Office for
Budget Responsibility

Economic and fiscal outlook

Devolved taxes forecast

March 2015

1 Introduction

1.1 The Office for Budget Responsibility (OBR) was established in 2010 to provide independent and authoritative analysis of the UK's public finances. Twice a year, alongside the Budget and Autumn Statement, we produce forecasts for the UK economy and the public finances. We publish these in our *Economic and fiscal outlook (EFO)*.

1.2 Since 2012, we have forecast some tax streams that are devolved to the Scottish Parliament, and since last year we have also produced forecasts of taxes where there are firm plans for them to be devolved to the National Assembly for Wales. Our forecasts for devolved taxes are published alongside each *EFO* and are consistent with our main UK forecasts. As with those UK forecasts, these extend over a five-year forecast period – to 2019-20 in this *EFO*.

The Scotland Act 2012

1.3 The Scotland Act 2012 gave new powers to the Scottish Parliament relating to taxation and borrowing. From April 2015, stamp duty land tax (SDLT) and landfill tax will be fully devolved to Scotland. The Scottish Government has announced that it will replace SDLT with a new land and buildings transaction tax (LBTT) at that point. From April 2016, the Scottish Parliament will be asked to set a Scottish rate of income tax, to replace a 10p reduction from each band of UK income tax.

1.4 The Command Paper: *Strengthening Scotland's Future*[1] – published alongside the Scotland Bill in 2010 – set out our role in providing forecasts of Scottish income tax, landfill tax, stamp duty land tax and aggregates levy receipts. Currently, the Treasury notionally assigns these forecast receipts to the Scottish Budget to show how much of what is currently grant funding would be replaced by tax. The Scottish Budget will not be varied in line with fluctuations in tax receipts until the devolution of these taxes takes place.

The Wales Act 2014

1.5 The Wales Act 2014 gave new powers for the Welsh Assembly relating to taxation and borrowing. It provides for the full devolution of SDLT and landfill tax from April 2018. Subject to the outcome of a referendum in Wales on the introduction of Welsh rates of income tax, the Welsh Assembly will also be able to set new Welsh rates for each band of income tax that would replace a reduction in the rate of UK income tax. The timing of such a change has not yet been specified. The Government is also intending to devolve aggregates levy, subject to the resolution of current legal challenges.

[1] *Strengthening Scotland's Future*, November 2010, Cm 7973.

1.6 The Command Paper: *Wales Bill: Financial Empowerment and Accountability*[2] – 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 currently includes 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 LBTT – 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.

Methodology

1.7 We published a methodology note in March 2012 that described how we planned to forecast Scottish tax receipts.[3] 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 remains the case. We are therefore not able to produce a Scottish macroeconomic forecast to drive the Scotland tax forecast. These challenges apply equally to forecasting Welsh taxes.

1.8 Given these challenges, the methodologies we use are generally based on estimating and projecting Scottish and 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 Scottish or Welsh share of a particular tax, or there is evidence pointing to different trends in an underlying tax base.

1.9 The exception to this is our LBTT forecast. As the Scottish Government has to date only published a forecast of LBTT receipts for one year, we sought assistance from HM Revenue and Customs (HMRC) in producing a five-year LBTT forecast. As a new tax, this forecast will clearly be subject to even greater uncertainty than our previous forecasts for the Scottish share of UK SDLT receipts. That forecast was itself subject to considerable uncertainty given its sensitivity to the growth of property transactions, which can be volatile from year to year.

1.10 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.

1.11 We consider these methodologies to remain work-in-progress. The OBR's role in forecasting started three years ahead of the initial devolution of these taxes in Scotland. This has

[2] *Wales Bill: Financial Empowerment and Accountability*, March 2014, Cm 8838.
[3] *Forecasting Scottish taxes*, March 2012.

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

The forecast process

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

- HMRC officials produced draft Scottish and Welsh tax forecasts on our behalf using a near-final pre-measures UK economic and fiscal forecasts. This took into account the tax forecasts for 2015-16 contained in the Scottish Government's Draft Budget, published in October 2014. The BRC and OBR staff discussed these forecasts with HMRC, Scottish Government, Scottish Fiscal Commission and Welsh Government officials on 5 and 9 March; and

- in the final week before the Budget, HMRC officials provided us with a final set of Scottish and Welsh forecasts using our final post-measures UK economic and fiscal forecasts, and taking into account Budget policy measures. Due to the confidentiality of the measures, we were unable to involve the Scottish Government and Welsh Government in this stage of the process.

1.13 The Scottish Government produced a forecast for 2015-16 receipts from the new Scottish LBTT and landfill tax in its Draft Budget. The Scottish Government has not provided us with information about expected receipts from these taxes over the remainder of our five-year forecast period, so HMRC produced these forecasts at our request. We will continue to work with the Scottish and Welsh Governments, and with the Scottish Fiscal Commission, to ensure that we can bring all relevant information to bear in producing these forecasts. At this stage, the forecast we present in this document is our own. Differences between our own forecast and the Scottish Government forecasts for 2015-16 are explained in Chapters 3 and 4.

Summary of forecasts

1.14 Tables 1.1 and 1.2 detail the forecasts for the Scottish and Welsh taxes. This includes the Scottish share of SDLT receipts in 2014-15 and receipts from the new LBTT from 2015-16 onwards.

Table 1.1: Summary of March 2015 Scottish tax forecasts

	£ million					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Income tax	4379	4532	4791	5087	5370	5748
LBTT[1]	429	431	510	598	704	810
Landfill tax	104	100	77	83	86	92
Aggregates levy	57	55	55	55	56	57
Total	**4969**	**5118**	**5433**	**5823**	**6216**	**6707**

[1] Scottish share of SDLT in 2014-15

Table 1.2: Summary of March 2015 Welsh tax forecasts

	£ million					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Income tax	1910	1972	2084	2216	2344	2514
SDLT	166	165	188	221	259	295
Landfill tax	50	49	37	40	42	45
Aggregates levy	28	27	27	27	28	28
Total	**2154**	**2212**	**2337**	**2504**	**2672**	**2882**

Past forecast performance

1.15 As with our full UK forecasts, we believe it is important to look back at our forecasts for devolved taxes to understand the sources of errors and where possible to learn lessons that can be applied to future forecasts. We use the term 'errors' to describe the arithmetic difference between forecast and outturn, but that does not imply that it would have been possible to avoid those errors given the information available at the time – differences with outturn may reflect unforeseeable developments after the forecast was made. In our devolved tax forecasts, data limitations – not knowing recent history – are one factor that will affect the performance of our forecasts.

1.16 We now have full outturn data for Scottish tax receipts in 2012-13 (and provisional data on some taxes for 2013-14). In Box 1.1, we set out a preliminary analysis of the performance of our first Scottish tax forecast for 2012-13, which was published in March 2012.

Box 1.1: Evaluation of our March 2012 Scottish tax forecast

Table A presents our March 2012 forecast for Scottish tax receipts in 2012-13 and the estimated outturns published by HMRC. It shows that in total, receipts from Scottish taxes were over-estimated. By individual tax, it shows that:

- in absolute terms, the largest error (a £152 million over-estimate) was in the Scottish income tax forecast. In relative terms, that was a 3.4 per cent forecast error. It was more than explained by the error in our UK income tax forecast, which was related to the weakness of real earnings growth and the effective tax rate. The Scottish share of income tax is estimated to have been slightly higher than we assumed in our March 2012 forecast, partly offsetting the effect of lower UK receipts;
- Scottish SDLT receipts were the second largest source of error in absolute terms (£45 million). That was 14 per cent below forecast. In contrast to income tax, the error was more than explained by the Scottish share being lower than expected, while our UK forecast under-estimated actual receipts. Both factors are likely to reflect the strong pick-up in London house prices and the resulting rise in the share of SDLT receipts accounted for by London (from 38.9 per cent in 2011-12 to 41.4 per cent in 2012-13);
- Scottish landfill tax receipts were much lower than forecast (£26 million or 21 per cent). The main reason was our UK forecast being over-optimistic, but the Scottish share of those receipts was also lower than expected; and
- Scottish aggregates levy receipts were in line with forecast, as the effect of lower-than-expected receipts at the UK level was offset by a higher-than-expected Scottish share of those receipts.

Table A: March 2012 forecast errors on Scottish taxes

	Income tax	SDLT	Landfill tax	Aggregates levy
March 2012 forecast	4417	328	123	43
2012-13 outturn	4265	283	97	43
Error	-152	-45	-26	0
of which:				
UK forecast	-198	33	-22	-4
Scottish share	46	-78	-4	4

2 Income tax

Scottish rate of income tax

2.1 Under the Scotland Act 2012, the existing basic, higher and additional rates of income tax levied by the UK Government will from April 2016 be reduced by 10p in the pound for those individuals defined as Scottish taxpayers. The Scottish Parliament will then levy a new Scottish rate of income tax, which will apply equally to Scottish taxpayers in all of the main UK bands. The new Scottish rate of income tax will need to be set every year by the Scottish Parliament. The block grant from the UK Government to Scotland will then be reduced to reflect the fiscal impact of the devolution of these tax-raising powers.

2.2 The Scottish rate of income tax will be paid by Scottish taxpayers, who will be defined as a UK taxpayer either resident in Scotland or whose closest connection is with Scotland. It will be levied on non-savings, non-dividend income liabilities (i.e. earnings from employment, self-employment, pension income, foreign income, taxable benefits and income from property). Tax liabilities for a particular year would include both PAYE (largely paid in the same year as the activity that created the tax liability) and self-assessment (which is usually paid in the year after the activity that took place to create the tax liability).

2.3 In our forecast, we assume a 10p rate is levied in every year.

Welsh rate of income tax

2.4 The Wales Act 2014 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.

2.5 The forecasts presented in this document 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.

Methodology

2.6 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.

2.7 We then apply the latest estimated Scottish and Welsh shares to the UK total of these forecast components. We then include deductions in respect of the Scottish and Welsh shares of Gift Aid repayments. Finally, we add estimates of the Scottish and Welsh element of policy measures announced in Budget 2015.

2.8 Information on the share of UK income tax in Scotland and 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 2012-13. In the run up to the devolution of the Scottish rate of income tax, HMRC will identify each individual taxpayer as Scottish or not, and flag them as such on its PAYE and SA systems. Once this has been done, it will be possible to determine the Scottish share of UK liabilities with much greater precision.

2.9 The Scottish and Welsh shares can be affected by a number of factors. These include:

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

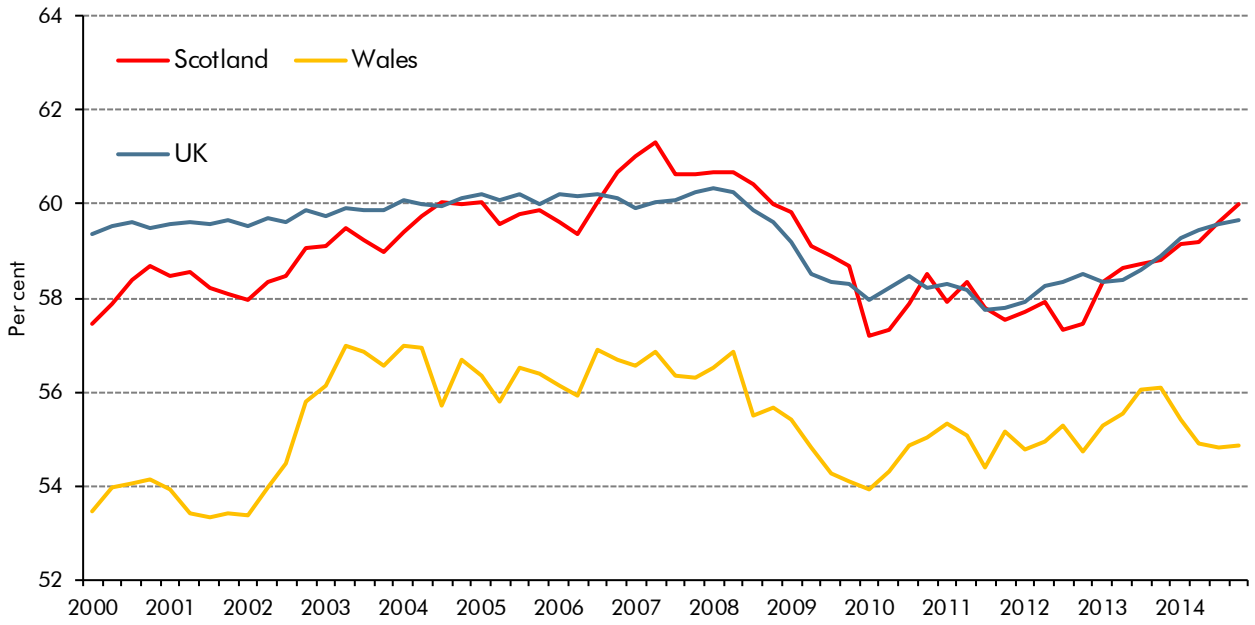
2.10 The Scottish share was very stable over the period from 2001-02 to 2010-11, with the share close to 3.15 per cent in most years. The share in Wales has varied more and there is some indication of a downward trend in the share from 2003-04. Table 2.1 shows the estimates of the Scottish and Welsh share from the SPI.

Table 2.1: Scottish and Welsh income tax shares

	Per cent of UK total for non-savings, non-dividend liabilities													
	99-00	00-01	01-02	02-03	03-04	04-05	05-06	06-07	07-08	08-09	09-10	10-11	11-12	12-13
Scotland	3.04	3.03	3.14	3.15	3.23	3.15	3.13	3.15	3.14	n/a	3.16	3.15	3.08	3.04
Wales	1.45	1.40	1.48	1.51	1.55	1.53	1.50	1.47	1.44	n/a	1.42	1.42	1.37	1.34

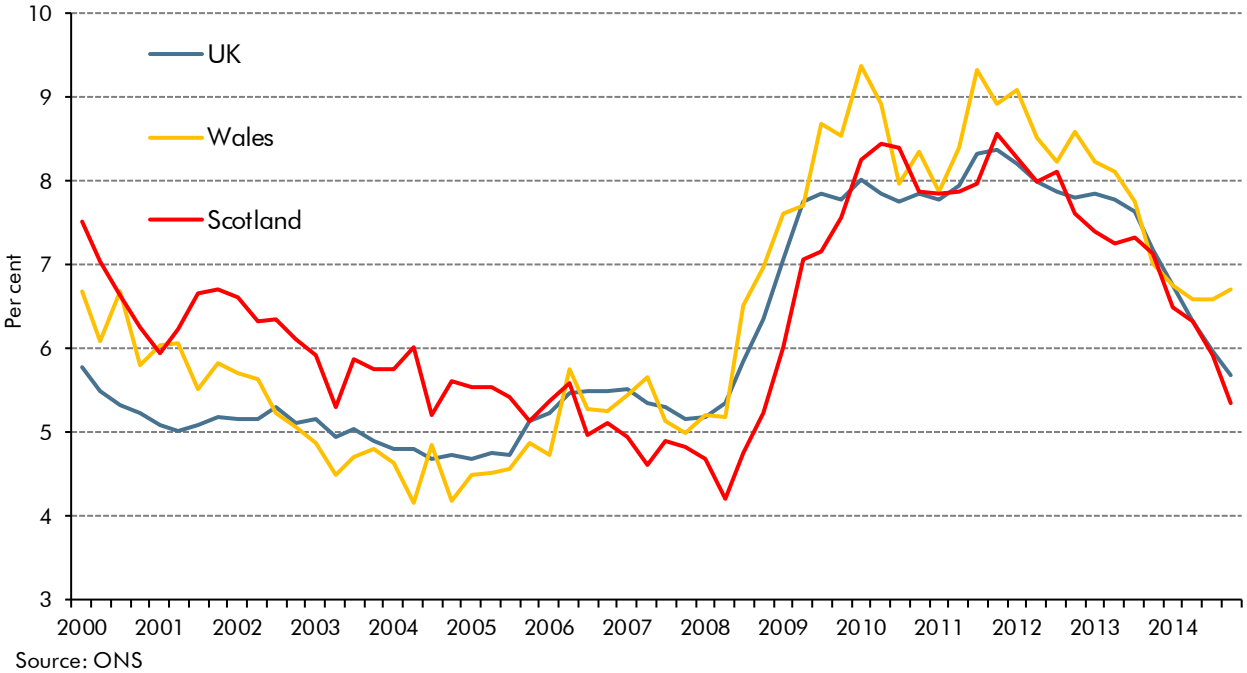
2.11 These different shares of UK income tax can partly be explained by different labour market trends in Wales and Scotland relative to the rest of the UK. Charts 2.1 and 2.2 show that employment and unemployment trends in Scotland have generally been more similar to the UK as a whole than has been the case in Wales. In particular, the employment rate has typically been lower in Wales, mainly reflecting a higher inactivity rate. The latest unemployment rate for Wales is around 1 per cent higher than in Scotland and the UK as a whole.

Chart 2.1: Employment rates in the UK, Scotland and Wales



Source: ONS

Chart 2.2: Unemployment rates in the UK, Scotland and Wales

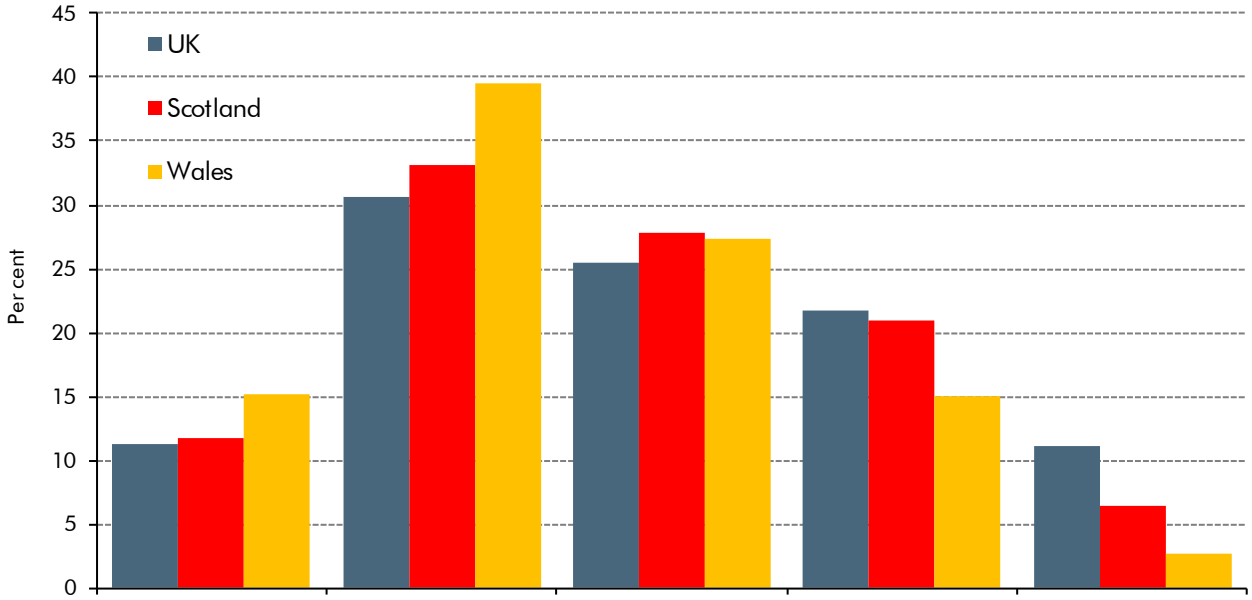


Source: ONS

2.12 The main factor behind the drops in Scottish and Welsh shares of income tax since 2009-10 is likely to be the asymmetric effect from policy measures. 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 cuts such as raising the personal allowance to £11,000 by 2017-18 have had more of an effect at the lower end of the income distribution.

2.13 Chart 2.3 shows the proportion of total taxpayer income by income bands. The proportion of taxpayer income generated from individuals with incomes below £30,000 is higher in Scotland, and particularly so in Wales. We have therefore made adjustments to the Scottish and Welsh share to account for recent policy measures that are not yet reflected in the SPI data.

Chart 2.3: Proportion of total taxpayer income by income bands (2012-13)



Source: HMRC

2.14 Finally, we add the estimated Scottish and Welsh share of newly announced policy measures to the pre-measures forecast.

UK forecast

2.15 Table 2.2 shows the UK forecast of tax liabilities on non-savings, non-dividend (NSND) income. To aid comparison with the previous forecast, we have constructed a March forecast that excludes Autumn Statement 2014 measures. Compared with the December forecast, the UK forecast is lower in 2013-14 reflecting latest data on SA liabilities but higher in each year from 2014-15 onwards.

Table 2.2: UK forecast of tax liabilities on non-savings, non-dividend income (prior to Budget 2015 measures)

	£ million							
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
March 2015								
Post AS 2014 measures	141.6	146.6	152.0	158.6	167.8	178.6	189.4	202.4
Pre AS 2014 measures (a)	141.6	146.6	152.1	158.8	168.0	178.8	189.6	202.6
December 2014 (pre-measures) (b)	141.5	147.4	151.6	157.7	165.8	176.2	186.6	197.8
Difference (a-b)	0.1	-0.8	0.4	1.1	2.1	2.5	3.0	4.8

2.16 The reduction in liabilities in 2013-14 stems from lower than expected payments of SA relating to that year which became due at the end of January 2015. Although SA receipts were 12 per cent up on a year earlier, in part due to income shifting related to the reduction in the additional rate of income tax, growth was lower than expected. Relative to our December forecast, the shortfall was in self-employment and savings income for those below the additional rate threshold. The weaker starting point is the main driver of lower SA receipts over most of the forecast period.

2.17 PAYE receipts have been stronger than expected since our December forecast, more than offsetting the shortfalls in SA liabilities from 2014-15 onwards. The higher PAYE largely reflects receipts from the business services sector and from financial sector firms in non-bonus months. Although we have revised up our 2014-15 PAYE forecast, receipts have been held back this year by weak earnings growth and a fall in the effective tax rate, which have offset the effects of strong growth in employment. The drop in the effective tax rate reflects the increase in the personal allowance to £10,000 and changes in the composition of employment. PAYE receipts in the UK are expected to be higher in each year of the forecast, compared with December. This reflects the higher receipts in 2014-15 being pushed through to future years, lower CPI inflation meaning slower growth in allowances and thresholds and employment growth being revised up from 2016-17 due to a higher projection for population growth.

2.18 There is a further boost to the UK forecast for non-savings, non-dividend liabilities from lower income tax repayments. These have been lower than expected in recent months.

2.19 The main measures affecting income tax in Budget 2015 are:

- increase in the personal allowance to £10,800 in 2015-16 and £11,000 in 2016-17;
- the introduction of a £1,000 allowance for savings income for basic rate taxpayers and a £500 allowance for higher rate taxpayers;
- increased flexibility allowing pensioners to sell their annuities;
- reducing the lifetime allowance to £1 million from 2016-17 and indexing it with CPI inflation from 2018-19; and

- anti-avoidance measures such as that related to employment intermediaries.

2.20 The introduction of the savings allowance will not have a direct effect on the definition of liabilities used for the Scottish rate of income tax, which is on a non-savings basis. However, with the TDSI (tax deduction scheme for interest) mechanism used to deduct tax on savings earned through a bank or building society being switched off, any additional liabilities on savings income will be paid through SA or PAYE coding adjustments. Greater use of these coding adjustments would boost the PAYE element of the UK forecast, since we include all PAYE receipts with the exception of the high income child benefit charge.

Scottish forecast

2.21 Table 2.3 shows our latest forecast of the Scottish share of income tax. The 2012-13 SPI was published in January 2015 and suggests that the Scottish share in 2012-13 was 3.04 per cent. This was marginally lower than the 3.05 per cent used in our December forecast. We expect a further fall in the Scottish share over the forecast period as a result of the asymmetric effect of policy measures in recent years. We have not made any further adjustments.

Table 2.3: Scottish share of income tax

	Per cent of UK total for 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	3.08	3.05	2.92	2.92	2.90	2.90	2.90	2.90	2.90
March 2015	3.08	3.04	2.91	2.91	2.89	2.89	2.89	2.89	2.88

2.22 Table 2.4 provides a forecast for Scottish income tax liabilities on non-savings, non-dividend income. These are the liabilities specifically for the Scottish rate. Prior to a decision in the Scottish Parliament on the new Scottish tax rate for 2016-17, the forecast assumes that a 10p Scottish rate will be levied. In line with the UK forecast, we expect more rapid growth in tax liabilities from 2016-17 onwards.

Table 2.4: Scottish income tax forecast

	£ million							
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Scottish income tax liabilities (pre-measures)	4265	4223	4379	4531	4796	5102	5410	5781
Budget 2015 measures	0	0	0	1	-5	-16	-40	-33
Scottish income tax liabilities (post-measures)	4265	4223	4379	4532	4791	5087	5370	5748

2.23 Table 2.5 provides a breakdown of the change in the Scottish income tax forecast since December. Receipts are lower between 2012-13 and 2014-15 and are then higher in each year from 2015-16 onwards. The lower estimates between 2012-13 and 2014-15 reflect the lower outturn Scottish share and lower-than expected SA liabilities in 2013-14.

Thereafter, the effect from the higher UK forecasts for PAYE liabilities offsets the lower starting point and the additional downward effect from Budget 2015 policy measures. Within the Budget policy measures, the effect of further above-inflation rises in the personal allowance in 2016-17 and 2017-18 more than offsets the boost to receipts from the annuities reform, the reduction in the lifetime allowance and anti-avoidance measures.

Table 2.5: Changes in Scottish income tax since March

	£ million							
			Forecast					
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	4273	4258	4383	4510	4757	5058	5354	5674
March 2015	4265	4223	4379	4532	4791	5087	5370	5748
Change in income tax	-8	-36	-4	23	35	28	16	74
of which:								
Scottish share	-11	-13	-12	-15	-16	-21	-24	-26
Other (including previous measures)	1	0	-4	5	-6	-8	-7	-6
Budget 2015 measures	0	0	0	1	-5	-16	-40	-33
UK forecast	3	-23	13	31	62	73	87	139

Welsh forecast

2.24 Table 2.6 shows our forecast for the Welsh share of income tax. The recently published SPI data for 2012-13 indicates a Welsh share of 1.34 per cent, lower than the 1.36 per cent assumed in our December forecast. As with the Scottish share, the asymmetric effect of policy measures is likely to be the key factor behind the recent drop in the share and the expected further drop over the forecast period. We have not made any further adjustments.

Table 2.6: 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
March 2015	1.37	1.34	1.27	1.27	1.26	1.26	1.26	1.26	1.26

2.25 Table 2.7 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. Again, in line with the UK forecast we expect more rapid growth in tax liabilities from 2016-17 onwards. With the income distribution more skewed towards the bottom end in Wales, the raising of the personal allowance has a slightly larger than proportionate effect on Welsh income tax liabilities than in Scotland.

Table 2.7: 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)	1880	1839	1910	1971	2090	2227	2365	2531
Budget 2015 measures	0	0	0	0	-5	-11	-21	-17
Welsh income tax liabilities (post-measures)	1880	1839	1910	1972	2084	2216	2344	2514

2.26 Table 2.8 provides a breakdown of the changes in the Welsh income tax forecast since December. The forecast is down in each year of the forecast, except for 2019-20. The combination of a lower Welsh share, Budget 2015 policy measures and weaker SA liabilities offset the positive effect from a stronger UK forecast for PAYE liabilities. Upward revisions to the UK forecasts for earnings and employment growth towards the end of the forecast period explain why the Welsh forecast is slightly higher in 2019-20 than in our December forecast.

Table 2.8: Changes in Welsh income tax since December

	£ million							
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	1902	1874	1930	1981	2092	2229	2364	2510
March 2015	1880	1839	1910	1972	2084	2216	2344	2514
Change in income tax	-23	-35	-21	-9	-8	-13	-20	4
of which:								
Welsh share	-24	-25	-24	-25	-26	-30	-33	-36
Other (including previous measures)	0	0	-2	2	-3	-4	-4	-3
Budget 2015 measures	0	0	0	0	-5	-11	-21	-17
UK forecast	1	-10	6	14	27	32	38	61

3 Taxes on property transactions

Scottish land and buildings transaction tax

3.1 The Scotland Act provided for stamp duty land tax (SDLT) to be entirely devolved to Scotland in April 2015, which included the power to change the tax system as well as tax rates. The Land and Buildings Transaction Tax (Scotland) Act 2013 received Royal Assent on 31 July 2013.

3.2 In April 2015, the land and buildings transaction tax (LBTT) will replace the current UK-wide SDLT within Scotland. But there were also reforms to the UK SDLT tax system that took place late last year. The main changes that have affected the taxation of property transactions in Scotland are:

- on 4 December 2014, the UK residential SDLT regime moved from a 'slab' to a 'slice' system. As a result, until the end of March 2015 property transactions will be taxed under the new UK SDLT regime, before moving to the LBTT regime in April 2015. The UK changes were discussed in detail in our December 2014 *EFO*;
- a requirement to pay LBTT prior to registration of the title, intended to encourage prompt payment; and
- modifications to reliefs and exemptions, including the withdrawal of sub-sale relief arrangements.

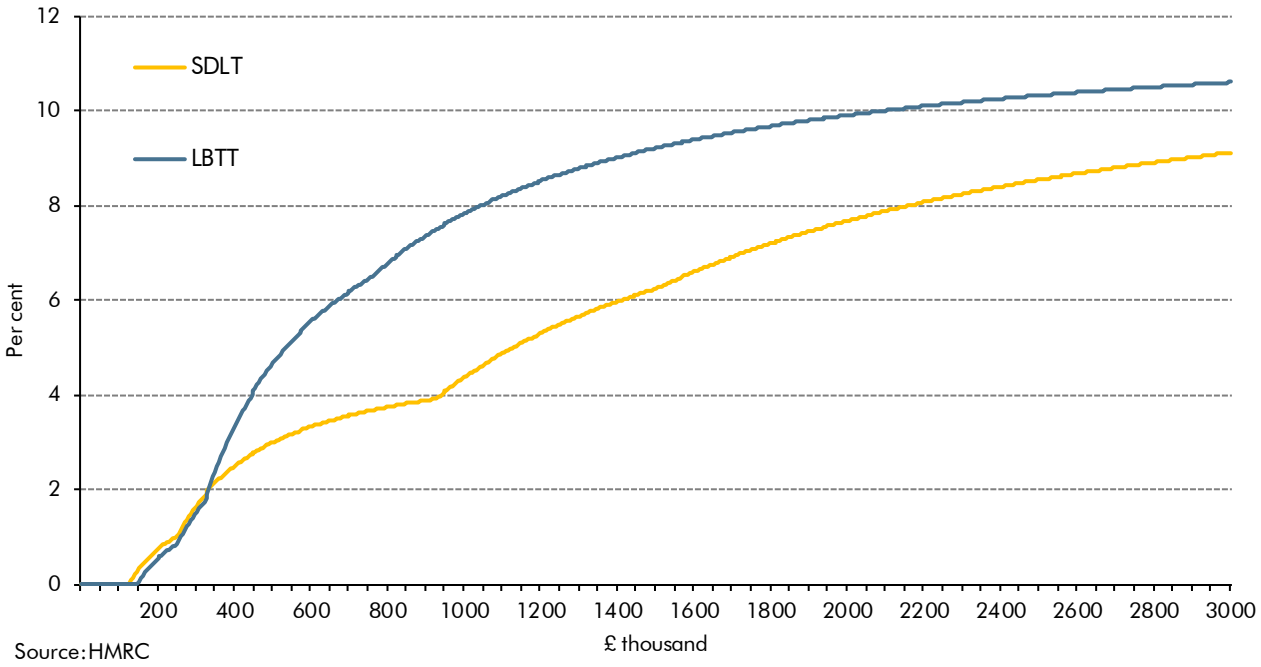
3.3 The Scottish Government announced LBTT rates and bands in its October 2014 Draft Budget and subsequently announced amendments to them in January 2015. For residential property the rates are:

- 0 per cent on residential property transactions up to £145,000;
- 2 per cent on the portion to £250,000;
- 5 per cent on to £325,000;
- 10 per cent on to £750,000; and
- 12 per cent on value above £750,000.

3.4 Chart 3.1 shows how the amount of tax paid on transactions at different property prices differs between the current UK SDLT regime and the forthcoming Scottish LBTT system. It shows that there are substantial differences at some prices. For example, the purchaser of a

£260,000 house – just above the 2 per cent threshold in the UK SDLT system and the 2 per cent threshold in the Scottish LBTT system – would pay £400 less in tax in Scotland. By contrast, the purchaser of a £1.5 million house would pay £45,000 more tax under the Scottish system.

Chart 3.1: UK SDLT and Scottish LBTT tax schedules for residential property



Source: HMRC

3.5 The new rates for commercial property are:

- 0 per cent on commercial property transactions up to £150,000
- 3 per cent between £150,000 and £350,000; and
- 4.5 per cent above £350,000.

Welsh rate

3.6 The Wales Act 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.

Methodology

3.7 The forecast for LBTT uses the HMRC stamp duty model (SDM). This is a microsimulation model that allows us to apply the new tax schedules for LBTT to a representative sample of transactions that are grown in line with our price and transactions forecasts for the residential and commercial markets. We assume that Scottish prices and transactions grow

in line with those for the UK as a whole from 2014-15 forwards, with an adjustment to residential prices in 2013-14 to reflect Scottish prices.

3.8 Our Welsh residential SDLT forecast has also been produced using HMRC's SDM. This replaces the use of a time series model that had been estimated on data that reflected the previous UK slab structure of SDLT, so was no longer appropriate for use in our forecasts. Welsh commercial SDLT receipts are still forecast by assuming a constant share of UK receipts, which, since there have not been reforms to the UK commercial SDLT system, continue to be forecast using an econometric model.

3.9 Table 3.1 shows how the Scottish and Welsh shares of SDLT receipts have evolved since 2007-08. It shows that they have generally been on a declining path, which has reflected the relative strength of London prices over the period.

Table 3.1: Historical Scottish and Welsh shares and SDLT receipts

	£ million						
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
UK							
Total	9958	4796	4885	5960	6130	6907	9273
Residential	6680	2950	3290	4040	4220	4905	6450
Commercial	3278	1846	1595	1920	1910	2002	2823
	Totals						
Scotland:	565	320	250	330	275	283	389
of which:							
Residential	340	185	135	165	155	170	215
Commercial	225	135	115	165	120	113	175
Wales:	210	115	100	115	125	105	150
of which:							
Residential	130	55	55	65	65	70	90
Commercial	80	60	45	50	60	35	60
	Per cent of UK total						
Scotland:							
Residential share	5.1	6.3	4.1	4.1	3.7	3.5	3.3
Commercial share	6.9	7.4	7.2	8.6	6.3	5.5	6.2
Wales:							
Residential share	1.9	1.9	1.7	1.6	1.5	1.5	1.4
Commercial share	2.4	3.2	2.8	2.6	3.1	1.7	2.1

UK forecast

3.10 UK SDLT receipts are forecast to increase from £10.9 billion in 2014-15 to £18.0 billion in 2019-20 (excluding Scotland's LBTT). This reflects growth in house prices, a recovery in residential property transactions back to historically typical rates and that the combination of higher house prices and fixed tax thresholds push up the effective tax rate. Compared with December, UK receipts are lower by £0.6 billion in 2014-15 and our forecast is lower by between £0.7 billion and £2.0 billion over the forecast period.

3.11 In particular, residential property transactions are expected to be lower throughout the forecast period than previously assumed. Lower outturns since December and the subdued level of mortgage approvals reduce our near-term forecast, while we have revised down our long-run assumption for transactions. Reflecting recent outturns, house price growth is weaker in the first two years of the forecast than in our December forecast, but is then higher reflecting stronger growth in real income per household. Commercial property has surprised on the upside since December and we have revised up the level of both prices and transactions in the sector throughout the forecast. With UK-wide determinants being used in the LBTT forecast, these trends will affect that forecast as well.

Scottish forecast

3.12 Our forecast for Scottish LBTT takes on the revised LBTT rates for residential property announced in January. Table 3.2 shows our latest forecasts for residential and commercial LBTT. Tables 3.3 and 3.4 show the sources of changes since December. The revised LBTT rates and the lower level for residential property transactions (reflecting our UK forecast) are the key drivers of the lower residential forecast. Higher house prices towards the end of the forecast help to reduce the shortfall relative to December. A stronger than expected commercial property market explains the upward revision to commercial LBTT.

3.13 As with SDLT in the rest of the UK, we expect strong growth in LBTT receipts over the forecast from the same combination of higher house prices, a recovery in residential property transactions back to historically typical rates and a rising effective tax rate. As with SDLT, our assumption is that tax thresholds for LBTT are fixed throughout the forecast period. On this basis, we assume that growth in residential LBTT will be stronger than that for residential SDLT in the rest of the UK. This reflects a steeper rise in the effective tax rate given the marginal tax rates shown in Chart 3.1.

Table 3.2: Land and buildings transaction tax forecast

	£ million				
	2015-16	2016-17	2017-18	2018-19	2019-20
Total LBTT					
December 2014	499	600	676	749	811
March 2015	431	510	598	704	810
Difference	-68	-90	-78	-45	-1
Residential LBTT					
December 2014	328	423	491	557	610
March 2015	226	297	375	467	554
Difference	-102	-126	-116	-90	-56
Commercial LBTT					
December 2014	171	177	185	192	201
March 2015	205	213	223	237	256
Difference	34	36	38	45	55

Table 3.3: Changes in residential land and buildings transactions tax since December

	£ million				
	2015-16	2016-17	2017-18	2018-19	2019-20
Change in residential LBTT	-102	-126	-116	-90	-56
of which:					
Change in LBTT rates	-47	-61	-72	-81	-88
Modelling changes	-7	-4	8	15	20
Property transactions	-37	-44	-37	-27	-25
House prices	-12	-18	-15	4	37

Table 3.4: Changes in non-residential land and buildings transaction tax since December

	£ million				
	2015-16	2016-17	2017-18	2018-19	2019-20
Change in non-residential LBTT	34	36	38	45	55
of which:					
Commercial property transactions	7	8	6	8	9
Commercial property prices	21	21	23	24	30
Modelling changes	6	7	10	12	16

3.14 Our forecast for Scottish LBTT in 2015-16 of £431 million is higher than the Scottish Government's estimate of £381 million. This difference is concentrated in the non-residential LBTT forecast. Such are the uncertainties around estimating the fiscal effect of the introduction of new taxes that the difference between the two estimates should not be regarded as significant. In particular, differences in the number of property transactions in Scotland could result in LBTT receipts in 2015-16 that are higher than our forecast or lower than the Scottish Government's forecast. Forecast revisions to residential property transactions can be substantial. In our last two forecasts, we have revised down 2015-16 transactions by almost 20 per cent. More detail on the modelling undertaken to estimate the impact of reforms to UK SDLT and the introduction of the Scottish LBTT can be found in Box 4.5 of the December 2014 *EFO*.

3.15 Our forecast takes into account the bringing forward of some higher-priced transactions in order to avoid the higher rates in 2015-16 and some delayed transactions at the lower end. This increases UK SDLT receipts under the old system by £11 million in 2014-15 and reduces the LBTT forecast by £20 million in 2015-16.

Welsh forecast

3.16 As described above, the Welsh residential SDLT forecast has been estimated using HMRC's SDM and UK-wide house price and residential transaction forecasts. Welsh commercial SDLT has been forecast as a constant share of UK commercial SDLT.

3.17 We then include the assumed Welsh share of SDLT measures in order to produce a final post-measures forecast. It has been estimated from administrative SDLT data that the policy

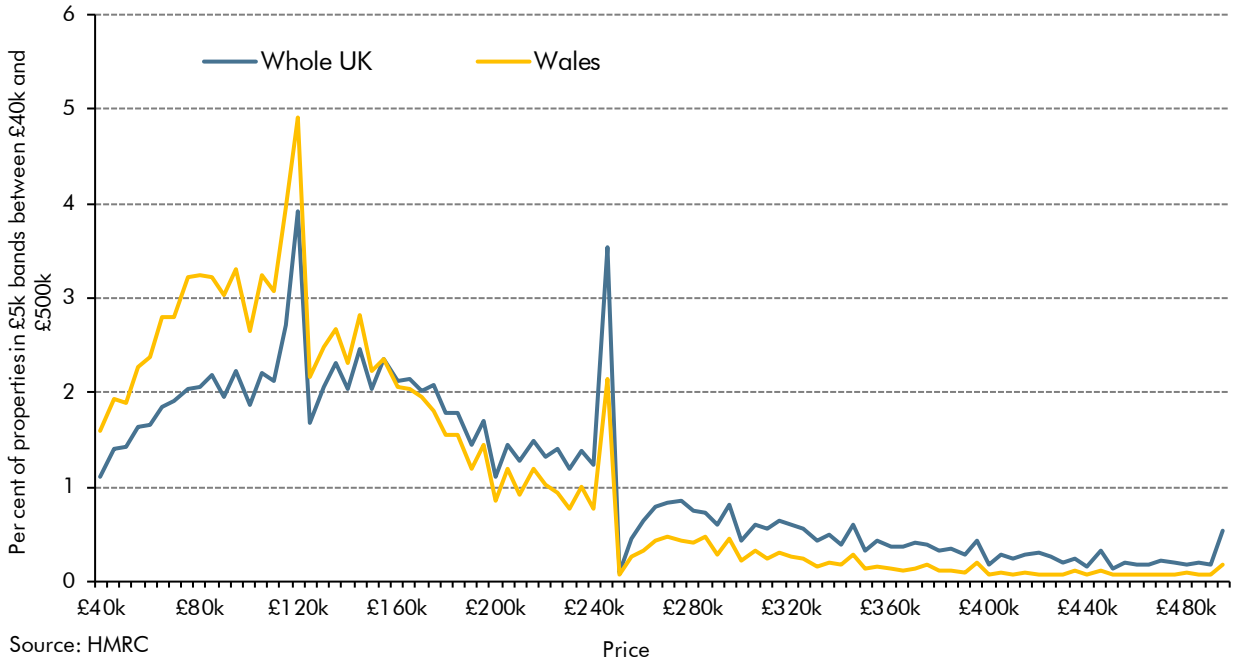
change announced in Budget 2015 will have a negligible impact on Welsh receipts, as their effect is concentrated at the top end of the UK-wide house price distribution.

Table 3.5: Welsh SDLT forecast

	£ million					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Residential SDLT	102	89	110	141	175	208
Change since December 2014	-4	-18	-14	-1	17	37
Commercial SDLT	64	76	77	80	83	87
Change since December 2014	5	15	12	11	10	12
Total SDLT	166	165	188	221	259	295

3.18 The forecast for Welsh residential SDLT has been revised up since December. That contrasts with the UK forecast. The difference is explained through the greater fiscal drag in Wales in the SDM modelling of Welsh SDLT receipts than was implied by taking a Welsh share of the UK forecast in December. This reflects the relatively high proportion of transactions in Wales close to the 2 per cent threshold in the new UK SDLT regime (£125,000). The change to a slice system will mean that transactions at prices just below the threshold are more likely to move up into the SDLT regime over time. (The slab system encouraged bunching below thresholds because of the substantial impact on the amount of tax paid when moving from below to above a threshold.)

Chart 3.2: Distribution of house prices in Wales compared to the UK



Source: HMRC

4 Environmental taxes

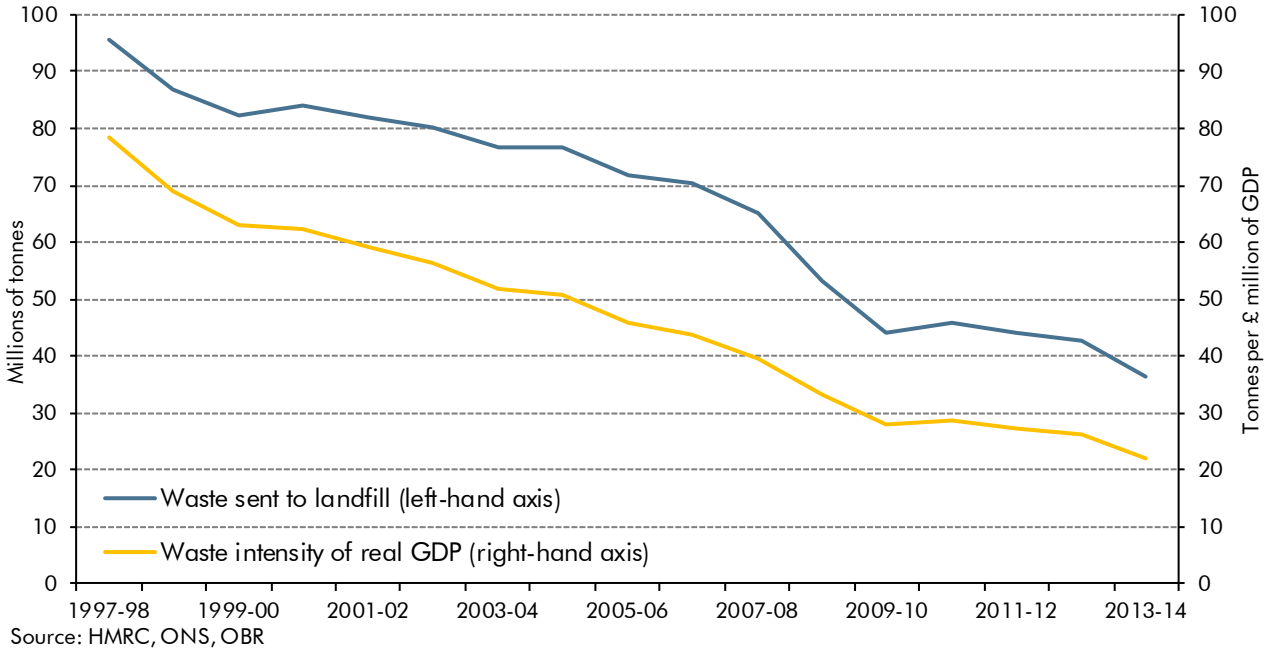
Landfill tax

Trends in UK landfill tax receipts

4.1 Landfill tax is a tax on the disposal of waste that was introduced in 1996. It applies to all waste disposed of by way of landfill at a licensed landfill site unless the waste is specifically exempt. Our forecast for UK landfill tax is driven by the tax base (the amount of waste sent to landfill) and the effective tax rate that will be paid (largely driven by policy decisions on the rates paid, but also by the composition of waste sent to landfill as there are two rates paid). Both elements represent sources of uncertainty in the forecast.

4.2 Since waste is largely a by-product of economic activity, we would expect the tax base to be associated with GDP growth. And since the tax is paid on the volume of waste (per tonne), the relationship should be with real GDP. As Chart 4.1 shows, that relationship has been one of declining volumes of waste per unit of real GDP. Indeed, since landfill tax was introduced, there has been a clear downward trend in the amount of waste sent to landfill in the UK, falling from 97 million tonnes in 1997-98 to 36 million tonnes in 2013-14.

Chart 4.1: Landfill waste tonnage relative to economic activity

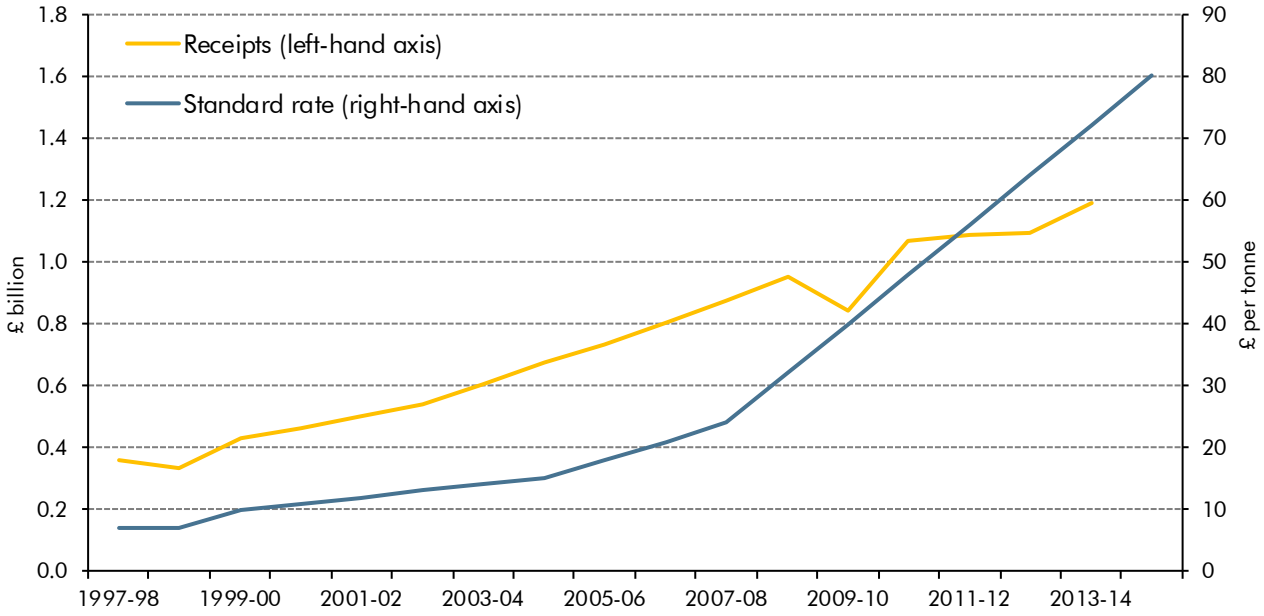


Source: HMRC, ONS, OBR

4.3 As Chart 4.2 shows, despite a declining tax base, landfill tax receipts have risen significantly over the past 15 years, mainly due to large increases in the duty rate. The standard rate has

been raised from £7 a tonne in 1997-98 to £80 a tonne in 2014-15. This has more than offset the reduction in the effective tax rate caused by a steady decline in the proportion of waste sent to landfill that is subject to the standard rate – itself partly due to HMRC losing a court case that led to a narrowing of the scope of the standard rate.

Chart 4.2: Landfill tax standard rate and receipts



Source: HMRC

Scottish rate

4.4 Landfill tax will be fully devolved to the Scottish Government in April 2015. In October 2014, as part of the Scottish Government's Draft Budget, it was announced that landfill tax rates will be set in line with those in the rest of the UK in 2015-16.

Welsh rate

4.5 The Wales Act 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.

Methodology

4.6 The Scottish and Welsh landfill tax forecasts are produced by applying an assumption about the path of the Scottish and Welsh share of landfill tax to the UK forecast.

4.7 As noted above, the 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 for Environment, Food and Rural Affairs (DEFRA) projections of municipal solid waste, and commercial and industrial waste, sent to landfill. The expected

amount of municipal waste sent to landfill is estimated by comparing the cost of alternative waste treatment options. DEFRA's detailed 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 RPI inflation in the absence of announced policy.

4.8 Data on the Scottish and Welsh shares of landfill tax receipts are not currently available, since landfill operators submit data returns that cover sites throughout the UK. The shares are therefore estimated from various data sources on landfill tonnages. The Scottish share uses data from the Scottish Environment Protection Agency that covers only Scotland. The Welsh share is calculated using data from Natural Resource Wales. This is a detailed dataset that offers comprehensive coverage of the amount of waste sent to landfill in Wales. Data for Northern Ireland are sourced from the Department of the Environment Northern Ireland to allow us to complete the picture for total UK landfill tonnage and calculate the Scottish and Welsh shares. The latest available data are shown in Table 4.1.

Table 4.1: Landfill tonnage in the UK

	Tonnes (million)						
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
England	63.9	59.0	51.3	43.9	43.8	44.0	41.0
Scotland	7.3	7.0	5.9	4.7	4.6	4.6	4.4
Wales	3.8	3.1	2.8	2.5	2.3	2.2	2.2
Northern Ireland	2.0	1.9	1.7	1.6	1.5	1.3	1.2
UK	**77.0**	**71.1**	**61.8**	**52.7**	**52.3**	**52.1**	**48.8**
	Per cent of UK total						
Scotland	9.5	10.0	9.5	9.0	8.9	8.9	9.1
Wales	4.9	4.4	4.5	4.7	4.4	4.2	4.4

UK forecast

4.9 Since our December forecast, we have lowered our UK landfill tax forecast significantly. The main driver of the revision is a lower proportion of local authority waste sent to landfill, consistent with DEFRA projections that have been updated since our December forecast. The forecast has also been reduced due to lower-than-expected receipts in 2014-15. In total, we have reduced our UK landfill tax forecast by around £200 million a year on average from 2016-17 onwards.

Table 4.2: UK landfill tax forecast

	£ million						
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	1178	1226	1152	1077	1082	1134	1206
March 2015	1179	1138	1100	846	912	943	1014
Difference	1	-88	-52	-231	-170	-191	-192

Scottish forecast

4.10 The estimated Scottish share of waste sent to landfill increased by 0.2 percentage points to 9.1 per cent in 2012-13. We have assumed that the share will remain constant at that rate throughout the forecast period. Implicit in assuming a constant share for the devolved Scottish landfill tax is that Scottish landfill rates will be uprated in line with those in the UK (i.e. by RPI inflation) during the rest of the forecast period and that the same declining trend in waste sent to landfill will be seen in Scotland as expected in the UK as a whole.

4.11 The Scottish forecast has been lowered since December because of the revision to our UK forecast. That is slightly offset by the higher estimated Scottish share of receipts. It is possible that the Scottish share has risen further since 2012-13 – the latest year for which landfill tonnage data are available. That may be one reason why our 2015-16 forecast is lower than the £118 million included in the Scottish Government's Draft Budget.

4.12 Landfill tax is fully devolved to the Scottish Government. As a result, the Budget 2015 policy decision to reduce the landfill communities fund has not affected our Scottish landfill tax forecast.

Table 4.3: Scottish landfill tax forecast

	£ million						
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	105	109	103	96	97	101	108
March 2015	107	104	100	77	83	86	92
Difference	2	-6	-3	-19	-14	-15	-15

Welsh forecast

4.13 The estimated Welsh share of waste sent to landfill increased by 0.2 percentage points to 4.4 per cent in 2012-13. We have assumed that the share will remain constant at that rate throughout the forecast period. The Welsh share of the Budget 2015 landfill communities fund measure has been assumed to have a negligible effect on the Welsh forecast. (At a UK level, it is expected to yield £5 million in 2015-16.)

4.14 The Welsh forecast has been lowered since December because of the revision to our UK forecast. That is slightly offset by the higher estimated Welsh share of receipts.

Table 4.4: 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
March 2015	52	50	49	37	40	42	45
Difference	0	-4	-2	-10	-8	-8	-8

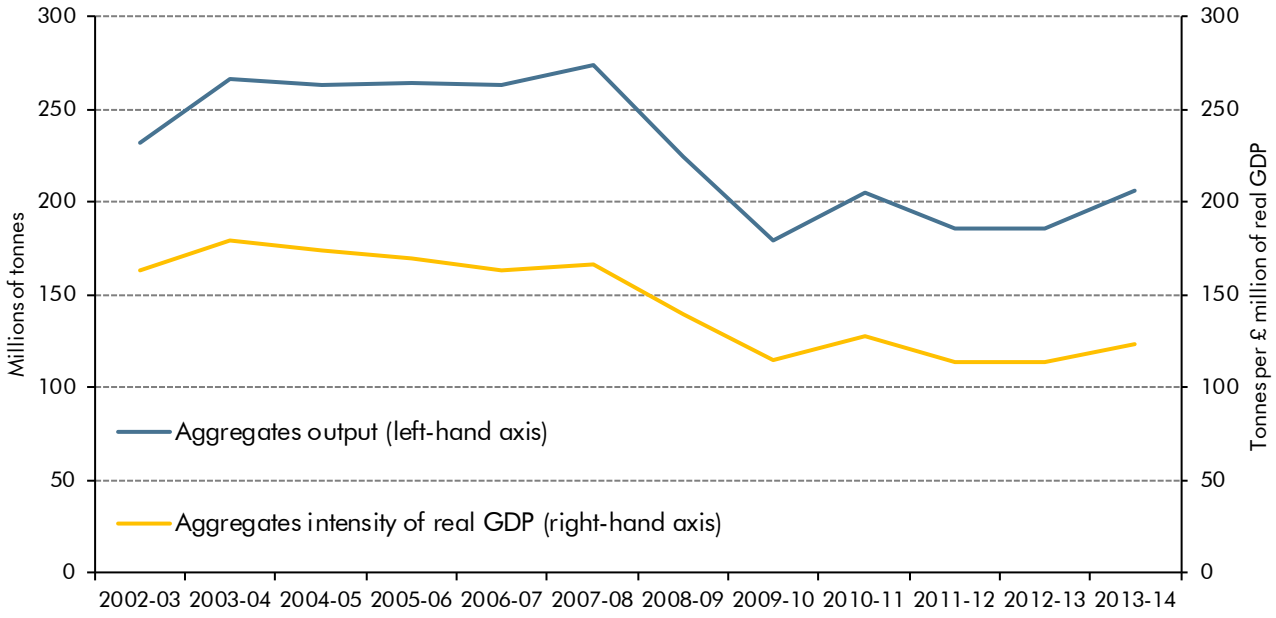
Aggregates levy

Trends in UK aggregates levy receipts

4.15 The aggregates levy is a tax on the commercial exploitation in the UK of rock, sand and gravel. It is due from any business that quarries, dredges or imports these products. The levy came into effect in 2002. Our forecast for UK aggregates levy is driven by the tax base (the volume of aggregates) and the effective tax rate that will be paid (largely driven by policy decisions on the rates paid, but also by the composition of the tax base as some aggregates are relieved or exempt from the levy). The tax base represents the main source of uncertainty in the forecast.

4.16 Since aggregates are largely an input into broader economic activity, we would expect the tax base to be associated with GDP growth. And since the tax is paid on the volume of aggregates (per tonne), the relationship should be with real GDP. As Chart 4.3 shows, that relationship has been one of relatively stable volumes of aggregate per unit of real GDP, with a shift in the level during the late 2000s recession that has persisted. Since the aggregates levy was introduced, output in absolute terms was relatively stable during the pre-crisis period, then fell sharply in 2009-10, and has since been relatively stable again.

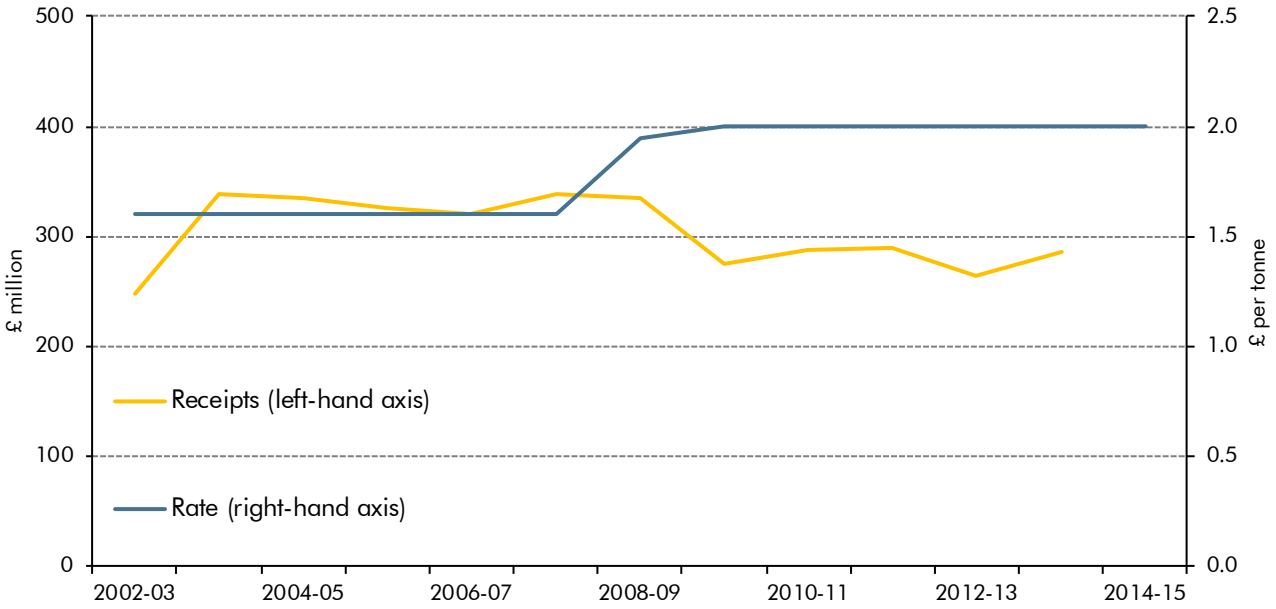
Chart 4.3: Aggregates output relative to economic activity



Source: HMRC, ONS, OBR

4.17 As Chart 4.4 shows, aggregates levy receipts have fallen since 2008-09. The increases in the rate per tonne in 2008-09 and 2009-10 were not sufficient to offset the fall in the tax base in 2009-10, which meant annual receipts fell from slightly above £300 million a year in the pre-crisis period to slightly below £300 million a year since then.

Chart 4.4: Aggregates levy rate and receipts



Source: HMRC

Scottish and Welsh rates

4.18 The Government has committed to keeping the devolution of aggregates levy to Scotland and 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 Scotland and Wales.

Methodology

4.19 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 substitution away from the extraction of primary aggregates. The tax rate is assumed to be uprated in line with RPI inflation in the absence of announced policy.

4.20 To produce Scottish and Welsh aggregates levy forecasts, we apply our assumptions for their respective shares to the UK receipts forecast. These shares are estimated using data on the Scottish and Welsh share of aggregates production from the United Kingdom Mineral Yearbook 2013, which are shown in Table 4.5.

Table 4.5: Aggregates tonnage in the UK

	Tonnes millions						
	2006	2007	2008	2009	2010	2011	2012
England	152.8	140.1	136.8	106.2	95.4	104.8	95.9
Scotland	33.3	37.2	32.3	28.4	28.6	27.5	24.8
Wales	21	20.8	18	12.2	12.6	13.6	12.3
Northern Ireland	6.1	6.7	5.3	4.8	3.9	20	18.4
UK	213.3	204.8	192.5	151.6	140.5	165.9	151.3
	Per cent of UK total						
Scotland	15.6	18.2	16.8	18.7	20.3	16.6	16.4
Wales	9.9	10.2	9.4	8.1	9.0	8.2	8.1

4.21 Finally, we add the Scottish and Welsh element of any policy measures to produce the post-measures forecast.

UK forecast

4.22 Since our December forecast, we have revised up the UK forecast for aggregates levy receipts. This reflects higher-than-expected receipts in 2014-15, which we have fed through to future years of the forecast. The Budget announced that aggregates levy rates would be frozen at £2 per tonne in 2015-16 – as has been the case over the past five years. This measure reduced the UK forecast by £5 million a year across the forecast period. We have not made any other significant changes to the forecast.

Table 4.6: UK aggregates levy forecast

	£ million						
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	296	315	311	314	318	323	328
March 2015	295	349	334	335	338	342	345
Difference	-1	34	24	21	20	18	17

Scottish forecast

4.23 We assume that the latest outturn for the Scottish share of aggregates levy receipts will remain constant at 16.4 per cent over the forecast period. Applying the Scottish share of aggregates levy to the measure to freeze the levy rates in 2015-16 takes £1 million a year off the Scottish forecast from 2015-16.

4.24 The main reason for the higher Scottish aggregates levy forecast since December is the higher UK forecast, which is partly offset by the effect of freezing the duty rate in 2015-16.

Table 4.7: Scottish aggregates levy forecast

	£ million						
	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
December 2014	48	52	51	51	52	53	54
March 2015	48	57	55	55	55	56	57
Difference	0	6	4	3	3	3	3

Welsh forecast

4.25 The Welsh share of aggregates tonnage has remained fairly constant over the past five years. We assume that it will remain constant at 8.1 per cent over the forecast period. Applying the Welsh share to the measure to freeze the levy rates in 2015-16 takes a small amount off the Welsh forecast from 2015-16.

4.26 The reason for the increase in the Welsh forecast since December 2014 is due to the upward revision of the UK aggregates levy forecast.

Table 4.8: 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
March 2015	24	28	27	27	27	28	28
Difference	0	3	2	2	2	1	1