A Autumn Statement 2014 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 on the public finances. In the run-up to each statement, the Government provides us with draft estimates of the cost or gain from each measure it is considering. We discuss these with the relevant experts and then suggest amendments if necessary. After this scrutiny process is complete, the Government chooses which measures to implement and which costings to include in its table of policy decisions. We then choose whether to certify the costings as 'reasonable and central', and whether to include them – or alternative costings – in our forecast.

A.2 In this Autumn Statement, we have certified all the costings of tax and annually managed expenditure (AME) measures that appear in the Government's policy decisions tables as reasonable and central. These tables are reproduced in this annex as Tables A.1 and A.2, with further details set out in Chapter 4 of the *EFO* and in the Treasury's *Autumn Statement 2014 policy costings document*, which summarises the methodologies used to produce each costing and provides some information on the main areas of uncertainty within each.

Uncertainty

A.3 At past Budgets and Autumn Statements, we have used our annex in the Treasury's policy costings document to highlight costings that were particularly uncertain. In this *EFO*, we have introduced a more systematic and transparent assessment of the uncertainty around each costing, building on an approach developed by the Australian Parliamentary Budget Office. It is important to stress that all the costings remain central estimates and that any uncertainty lies on both sides: the measures could raise or cost more or less than expected.

A.4 Under our new approach, we have assigned each certified costing a subjective uncertainty rating, which are shown alongside the costings in Tables A.1 and A.2. These 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 measure. We take into account the relative importance of each source of uncertainty for each costing.

Table A.1: HM Treasury table of Autumn Statement policy decisions and OBR assessment of the uncertainty of costings

		Head	£ million						
			2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Uncertainty
Households									
1	Personal Allowance: increase to £10,600 in 2015-16 with full gains to higher rate taxpayers	Tax	0	-530	-635	-640	-655	-655	Medium
2	ISAs: transfer to surviving spouses	Tax	0	*	*	-5	-5	-10	Medium
3	Air Passenger Duty: exempting children	Tax	0	-40	-80	-85	-90	-95	Medium-low
Property									
4	Stamp duty land tax reform: new marginal rate system	Tax	-395	-760	-840	-850	-815	-785	Medium-high
5	Enveloped dwellings: increase charge for properties over £2m	Tax	+10	+95	+50	+45	+90	+140	Medium
Business and employment									
6	Employer NICs: abolish for apprentices under 25	Tax	0	0	-105	-110	-120	-125	Medium-high
7	Business Rates: small business relief extension	Tax	0	-500	+70	+5	0	0	Medium-low
8	Business Rates: cap increase at 2% in 2015-16	Tax	0	-125	-90	-85	-85	-85	Low
9	Business Rates: increase retail discount to £1,500 in 2015-16	Tax	0	-130	+20	+5	0	0	Low
10	Business Rates: transitional relief	Tax	0	-10	-5	0	0	0	Medium-low
11	Employment Allowance: extend to carers	Tax	0	-10	-10	-10	-10	-10	High
12	R&D tax relief: increase large firms and SME credit	Spend	0	-40	-	-	-	-	Medium-low
13	R&D tax relief: changes to qualifying expenditure	Spend	0	+20	-	-	-	-	Medium
Investment and growth									
14	High value manufacturing catapult	Spend	0	-25	-	-	-	-	N/A
15	R&D: innovation funding	Spend	0	-70	-	-	-	-	N/A
16	Higher education: postgraduate loans	Spend	0	-15	-	-	-	-	N/A
17	Entrepreneurs' Relief: reinvested gains	Tax	0	0	-5	-5	-5	-5	Medium-low
18	Social investment tax relief	Tax	0	0	-10	-15	-20	-25	Medium-high
19	Peer-to-peer lenders: bad debt relief	Tax	0	0	-10	-15	-20	-25	Medium
20	Supporting first-time exporters	Spend	0	-20	-	-	-	-	N/A

Energy and environment									
21	Oil and gas: 2% cut to Supplementary Charge	Tax	0	-55	-60	-50	-65	-60	Medium-low
22	Oil and gas: support for investment	Tax	0	-5	-15	-15	-10	-95	Medium-high
23	Household energy efficiency incentives	Spend	-30	-70	-	-	-	-	N/A
24	Support for off-gas-grid households	Spend	0	-30	-	-	-	-	N/A
25	Corporation tax: flood defence relief	Tax	*	-5	-5	-5	-5	-5	Medium
Community									
26	Schools and children	Spend	0	-40	-	-	-	-	N/A
27	Culture and sport	Spend	-5	-30	-	-	-	-	N/A
28	Listed places of worship: support for repairs	Spend	-15	*	-	-	-	-	N/A
29	VAT: support for search & rescue and hospices	Tax	-5	-10	-5	-5	-5	-5	Low
Base erosion and profit shifting (BEPS)									
30	Diverted profits tax	Tax	0	+25	+270	+360	+345	+355	Medium-high
31	Corporation tax: hybrids	Tax	0	0	+15	+70	+85	+90	High
32	Corporation tax: country-by-country reporting	Tax	0	+5	+5	+10	+10	+15	Very high
Avoidance, tax planning and fairness									
33	Corporation tax: accounting treatment of credit losses	Tax	0	0	+5	+10	+240	+40	Medium
34	Corporation tax: bank losses restriction	Tax	0	+695	+765	+705	+695	+625	Very high
35	Non-domiciles: increase remittance basis charge	Tax	0	0	+120	+90	+90	+90	Medium
36	Self-incorporation: intangible assets	Tax	+5	+30	+80	+110	+135	+155	Medium
37	Investment managers' disguised fee income	Tax	0	*	+160	+80	+65	+55	Medium-high
38	Stamp duty on shares: schemes of arrangement	Tax	*	+65	+65	+55	+50	+50	Medium-high
39	Special purpose share schemes	Tax	0	0	+45	+40	+40	+40	Medium-high
40	Income tax: miscellaneous losses	Tax	0	+5	+5	+5	+5	+5	Medium
41	Venture capital schemes: restrictions on use	Tax	0	-15	+30	+10	+10	+10	Medium-high
42	Income tax: salary sacrifice and expenses, including umbrella companies	Tax	0	0	+120	+90	+75	+75	Very high
43	Office of Tax Simplification: review of expenses	Tax	0	-10	-5	-10	-10	-10	Medium
44	DOTAS regime changes	Tax	0	*	*	+30	+50	+70	High

45	HMRC: operational measures	Tax	0	-10	+260	+365	+145	+55	Medium-high
46	Corporation tax: accelerated payments and group relief	Tax	0	+425	-345	-40	-30	0	Medium-high
Previously announced									
47	Counter-terrorism funding	Spend	-20	-110	-	-	-	-	N/A
48	Pensions flexibility: decisions since Budget 2014	Tax	0	+60	-25	-25	+30	-10	Very high
49	Rail fares cap for 2015	Spend	-25	-95	-	-	-	0	N/A
50	Glasgow City Deal	Spend	0	-15	-	-	-	-	N/A
51	Migrant access to benefits	Spend	0	+15	-	-	-	-	Medium
52	Pool Reinsurance Limited: increased fee	Spend	+50	+175	+175	+175	+175	+175	N/A
Other									
53	Peer-to-peer lenders: withholding tax regime	Tax	0	0	0	+60	+10	+35	Medium
54	Public service pensions: next steps in revaluation	Spend	0	+335	+365	+375	+385	+390	Medium
55	Special Reserve	Spend	+200	0	-	-	-	-	N/A
56	Total fiscal impact of welfare cap measures[3]	Spend	-20	+150	-	-	-	-	See Table A.2
Health									
57	Foreign Exchange fines	Tax	+1,115	0	0	0	0	0	Low
58	NHS: fund to upgrade GP services[4]	Spend	0	-295	-295	-295	-295	0	N/A
59	Mental health and dementia	Spend	0	-45	-	-	-	-	N/A
TOTAL POLICY DECISIONS			**+865**	**-1,030**	**+75**	**+410**	**+450**	**+425**	
Total spending policy decisions			+130	-470	+240	+250	+260	+565	
Total tax policy decisions			+735	-560	-165	+160	+190	-140	
	Memo: NHS funding from the Reserve, reflected in 2015-16 spending numbers[4]	*Spend*	*0*	*-1,200*	-	-	-	-	

** Negligible*

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

[2] *Only spending numbers which directly affect borrowing in 2016-17, 2017-18, 2018-19 and 2019-20 are shown. All other spending measures do not affect borrowing as they fall within the Total Managed Expenditure assumption in those years.*

[3] *See Table A.2.*

[4] *Spending numbers include allocations for Scotland, Wales and Northern Ireland.*

Table A.2: HM Treasury table of welfare cap policy decisions and OBR assessment of the uncertainty of costings

		£ million						
		2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Uncertainty
Previously announced meaures								
a	Universal Credit: updated delivery schedule[3]	*0*	+55	+425	+915	-110	-395	Medium-high
b	Universal Credit: supporting 85% of childcare costs	*0*	0	-10	-130	-245	-310	Medium
c	Employment and Support Allowance: additional healthcare professionals	*0*	+30	+125	+95	+75	0	Medium
d	Employment and Support Allowance: restricting repeat claims	*0*	+25	+25	+10	+10	+15	Medium
e	Personal Independence Payment: updated delivery schedule	*-30*	-85	-45	-5	-10	0	Medium-low
f	Pensions flexibility: notional income rules for benefits	*0*	*	*	-5	-5	-5	Low
g	Bereavement benefits reform	*0*	0	0	-40	-35	-15	Medium-low
Universal Credit								
h	Simplifying assessment periods	*0*	-5	-10	-20	-25	-25	Medium
i	Work allowances: maintain current level in 2017-18	*0*	0	0	+60	+115	+145	Medium-low
Operational policy decisions								
j	DWP fraud and error: additional capacity	*0*	+45	+10	+5	-10	0	Medium
k	DWP fraud and error: local authority incentive scheme	*+10*	+65	+5	0	0	0	Medium
l	Tax credits: prevent overpayments following change of circumstances in-year	*0*	+60	+40	+30	+15	+10	Medium-low
m	Tax credits: self-employment tests for Working Tax Credit	*0*	+45	+45	+30	+15	+10	Medium-high
Other policy decisions								
n	Pension credit passthrough	*0*	-10	*	+5	+10	+15	Low
o	Carer's allowance: higher earnings limit	*0*	-5	-10	-20	-20	-20	Medium
p	Welfare cap impacts of other policy decisions[4]	*0*	-15	-5	+20	+20	+10	N/A
	Total impact of policy decisions on welfare cap	*-20*	**+205**	**+595**	**+950**	**-200**	**-565**	
	Total fiscal impact of welfare cap policy decisions[5]	**-20**	**+150**	**-**	**-**	**-**	**-**	

** Negligible*

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

[2] 2014-15 is not covered by the welfare cap.

[3] This reflects the updated delivery schedule announced by the government in October 2014, and the OBR's additional judgements as set out in their Economic and Fiscal Outlook.

[4] This reflects the impacts on benefits within the welfare cap of non-welfare measures, such as the impact of the Personal Allowance changes on UC entitlement.

[5] This reflects the total impact (both inside and outside the cap) of the welfare measures in this table, including impacts on non-welfare cap benefits and DWP DEL funding.

A.5 Table A.3 shows the detailed criteria and applies them to a sample policy measure from this Autumn Statement: 'Air passenger duty: exempting children', which is estimated to cost £80 million a year on average over the forecast period. For this policy we have judged that the most important source of uncertainty will be modelling, followed by the data, with the least important being behaviour. The data used to estimate this measure are high quality HMRC administrative data, so we consider this to be a 'low' source of uncertainty. The likely behavioural response is reasonably clear: lower post-tax prices for children's flights would be expected to increase demand. But this has only a relatively small impact on the costing, so we deem this a 'medium-low' source of uncertainty. The modelling is more problematic, as assumptions have to be made about the proportion of children travelling in each APD band and how those will change over the forecast period. So we regard this as a 'medium' source of uncertainty. Taking all these judgements into account, we have assigned the costing an overall uncertainty rating of 'medium-low'.

Table A.3: Example of assigning uncertainty rating criteria: 'Air passenger duty: exempting children'

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 Few sensitive assumptions required	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	Low	Medium
Overall		**Medium-low**	

A.6 In this Autumn Statement, we have judged seven measures in the policy decisions table to have 'high' or 'very high' uncertainty around the central costing. These represent 12 per cent of the measures in the Autumn Statement by number and 16 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 £4.2 billion in total over the scorecard period. The reasons for their ratings are as follows:

- **pensions flexibility: decisions since Budget 2014**: This costing receives a 'very high' uncertainty rating. The yield over the scorecard period – and the resulting costs in the longer term – depends on take-up and on other behavioural responses. Some people will temporarily increase pension saving in order to benefit from tax-free lump sum withdrawals. It is possible that funds will be redirected from annuities and into other assets, such as other financial products or housing. It is also possible that such funds could be used to finance consumer spending;

- **corporation tax: bank losses restriction:** This costing receives a 'very high' uncertainty rating. The measure restricts banks' ability to set their accumulated losses off against their taxable profits. 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 to this measure. In particular, we consider the modelling to be both complex and important for the costing. If the banking sector makes higher or lower than expected gross profits over the next few years then the yield from this measure could be considerably higher or lower;

- **exemption on qualifying expenses:** This costing receives a 'very high' uncertainty rating. The measure replaces the 'dispensations' regime with an exemption for qualifying expenses payments, introducing a new rule that the exemption cannot be used in conjunction with salary sacrifice arrangements. HMRC does not hold detailed information in this area and so the costing relied on uncertain external data sources. There are also a large number of behavioural adjustments in the costing that reduce the post-behavioural yield significantly relative to the static costing and are subject with significant uncertainty;

- **base erosion and profit shifting – country-by-country reporting:** This costing receives a 'very high' uncertainty rating. The measure will result in UK multinational corporations filling in a template giving financial information, including tax paid, in each of the jurisdictions where they have a presence. There is considerable uncertainty around both the data and behavioural response in this costing. There is little information available to HMRC on the level of profit shifting that will be captured by this measure. This measure is expected to lead to increased compliance by multinational corporations whose behaviour is very hard to predict;

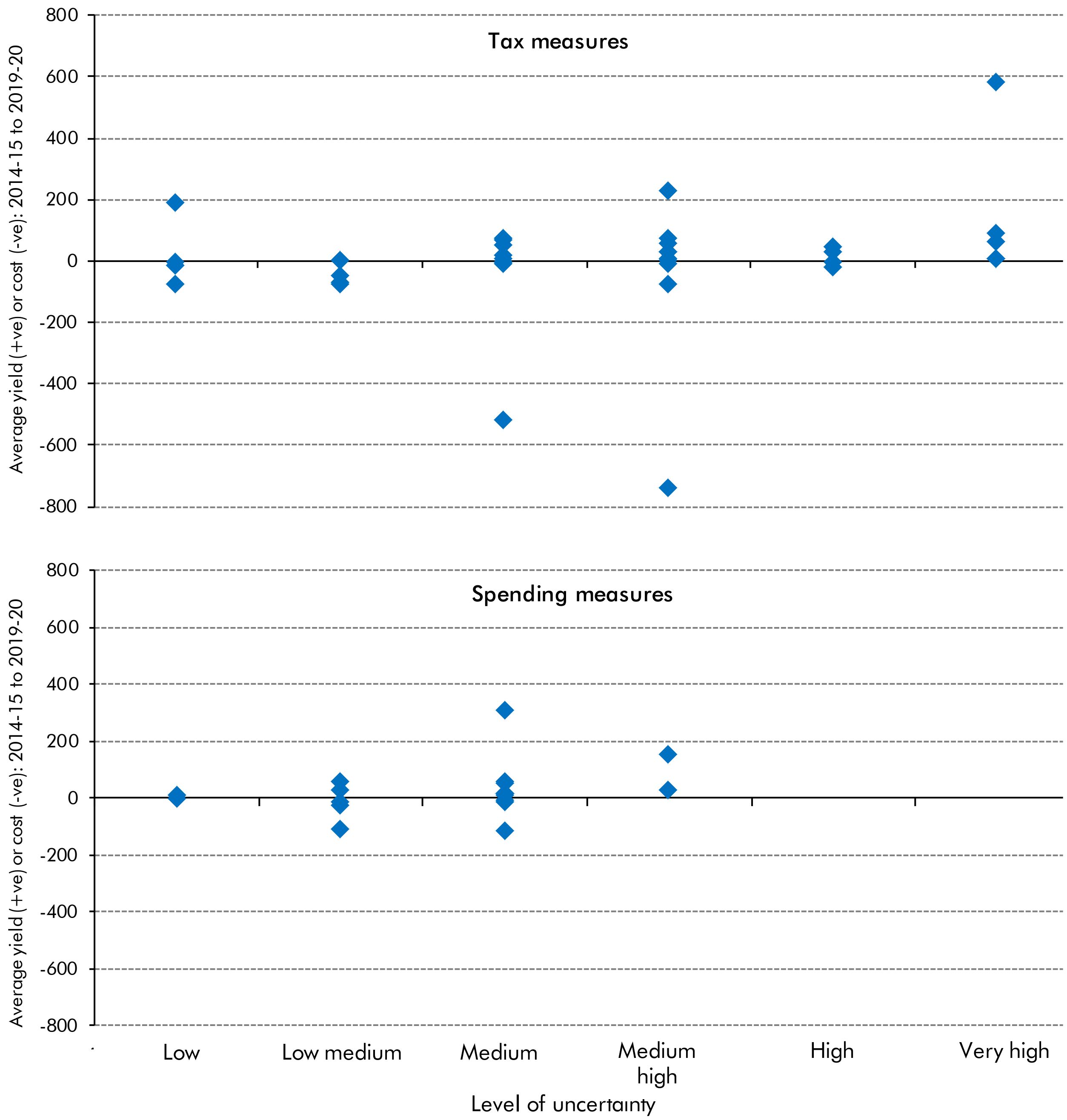
- **base erosion and profit shifting – corporation tax: hybrids:** This costing receives a 'high' uncertainty rating. The measure implements the proposed OECD rules on hybrid mismatch arrangements, used by companies to gain tax deductions in two jurisdictions for a single payment or to claim a deduction with no corresponding receipt. There is a high level of uncertainty with both the data and behaviour in this costing. The data used to produce the costing is based on incomplete HMRC data and external sources. The behaviour change is likely to be volatile and large due to the characteristics of the companies targeted by this measure;

- **employment allowance: extend to carers:** This costing receives a 'high' uncertainty rating. The measure extends the employment allowance to employers of domestic care workers. HMRC does not have detailed information on the amount of employers who will be affected and therefore the costing relies on uncertain external data sources; and

- **DOTAS regime changes:** This costing receives a 'high' uncertainty. The aim of this measure is to expand the existing set of DOTAS hallmarks to identify and tackle avoidance that is not being disclosed. There is likely to be a highly uncertain behavioural response as the DOTAS regime targets a specific subset of taxpayers who are already actively changing their behaviour in response to the tax system.

A.7 We have judged 23 measures to have 'low-medium' or 'high-medium' uncertainty around the central costing, with a further 6 costings having 'low' uncertainty. That means that 77 per cent of the Autumn Statement measures have been placed in the medium range (78 per cent by absolute value) and 11 per cent have been rated as low uncertainty (6 per cent by absolute value). Chart A.1 plots these uncertainty ratings relative to the amount each policy measure is expected to raise or cost.

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



Anti-avoidance costings

A.8 The revenue impact of anti-avoidance measures tends to be particularly uncertain. This has been borne out by an evaluation of past measures. The Treasury Select Committee's report on Autumn Statement 2013 recommended that we report on whether the yields from anti-avoidance measures were attained as originally costed. We have presented our findings in Box 4.2 of the *EFO*. This exercise has confirmed that such costings are subject to significant uncertainty – these measures often target a specific subset of taxpayers who are already actively changing their behaviour in response to the tax system. It also suggests that there has not been systematic bias across the costings: while the shortfall from the UK-Swiss tax agreement means that the total yield from the measures reviewed was lower than expected, across other measures there were both upside and downside surprises. We will continue to work with HMRC to review the performance of anti-avoidance measures and ensure that the lessons learnt are applied when we look at future policy costings in these areas.

Pensions flexibility measures

A.9 Our forecast reflects the expected effect of further changes to the rules governing people's access to their pension assets announced in the Autumn Statement, and an updated assessment of the effect of the changes announced in Budget 2014. Relative to the amounts incorporated in our March forecast, these effects are small. But both the latest adjustments and the original estimate are small relative to the uncertainty associated with the large financial flows that are likely to result from the changes. Among other effects, these include:

- flows out of pension assets for some people incentivised by the reduction in the tax charge and the removal of the requirement to annuitise, which could flow into other financial and real (e.g. housing) assets or immediate spending. Such withdrawals would raise income tax receipts as they happen, but reduce them later; and

- flows into pension assets for some people incentivised by the more flexible access to that tax-efficient saving in the future, which could reduce amounts that would have otherwise flowed into other financial and real assets, or spending if those people saved more to maximise their post-tax returns from this saving.

A.10 We have assumed that these flows will increase income tax receipts in the forecast period, but reduce NICs, which are only affected by greater flows into pension assets. We have also assumed that the effect of flows into other financial and real assets, and consumer spending, will net off. But that reflects the lack of any strong evidence to assume one effect will be larger than the other. In reality, the effect is very unlikely to be perfectly neutral.

Small measures

A.11 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 £25 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 behaviour response; and
- it is not a contentious measure.

A.12 The small measures process has been particularly helpful at this Autumn Statement due to the unusually large number of measures we have been asked to scrutinise.

A.13 A good example of a small measure announced at Autumn Statement 2014 is 'VAT refunds: search and rescue'. This costing was based on qualifying expenditure from published accounts, the modelling involves simple assumptions about the proportion of expenditure that is standard-rated for VAT, and there was judged to be no behavioural response that could plausibly lead to a cost above the small measures cap.

A.14 By definition, any costings that meet all of these conditions will have a maximum uncertainty rating of 'medium'.

Indirect effects on the economy

A.15 The measures in the Autumn Statement do not, in aggregate, alter our GDP growth forecast. The Government has announced a number of measures taking effect between 2014-15 and 2019-20 that are expected to have a neutral fiscal impact overall, with 'giveaways' offsetting 'takeaways' over this period. Further details are provided in Box 3.1

A.16 The immediate reforms to stamp duty land tax announced in the Autumn Statement are likely to have significant effects on the UK housing market. The main effect is likely to be distributional – house prices and transactions will be lifted at lower prices (where the effective tax rate has been reduced) and will be depressed at higher prices (where the effective tax rate has risen). These effects are reflected in the costing of the measure (described in Box 4.5) rather than via our economy forecast.

A.17 We have, however, increased the overall volume of property transactions by an eventual 1.1 per cent to reflect the fact that the volume-weighted effective tax rate has been reduced – i.e. that the costs associated with the vast majority of transactions will be slightly cheaper, more than offsetting the small number where they will be significantly more expensive. As property transactions contribute directly to the measure of residential investment in GDP, we have also adjusted our residential investment forecast upwards by an eventual 0.2 per cent. We assume that this affects the composition of GDP rather than the overall size of the economy, since we have not assumed that the policy raises whole economy productivity.

A.18 We have not adjusted our economy forecast in light of the further changes to the rules governing people's access to their pension assets announced in the Autumn Statement, or our updated assessment of the effect of the changes announced in Budget 2014.

Departmental spending

A.19 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 scrutinise the DEL implications of measures that affect current receipts or AME spending, where those are also wholly determined by Government policy decisions. 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. In this forecast, we judge – in line with historical experience and our recent forecasts – that they will be modestly underspent in 2014-15 and 2015-16.

Total managed expenditure beyond the Spending Review

A.20 Beyond the years for which the Government has set detailed spending plans, our forecasts are based on the Government's assumption for the growth in Total Managed Expenditure (TME). While changes in this assumption do not appear in the Treasury's table of policy decisions, they can lead to substantial changes in the implied envelopes for current and capital spending in our forecast. The changes that have resulted at this Autumn Statement are described in Chapter 4 of the *EFO*.