis from the Family and Children Study, New Deal for Lone Parents (NDLP) statistics, and the DWP Destinations Survey
- the number of new claims by lone parents for benefits are similar to past trends, although a deterrent effect equivalent to a 10 per cent reduction in claims is assumed because of the more onerous requirements for JSA or ESA;
- the affected cohort of lone parents leave benefits at a slightly lower rate than those with a youngest child 12 to15, accounting for the risk that they might be less work ready or need more time to find a suitable job that fits with their caring responsibilities. It is also assumed that a proportion of those who moved into employment move back onto JSA at a later date (based on current evidence on jobseekers); and
- 60 per cent of lone parents leaving benefit go into paid employment, based on analysis from the Family and Children Study, New Deal for Lone Parents (NDLP) statistics, and the DWP Destinations Survey.

These assumptions result in the costing set out in Table 1.

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact:	0	0	+50	+150	+180

Housing Benefit reform

Measure description

This covers a package of reforms to Housing Benefit including:

- changing the basis for setting Local Housing Allowance (LHA) rates from the median to the 30th percentile of local market rents from October 2011 (Measure 1);
- capping LHA rates at £250 per week for a 1 bedroom property, £290 p/w for a 2 bedroom property, £340 p/w for a 3 bedroom property, and £400 p/w for all properties with 4 bedrooms or more, from April 2011. This replaces the inherited policy to exclude the top 1 per cent of rents from the market evidence used to calculate LHA rates. (Measure 2);
- uprating LHA rates by the Consumer Price Index from April 2013 (Measure 3).
- uprating non-dependent deductions to reflect increases in rent since 2001/02, in April 2011 and annually on the same basis (Measure 4);
- restricting Housing Benefit for working age social tenants who occupy a larger property than their family size warrants to a standard regional rate for a property of the appropriate size, from April 2013 (Measure 5);
- restricting Housing Benefit to 90 per cent of the full award after 12 months for claimants who are in receipt of Jobseekers Allowance, from April 2013 (Measure 6);
- amending the size criteria to provide an extra bedroom for disabled claimants who have a non-resident carer, from April 2011 (Measure 7); and
- increasing the Government contribution to the Discretionary Housing Payments budget by £10m in 2011/12 and by £40m per annum from 2012/13 (Measure 8).

Cost base

Together with Housing Benefit projections used in the main social security forecast, these measures draw on the following data sources:

- the Single Housing Benefit Extract, a 100 per cent monthly dataset of Housing Benefit recipients, based on local authorities' administrative data which enables an assessment of the rent levels of Housing Benefit customers;
- the annual Market Evidence Dataset, provided by Valuation Office Agency, containing the entire list of non-Housing Benefit rents used to calculate the Local Housing Allowance rates for April each year; and
- DWP's Policy Simulation Model, which is based on the Family Resource Survey.

Costing

Measures 1 and 2

Current and new Local Housing Allowance (LHA) rates are calculated directly from the Market Evidence Dataset. These rates are then combined with the Single Housing Benefit Extract to see how average entitlement changes. This depends on a) how quickly the full private sector caseload migrates on to the LHA scheme; b) the proportion of LHA claimants that see a reduction; and c) how the overall private rented sector caseload changes. For these purposes, the modelling assumes the same estimates as used for overall HB forecasting. No behavioural effects are assumed on the basis that there is no evidence that the measure would have a significant impact on rents or caseload (emerging evidence suggests that landlords do not actively use the LHA to set rents).

Measure 3

The savings estimates are the difference between the forecast growth in LHA rates and CPI from 2013/14. No behavioural impact is assumed over the forecast period as differences in rents will be small in the early years compared to the transaction costs of moving.

Measure 4

An uprating index was calculated on the basis of growth in HB eligible rent a Council Tax Benefit eligible Council Tax. The index was then applied to the fixed Non Dependent Deduction (NDD) rates. The uprated NDD rates are then run through DWP's Policy Simulation Model. Uprating for subsequent years is estimated on the basis of RPI.

Measure 5

Average social sector rents were obtained from the Family Resources Survey (FRS). New standard social sector rates are calculated as the average rent across each region for a given size property. A new HB rate based on household size (using the current private rented sector housing size criteria) was then assigned to each social sector tenant in the FRS sample to allow comparison with current HB entitlement. Dynamic effects (i.e. displacement of under-occupiers by over-occupiers (which reduces savings), and by private tenants awaiting large social sector properties (which increases savings)) were calculated using estimates of under- and over-crowding from the Survey of English Housing. This gives a range of 50 per cent to 85 per cent of estimated gross savings, and the midpoint was used to provide a central estimate.

Measure 6

The measure will affect all working age HB claimants in receipt of Jobseekers Allowance on HB for more than 12 months. This is approximately one sixth of total Working Age HB claimants. The numbers on Jobseekers Allowance are taken from the HB quarterly release. The average duration on HB for JSA claimants is estimated by merging data from the 100 per cent Single Housing Extract with the 100 per cent National Benefit Database. The 10 per cent reduction is then applied to the full HB award for affected private and social rented tenants once they have been claiming HB for 12 months.

Measure 7

The Family Resources Survey is used to estimate the number of disabled HB claimants with a non-resident carer. DWP's Policy Simulation Model was used to estimate the cost of including an additional bedroom within the size criteria for this group, drawing on information on rents of different sized properties.

Measure 8

This measure is a simple increase to central Government's fixed contribution to funding for Discretionary Housing Payments.

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Set LHA at 30th percentile	0	+65	+365	+415	+425
Cap LHA rates	0	+55	+65	+70	+65
Uprate non-dependent deductions	0	+125	+225	+320	+340
Uprate LHA rates by CPI	0	0	0	+300	+390
Limit social sector HB to appropriate-size property	0	0	0	+490	+490
HB to 90 per cent after 1 year for JSA claimants	0	0	0	+100	+110
Extra room for carer	0	-15	-15	-15	-15
Increase DHPs	0	-10	-40	-40	-40

Changes to the Child and Working Tax Credits and Child Benefit

Measure description

This package makes the following changes to the Child and Working Tax Credits and Child Benefit from 2011-12 onwards, compared to a baseline of indexation in line with CPI:

- freeze both rates of Child Benefit for three years from 2011-12;
- reduce the tax credits second income threshold to £40,000 in 2011-12;
- increase the first and second withdrawal rates to 41 per cent in 2011-12;
- taper the family element of the Child Tax Credit immediately after the child element in 2012-13;
- remove the baby element in the Child Tax Credit from 2011-12;
- remove the 50 plus element in the Working Tax Credit from 2012-13;
- reverse the £4 supplement in the Child Tax Credit for children aged one and two from 2012-13;
- reduce the income disregard from £25,000 to £10,000 for two years from 2011-12 then to £5,000 in 2013-14;
- reduce backdating for new claims and changes of circumstances from three months to one month in 2012-13;
- introduce an income disregard of £2,500 for falls in income from 2012-13; and
- increase the child element of the Child Tax Credit by £150 in 2011-12 and £60 in 2012-13 above indexation.

The impact of each measure has been estimated by modelling it in a sequence, in the order in which it is presented above.

The cost base

For the freezing of Child Benefit, the base affected can be taken directly from the Child Benefit forecast. The Child Benefit forecast model is an aggregate model which uses administrative outturn data and ONS child population projections combined with information on the trend of the number of 16-19 year olds staying on in full-time non-advanced education provided by the Department for Education. The overall 0-19 year old population is then split by first and subsequent child (because they attract different amounts of Child Benefit as explained) using information from the administrative system. These estimates are then multiplied by the Child Benefit rates to derive the overall Child Benefit expenditure forecast.

For tax credits, changes to tapering, thresholds, increases to the child element, and the removal of the baby and 50 plus elements, the base affected can be taken directly from the tax credits forecast. The forecast is based on data for a sample of finalised 2008-09 awards, updated to reflect the latest estimates of expenditure and numbers of claims. For future years, changes in line with the emergency Budget economic forecasts are accounted for, in particular growth in wages and salaries. In 2011-12, the value of total awards is projected to be £31.0 billion.

The saving from reversing the £4 supplement in the child tax credit for children aged one and two is based on provisional information of families in award as at April 2010 since this is the best available source of data on children at these ages. This has been adjusted for changes reported at finalisation to give a forecast of the annual impact on entitlement.

For the remaining changes which will affect claimants whose income or circumstances change, the base has been estimated by analysing a more detailed sample of 2008-09 awards. In assessing the saving from reducing the income disregard for rises in income, in 2008-09 around 255,000 families had income increases between £10,000 and £25,000, but only those whose award would be affected by an income change would have benefited from the disregard. Modelling the impact in 2011-12 suggests that around 155,000 families would lose a combined level of £225m entitlement as a result of the change in the disregard.

A similar approach has been used to model the impact of introducing a disregard for income falls. Analysis suggests that families would lose a total of £550-£620 million entitlement as a result of this.

The saving from reducing backdating of new awards to one month from three months has been modelled from the same detailed data set used for the income disregards. This makes up around two thirds of the costing. The impact on existing awards has been estimated by analysing a smaller sample of awards in even greater detail.

Static costing

The static Exchequer impact is calculated by applying the pre-Budget and post-Budget tax credit system to the base data described above. The full impact of reducing the disregard for income increases is not realised immediately, because where income rises generate overpayments, these may take a number of years to recover.

Post-behavioural costing

The only behavioural response included in this costing allows for changes in reporting behaviour in response to the reduced backdating period. It is assumed that if claimants know that their awards can only be backdated for one month rather than three, they may report changes more quickly, which reduces the expenditure saving from the measure. This behavioural response results in decreased Exchequer savings of around £15-20 million per year.

The costing for lowering the disregard for income increases is assumed to only have a negligible impact on reporting behaviour. Analysis of income reporting following the increase of the disregard from £2,500 to £25,000 in 2006-07 showed that this only led to a very small reduction in the number of families reporting income changes during the year.

As the individual measures in the package all interact, the impact of each has been estimated by modelling it in a sequence, in the order in which it is presented below, on a National Accounts basis.

Table 2 – Post-behavioural Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Freeze Child Benefit for three years from 2011-12	0	+365	+695	+940	+975
Reduce the tax credits second income threshold to £40,000 in 2011-12	0	+140	+145	+155	+145
Increase first and second withdrawal rates to 41 per cent in 2011-12	0	+640	+710	+730	+765
Taper the family element of the Child Tax Credit immediately after the child element	0	0	+510	+515	+480
Remove the baby element in the Child Tax Credit	0	+295	+275	+270	+275
Remove the 50 plus element in the Working Tax Credit	0	0	+35	+40	+40

Reverse the £4 supplement in the Child Tax Credit for children aged one and two from 2012-13	0	0	+180	+180	+180
Reduce the income disregard from £25,000 to £10,000 for 2 years from 2011-12 then to £5,000 in 2013-14	0	+105	+140	+340	+420
Reduce backdating for new claims and changes of circumstances from 3 months to 1 month in 2012-13	0	0	+315	+320	+330
Introduce an income disregard of £2,500 for falls in income from 2012-13	0	0	+550	+560	+585
Increase the child element of the Child Tax Credit by £150 in 2011-12 and £60 in 2012-13 above indexation	0	-1,200	-1,845	-1,930	-1,995

Abolish Health in Pregnancy Grant

Measure description

This measure abolishes the Health in Pregnancy Grant, from January 2011.

The tax base

The base affected by this measure is expectant mothers who are 25 weeks pregnant or more. It is estimated that there are around 750,000 pregnancies per year, based on National Statistics projections of births.

Costing

Exchequer savings from this measure are simply the reverse of the forecast costs of continuing the grant, which is the £190 grant multiplied by the expected number of pregnancies. It is assumed that there is no Exchequer impact resulting from any behavioural response. This results in the following costing which is presented on a National Accounts basis:

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	+40	+150	+150	+150	+150

Reduce Sure Start Maternity Grant

Measure description

The Sure Start Maternity Grant (SSMG) is currently available for each child in eligible households. This measure restricts the SSMG to the first child (or children where the first is a multiple birth).

Cost base

Historical data on the number of SSMG awards and expenditure is taken from the Department for Work and Pensions Social Fund Policy, Budget and Management Information System.

For the current scheme, the total number of awards is forecast as 35.5 per cent of the forecast total number of live births, based on historical data. The forecast total number of live births is taken from Office for National Statistics (ONS) 2008-based population projections.

ONS information on the number of live births which are for a first child is available only for births within marriage. This figure has therefore been estimated from the Department for Work and Pensions Income Support and Jobseeker's Allowance Quarterly Statistical Enquiries, by analysing families with a child (or children) aged under one. Using this data, it is assumed that when SSMG's are restricted to the first child, the number of awards will be reduced to 48 per cent of current projections.

Costing

It is assumed that the average SSMG award size will be unchanged under the new scheme. The costing is therefore simply the reduced number of awards multiplied by the average award size.

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	0	+75	+75	+75	+75

Reform Support for Mortgage Interest

Measure description

The measure will set the standard interest rate at which Support for Mortgage Interest is paid in line with the Bank of England average mortgage rate.

Cost base

The analysis underpinning this costing is primarily based on the departmental Quarterly Statistical Enquiry. This is a point-in-time survey of the characteristics and type of payment received by benefit customers. Information is based on a 5 per cent sample of all customers collected from the benefits payment system.

The methodology for estimating the costs of options to set the standard interest rate is based on the latest available estimate of the prevailing level of annual support for mortgage interest expenditure, and the level of standard interest rate that drove this level of expenditure.

Costing

The prevailing level of support for mortgage interest expenditure is adjusted by the per cent difference between the average standard interest rate and the standard interest rate assumption going forward, assuming a constant and linear relationship between the standard interest rate and the level of Support for Mortgage Interest expenditure.

The modelling incorporates HM Treasury forecasts of the Bank of England base rate and the average mortgage rate, so the standard interest rate assumptions going forward are consistent with the way these are expected to move over time and with forecast AME expenditure.

The cost of the standard interest rate policy going forward is calculated as the estimated cost of support for mortgage interest implied by the policy option standard interest rate, minus the estimated cost of support for mortgage interest implied by the baseline standard interest rate formula which was in place prior to January 2009.

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	+15	-75	-10	+40	+65

Abolish Savings Gateway

Measure description

This measure announces that the Saving Gateway, which had been due to be introduced from July 2010, will now not be introduced.

People affected

The base affected by this measure is working age people on lower incomes, who would have been eligible for the Saving Gateway.

Costing

Exchequer savings from this measure are simply the reverse of the forecast costs of introducing the Saving Gateway from July 2010. These forecast costs had been based upon assumptions about the number of individuals opening Saving Gateway accounts, and the amount of money saved into the accounts. This results in the following costing, which is presented on a National Accounts basis:

Table 1 – Direct Exchequer impact (£m)

	2010-11	2011-12	2012-13	2013-14	2014-15
Exchequer impact	+10	0	+75	+110	+115

It is assumed that there is no significant behavioural response on other tax bases.

A Indexation in public finance forecast baseline

The following table shows the indexation assumptions that have been included in the public finance forecast baseline, including all pre-announcements.

Forecast area	Element	Default indexation assumed in baseline	Pre-announced policy changes from 2011-12 onwards
Income Tax	Personal allowances [1]	RPI [3]	Personal allowances will increase by £130 less than RPI in 2011-12
	Thresholds for starting, basic and higher rate bands	RPI [3]	Basic rate limit will be held constant in 2011-12, and higher rate threshold will be held constant in 2012-13
	Threshold for additional (50 per cent) rate	Fixed at £150,000	
	Threshold for tapered withdrawal of personal allowances[1]	Fixed at £100,000	
	Thresholds for tapered withdrawal of pensions relief[1]	Fixed at £130,000 and £150,000	
	Individual Savings Accounts limits for cash and equities	Total limit fixed at £10,200, of which cash limit fixed at £5,100	Limits will increase with RPI [3] every year from 2011-12 onwards
National Insurance Contributions	Lower earnings limit	Minimum of 2.5 per cent or RPI [3]	
	All other limits and thresholds	RPI [3]	Primary threshold will be aligned with the personal allowance in 2011-12, and primary threshold will increase by an additional £570 (above RPI) in 2011-12
	Contribution rates	Fixed	Class 1 employers, Class 1 employees and Class 4 contributions will all increase by 1 percentage point in 2011-12
Capital Gains Tax	Main annual exempt amount	RPI [3]	
	Annual exempt amount for trustees	RPI [3]	
	Lifetime allowance for entrpreneurs' relief	Fixed at £2m	
Inheritance Tax	Nil rate band allowance threshold	RPI [3]	Nil rate band threshold will be frozen until 2014-15 inclusive

[1] Public Finance baseline includes scored yield from FA10 pensions tax reform. The Government intends to introduce alternative approach based on a new, reduced Annual Allowance

Forecast area	Element	Default indexation assumed in baseline	Pre-announced policy changes from 2011-12 onwards
Disability Benefits (Disability Living Allowance, Attendance Allowance, Carer's Allowance) and Maternity Benefits	All elements	RPI [3]	Forecast assumes that benefits uprated by RPI reduced by 1.5 per cent in 2011-12, in order to recoup the 1.5 per cent advance paid in 2010-11
Income-related benefits (Jobseeker's Allowance, Income Support, Incapacity Benefit, Employment Support Allowance)	All rates	Rossi[6]	None
Basic State Pension	All categories	RPI in 2011-12, earnings thereafter	Switch to earnings indexation from 2012-13
Additional State Pension	All elements	RPI [3]	None
Pension Credit	Guarantee Credit	Earnings	None
	Savings Credit	Savings Credit Threshold uprated by earnings until 2015. From 2015, the maximum Savings Credit will be forzen in real terms.	None
Child Tax Credit	Family element and baby addition	Fixed at £545 per year, with £545 baby addition	
	Child element	RPI [3]	
	Disabled and enhanced disabled child elements	RPI [3]	Elements increased by RPI reduced by 1.5 per cent in 2011/12 - see comment for disability benefits
Working Tax Credit	All award elements	RPI [3]	Elements increased by RPI reduced by 1.5 per cent in 2011/12 - see comment for disability benefits
	Maximum eligible childcare costs (for 1 and 2+ children)	Fixed at £175 and £300 per week	
Child Benefit	Eldest (or only) child and subsequent children amounts	RPI [3]	Elements increased by RPI reduced by 1.5 per cent in 2011/12 - see comment for disability benefits
Corporation Tax	Marginal relief lower limit	Fixed at £300,000 profit	
	Marginal relief upper limit	Fixed at £1.5m profit	
	Small profits rate	Fixed at 21 per cent	Small profits rate will increase to 22 per cent in 2011-12
Stamp Duties	Stamp duty land tax thresholds	Fixed at £125,000, £250,000 and £500,000	New £1m threshold will be introduced for 5 per cent tax band from 2011-12
	Stamp duty land tax first time buyer threshold	Fixed at £125,000	First time buyer threshold temporarily increased to £250,000 until 2011-12 inclusive
Climate Change Levy	Levy amount	RPI [3]	

Forecast area	Element	Default indexation assumed in baseline	Pre-announced policy changes from 2011-12 onwards
Aggregates Levy	Levy amount	RPI [3]	Aggregates levy will increase to £2.10 per tonne in 2010-11
Landfill Tax	Tax rates	RPI [4]	Landfill tax rates will increase by £8 per tonne until 2014-15
Vehicle Excise Duty	Duty rates	RPI [4]	
Amusement Machine Duty	Duty rates	RPI [4]	
Air Passeger Duty	Duty rates	RPI [4]	
Tobacco Duties	Duty rates on all tobacco products	RPI [4]	Duty rates will increase by an additional 2 percentage points above RPI every year until 2014-15 inclusive
Alcohol Duties	Duty rates on all alcohols	RPI [4]	Duty rates will increase by an additional 2 percentage points above RPI every year until 2014-15 inclusive
Fuel Duties	Duty rates on petrol and diesel [2] Duty rate on liquefied petroleum gas (LPG)	RPI [4] In line with changes in petrol and diesel duty rates	Duty rates will increase by an additional 1p per litre above RPI every year until 2014-15 inclusive LPG rate will increase by an additional 1p per litre above changes in petrol and diesel duty rates, every year until 2014-15 inclusive
VAT	VAT registration threshold	RPI [5]	
Gaming Duty	Gross gaming yield bands	RPI [5]	
Business Rates	Business rates multiplier	RPI [3]	

Notes

Unless otherwise stated, changes take place in April each year

Unless otherwise stated, tax rates are assumed to be fixed

[1] and other allowances e.g. married couples', blind persons

[2] and consequential rates for other fuels e.g. rebated oils

[3] RPI is measured in the year to September prior to the respective change

[4] RPI is measured in the year to the third quarter following the respective change

[5] RPI is measured in the year to December prior to the respective change

[6] Rossi is RPI excluding housing costs, and is measured in the year to September prior to the respective change

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This document can be found in full on our website at:
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