

December 2014 Welsh tax forecast

The material in this note has been taken from the Devolved taxes forecast document published alongside the December 2014 Economic and fiscal outlook.

http://cdn.budgetresponsibility.independent.gov.uk/Devolved_taxes_Dec2014-web519.pdf

Introduction

- 1.1 The Command Paper: Wales Bill: Financial Empowerment and Accountability – published alongside the Wales Bill in 2014 – required us to begin to forecast Welsh taxes alongside Autumn Statement 2014 and twice a year thereafter. This will initially include forecasts for stamp duty land tax, landfill tax, aggregates levy and the Welsh rate of income tax. Our forecasts will reflect any Welsh replacement taxes – as with Scotland’s land and buildings transactions tax – when details of any changes become sufficiently clear. The Treasury will notionally assign these forecast receipts to the Welsh Budget to show how much of what is currently grant funding would be replaced by tax. Again, the Welsh Budget will not be varied in line with fluctuations in tax receipts until the devolution of these taxes has been fully implemented.
- 1.2 We published a methodology note in March 2012 that described how we planned to forecast Scottish tax receipts. It explained that it is not possible to replicate in full the methodology we use to produce our UK-wide forecasts. In particular, the macroeconomic data that we would need to produce a Scottish macroeconomic forecast and economic determinants were generally not available at a Scottish level or were only available with a long lag. That is also the case for Wales. We are therefore not able to produce a Welsh macroeconomic forecast to drive the Welsh tax forecast.
- 1.3 Given these challenges, the methodologies we use are generally based on estimating and projecting Welsh shares of relevant UK tax streams. We typically assume that the shares will continue at recent average levels, unless available evidence suggests we should adjust those assumptions to ensure our forecasts are central. For example, if a newly announced policy can be expected to have a disproportionate impact on the Welsh share of a particular tax, or there is evidence pointing to different trends in an underlying tax base.
- 1.4 As with our UK forecasts, the methodology and the forecasts represent the collective view of the three independent members of the OBR’s Budget Responsibility Committee (BRC). The BRC takes full responsibility for the judgements that underpin them.
- 1.5 We consider these methodologies to remain work-in-progress. The OBR’s role in forecasting has started well ahead of the initial devolution of these taxes in Wales. This will

allow us to develop and improve forecasts in light of experience and the availability of new information sources.

Forecast process

1.6 The process for producing the devolved tax forecasts has been as follows:

- HMRC officials produced a draft Welsh tax forecast using a near-final pre-measures UK economic and fiscal forecast. The BRC and OBR staff discussed these forecasts with HMRC and Welsh Government officials on 19 November; and
- in the final week before the Autumn Statement, HMRC officials provided us with a final set of Welsh forecasts using our final post-measures UK economic and fiscal forecasts, and taking into account Autumn Statement policy measures. Due to the confidentiality of the measures, we were unable to involve the Welsh Government in this stage of the process.

Table 1.1: Summary of December 2014 Welsh tax forecasts

	£ million					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Income tax	1930	1981	2092	2229	2364	2510
SDLT	165	168	190	211	231	246
Landfill tax	54	51	48	48	50	53
Aggregates levy	26	25	25	26	26	27
Total	2175	2225	2356	2514	2670	2836

Welsh rate of income tax

1.7 The Wales Bill includes provision for a referendum to determine whether the Welsh Assembly will be able to introduce a Welsh rate of income tax. The income tax levied by the UK Government would be reduced by 10p in the pound for those individuals defined as Welsh taxpayers. The Welsh Assembly would then levy separate Welsh rates for each band of income tax. The new Welsh income tax rates would need to be set every year by the Welsh Assembly. The block grant from the UK Government to Wales would then be reduced to reflect the fiscal impact of the devolution of these tax-raising powers.

1.8 The Autumn Statement 2014 forecasts assume that the referendum results in the implementation of a Welsh rate of income tax and that the Welsh Assembly then levies a 10p rate across all the income tax bands in every year.

1.9 We generate a UK forecast for non-savings, non-dividend income tax liabilities from the full UK income tax receipts forecast published in our EFO. The key components of the UK forecast are:

- total pay-as-you-earn (PAYE) liabilities;

- self-assessment (SA) liabilities on non-savings, non-dividend income. The forecast for SA in the EFO is on a receipts basis (i.e. when the cash is received). This is adjusted to be on a liabilities basis (i.e. when the activity occurred) and to exclude the savings and dividend elements of SA; and
- PAYE repayments and repayments to pension providers, from our income tax repayments forecast.

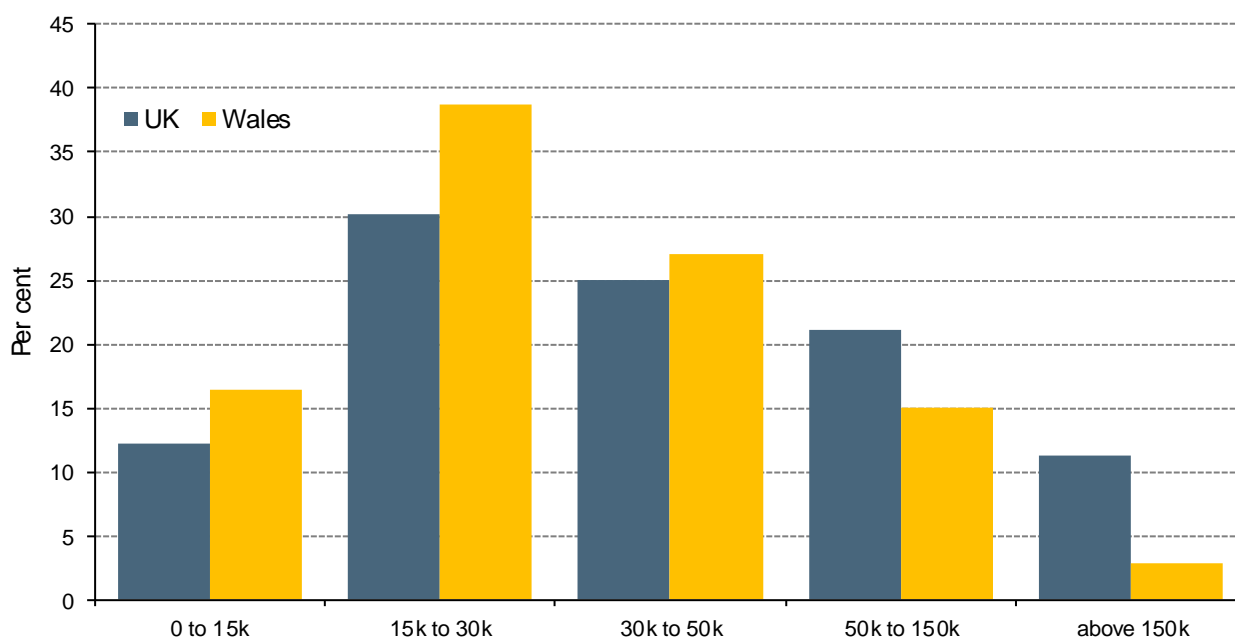
1.10 We then apply the latest estimated Welsh share to the UK total of these forecast components. We then include deductions in respect of the Welsh shares of Gift Aid repayments. Finally, we add estimates of the Welsh element of policy measures announced in Autumn Statement 2014.

1.11 Information on the share of UK income tax in Wales is derived from the Survey of Personal Incomes (SPI), an annual survey based on a sample of about 700,000 individuals in contact with HMRC during the course of the year through the PAYE, SA or repayment claim systems. This is only available with a long lag, with data currently only available up to 2011-12. An estimate for 2012-13 will be available for our next forecast. The Welsh share can be affected by a number of factors. These include:

- different economic trends between Wales and the UK as a whole;
- different movements in the income distribution between Wales and the UK; and
- different effects of policy measures.

1.12 Wales has a different distribution of taxpayer income from the UK as a whole. Chart 1.X shows that the proportion of taxpayer income generated from individuals with incomes below £30,000 is substantially higher in Wales than for the UK as a whole. In recent years, revenue-raising policies have generally affected the top end of the income distribution. These include the additional rate of income tax for incomes over £150,000, the withdrawal of personal allowances over £100,000, freezes in the basic rate limit and higher rate thresholds and anti-avoidance measures. In contrast, tax reductions such as raising the personal allowance have been concentrated at the lower end of the income distribution.

Chart 1.1: Proportion of total taxpayer income by income bands (2011-12)



Source: HMRC

1.13 Table 1.2 shows our forecast for the Welsh share of income tax. The asymmetric effect of policy measures over recent years is expected to reduce the Welsh share in the first half of the decade. We have not made any further adjustments.

Table 1.2: Welsh share of income tax

	Per cent of UK total of non-savings, non-dividend liabilities								
	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	1.37	1.36	1.29	1.29	1.28	1.28	1.28	1.28	1.29

1.14 Table 1.3 provides a forecast for Welsh income tax liabilities on non-savings, non-dividend income. These are the liabilities specifically for the Welsh rate. It assumes that a 10p rate is implemented by the Welsh Assembly. Matching the UK forecast, we expect more rapid growth in tax liabilities from 2016-17 onwards. With income more skewed to the bottom end of the income distribution in Wales, the raising of the personal allowance to £10,600 has a slightly larger than proportionate effect on Welsh income tax liabilities than in the rest of the UK

Table 1.3: Welsh income tax forecast

	£ million							
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Welsh income tax liabilities (pre-measures)	1902	1874	1930	1991	2098	2234	2370	2517
Autumn Statement 2014 measures	0	0	0	-10	-5	-5	-6	-7
Welsh income tax liabilities (post-measures)	1902	1874	1930	1981	2092	2229	2364	2510

Welsh SDLT

- 1.15 The Wales Bill provides for SDLT to be fully devolved to Wales in April 2018. The Welsh Assembly has not yet announced any change from the UK system. Until any announcements are made and sufficient detail is available, our Welsh forecast will assume that the new UK SDLT system would remain after the tax is fully devolved.
- 1.16 The Welsh SDLT forecast is based on a constant share of the UK SDLT forecast. The Welsh share of residential SDLT has drifted down over the past four years, primarily because of the strength of the London housing market. We assume that rises in house prices will be more evenly distributed across the UK over the rest of the forecast period. As a result, we hold the Welsh share constant at 1.4 per cent throughout the forecast period. The Welsh share of commercial SDLT is more volatile, so we use a three-year average and project this forward. A share of 2.3 per cent has been used across the forecast period.
- 1.17 We then included the assumed Welsh share of SDLT measures in order to produce the final post-measures forecast. It has been estimated from administrative SDLT data that the policy to change the UK SDLT regime will have a disproportionately large impact on Welsh receipts. This is because the distribution of house prices in Wales is skewed towards lower prices, where transactions will face lower tax rates under the new system. We assume this reduces the Welsh share of SDLT to 1.06 per cent from 2015-16 onwards. The Welsh share in 2014-15 has been adjusted down to 1.2 per cent from 1.4 per cent to reflect that the new SDLT regime will only be in place from 4 December.

Table 1.4: Welsh SDLT forecast

	£ million						
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Residential SDLT	90	106	107	124	142	158	171
Commercial SDLT	60	59	61	65	69	73	75
Total SDLT	150	165	168	190	211	231	246

Landfill tax

- 1.18 The Wales Bill provides for landfill tax to be fully devolved from April 2018. As with SDLT, we assume that the Welsh Assembly will implement the UK regime and forecast landfill tax on that basis. We will update this assumption when sufficient detail about any replacement tax is available.
- 1.19 The Welsh landfill tax forecast is produced by applying an assumption about the path of the Welsh share of landfill tax to the UK forecast.
- 1.20 UK forecast is compiled using a forecast for the tonnage of waste sent to landfill, which is multiplied by the appropriate tax rate. The tonnage forecast is generated from separate Department of Food, Environment and Rural Affairs (DEFRA) projections of municipal solid waste, and commercial and industrial waste, sent to landfill. The amount of municipal waste

going into landfill is determined by comparing the cost of alternative waste treatment options. DEFRA's models cover England, so are scaled up to get to a UK-wide forecast. The split between standard and lower tax rates is based on historical trends. The tax rates are assumed to be uprated in line with inflation in the absence of announced policy.

- 1.21 Prior to devolution, there is no directly available data on the Welsh share of landfill tax, since landfill operators provide data returns that cover sites throughout the UK. The Welsh share is calculated using data on the amount of waste sent to landfill available from the Environment Agency.
- 1.22 The proportion of Welsh waste sent to landfill has remained fairly constant over the last five years. We have assumed that the Welsh share will remain constant at 4.4 per cent over the forecast period. There are no relevant policy measures to be added to the forecast.

Table 1.5: Welsh Landfill tax forecast

	£ million						
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	52	54	51	48	48	50	53

Aggregates levy

- 1.23 The Government has committed to keeping the devolution of aggregates levy to Wales under review. It intends, subject to the resolution of a legal challenge in the European courts, to devolve this tax in the future. In the interim, the Treasury will assign aggregates levy receipts to Wales.
- 1.24 The UK forecast is generated from a projection of the tax base multiplied by the tax rate. An econometric model relates the sales of primary aggregates to construction sector growth. The model also allows for the usage of recycled aggregates to increase over time and for the substitution away from the extraction of primary aggregates. The tax rate is assumed to be uprated in line with inflation in the absence of announced policy.
- 1.25 To produce Welsh aggregates levy forecasts, we apply our assumptions of their respective share to the UK forecast. Data on the Welsh share of aggregates production is taken from the United Kingdom Mineral Yearbook 2013.
- 1.26 The Welsh share of aggregates tonnage has remained fairly constant over the past five years. We assume that the Welsh share will remain constant at 8.1 per cent over the forecast period. There are no relevant policy measures to be added to the forecast.

Table 1.6: Welsh Aggregates levy forecast

	£ million						
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	24	26	25	25	26	26	27