A Policy measures

Overview

A.1 Our *Economic and fiscal outlook* (*EFO*) forecasts incorporate the expected impact of the policy decisions announced in each Budget or other fiscal statement. In the run-up to each one, the Government provides us with draft estimates of the cost or gain from each policy measure it is considering. We discuss these with the relevant experts and then suggest amendments as necessary. This is an iterative process where individual measures can go through several stages of scrutiny. After this process is complete, the Government chooses which measures to announce and which costings to include in its main policy decisions scorecard. For these scorecard costings we choose whether to certify them as 'reasonable and central', and whether to include them – or alternative costings of our own – in our forecast. We also include the effects of policy decisions that do not appear on the scorecard. In this *EFO* we have certified all tax and AME measures as reasonable and central.

A.2 Once again, we are grateful to officials across departments for ensuring the process worked as smoothly as it did under difficult circumstances, and for providing the information that we required to complete the scrutiny process. We were first notified of one measure five days after the deadline for new measures agreed with the Treasury. On some previous occasions, late notification has meant we have needed to use uncertified costings that we return to at the next forecast. But on this occasion we were content to certify the costing on the basis that it was a straightforward change to one that had been previously certified. Again, all our questions about it were answered fully and promptly to allow that to happen.

A.3 Table A.1 summarises the direct and indirect effects of the Government's policy decisions. Table A.2 reproduces the Treasury scorecard alongside our subjective assessment of the uncertainty around each costing. Table A.3 provides the costings and uncertainty assessments of non-scorecard measures.

Government policy decisions

A.4 The three main policy elements to this Budget are the large sums of additional virus-related support in the near term, measures designed to stimulate economic recovery over the next two years, followed by significant tax rises in the medium term. Taking each of these in turn:

- The Government has increased its **virus-related support** to households and businesses by extending most of its main support schemes to cover the second wave of the pandemic. This Budget confirms an extra £3.3 billion of support in 2020-21, and announces a further £43.2 billion in 2021-22. The six-month extension to the

Coronavirus Job Retention Scheme (CJRS) and two further rounds of grants under the Self-Employed Income Support Scheme (SEISS) account for around 80 per cent of the £26 billion of support to households, while the close to £20 billion of additional support to businesses comes largely from extensions to the business rates holiday, business grants and the temporary reduced rate of VAT for the hospitality and accommodation sectors. This takes the total cumulative cost of the Covid rescue package since the start of the pandemic to £344 billion (see Box 3.1).

- The most significant contributor to the **economic recovery measures** is the time-limited 130 per cent capital allowances super deduction that will be in place in 2021-22 and 2022-23. This is expected to cost £27 billion in total between 2021-22 to 2023-24, with the direct cost sensitive to how successful it is in incentivising firms to invest more while it is in place. But since it largely brings forward planned investment from future years, it boosts receipts by the end of the forecast as investment then is lower than it would have been in the absence of the measure. There are more modest costs from the decision to extend from one to three the number of years that firms can carry back losses to offset against corporation tax, and the customary freezing of duty rates for fuel and alcohol. The launch of the 'Recovery Loan Scheme' to succeed the existing virus-related loan schemes also adds to recorded spending this year.

- The **medium-term fiscal tightening** rises to £32 billion in the final year of the forecast (including the final-year effects of some of the rescue and recovery measures). Around half of that (£17.2 billion) is due to the 6 percentage point increase in the main rate of corporation tax from April 2023 (tempered by the reintroduction of the small profits rate). Around a quarter (£8.2 billion) is due to the freezing of the income tax personal allowance and the higher rate threshold in cash terms from April 2022 to the end of the forecast period. A seventh of the final year consolidation (£4.2 billion) is due to further planned cuts to pre-virus departmental spending totals.

Table A.1: Summary of the total effect of Government decisions since November

	£ billion					
	Forecast					
	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total effect of Government decisions	**-8.5**	**-53.5**	**0.0**	**19.1**	**31.5**	**36.4**
of which:						
Direct effect of scorecard policies	-6.0	-58.9	-7.8	13.1	25.0	29.7
Direct effect of non-scorecard policies	-3.0	0.0	2.3	2.0	2.4	2.6
Indirect effect of Government decisions	0.5	5.4	5.5	4.0	4.0	4.1
of which:						
Virus-related support measures	**-3.3**	**-43.2**	**1.3**	**-0.1**	**0.3**	**0.6**
of which:						
Support for households	-0.5	-27.2	1.1	-0.1	0.3	0.6
Support for business	-2.8	-16.0	0.1	0.0	0.0	0.0
Other measures	0.0	0.0	0.0	0.0	0.0	0.0
Economic recovery measures	**-5.6**	**-15.7**	**-15.3**	**-5.1**	**-0.5**	**0.0**
of which:						
Capital allowances super deduction	-1.7	-12.3	-12.7	-2.4	2.1	2.8
Losses carry back	-0.8	-0.2	0.6	0.3	0.2	0.1
Duty freezes	0.0	-1.3	-1.3	-1.3	-1.3	-1.3
Other measures	-3.0	-2.0	-1.9	-1.7	-1.5	-1.6
Fiscal consolidation measures	**-0.1**	**0.0**	**8.5**	**20.3**	**27.7**	**31.8**
of which:						
Corporation tax rate increase	0.0	0.0	2.4	11.9	16.3	17.2
Income tax threshold freezes	0.0	0.0	1.6	3.7	5.8	8.2
RDEL cuts	0.0	0.0	4.0	3.5	3.9	4.2
Other measures	-0.1	0.0	0.5	1.2	1.8	2.3
of which:						
Receipts	-3.5	-25.1	-9.0	11.9	23.4	27.9
Resource DEL	-0.2	-8.5	3.1	2.7	3.2	3.5
Capital DEL	0.1	0.2	0.0	0.0	0.0	0.0
AME spending	-5.5	-25.5	0.4	0.6	0.8	0.9

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).

A.5 Table A.2 reproduces the Treasury's scorecard alongside our subjective assessment of the uncertainty around each costing.[1]

[1] We present a more detailed tax and spending breakdown of each costing in a supplementary table that is available on our website.

Table A.2: Treasury scorecard of policy decisions and OBR assessment of the uncertainty of costings

		Head[2]	£ million[1]						Uncertainty
			2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	
Protecting the jobs and livelihoods of the British									
1	Coronavirus Job Retention Scheme (CJRS): extension to September 2021	Spend	0	-6,945	0	0	0	0	Medium-High
2	Self-employment income support scheme (SEISS): two further grants[3]	Spend	-55	-12,760	+1,650	0	0	0	Medium-High
3	Restart Grants and Additional Restrictions Grants	Spend	0	-5,005	0	0	0	0	N/A
4	Business Rates: three months 100% holiday, nine months 66% relief with cap[4]	Tax	+135	-6,835	+135	-35	0	0	Medium-Low
5	VAT: extension to reduced rate for hospitality, accommodation and attractions (5% to 30 September 2021 then 12.5% to 31 March 2022)	Tax	0	-4,720	0	0	0	0	Medium-High
6	VAT: extend the window for starting deferred payments through the VAT New Payment Scheme by up to three months	Tax	-80	0	0	0	0	0	Medium-High
7	Stamp Duty Land Tax: maintain nil-rate band at £500k until 30 June 2021, £250k until 30 September 2021	Tax	-255	-1,350	*	*	-5	0	High
8	Fuel Duty: one year freeze in 2021-22	Tax	0	-795	-885	-910	-925	-945	Low
9	Alcohol Duty: one year freeze in 2021-22	Tax	-45	-315	-320	-325	-340	-350	Medium-Low
10	Traineeships: extension for 16-24 year olds in England	Spend	0	-100	-50	0	0	0	N/A
11	Universal Credit: maintain £20 increase to standard allowance for six months	Spend	0	-2,240	0	0	0	0	Medium
12	£500 payment to eligible Working Tax Credit recipients[5]	Spend	0	-765	-20	0	0	0	N/A
13	Universal Credit: three month delay to Minimum Income Floor reintroduction	Spend	0	-25	-60	-5	0	0	Medium-Low
14	Universal Credit: maintain surplus earnings de minimis at £2,500 in 2021-22	Spend	0	-110	0	0	0	0	Medium-High
15	Shared Accommodation Rate (SAR): accelerate introduction of exemptions	Spend	0	-10	-10	-5	0	0	Medium-High
16	Statutory Sick Pay Rebate Scheme: extension	Spend	0	-35	0	0	0	0	Low
17	COVID-19: HMRC exemptions	Tax	0	-105	-5	*	*	*	High
Investment-led recovery									
18	Capital allowances: 130% Super Deduction for main rate assets and 50% First Year Allowance for special rate assets for two years	Tax	-1,735	-12,255	-12,695	-2,395	+2,090	+2,780	Very High
19	Loss carry back: extended to 3 years with £2,000,000 cap	Tax	-840	-205	+580	+325	+160	+80	Very High
20	Help to Grow: management	Spend	0	-60	-75	-85	0	0	N/A
21	Help to Grow: digital	Spend	0	-50	-115	-130	0	0	N/A

Strengthening the public finances									
22	Corporation Tax: 19% rate for profits up to £50,000, tapering to main rate of 25% for profits over £250,000, from April 2023	Tax	-5	+20	+2,390	+11,900	+16,250	+17,200	Medium
23	Income Tax: maintain personal allowance and higher rate threshold at 2021-22 levels up to and including 2025-26[6]	Tax	0	*	+1,555	+3,655	+5,790	+8,180	Medium
24	VAT: maintain registration threshold at £85,000 up to and including 2023-24	Tax	0	0	+55	+125	+135	+165	Medium-High
25	Inheritance Tax: maintain thresholds at 2020-21 levels up to and including 2025-26	Tax	0	+15	+70	+165	+290	+445	Medium
26	Pensions Lifetime Allowance: maintain at £1,073,100 up to and including 2025-26	Tax	-10	+80	+150	+215	+255	+300	High
27	Capital Gains Tax: maintain the Annual Exempt Amount at £12,300 up to and including 2025-26	Tax	0	*	+5	+10	+20	+30	Medium-High
Fair and sustainable tax system									
28	Corporation Tax: exemption for the Northern Ireland Housing Executive	Tax	0	-20	-10	-10	-10	-10	Low
29	EU Interest and Royalties Directive: repeal	Tax	0	+10	+10	+10	+5	0	Medium-High
30	Red Diesel: exemptions	Tax	0	0	-80	-85	-100	-110	Very High
31	Vehicle Excise Duty: freeze for HGVs in 2021-22	Tax	0	-5	-5	-5	-5	-5	Low
32	HGV Road User Levy: suspend for a further 12 months from August 2021 and freeze rates	Tax	0	-140	-75	-5	-5	-5	Low
33	Carbon Price Support (CPS) rate: maintain in 2022-23	Tax	0	0	-5	-10	-10	-5	Medium-Low
34	Aggregates Levy: one year freeze in 2021-22	Tax	0	-10	-15	-15	-15	-15	Low
35	Interest harmonisation and tax penalty reform	Tax	0	0	+5	+90	+155	+155	High
36	VAT: powers to tackle Electronic Sales Suppression (ESS)	Tax	*	+5	+20	+20	+20	+20	Very High
37	OECD Mandatory Disclosure Rules	Tax	0	0	*	+5	+5	+5	Very High
38	HMRC: investment in compliance[7]	Tax	-55	-500	-460	+110	+750	+1,310	High
39	HMRC: investment in digital infrastructure	Spend	0	-30	-25	-15	-5	*	N/A
40	DWP: investment in compliance	Spend	0	-10	+190	+235	+250	+250	High
Financial Transactions									
41	Public sector net borrowing impact of changes to financial transactions and guarantees	Spend	-2,690	-945	+280	+365	+410	+435	High

	Previously announced policy decisions								
42	CJRS: extension to April 2021	Spend	0	-2,665	0	0	0	0	Medium-High
43	Research and Development PAYE Cap: updated design	Spend	0	*	-20	-80	-105	-115	Medium-High
44	Business rates: changes to tax deductibility of business rate repayments	Tax	-160	-30	0	0	0	0	Medium-Low
45	UK Emissions Trading Scheme	Tax	0	+15	+50	+35	+15	0	Very High
46	VAT: Tour Operators Margin Scheme	Tax	-5	-30	-45	-70	-100	-105	Medium
47	VAT: reversal of the removal of Second Hand Margin Scheme for cars	Tax	*	-5	-5	-5	-5	-5	Medium-Low
48	VAT: repeal the VAT Treatment of Transactions Order 1992	Tax	0	+5	+15	+15	+15	+15	Low
49	Self-assessment: penalty easement	Tax	-105	+100	*	*	*	0	Medium
50	COVID-19: easement for employer-provided cycles exemption	Tax	-5	*	0	0	0	0	Medium
51	HMRC: additional resource for debt pursuit, delay from September 2020 to April 2021	Tax	-55	*	0	0	0	0	Medium-High
52	UK-EU Future Relationship Agreement on Social Security Coordination: benefit rules	Spend	*	*	+5	+5	+5	+5	Medium-High
53	Local government: exceptional financial support for Local Authorities through a capitalisation direction	Spend	-60	-55	+30	+30	+30	+30	Low
	Total policy decisions [8]		**-6,010**	**-58,865**	**-7,785**	**+13,105**	**+25,025**	**+29,735**	
	Total spending policy decisions [8]		-2,765	-34,770	+215	+345	+720	+875	
	Total tax policy decisions [8]		-3,245	-24,095	-8,005	+12,760	+24,305	+28,860	
	Memo: Resource DEL: maintain real terms growth assumption for future years, reflecting latest OBR deflators (2.1% real)		0	0	+3,975	+3,520	+3,875	+4,160	

*Negligible.

[1] Costings reflect the OBR's latest economic and fiscal determinants.

[2] Many measures have both tax and spend impacts. Measures are identified as tax or spend on the basis of their largest impact.

[3] Self-Employment Income Support Scheme grants are taxable income and also subject to National Insurance contributions.

[4] Business rates are deductible for corporation tax and income tax self-assessment. Increased business rates relief reduces the amount of business rates paid and so increases these other tax receipts.

[5] Includes measure to exempt payment from income tax.

[6] Including the National Insurance Upper Earnings Limit and Upper Profits Limit, which will remain aligned to the higher rate threshold at £50,270 for these years.

[7] Includes funding for HMRC, impacts on compliance yield reflecting reprioritisation (including to respond to COVID-19), and additional compliance yield from higher staffing levels and new programmes.

Policy decisions not on the Treasury scorecard

A.6 Our forecasts include the effect of several policy decisions that the Treasury has chosen not to present on its scorecard:

- **RDEL spending beyond the Spending Review period**: Spending Review 2020 set plans for 2021-22 only, with the Government setting totals for future years but not allocating them fully to departments. In the Budget it has reduced those totals from 2022-23 onwards, by amounts that rise from £4 billion in 2022-23 to £4.2 billion in 2025-26, including the effect of smaller assumed underspending against the lower totals.

- **Other departmental spending changes**: these mostly relate to the reprofiling of spending between 2020-21 and 2021-22 and include a neutral reallocation of £0.9 billion from RDEL to CDEL.

- **Rollover free-trade agreements:** the Government has now concluded 64 agreements with third countries that have free-trade deals with the EU that the UK is therefore no longer a party to. The UK Global Tariff came into effect from 11pm on 31 December 2020 and we included its impact for the first time in our November forecast, but only allowing for those rollover deals that had been agreed by that time. This costing relates to the additional deals agreed since then. Just under a half of the £1 billion a year cost relates to imports from Turkey, around a quarter to imports from Bangladesh, and around a sixth to the combined imports from Japan and Cambodia.

- **State pension underpayment correction:** an administration error identified in March 2020 suggested that a small number of people had been underpaid in the 'category BL' element of the state pension. The underpayment affected married women whose husbands reached pensionable age before 2008 and who were unknowingly entitled to 'enhanced pension' that would have boosted their payments by up to 60 per cent. DWP investigations between May and December 2020 uncovered a systematic underpayment of state pensions, meaning tens of thousands of married, divorced and widowed people may have been underpaid since 2008. A repayment programme began on 11 January 2021, with the associated costs set out in Table A.3, some of which are expected to fall outside the forecast period. This costing is subject to a high degree of uncertainty as the true extent of the underpayment is not yet established.

- **Natwest Group (NWG) share sale:** the Government has delayed completion of the disposal of its remaining holdings of former RBS shares by a year. Based on the share price as of 29 January, this reduces PSND in 2025-26 by £2.6 billion, but with fewer shares being sold in earlier years than was assumed in our November forecast, increases it by £0.2 billion a year prior to that. Table A.3 shows the relatively modest impact of this on our receipts forecast via the dividends received on the shares.

- **Universal credit (UC) managed migration:** the Government has again paused the pilot phase of the UC managed migration scheme, this time until April 2022. The surge of new UC claims during the early stages of the pandemic led to a pause in managed migrations as operational capacity became stretched. It also increased the number of 'natural migrations' from legacy benefits, reducing anticipated managed migration volumes by 50,000. There remain around 3 million cases on the legacy benefits that will transfer to UC, with 1.6 million of those expected to go through managed migration. The full rollout is still assumed to finish in September 2026.

- **Personal independent payment (PIP) legal case**: DWP will implement an Upper Tribunal ruling that deaf or severely hearing-impaired claimants are at risk of not hearing fire alarms if required to remove hearing aids when washing.[2] Claimants' PIP

[2] KT and SH v Secretary of State for Work and Pensions.

assessments and payments will now reflect a higher score for 'ability to wash independently'. The ruling means that some existing claimants will be eligible for a higher rate of PIP, while others will become eligible where they previously were not.

- **PIP telephone assessments**: at the onset of the pandemic DWP introduced a range of 'easements' and moves away from face-to-face appointments. This costing reflects that one of these, relating to PIP assessments carried out by telephone, will continue beyond the point at which our November forecast assumed it would have ended.[3]

Table A.3: Costings for policy decisions not on the Treasury scorecard and OBR assessment of the uncertainty of costings

	Head	£ million						Uncertainty
		2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	
Spending assumption	Spend	0	0	3,975	3,520	3,875	4,160	N/A
Other DEL spending changes	Spend	-2,640	1,605	-160	-140	-170	-185	N/A
Rollover free trade deals	Tax	-225	-970	-1,020	-1,025	-1,030	-1,045	Medium
State pension underpayment	Spend	-120	-670	-625	-635	-535	-390	High
Natwest group share sale	Tax	0	-5	45	120	150	85	Medium
UC managed migration	Spend	5	25	80	180	150	30	Medium
PIP legal case	Spend	0	-5	-15	-10	-10	-15	Medium-low
PIP telephony assessments	Spend	20	30	-5	-15	0	0	Medium
Direct effect of Government		**-2,965**	**10**	**2,275**	**2,000**	**2,430**	**2,635**	

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).

Scottish and Welsh Government policy decisions

A.7 Our UK public finances forecasts are also affected by decisions taken by the devolved administrations. These can affect UK-wide taxes, such as income tax and NICs, or those that have been fully devolved, such as the Scottish land and buildings transactions tax (LBTT). Since November both the Scottish and Welsh Governments have announced measures that have been reflected in this forecast:[4]

- **Scottish non-domestic rates:** the Scottish Government has made several changes to business rates policy. First, the **100 per cent relief for the retail, hospitality, leisure and aviation sectors will be extended** by twelve months, to 31 March 2022. We expect this to cost around £0.7 billion in 2021-22. Second, the **poundage for 2021-22 will be set at 49p**, which cuts the basic rate of tax applied to a property's rateable value by 0.8p compared to 2020-21. Rates are assumed to rise in line with CPI inflation thereafter. Third, it is **changing the eligibility criteria for the Business Growth Accelerator relief**. This expands eligibility for the relief to include properties where there has been a change of use, effective from 1 April 2021. These measures have implications for local authority spending, which we have assumed will move one-for-one with the changes in local authority income they generate.

[3] Telephone assessment easements for the work capability assessment are continuing in line with the PIP ones.
[4] For more information see our *Devolved taxes and spending forecasts*, published alongside this *EFO* and available on our website. The effects detailed here need to be considered alongside the fiscal consequences set out in the Treasury's fiscal framework agreements with the Scottish and Welsh Governments respectively, which set out the methodology by which block grant adjustments are made.

- **Land transaction tax:** the Welsh Government announced two new policies in its draft Budget, both effective from 22 December. First, it **raised the higher rates on additional property purchases** by one percentage point, to 4 per cent. This is expected to raise around £15 million a year from 2021-22 onwards. Second, it **raised the tax-free threshold for commercial transactions** from £150,000 to £225,000, as well as the tax-free threshold for transactions that have a lease rent net present value liable for tax.

- **Welsh non-domestic rates: freezing the multiplier in 2021-22:** this measure freezes business rates in 2021-22, rather than them uprating in line with CPI inflation.

Table A.4: Costings for devolved administration policy decisions

		£ million					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Scottish Government policy decisions							
Non-domestic rates: setting the 2021-22 poundage at 49p	Receipts	0	-65	-65	-75	-80	-80
Non-domestic rates: extension of relief for retail, hospitality, leisure and aviation	Receipts	0	-740	0	0	0	0
Non-domestic rates: changing the eligibility criteria for BGAc relief	Receipts	0	neg	-5	-5	-5	-5
Direct effect of Scottish Government decisions		**0**	**-805**	**-65**	**-80**	**-85**	**-85**
Welsh Government policy decisions							
Land transaction tax: raising the higher rates on additional property purchases	Receipts	5	15	15	15	15	15
Land transaction tax: raising the tax-free threshold for commercial transactions	Receipts	neg	neg	neg	neg	neg	neg
Non-domestic rates: freezing the multiplier in 2021-22	Receipts	-10	-5	-5	-5	-5	-5
Direct effect of Welsh Government decisions		**-10**	**5**	**5**	**5**	**5**	**5**

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB). These costings are included in our pre-measures forecast, with the post-measures forecast only accounting for policy decisions by the UK Government.

Policy costings and uncertainty

A.8 In order to be transparent about the potential risks to our forecasts, we assign each certified costing a subjective uncertainty rating, shown in Tables A.2 and A.3. These range from 'low' to 'very high'. In order to determine the ratings, we assess the uncertainty arising from each of three sources: the data underpinning the costing; the complexity of the modelling required; and the possible behavioural response to the policy change. We take into account the relative importance of each source of uncertainty for each costing. The full breakdown that underpins each rating is available on our website. It is important to emphasise that where we see a costing as particularly uncertain, we see risks lying to both sides of what we nonetheless judge to be a reasonable and central estimate.

A.9 Using this approach, we have judged 13 scorecard measures and one non-scorecard measure to have 'high' or 'very high' uncertainty around the central costing. Together, these represent 20 per cent of the scorecard measures by number, or 25 per cent of the tax and

AME measures we have certified (as we do not certify the cost of DEL spending measures). They represent 30 per cent of certified measures by absolute value.[5]

Corporation tax measures

A.10 The Government has announced very significant changes to the corporation tax (CT) regime in this Budget. There are two elements - **the headline rate of CT is to increase from 19 to 25 per cent with effect from April 2023**. This reverses more than half the cumulative 9-percentage point reduction brought in in several steps by the Coalition and Conservative Governments from April 2011 onwards. The measure is estimated to raise amounts rising to £17.2 billion in 2025-26. As discussed in Box 3.2, during the period that the headline rate was being reduced the effective tax rate remained relatively stable, in part thanks to several measures that broadened the tax base. This means that the increase in the rate now yields significantly more than it would have done previously. This part of the costing – the 'static' element – is relatively certain. The main area of uncertainty relates to the behavioural response, where we allow for a small reduction in the yield for 'profit shifting' as large corporations move some taxable income to lower-taxed jurisdictions. There is a broadly offsetting impact by the measure reducing the incentive for individuals to incorporate rather than work as an employee or be self-employed. We also allow for some increase in tax avoidance.

A.11 The second element of this policy – the **reintroduction of a small profits rate of CT** creates greater uncertainty. This will apply the existing 19 per cent rate for those with profits less than £50,000 and the headline rate for those with profits greater than £250,000. For those in between there is a marginal relief, similar to the previous small profits rate policy, so that in effect the average tax rate is tapered. A company with £100,000 of profits will therefore pay around 22 per cent and one with £150,000 of profits will pay roughly 24 per cent.

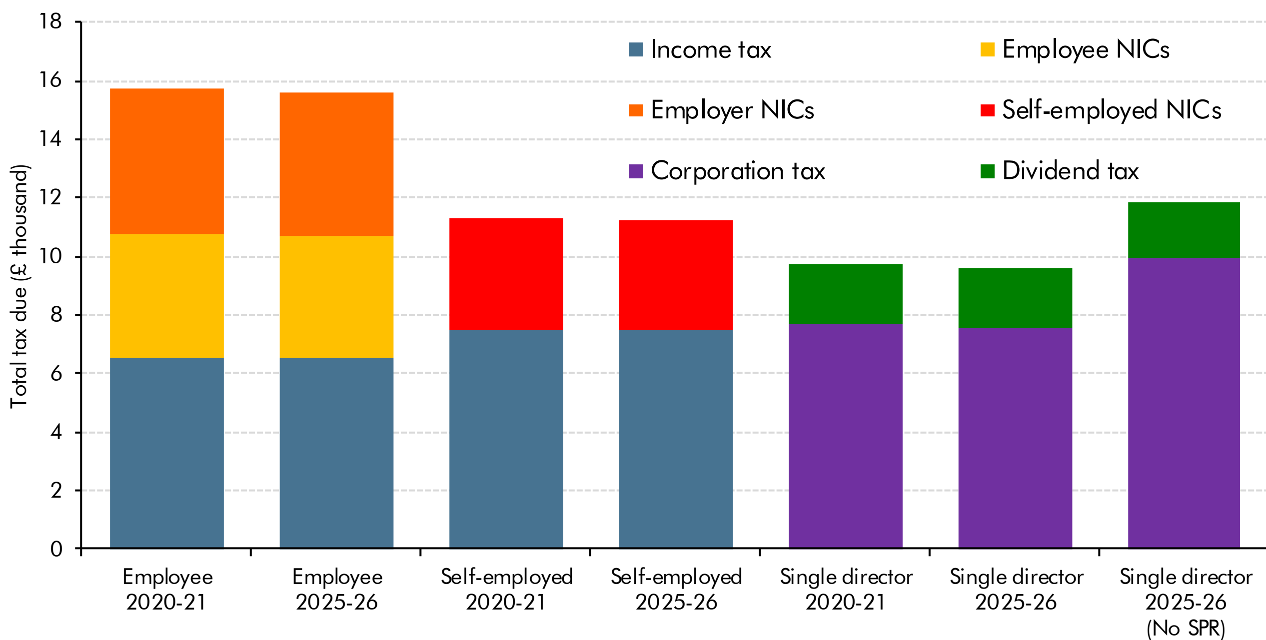
A.12 The main uncertainty with the small profits element of the costing is around how much it reverses the disincentive to incorporate associated with the main rate element. The Institute for Fiscal Studies has previously said that the small profits rate incentivised "*people to set up companies purely as a tax planning device*".[6] The costing assumes that the small profits rate will reduce the amounts raised by reducing the incentive to incorporate by around three-quarters relative to the main rate element of the costing.

A.13 The reason for this large reversal is that the small profits rate maintains a large differential between the amounts of tax paid in different employment statuses at the levels of income where the incentive to incorporate is greatest. Charts A.1 and A.2 show how tax paid under the 2025-26 tax system would compare with that paid under the 2020-21 system for those earning £50,000 or £150,000 – and with 2025-26 shown with and without the effect of the small profits rate for single-director companies.[7]

[5] The absolute value refers to the magnitude of the costing irrespective of whether is it is an Exchequer cost or a gain.
[6] The IFS Green Budget: February 2012.
[7] These calculations assume the individual has only one source of income. The deduction of employer NICs means that less of an employee's total compensation is made up of their wage, thereby paying less income tax but more NICs than the self-employed.

A.14 For an employee or someone in self-employment, the amount barely changes thanks to the personal allowance and higher rate threshold being frozen in cash terms over this period. For someone working as a single-director company, there is little change for someone earning £50,000 – thanks to the small profits rate. But more tax would be paid by someone earnings £150,000 – as the CT rate tapers up towards the headline rate. So the incentive to incorporate barely changes at £50,000 whereas it will have fallen at £150,000. And of course, many more people earn around £50,000 than earn around £150,000.

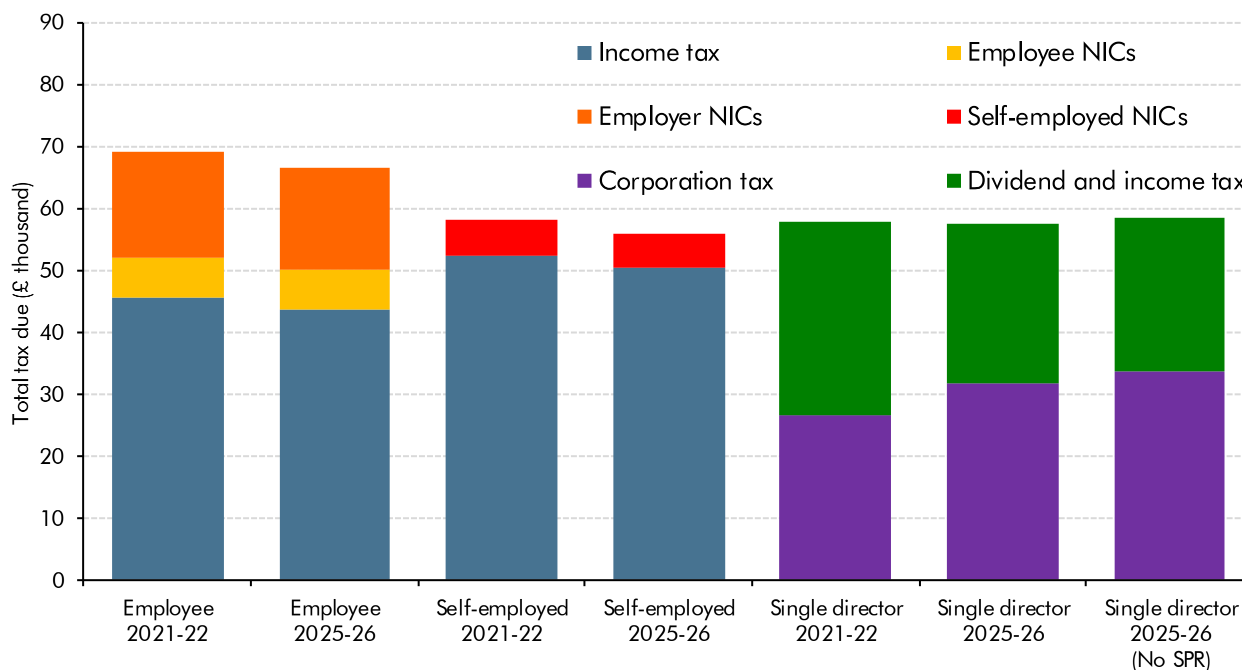
Chart A.1: Tax due on £50,000 of income in 2021-22 and 2025-26



Source: OBR

Company directors are assumed to withdraw profits in the most tax efficient way, paying themselves a salary up to the primary threshold for NICs, and taking the rest as dividends, all in the same year. These examples all reflect taxpayers outside Scotland. In Scotland higher tax rates at the top-end of the distribution create a slightly larger incentive to incorporate

Chart A.2: Tax due on £150,000 of income in 2021-22 and 2025-26



Source: OBR

A.15 The **two-year temporary capital allowances 130 per cent super deduction** applies to expenditure on new plant and machinery that qualifies as a 'main rate' asset, while a 50 per cent rate will apply to expenditure that qualifies for the 'special rate'. Capital allowances on these assets are currently 18 and 6 per cent, so these are very large temporary increases. The allowances only cover companies (since unincorporated businesses rarely invest more than the 100 per cent annual investment allowance). Not only are the rates generous, but they are not limited by value.

A.16 The main uncertainty with the costing relates to behaviour. As a temporary measure, it provides companies with a very strong incentive to bring forward investment from future periods to take advantage of the temporarily much more generous allowances. We assume that at its peak in 2022-23, this will raise the level of business investment by around 10 per cent (equivalent to around £20 billion a year) as spending is brought forward. Overall, the measure costs £29 billion between 2020-21 and 2023-24, with a peak single-year cost of £12.7 billion in 2022-23. To put this in context, in Budget 2009 the Labour Government also introduced a temporary capital allowances measure to support investment that had been hit by the financial crisis. It was for one year and at a rate of 40 per cent, and was expected to cost £1.6 billion in 2009-10. Relative to GDP, that makes this Budget's measure five times more generous in the peak year and over ten times more in total.

A.17 The measure then raises receipts by £4.9 billion in total over the final two years of the forecast due to lower investment and capital allowances claims in those years (since investment has been brought forward to benefit from the measure). This effect would continue beyond the forecast horizon. We have applied a 'very high' uncertainty rating to the behavioural element and the overall costing.

A.18 The **loss carry back** measure extends the period that trading losses from companies, partnerships and self-employed traders can be carried back by a further two years. Losses generated in 2020-21 and 2021-22 can now be offset against liabilities from 2017-18 to 2019-20 rather than just 2019-20. The measure applies to self-assessed income tax as well as CT. The amount that can be carried back to the two additional years is capped at £2 million a year.[8] Each of the elements in this costing are uncertain. The data are highly uncertain since HMRC does not hold full administrative tax data for 2020-21, and will not do until 2022 for income tax. The amount of losses that have been or will be generated is itself dependent on uncertain external factors such as the path of the virus, the resulting level of restrictions and the extent of government support schemes. These uncertainties result in a costing that relies on several assumptions and judgements. We assign it a 'very high' uncertainty rating overall, with both modelling and data rated as 'very high'.

HMRC and DWP compliance measures

A.19 The Government has announced a package of measures designed to generate additional revenue and savings from HMRC and DWP compliance activity. Compliance measures are often subject to a high degree of behavioural uncertainty since they are targeting a subset of individuals or companies that are already actively changing their behaviour to avoid or evade tax or engage in benefit fraud. This kind of uncertainty applies to **'OECD Mandatory Disclosure Rules'**, **'VAT: power to tackle Electronic Sales Suppression (ESS)'**, **'HMRC: investment in compliance'** and **'DWP: investment in compliance'**. The **'interest harmonisation and tax penalty reform'** measure is subject to a different kind of behavioural uncertainty that relates to how taxpayers will respond to a change in HMRC's penalty regime.

A.20 Since compliance measures are directed at uncollected tax or fraudulent benefit claims, there is usually less reliable data available to inform the costing. For example, the ESS measure relies on limited data on the number of businesses that engage in sales suppression. To overcome these challenges many compliance measures rely on complex multi-stage modelling and assumptions that are difficult to test. They are often also subject to uncertainty around operational delivery, such as new IT systems. For example, the costing for the penalty reform measure is tied in with the delivery of HMRC's 'making tax digital' initiative, which is itself uncertain.

Other highly uncertain measures

A.21 The uncertainty around the **state pension underpayment** is described above. The other measures subject to a 'high' or 'very high' uncertainty rating are:

- **'Red Diesel: exemptions':** this measure extends the red diesel relief to fairgrounds, winter wonderlands, circuses, amateur sports clubs, golf clubs, and inland passenger ferries. The main uncertainty in this costing relates to the paucity of reliable data, meaning the estimate of the affected tax base had to be pieced together from a variety

[8] Groups will also be subject to a cap of £2 million a year.

of sources overlaid by uncertain judgements. Overall, we assign this costing a 'very high' uncertainty rating, with data uncertainty also 'very high'.

- **'Stamp duty land tax: maintain nil rate band at £500k until June 2021, £250k until 30 September 2021':** this extension to the stamp duty land tax (SDLT) holiday is given a 'high' uncertainty rating. Previous SDLT changes have demonstrated that buyers will try to bring forward their transactions to benefit from the lower amount of tax that is due. The extent of this behaviour and how it unwinds once SDLT thresholds return to their pre-holiday levels is the main uncertainty.

- **Government-backed loan schemes:** the Government has extended its existing virus-related loan schemes by two months to the end of 2020-21 and has introduced a new Recovery Loan Scheme that will succeed the existing schemes and will run until the end of 2021.[9] The main components of these costings are assumptions about the amount of loans guaranteed and fiscal loss rates (combining overall loss rates with the proportion that is covered by the government guarantee). Loss rates determine the Exchequer cost and are the most uncertain aspect of the costing. We have used past evidence to guide our assumptions but there is limited historical information to confidently reference against in these extraordinary circumstances. The assumed volume of lending under the new scheme is based on recent months' experience with the existing ones, but it is difficult to know how demand for loans might evolve as the output recovers – especially given the strong incentive to bring forward investment created by the temporary capital allowances super deduction. The ONS decision to record expected write-offs in the year that the guarantee was made means that all these uncertainties apply to large costs recorded in 2020-21 and 2021-22, but the true costs of calls on these guarantees will not be known for several years.

- **Pensions lifetime allowance (LTA) freeze**: this measure freezes the limit on the amount of tax relieved pension savings an individual can accumulate over their lifetime at its current level of £1,073,100 until 2025-26. This generates an Exchequer yield via additional income tax and NICs receipts from individuals reducing their pension contributions, as well as from LTA charges paid by those who accumulate pension savings above the limit. The main reason we assign this costing a 'high' uncertainty rating is around the extent of the behavioural response.

- **'COVID-19: HMRC exemptions'**: the main element of this measure is extending employer-provided and employer-reimbursed Covid tests into 2021-22. The data are of 'high' uncertainty because employers are not required to report payments or reimbursements to HMRC now that they are exempt from tax. There are also uncertainties around the variation in the price of tests and the likelihood of employers continuing to provide or reimburse these tests throughout 2021-22. We give this costing a 'high' uncertainty rating.

[9] The three existing schemes are the Bounce Back Loan Scheme, the Coronavirus Business Interruption Loan Scheme, and the Coronavirus Large Business Interruption Loan Scheme.

Update on previous measures

A.22 We cannot review and re-cost all previous measures at each fiscal event (the volume being too great), but we do look at any where the original (or revised) costings are under- or over-performing, and at costings that were identified as particularly uncertain.

Recostings of virus-related support measures

A.23 As we set out in Chapter 3, the cumulative cost of the Government's virus-related support measures has risen to £344 billion, with several measures being extended in this Budget. But the cost of those measures that were included in our November forecast has actually fallen considerably, lowering the 2020-21 cost by £33 billion.

A.24 Table A.5 shows that the main changes are due to:

- A **reduction of £12 billion due to virus-related DEL budgets being underspent** by more than expected, as spending by those departments most heavily involved in the Covid response has not risen quite as sharply as planned (see Chapter 3).

- The **net cost of the CJRS to March 2021 has fallen by £3.5 billion** relative to our November forecast, as the scheme was used less heavily during November and December than we expected, though that is partly offset by upward revisions to the monthly costs for January to March to reflect the third lockdown.

- The latest data suggest **take-up of HMRC's online self-serve time-to-pay facility has been considerably lower than we expected**. This has led to self-assessed income tax receipts being revised up by £3.9 billion in 2020-21, down by £4.5 billion in 2021-22 and up again by £0.7 billion in 2022-23. The modest reduction in the net cost reflects the fact that a proportion of the tax deferred is assumed to go unpaid, so while the timing effect is large, the impact on the overall costing is small, reducing it by £0.1 billion.

- We have **revised down the costs relating to Government-backed loan schemes by £4.8 billion** for 2020-21, as take-up of the Bounce Back Loan Scheme has been lower than expected. The loans are guaranteed by Government, so any that are written off generate a cost to the Exchequer. The ONS has determined that the costs will score in the year that the guarantees are issued, rather than when the default takes place, meaning the estimate will continue to be revised for several years.

- The **net costs relating to the first three rounds of SEISS grants is £1.1 billion lower than expected**. Take-up has been lower than we assumed, and progressively lower from one grant to the next, falling from 77 per cent for the first grant to 69 per cent for the second and 65 per cent for the third. This is likely to be because sectors such as construction have faced lighter restrictions than they did during the initial lockdown. Take-up of the third grant may also have been affected by tighter eligibility rules, something that was not brought to our attention when scrutinising the initial costing.

- The news that **some large retailers will not take advantage of the business rates holiday is expected to result in over £2 billion being returned to the Exchequer**. For statistical purposes, these are recorded as gifts rather than additional business rates revenue, since the companies in question do not have a tax liability this year.

- The costing for the **temporary cut to VAT for the hospitality, accommodation and attractions sectors (to March) has been revised up by £0.5 billion**. This is largely due to incorporating the latest economic data, particularly newly available sectoral GDP outturns. These suggest the initial costing underestimated the pre-measure tax base.

- The **stamp duty holiday (to March) is due to cost £0.4 billion more in 2020-21** than we expected in our November forecast. This is mostly due to both house prices and residential property transactions being higher than we expected, with the latter rebounding once restrictions had been eased, partly as a result of the measure.

- The cost of the measure providing a relief from **import VAT and customs duty for medical equipment has been reduced by £150 million**. The change simply reflects outturn data that show import volumes were lower than expected.

Table A.5: Recostings of virus-related support measures

		£ billion					
		Forecast					
	Head	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
November costings		-280.0	-52.7	-1.9	-0.7	-0.7	-0.5
Restated November costings		-246.7	-50.1	-1.2	-0.7	-0.7	-0.5
Difference		**33.3**	**2.5**	**0.7**	**0.0**	**0.0**	**0.0**
of which:							
DEL underspend	Spend	12.0	0.0	0.0	0.0	0.0	0.0
Loan schemes	Spend	4.8	0.0	0.0	0.0	0.0	0.0
CJRS[1]	Spend	3.5	0.0	0.0	0.0	0.0	0.0
Self-serve time-to-pay	Tax	3.9	-4.5	0.7	0.0	0.0	0.0
SEISS[1]	Spend	1.1	-0.1	0.0	0.0	0.0	0.0
Business rates holiday	Spend	0.9	1.5	0.0	0.0	0.0	0.0
VAT: reduced rate for hospitality	Tax	-0.5	0.0	0.0	0.0	0.0	0.0
Stamp duty holiday	Tax	-0.4	-0.1	0.0	0.0	0.0	0.0
Other measures	Tax/ spend	8.0	5.8	0.0	0.0	0.0	0.0

Note: This table uses the convention that a negative sign implies a loss to the Exchequer (and is therefore an increase in PSNB).
[1] Measure has both tax and spend impacts and only the larger is identified.

Policy reversals

A.25 There are five measures in this Budget that fully or partially reverse past policy decisions:

- Six years ago, the **small profits rate of corporation tax** was phased out when the main rate of corporation tax fell to 20 per cent. It has been reintroduced in this Budget with a similar policy design.

- Three years ago, the then Chancellor introduced a **PAYE cap on the amount of payable R&D tax credit** that can be claimed by a company under the small or medium-sized companies scheme. This was itself a reversal of a 2012 decision to abolish the cap, and was designed to "*prevent abuse*". The cap has yet to be introduced but has already been relaxed twice. At Budget 2020 the Government decided that claims below £20,000 would not be subject to the cap, while in this Budget there are two further concessions relating to R&D carried out by 'connected parties'. These combined changes reduce the medium-term yield from the cap by around a half.

- One year ago, the Government removed **red diesel relief** from around three-quarters of existing consumption, to encourage energy efficiency. Agriculture, fish farming, rail and non-commercial heating retained the relief. In the Budget, it has reversed the effect of the measure for more sectors by extending relief to fairgrounds (including winter wonderlands), circuses, certain sports clubs and inland passenger ferries.

- Four months ago, our forecast included the removal of the **second-hand margin scheme** for VAT that applied to the sale of goods originating in Great Britain and sold in Northern Ireland. This applied particularly to the purchase of second-hand cars by dealers in Northern Ireland. That decision has now been reversed.

- Two months ago, the Government announced that following the conclusion of the UK-EU Trade and Cooperation Agreement the UK would not in fact be applying the EU Directive **'DAC 6'**. This measure, which we first included in our March 2020 forecast, involved the mandatory reporting of cross-border tax arrangements by 'intermediaries', and the Government's announcement is just a few weeks before the first disclosures were due in late January. We have removed its effects from our forecast.

Policy delays

A.26 To certify costings as central, we need to estimate when – as well as by how much – measures will affect the public finances. As we have set out in previous *EFOs*, many policy measures do not meet the timetable factored into the original costings – even where we have required greater contingency margins before certifying them. This continues to pose a risk to our forecast. Policy delays we have been notified about since November include:

- **Universal credit (UC) rollout**: the pandemic means the Government has delayed the managed migration phase of the UC pilot scheme until April 2022. While this is now almost three years later than first planned, it does not further extend the September 2026 end date, which remains nine years behind schedule.

- **Natwest Group**: the Government's disposal of former RBS shares has been further pushed back, and is now expected to conclude by 2025-26.

- **Tax credits: enhanced collection**: this Budget 2017 measure transfers debts owed by tax credits claimants from HMRC to DWP and has been beset by a series of

operational delays from the outset. The transfer of debts has been paused for much of 2020-21, initially as staff were redeployed to virus-related activity, and until there is a confirmed date for resumption we have removed its effects from the forecast.

Policy risks

A.27 Parliament requires that our forecasts only reflect current Government policy. As such, when the Government sets out 'ambitions' or 'intentions' we ask the Treasury to confirm whether they represent firm policy. We use that information to determine what should be reflected in our forecast. Where they are not yet firm policy, we note them as a source of risk to our central forecast. The full list of risks to this forecast and changes from previous updates is available on our website. Risks that are particularly large, have changed materially since our last forecast, or are new include:

- **The 'Augar' review of post-18 education funding** was launched in February 2018 and reported in May 2019. It made recommendations relating to skills, higher education, further education and student contributions. Those with significant fiscal implications include reducing the student fee cap to £7,500 a year and freezing it until 2022-23, and changes to repayment terms. The Government published an interim conclusion in January 2021 and plans to publish a full conclusion alongside the next Spending Review this autumn, which will "*include consideration of elements mentioned in the Augar Report*".

- **The 2018 McCloud-Sargeant ruling** concluded that transitional protections offered as part of the 2015 public service pension reforms were discriminatory. The Government published a consultation in July 2020 setting out two options to remedy the discrimination and a response selecting its favoured remedy was published in February 2021. But there is currently insufficient detail on how it will be implemented by schemes to cost its medium-term implications for public spending (see Box 3.5).

- In July 2020, **the Goodwin case** successfully challenged on the grounds of sexual orientation disparities in rights to survivor's benefits in the Teachers' Pension Scheme (TPS). A consultation is currently underway on options to remedy the discrimination in the TPS, but the Government believes that this will also need to be remedied in those other public service pension schemes where similar circumstances exist.

- In its November 2020 Bidding Prospectus for **'Freeports'**, the Government sought bidders for up to ten potential freeport locations, with the successful locations to be announced in Spring 2021. Further details have been announced in the Budget but came too late to be incorporated into our forecast. We will return to this in our next *EFO*.

- On 10 December 2020 the UK-EU Joint Committee that was tasked with overseeing the implementation of the **Northern Ireland protocol** published a series of decisions on how the protocol will operate. These included the creation of a new UK Trader Scheme to which businesses can self-declare when the goods they are moving from Great

Britain to Northern Ireland are not 'at risk' of onward movement into the EU. This prevents them being subject to EU tariffs. The Joint Committee decisions also included several temporary 'grace periods' requested by the UK Government. For example, supermarkets and their suppliers bringing agri-food into Northern Ireland from Great Britain have been granted a grace period until 1 April. Similarly, 'qualifying goods' in free circulation in Northern Ireland gain temporary 'unfettered access' to Great Britain. A recent Government letter to the European Commission requesting an extension of certain grace periods to 2023 suggests uncertainty over the longer-term implementation of the protocol will continue for some time.

- **Cladding tax.** On 10 February the Government announced further funding for the removal of unsafe cladding in the form of loans and grants. It also announced a new tax, intended to raise £2 billion over a decade. Details of the rate and precise mechanism of the tax are yet to be confirmed, so while the loans and grants are reflected in our forecast, the revenue remains a risk until decisions have been made on these policy parameters.

- The Government is reviewing the **bank surcharge** and intends to set out in the autumn how to ensure that the combined rate of tax on banks' profits does not increase substantially from its current level, that rates of taxation here are competitive with our major competitors in the US and the EU, and that the UK tax system is supportive of competition in the UK banking sector. Given the increase in the corporation tax rate, our forecast is based on corporation tax on banks' profits rising from 27 to 33 per cent in April 2023. If the Government's review deems that to be a substantial increase, it seems likely that the bank surcharge rate will be cut. Bank surcharge receipts rise to £1.4 billion in 2025-26.

A.28 The Government has announced that it will publish a number of **tax consultations** and calls for evidence on 23 March. In a letter to the Treasury Select Committee, the Financial Secretary to the Treasury stated that this would be "*an important part of the Government's 10-year tax administration strategy, 'Building a trusted, modern, tax administration system'*." These consultations are likely to point to future sources of policy risk to our forecasts.