A Summer Budget 2015 policy measures

Overview

A.1 Our *Economic and fiscal outlook (EFO)* forecasts incorporate the expected impact of the policy decisions announced in each Budget and Autumn Statement. In the run-up to each statement, 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 if 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 implement and which costings to include in its scorecard. We choose whether to certify the costings as 'reasonable and central', and whether to include them – or alternative costings of our own – in our forecast.

A.2 In this Budget, we have certified all but one of the costings of tax and annually managed expenditure (AME) measures that appear in the Government's policy decisions table as reasonable and central. We were unable to certify one element of the welfare savings package in the time available, but we have included the Treasury's estimate of its impact in our forecast and will return to the costing at our next forecast.

A.3 Table A.1 reproduces the Treasury's scorecard, with further details set out in Chapter 4 and in the Treasury's *Summer Budget 2015 policy costings document*, which summarises the methodologies used to produce each costing and provides some information on the main areas of uncertainty within each.

A.4 As in March, the policy costings scrutiny process was particularly difficult for this Budget as we were not given details of costings for a large proportion of significant policy measures until just before our deadlines. That contributed to us being unable to complete enough of the iterative process to reach a position where we could certify the costing that removes the first child premium in universal credit for new claims as reasonable and central.

A.5 The Treasury also informed us of a change to the detail of its announcement on the sales of RBS shares on 3 July – the deadline for delivering final policy decisions for inclusion in the forecast – in a way that was sufficient to push our forecast for public sector net debt as a share of GDP in 2019-20 from slightly higher than it had been in March to slightly lower.

Uncertainty

A.6 In order to be transparent about the potential risks to our forecasts, we assign each certified costing a subjective uncertainty rating, shown in Table A.1. These ratings range from 'low' to 'very high'. In order to determine the ratings, we have assessed 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.

Table A.1: Treasury scorecard of Budget policy decisions and OBR assessment of the uncertainty of costings

		Head	£ million						
			2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	Uncertainty
Personal tax									
1	Personal allowance: increase to £11,000 in 2016-17, with equal gains to higher rate taxpayers	Tax	0	-1,055	-1,160	-1,195	-1,160	-1,200	Medium
2	Higher Rate Threshold: increase to £43,000 in 2016-17	Tax	0	-90	-200	-190	-255	-310	Medium
3	Inheritance Tax: £1m couples allowance from 2020 through new main residence nil-rate band phased in from 2017	Tax	0	0	-270	-630	-790	-940	High
4	Pensions tax relief: restrict for gross income over £150,000 from 2016-17	Tax	-70	+260	+425	+900	+1,180	+1,280	Very high
5	Rent-a-room relief: increase to £7,500	Tax	0	-5	-10	-10	-10	-15	Medium
Childcare									
6	Childcare: 30 hour entitlement for working parents of 3 and 4 year olds	Spend	0	0	-365	-640	-660	-670	N/A
7	Tax Free Childcare: updated rollout	Spend	+165	+370	-95	-130	-90	-40	Medium-low
8	Adoption reform	Spend	-20	-20	0	0	0	0	N/A
Business and Growth									
9	Corporation Tax: reduce to 19% from 2017-18, and 18% from 2020-21	Tax	0	-10	-605	-1,600	-1,870	-2,475	Medium-low
10	Annual Investment Allowance: set at new permanent level of £200,000	Tax	-5	-215	-850	-895	-840	-795	Medium
11	Banks: 8% Corporation Tax Surcharge and changes to Bank Levy	Tax	0	+415	+555	+365	+225	+105	Very high
12	Corporation Tax: bringing forward payments for large groups	Tax	0	0	+4,495	+3,135	+140	+60	Medium-low
13	Employment Allowance: increase by £1,000 from 2016-17	Tax	0	-630	-670	-685	-700	-695	Medium-low
14	Oil and gas: expand investment allowance	Tax	*	-5	-5	-5	-5	-10	Medium-low
15	Transport for the North and Midlands Connect: set up costs	Spend	-15	-10	-10	0	0	0	N/A

Reformand sustainability									
16	Dividends tax: abolish credit, introduce new £5,000 allowance, and increase effective rates by 7.5pp	Tax	0	+2,540	-890	+1,120	+2,055	+1,960	Medium-high
17	Residential property: restrict finance relief to basic rate, phase from 2017	Tax	0	0	0	+225	+415	+665	Medium
18	Residential property: reform wear and tear allowance	Tax	0	0	+205	+165	+165	+170	Medium
19	Insurance Premium Tax: increase by 3.5pp to 9.5%	Tax	+530	+1,460	+1,510	+1,530	+1,550	+1,580	Medium-low
20	VED: reform for new cars purchased from 2017, hypothecated to roads fund from 2021	Tax	0	+250	+195	+670	+940	+1,425	Medium-high
Imbalances in the tax system									
21	Non-domiciles: abolish permanent status	Tax	0	0	-15	+475	+380	+385	Very high
22	Non-domiciles: IHT on UK residential property	Tax	-5	-5	+35	+100	+75	+85	Very high
23	Climate Change Levy: equal treatment for generators	Tax	+450	+490	+575	+685	+800	+910	Medium
24	Intangible assets: remove relief for new claims	Tax	+35	+100	+165	+220	+280	+320	Medium
25	Employment Allowance: withdraw from single person companies	Tax	0	+80	+95	+100	+105	+110	Medium-low
26	Tax Motivated Incorporation: reduction due to dividend tax reform	Tax	0	+190	+360	+445	+505	+565	Very high
Avoidance and tax planning									
27	Capital Gains Tax: avoidance by private equity and hedge funds	Tax	0	+265	+375	+390	+390	+375	Very high
28	Controlled Foreign Companies: loss restriction	Tax	+65	+140	+190	+165	+150	+150	High
29	Corporation Tax: intra-group transfers	Tax	+15	+30	+30	+20	+15	+15	Low
30	Indirect tax: overseas insurance	Tax	0	+5	+5	+5	+5	+5	Low
Evasion and compliance									
31	Large Business: enhanced compliance	Tax	0	+40	+170	+340	+480	+625	Medium-high
32	Specialist Personal Tax: enhanced compliance	Tax	0	+5	+40	+110	+195	+280	Medium-high
33	Wealthy: enhanced compliance	Tax	0	-65	+40	+185	+260	+280	High
34	Tackling illicit tobacco and alcohol	Tax	0	+15	+115	+285	+430	+450	High
35	Hidden economy	Tax	0	+15	+110	+195	+255	+285	Medium-high
36	Local compliance	Tax	0	+15	+135	+360	+640	+920	Medium-high

Welfare									
37	Uprating: freeze working-age benefits, tax credits and Local Housing Allowances for 4 years from 2016-17	Spend	0	+90	+940	+2,325	+3,885	+4,010	Low
38	Benefit cap: reduce to £20,000, and £23,000 in London	Spend	0	+100	+310	+360	+405	+495	Medium
	Tax credits and Universal Credit								
39	Limit child element to 2 children for new births in tax credits and new claims in UC	Spend	0	0	+315	+700	+1,055	+1,365	Medium-low
40	Remove family element in tax credits and UC, and the family premium in Housing Benefit, for new claims	Spend	0	+55	+220	+410	+555	+675	Medium-low
41	Increase tax credits taper rate to 48%	Spend	0	+1,475	+1,035	+600	+345	+245	Low
42	Reduce income thresholds in tax credits and work allowances in UC	Spend	0	+2,880	+3,060	+3,180	+3,310	+3,440	Medium-low
43	Reduce income rise disregard in tax credits	Spend	0	+170	+225	+250	+180	+110	Medium-low
44	UC waiting days: revised schedule	Spend	-5	0	0	0	0	0	Low
	Housing Benefit								
45	End automatic entitlement for out-of-work 18-21 year olds	Spend	0	0	+25	+35	+35	+40	Medium
46	Reduce social sector rents by 1% each year for 4 years from 2016-17	Spend	0	+165	+475	+875	+1,320	+1,445	Medium
47	Pay to stay: higher income social housing tenants to pay market rents	Spend	0	0	+365	+185	+245	+240	High
48	Limit backdating awards to 4 weeks	Spend	0	+10	0	*	*	*	Medium-low
49	Support for Mortgage Interest: change from welfare payment to loan; maintain capital limit at £200,000	Spend	0	-30	-35	+270	+255	+255	Medium-high
	Employment and Support Allowance								
50	Align Work-Related Activity Group rate with JSA for new claims	Spend	0	0	+55	+225	+445	+640	Medium-low
	Other								
51	UC parent conditionality from when youngest child turns 3	Spend	0	0	-5	-5	+35	+30	High
52	Fraud, error and debt: tax credits changes	Spend	+60	+55	+30	*	*	*	Medium

Changes to spending									
53	In-year savings[2]	Spend	+2,595	0	0	0	0	0	N/A
54	HMRC funding	Spend	-60	-225	-270	-270	-265	-255	N/A
55	Discretionary Housing Payments	Spend	0	-150	-185	-170	-155	-140	N/A
56	Other welfare funding - including Youth Obligation and extra JCP support	Spend	-10	-100	-205	-285	-300	-325	N/A
57	TV Licence: BBC funding for over-75s	Spend	0	0	0	+200	+445	+745	Medium
58	Efficiency and reform	Spend	-55	0	0	0	0	0	N/A
59	Equitable Life: doubling payments to Pension Credit recipients	Spend	-50	0	0	0	0	0	Medium-low
60	Royal Mail share scheme	Spend	-50	0	0	0	0	0	N/A
	TOTAL POLICY DECISIONS		**+3,570**	**+9,075**	**+11,035**	**+15,095**	**+17,065**	**+18,885**	
	Total spending policy decisions		+2,590	+5,095	+5,945	+8,270	+11,280	+12,415	
	Total tax policy decisions		+980	+3,980	+5,090	+6,825	+5,785	+6,470	
	Total welfare policy decisions		*+55*	*+4,970*	*+7,015*	*+9,410*	*+12,070*	*+12,990*	
	Total receipts from avoidance and tax planning, evasion and compliance, and imbalances in the tax system		*+560*	*+1,320*	*+2,425*	*+4,080*	*+4,965*	*+5,760*	

** Negligible*

[1] *Costings reflect the latest economic and fiscal determinants.*

[2] *This measure forms part of the £3 billion departmental savings identified in 2015-16. See also the financials transactions policy measures table.*

A.7 Table A.2 shows the detailed criteria and applies them to a sample policy measure from this Budget: 'Insurance Premium Tax: increase by 3.5pp to 9.5%'. This is estimated to raise around £1.5 billion a year on average over the forecast period. For this policy we have judged that the most important source of uncertainty will be data, followed by behaviour, with the least important being modelling. The data used to estimate this measure are high quality HMRC administrative data on insurance premium tax (IPT) receipts, so we consider this to be a 'medium-low' source of uncertainty. The likely behavioural response is based on elasticities that have been estimated by HMRC. There is some uncertainty here because IPT receipts have fallen short of our forecasts since the main IPT rate was increased to 6 per cent in 2011-12. This could reflect changes in the insurance market or a bigger than expected behavioural response to that rate increase. But the costing is relatively insensitive to varying the assumed elasticities, so we deem this a 'medium' source of uncertainty. The modelling is based on a simple HMRC forecasting model, so we regard this as a 'medium-low' source of uncertainty. Taking all these judgements into account, we have assigned the costing an overall uncertainty rating of 'medium-low'.

Table A.2: Example of assigning uncertainty rating criteria: 'Insurance Premium Tax: increase by 3.5pp to 9.5%'

Rating	Data	Modelling	Behaviour
Very high	Very little data Poor quality	Significant modelling challenges Multiple stages and/or high sensitivity on a range of unverifiable assumptions	No information on potential behaviour
High	Little data Much of it poor quality	Significant modelling challenges Multiple stages and/or high sensitivity on a range of unverifiable assumptions	Behaviour is volatile or very dependent on factors outside the tax/benefit system
Medium-high	Basic data May be from external sources Assumptions cannot be readily checked	Some modelling challenges Difficulty in generating an up-to-date baseline and sensitivity to particular underlying assumptions	Significant policy for which behaviour is hard to predict
Medium	Incomplete data High quality external sources Verifiable assumptions	Some modelling challenges Difficulty in generating an up-to-date baseline	Considerable behavioural changes or dependent on factors outside the system
Medium-low	High quality data	Straightforward modelling	Behaviour fairly predictable
Low	High quality data	Straightforward modelling of new parameters for existing policy with few or no sensitive assumptions	Well established, stable and predictable behaviour
Importance	High	Medium	Low
Overall		**Medium-low**	

A.8 This Budget contained an unusually large number of HMRC compliance measures, which all shared a significant uncertainty associated with the baseline against which they should be assessed. In the absence of firm spending plans beyond 2015-16, it was not clear what should be assumed as the 'business as usual' compliance activity implicit in our pre-measures forecast. The approach we took to assuring ourselves that the scorecard measures were additional to the baseline is explained from paragraph A.17.

A.9 Using the approach set out in Table A.1, we have judged 12 measures in this Budget scorecard to have 'high' or 'very high' uncertainty around the central costing. These represent 24 per cent of the measures in the Budget by number and 14 per cent by absolute value (in other words ignoring whether they are expected to raise or cost money for the Exchequer). In net terms, they are expected to raise the Exchequer £12.3 billion in total over the forecast period. The measures are:

- **Non-domiciles: abolish permanent status**: This measure aims to increase the amount of tax paid by non-domiciled individuals on their worldwide income. It receives a 'very high' uncertainty rating. This arises from two main sources. First, HMRC does not hold detailed information on the value of offshore incomes and capital gains that would become subject to UK tax, so there is significant scope for error in the construction of the tax base. Second, the post-behavioural costing contains a particularly uncertain adjustment. There are four main potential responses considered in this costing: do nothing and pay the extra tax charge; increased tax planning; become non-resident for tax purposes; or leave the UK completely. The behaviour of high net worth individuals who are already actively altering their behaviour in response to the tax system is difficult to predict, especially in relation to how many will leave the UK as a result of this measure. The final scorecard costing of this package of measures that has been included in our forecast was more than 50 per cent lower than the (already uncertain) estimate of the static pre-behavioural costing;

- **Non-domiciles: IHT on UK residential property:** This measure receives a 'very high' uncertainty rating. It charges inheritance tax on UK residential property held indirectly through offshore structures by non-domiciles. The uncertainty in this costing arises from the behavioural response. It is assumed that most of the individuals who hold UK residential property in offshore structures are doing so to avoid inheritance tax. There is particular uncertainty around how many individuals will decide to 'de-envelope' their property, thereby no longer being liable for the annual tax on enveloped dwellings (ATED), and how many will find another way to avoid inheritance tax. Some of the behavioural responses designed to reduce future inheritance tax liabilities lead to more tax being paid over the short term. Again, the behaviour of high net worth individuals who are already actively altering their behaviour in response to the tax system is difficult to predict;

- **Capital Gains Tax: avoidance by private equity and hedge funds**: this measure receives a 'very high' uncertainty rating. It levies a capital gains tax (CGT) charge on the gains made by certain private equity and hedge fund managers. There is particular uncertainty around both the tax base and the behavioural response to the policy. The tax base has been imputed from external sources rather than detailed HMRC administrative data. There is a large, uncertain behavioural adjustment in this costing to reflect the established ability and willingness of these individuals to find new avenues of avoidance;

- **Banks: 8% Corporation Tax Surcharge and changes to Bank Levy**: this costing receives a 'very high' uncertainty rating, due to the element that imposes a surcharge of 8 per cent on the profits of banking companies. The yield from this measure is based on uncertain assumptions around the profitability of banks over the scorecard period – a key source of uncertainty in our corporation tax receipts forecast – and their behavioural response. In particular, we consider the modelling to be both complex and important for the costing. If the banking sector makes lower gross profits than expected over the next few years then the yield could be considerably lower. Similarly, a quicker return to historically normal levels of profits could push the yield higher;

- **Pensions tax relief: restrict for gross income over £150,000 from 2016-17:** This costing receives a 'very high' uncertainty rating. It restricts the tax relief on pension contributions available to additional rate taxpayers. HMRC does not hold detailed administrative data on the level of pension contributions that have been relieved at the additional rate. Highly complex modelling bringing together data from a variety of internal and external data sources was used to estimate the pension contributions targeted by this measure. The behavioural response is also particularly uncertain. The ability of individuals to tax plan around it is a key source of this extra uncertainty;

- **Tax Motivated Incorporation: reduction due to dividend tax reform:** This measure receives a 'very high' uncertainty rating. It captures an uncertain estimate of the behavioural response to a measure that we consider 'medium-high' uncertainty on its own. There is no agreed definition of a tax-motivated incorporation, so outturn estimates reflect HMRC judgements about the proportion of total incorporations that were tax motivated. And the modelling of how behaviour will be affected by changes in the tax system that alter the incentives to incorporate adds a further layer of uncertainty on top. The estimated effect of the overall scorecard on tax-motivated incorporations is set out from paragraph A.26;

- **Inheritance Tax: £1m couples allowance from 2020 through new main residence nil-rate band phased in from 2017**: This costing receives a 'high' uncertainty rating. It introduces a new relief from inheritance tax for main residences and extends the freeze of the existing nil rate band up until 2020-21. The main uncertainty is with the behavioural response of individuals. The costing rests on an uncertain judgement over how many individuals will restructure their wills in order to take advantage of the new relief. As noted in Box 3.3 in Chapter 3, this measure introduces new uncertainties into our economy forecast due to its potential effects on the housing market;

- **Tackling illicit tobacco and alcohol**: This package of measures receive a 'high' uncertainty rating. It provides HMRC with additional resource to tackle illicit tobacco and alcohol. The yields are based on how effective the additional resource will be at stopping illicit excise entering the UK market. The most uncertain part of the costing is the behavioural element. This includes both a displacement effect as criminals learn how to circumvent the rules and the response of individuals who will now be forced to buy higher priced duty paid goods. These effects reduce the final scorecard yield of the package;

- **Wealthy: enhanced compliance**: This package receives a 'high' uncertainty rating. It is another set of HMRC compliance measures. It includes extending the client relationship manager regime to another group of high net worth individuals and extra resource for HMRC to lead criminal investigations. This is based on uncertain assumptions around how many successful criminal cases HMRC can pursue in a given year. As each full-time equivalent compliance officer will only work a small number of complex high-yield cases, this assumption is sensitive to the assumed success rate, which could be higher or lower than factored into the costing. It is also based on how effective customer relationship managers will be at ensuring extra compliance from lower risk, less wealthy individuals;

- **Controlled Foreign Companies: loss restriction**: This package receives a 'high' uncertainty rating. The measure prevents a UK company from setting its own losses and surplus expenses, or those of other companies in its group, against its controlled foreign company (CFC) profits. The main uncertainty is with the data available to construct the tax base and the likely behavioural response. Any measure that targets companies already actively changing their behaviour in response to the tax system is particularly uncertain;

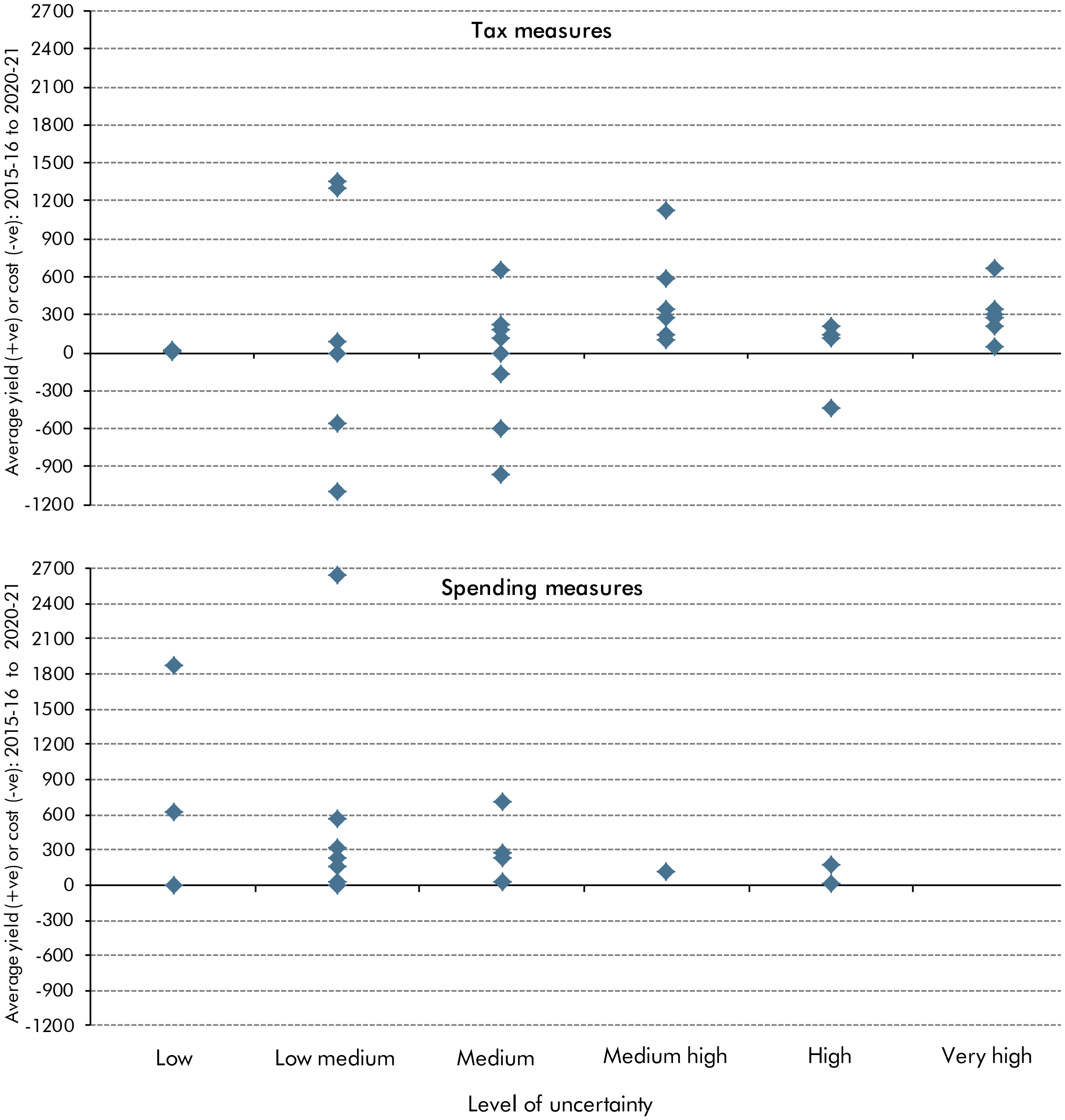
- **Pay to stay: higher income social housing tenants to pay market rents**: This costing receives a 'high' uncertainty rating. It requires social landlords to charge higher rents to households that earn above a defined threshold. The main uncertainties in the costing arise from the modelling assumptions and the behavioural adjustments. The baseline of the measure draws on 2012-13 data, so there is uncertainty in the modelling assumptions used to project the income levels of social tenants up to 2015-16 and beyond. The costing is sensitive to the amount of fiscal drag that has occurred in this group. There is also uncertainty around how individuals will behave. For example how many will choose to exercise their 'Right to Buy'; and

- **UC parent conditionality from when youngest child turns 3**: This costing receives a 'high' uncertainty rating. Under this policy, responsible carers claiming universal credit who have a youngest child aged 3 or 4 and whose household earnings are below the lower conditionality threshold will be placed in the 'intensive' rather than the 'work preparation' regime. The entire estimated saving from this measure reflects the assumed behavioural response from lone parents moving into work as a result of being placed into the 'work preparation' regime. DWP has good evidence on the impact of previous lone parent obligation changes, but it is not clear how applicable this is to parents with even younger children. They may face very different barriers of entry into the labour market.

A.10 We have judged 21 measures to have 'low-medium' or 'high-medium' uncertainty around the central costing, with a further five having 'low' uncertainty. That means that 67 per cent of the Budget measures have been placed in the medium range (74 per cent by absolute value) and 10 per cent have been rated as low (12 per cent by absolute value).

A.11 Chart A.1 plots these uncertainty ratings relative to the amount each policy measure is expected to raise or cost. One feature of the distribution of measures by uncertainty is that the welfare spending measures (as defined by the Treasury), which together are expected to raise £13.0 billion in the final year of the scorecard period, are typically assigned lower uncertainty ratings, while the tax raising measures, which together are expected to raise £15.9 billion in 2020-21 are typically assigned higher uncertainty ratings than the tax cuts. This is particularly true for the measures that aim to raise money from individuals with high incomes and high wealth who are already actively planning their affairs to reduce their tax liabilities.

Chart A.1: OBR assessment of the uncertainty of costings



Longer-term uncertainties

A.12 For most policy costings, the five-year scorecard period is sufficient to give a representative view of the long-term cost or yield of a policy change. Typically, that effect is either zero – because the policy has only a short-term impact that has passed by the end of the scorecard period – or it would be reasonable to expect it to rise broadly in line with nominal growth of the economy. In this Budget, the final year effects of most scorecard measures are representative of the longer-term cost or yield.

A.13 There are two measures that convert public spending into loan schemes. Within the scorecard period, these reduce spending (which lowers PSNB) and increase government lending to the private sector (which raises net debt, but not PSNB). Beyond the scorecard period, there will be a PSNB cost associated with any loans that are written off. Specifically:

- **BIS: switching maintenance grants to loans**: This involves lending to students from lower-income households that would previously have received grants. On the assumption that lifetime earnings are positively correlated with parental household income, write-off rates on these loans would be higher than in the student loan population as a whole. Any PSNB cost of student loan write-offs does not occur until 30 years after the loan is made; and

- **Support for Mortgage Interest: change from welfare payment to loan; maintain capital limit at £200,000**: This converts the existing support for mortgage interest for people in receipt of specific benefits into a loan that is repayable after moving off benefits or when a property is sold. As a second-charge secured loan, write-off rates would be expected to be smaller than for an unsecured loan, but would still be likely to build beyond the scorecard period as the stock of outstanding loans increases over time.

Small measures

A.14 The BRC has agreed a set of conditions that, if met, allow OBR staff to put an individual policy measure through a streamlined scrutiny process. These conditions are:

- the expected cost or yield does not exceed £40 million in any year;
- there is a good degree of certainty over the tax base;
- it is analytically straightforward;
- there is a limited, well-defined behavioural response; and
- it is not a contentious measure.

A.15 A good example of a small measure announced in this Budget is the 'Corporation Tax: intra-group transfers', which clarifies the tax treatment of transfers between related or connected parties of trading stock and intangible fixed assets. This costing was based on known avoidance by the groups involved in this behaviour. The modelling is straightforward and the behavioural adjustment involves assumptions about the proportion of the yield that will be lost to attrition.

A.16 By definition, any costings that meet all of these conditions will have a maximum uncertainty rating of 'medium'.

HMRC operational measures

A.17 In this Budget, the Government has announced a package of measures designed to increase the level and quality of compliance activity carried out by HMRC. This was a particularly challenging set of measures to scrutinise ahead of the forthcoming Spending Review (SR). Without an explicit forecast of the compliance activity necessary to meet the assumptions implicit in our pre-measures forecast. Without knowing how HMRC's SR settlement will impact on its compliance activity, it was difficult to certify that the new activities would be truly additional.

A.18 In order to certify the measures that have been announced in the Budget, we needed to satisfy ourselves about both the baseline assumptions and that the scorecard measures would be additional to that baseline. This was done in two stages:

- we scrutinised evidence on the performance of HMRC compliance activity over the last Parliament and its implications for the compliance productivity growth that would be required to offset any staff reductions that follow in the SR. This is subject to significant uncertainty – HMRC's measure of compliance activity does not translate directly into the National Accounts receipts that we forecast and it relates to estimates of non-compliant activity that is itself difficult to measure. But we were satisfied that the assumptions that would be required about baseline activity were reasonable; and

- we asked the Treasury to provide assurances that HMRC would receive the funding necessary to achieve the baseline compliance activity implicit in our forecast. The Treasury has provided this assurance by stating that "*As well as announcing additional resource for the measures announced today on evasion and non-compliance, the Government is committed to providing HMRC with the funding it needs to maintain its current level of compliance performance, whilst making efficiencies. HMRC's compliance yield targets will increase to reflect the impact of the Budget measures*" and by setting out the resource and capital DEL it expects to provide in the SR for HMRC's compliance activity. The figures are shown in Table A.3.

Table A.3: HMRC compliance: DEL commitment and DEL elements of related measures

	£ million					
	Forecast					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
HMRC compliance baseline (RDEL)	1190	1150	1110	1085	1065	1045
Investment to support HMRC's operational package (RDEL)	50	165	215	220	225	225
Investment to support HMRC's operational package (CDEL)	10	60	55	50	40	30

A.19 There were numerous sources of uncertainty associated with this package of measures. General concerns related to the average yield of each additional full-time equivalent staff member and to implementation risks. In many cases we asked for costings to incorporate increased time lags before new staff were assumed to be fully productive, in line with previous experience of such operational changes. We also carefully considered the likelihood of diminishing returns from additional staff as they were assumed to be working progressively more difficult compliance interventions.

A.20 We have certified the yields presented in the Treasury scorecard for these measures as reasonable and central. We will return to these assumptions once HMRC's full SR settlement has been published.

Interactions

A.21 An added difficulty when estimating the effects of a package of measures is estimating the interactions between all the different elements of the package. For example, changing the parameters associated with one benefit may alter the caseload for another, which would affect the costing of a measure that targeted that caseload. The order in which the measures appear on the scorecard is therefore important when estimating interactions, as the measure scored first can affect the costing of those further down – but not vice versa.

Welfare package

A.22 In the run up to this Budget, we worked closely with HMRC, DWP and the Treasury to make sure that we captured all the relevant interactions in the costings and avoided double counting. An example of the type of interactions captured is that tax credit awards feed into the income calculation for housing benefit. This means that cuts to tax credits would – all else equal – result in a corresponding increase in housing benefit spending.

A.23 Interactions between different measures mean that the order in which they are scored (and in which they therefore appear on the Treasury scorecard) can make a potentially significant difference to the cost or saving attributed to each measure. The cut in the 'benefit cap' is a case in point. Logically, you might score the benefit cap last as it is a cap applied to people's aggregate entitlement to benefits once all other reforms have taken place. But the Treasury has chosen to place it part way through the scorecard. This increases the estimated savings, because the cap is assumed to apply to a more generous welfare system than that which will actually be in place following the enactment of all the Budget measures.

A.24 Table A.4 shows that the scorecard saving from the benefit cap increases to £495 million in 2020-21. But if it were in last place on the scorecard, reflecting the reduced generosity of other benefits and tax credits, the saving would be less than half as large at £195 million.

Table A.4: The effect of interactions on estimated savings from reducing the benefit cap

	£ million				
	Forecast				
	2016-17	2017-18	2018-19	2019-20	2020-21
No interactions	100	310	360	405	495
Estimate with main interactions	95	225	195	165	195
of which:					
Child tax credit	0	-40	-80	-115	-215
Other benefits	-5	-45	-85	-125	-85
Total difference from interactions	**-5**	**-85**	**-165**	**-240**	**-295**

A.25 It is important to remember that changing the order that measures appear on the scorecard will not alter the net impact of the package as a whole. If the benefit cap was scored last, then the measures that precede it on the scorecard would save correspondingly more.

Effect on tax-motivated incorporations

A.26 Within our receipts forecast, we include an expected flow of tax-motivated incorporations (TMIs) and their impact on receipts. When individuals choose to form companies to lower their tax bills, this reduces income tax receipts and NICs, but raises corporation tax receipts, with the net effect negative for receipts overall. Many measures announced in this Budget will affect the incentives to incorporate by altering the differential between the two tax regimes. Apart from 'Dividends tax: abolish credit, introduce new £5,000 allowance, and increase effective rates by 7.5pp' where the yields are shown separately in the scorecard, the TMI effects are included in the costs of these measures.

A.27 HMRC's TMI model was used to estimate the effect of changes in incentives on the flow of TMIs over the scorecard period and applied the new incentives to the flow. The results are shown in Table A.4. As with any forecast of a behavioural response to the tax system, these estimates are subject to significant uncertainty.

A.28 The largest additional incentive to incorporate comes from the cut in corporation tax rates, but this is more than offset by taxing dividends more heavily. Overall, we have judged the net effect of the measures affecting incorporation is to reduce the flow of TMIs with the resulting increase in tax receipts reaching £425 million in 2020-21.

Table A.5: Scorecard effects on tax-motivated incorporations

	£ million				
	Forecast				
	2016-17	2017-18	2018-19	2019-20	2020-21
Pre Measures TMI	-1055	-1235	-1400	-1515	-1660
Personal allowance: increase to £11,000 in 2016-17, with equal gains to higher rate taxpayers	0	0	0	0	0
Higher Rate Threshold: increase to £43,000 in 2016-17	0	-5	-5	-5	-5
Corporation Tax: reduce to 19% from 2017-18, and 18% from 2020-21	0	-35	-105	-125	-175
Employment Allowance: increase by £1,000 from 2016-17	0	-10	-10	-15	-15
Dividends tax: abolish credit, introduce new £5,000 allowance, and increase effective rates by 7.5pp	190	360	445	505	565
Employment Allowance: withdraw from single person companies	35	45	45	50	55
Post Measures TMI policy	-835	-880	-1030	-1100	-1235

Departmental spending

A.29 We do not scrutinise the costings of policies that reallocate spending within departmental expenditure limits (DELs), since the total cost or yield is wholly determined by a Government policy decision. Neither do we typically scrutinise the DEL implications of measures that affect current receipts or AME spending, where those are also wholly determined by Government policy decisions. (The HMRC compliance measures at this Budget have been an exception to this normal practice.) Instead we include the overall DEL envelopes for current and capital spending in our forecast, plus judgements on the extent to which we expect those be over- or underspent in aggregate. We judge – in line with historical experience and our recent forecasts – that they will be modestly underspent in 2015-16.

A.30 Beyond the current SR period from 2016-17 onwards, the Government provides us with figures for the amount of departmental spending that it assumes it would wish to spend. These do not appear on the Treasury's scorecard, but we show changes in them as the effects of Government decisions in our forecast (see Table 4.3).

Indirect effects on the economy

A.31 This Budget contains a number of policy changes that we have judged to be sufficiently large to justify adjustments to our central economic forecast. These include:

- the pace and composition of fiscal consolidation has changed significantly. Bigger cuts in public spending in 2015-16 have reduced quarterly growth in late 2015 and early 2016. The significant slowing in the pace of spending cuts thereafter has raised quarterly growth through the rest of 2016. We have assumed that changes in later years will have only small effects on growth as the Bank of England will be able to factor them into its judgements when setting monetary policy;
- our inflation forecast has been affected by a number of policy measures, the most significant of which have been the increase in vehicle excise duty rates in 2017 and the decision to force social sector landlords to reduce rents by 1 per cent a year from 2016. As these are administered prices, we have assumed that the Bank of England will look through these effects when setting monetary policy; and
- we have made small adjustments to our assumptions for structural unemployment and potential output in light of the Government's decision to introduce a Living Wage Premium on top of the National Minimum Wage for people aged 25 and over. The response of firms and the impact on the labour market are subject to significant uncertainty. Annex B describes how we have estimated these effects, and the uncertainties around them.