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Dear Dame Harriett,

2023-24 Supplementary Estimates

Thank you for your letter dated 13 May 2024 regarding some of the movements in the supplementary estimates for HM Treasury, please see the responses below.

Asset Purchase Facility

1. *Can you please explain what specifically has changed in HM Treasury's approach to budgeting for Resource AME movements relating to the APF, and why a change of methodology was necessary this year?*

The APF is a subsidiary entity of the Bank of England through which schemes such as quantitative easing (QE) are delivered by the Monetary Policy Committee (MPC). HMT indemnifies the APF, with the departments current exposure under the indemnity represented as a derivative within its accounts. The derivative is valued based on the difference between the fair value of the APF's assets and liabilities.

HMT has continued to develop its approach to budgeting for the APF in recent years, to balance the requirement for estimates to be taut and realistic with the volatility and scale of the APF. A new methodology was introduced for the 2022-23 supplementary, which forecasts the year-end value of the APF derivative under several different scenarios, and then compares this to the opening value, to arrive at a projected total movement in the value of the derivative over the financial year. This total movement is made up of fair value movements (i.e., the income and expenditure) of the APF (which impact Resource AME) and the partial settlement of the liability through cash payments to the APF (which impacts Capital AME). To arrive at a budget figure for Resource AME then, the total movement should be calculated, and the impact of cash payments (Capital AME) removed.

When the new methodology was introduced, no adjustment was made for the impact of cash payments. This represented a reasonable basis at that time since the net impact of cash transfers was immaterial (c.0.6% of total movement). The

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same approach was then adopted for the Main Estimate 2023-24. As the cash transfers became a significant component, the methodology was updated to include them as a more appropriate basis for calculating the Resource AME budget. This revised methodology was used at supplementary 2023-24.

Whilst HMT's budgeting methodology provides a way of setting budgets for the APF by forecasting possible changes in the value of the derivative on a prudent basis, the resulting outturn is dictated by market conditions and MPC decisions during the reporting period and is therefore outside of HMT's control and not bound by the budgeted value. Any change in methodology therefore is about better forecasting the budgetary implications of the APF and does not in any way impact its value, which is driven by actual fair value movements (i.e., the income and expenditure) of the APF (Resource AME) and the cash transfers between the APF and HM Treasury (Capital AME).

- 2. What impact has this change of methodology had on budgeted losses on the APF derivative during 2023-24, and what proportions of the additional £47 billion resource AME requested at the supplementary estimate resulted from the (i) methodology change and from (ii) movements in gilt yields respectively?*

Had we followed the revised methodology at the Main Estimate 2023-24, the Resource AME budget would have been in line with the revised supplementary request of £63.0bn.

The revision in the budget for the supplementary estimate is made up of an adjustment for cash transfers of £44.5bn, as well as a £2.5bn change in the value of the derivative resulting from movements in gilt prices and the expected path of interest rates. The Capital AME budget, for cash transfers between the APF and HM Treasury, has also been revised through the Supplementary, to align to overall realised cash transfers of £44.5bn. The £4.6bn reduction in Capital AME from the main estimate to the supplementary reflects both the movements in gilt prices and interest rates, and the removal of the element of prudence build into the main estimate.

Gilt prices fluctuated over the 2023/24 financial year, ending lower across the curve as the Monetary Policy Committee continued to increase Bank Rate during the first half of the year.

Movements in Provisions

- 3. HM Treasury has requested an additional £511.4 million Resource AME at the supplementary estimate, primarily to cover potential increases in provisions for future cash outflows under the Help to Buy ISA programme (£247 million) and the oil and gas decommissioning relief deeds programme (£268.5 million).*

The latest reported valuations of these two provisions in the 2022-23 HM Treasury Annual Reports and Account were £438 million (for Help to Buy ISA) and £82 million (for Oil and Gas), therefore the increases requested at the supplementary estimate would be for 56% and 327% year-on-year respectively. Can you provide further explanation as to why HM Treasury has budgeted for such significant increases in these provisions in 2023-24?

The Help to Buy: ISA scheme offers first time buyers government bonuses to be claimed on completion of a successful property purchase across the UK. The provision represents the best estimate at that point in time to settle future utilisations of government bonuses. Budget is required for movements in the provision, with cover for an increase of £247m included at Supplementary. The lower provision estimate at 31 March 2023 reflected a period in which bonus volumes had decreased following the impacts of cost-of-living pressures and muted housing activity on consumer behaviours. Based on more recent housing transaction data and saving habits within the scheme, the HTB: ISA provision has been raised as HMT expect a greater number of bonuses to be paid later in the scheme's lifespan than had originally been forecasted in light of more recent economic and scheme-specific trends. These assumptions are reassessed regularly in the year.

The provision for the Oil and Gas decommissioning relief deeds (DRD) covers future payments for existing, and in some cases future claims. Decommissioning relief deeds are contracts that the government has signed with oil and gas companies to provide certainty on the level of tax relief they will receive on future decommissioning costs, in turn unlocking capital for investment in the UK. As payments are made, the provision reduces. Were HMT to receive a new DRD claim and determine that the claim is valid, a provision for all future payments under that claim would need to be recognised at the outset. At the point of finalising the Supplementary, HMT was aware of a potential new claim, and as such sought sufficient budget cover to recognise the potential long-term liabilities if/ when required under IAS 37.

Tax Infraction Fine

- 4. HM Treasury requested an additional £27.8 million Resource DEL at the supplementary estimate to cover payment of a tax infraction fine to the EU. Can*

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you please explain to the Committee what this fine relates to and why HM Treasury has taken responsibility for paying it?

In October 2018, the Court of Justice of the European Union (CJEU) ruled that the UK was in breach of the Fiscal Marking Directive by allowing private pleasure craft such as motor cruisers, yachts, and narrowboats to use lower-taxed rebated ("red") diesel for propulsion. Prior to the 2018 judgment, the UK allowed users of private pleasure craft to purchase rebated diesel for propulsion and then pay the duty difference with full duty diesel. This was what the Court ruled as infringing the Fiscal Marking Directive in 2018, considering that it raised the risk of the fraudulent use of rebated diesel for which the duty difference was not paid.

The European Commission asked that the Court fine the UK €38.7m for delays in implementing the ruling. The final judgment of the Court was received on the 28 September 2023 and imposed a fine of €32m (£27.8m). The Withdrawal Agreement committed the government to meet any legal obligations incurred whilst a member of the EU. HMT has strategic oversight of the tax system, including responsibility for the scope of the red diesel entitlement, and as such HMT has met the obligation to pay in this case. The fine was paid in November 2023. Information on this case was made publicly available through the CJEU website, which publishes details of the Courts judgments.

I trust this additional information answers your queries, do please come back to me should you require anything further.



James Bowler
Permanent Secretary