

Office for
**Budget
Responsibility**

Welsh taxes outlook

February 2023 update

1 Updated tax forecasts

Introduction

- 1.1 In our December 2022 *Welsh taxes outlook* (WTO) we presented five-year tax forecasts alongside the Welsh Government's draft Budget. It covered the Welsh rates of income tax, land transaction tax (LTT), and landfill disposals tax (LDT), as well as the equivalent UK Government taxes that are required to calculate block grant adjustments.¹
- 1.2 Those forecasts were based on our November 2022 UK-wide economy and fiscal forecasts, plus new receipts data published since then.² The Welsh Government has asked us to publish updated forecasts for LTT and LDT – reflecting the outturn data published since December – alongside its final Budget for 2023-24. These are still based on determinants from our November 2022 economy and fiscal forecasts for the UK as a whole.³
- 1.3 The ONS's Public Sector Finances (PSF) bulletin published on 21 February identified a £5.8 billion upside surprise in UK-wide self-assessment (SA) receipts relative to the monthly profiles consistent with our November forecast. These payments will largely relate to tax liabilities that accrued in the 2021-22 fiscal year, with the strength relative to forecast likely to be explained by a combination of payment timing (i.e. the split between January and February payments) and stronger underlying receipts. The breakdown between SA income tax and capital gains tax (which is also paid via SA) from administrative tax data in the February release is provisional and will be revised in subsequent releases based on detailed receipts data. Roughly two-thirds has been assumed to relate to UK-wide SA income tax based on this provisional data.⁴ It is also not known at this stage how much of the surplus relates to non-savings, non-dividend income tax – the element subject to the Welsh rates. But it is clear that this upside surprise will have implications for the Welsh rates for 2021-22 once final outturn liabilities have been calculated and published by HMRC later this year.
- 1.4 We have not updated our forecast for the Welsh rates of income tax in light of this surprise in this WTO update pending further information on the composition and future implications of the surplus. To the extent that higher-than-expected receipts generate an upward revision to 2021-22 liabilities, they may affect the outturn reconciliation adjustment for 2024-25, in line with the fiscal framework. The impact on the reconciliation adjustment will depend on how the revision affects Welsh revenues relative to those in England and Northern Ireland. It is also possible that higher liabilities in 2021-22 would indicate the need for upward

¹ The methodology for the block grant adjustment is set out in *The agreement between the Welsh Government and the United Kingdom Government on the Welsh Government's fiscal framework*, December 2016. The OBR has no direct involvement in these spending decisions or block grant negotiations, but the spending settlements do draw on our tax forecasts.

² See our November 2022 *Economic and fiscal outlook*.

³ Analysts in the Welsh Government produced final forecasts for LTT and LDT on 16 February 2022. The Budget Responsibility Committee scrutinised and finalised the LTT forecast via a meeting on 14 February and in subsequent correspondence for LDT.

⁴ For more details, see: OBR, *Commentary on the Public Sector Finances: January 2023*, February 2023.

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revisions to liabilities in future years too. The magnitude of such revisions will not be straightforward to judge and will depend on the underlying source of the surplus.

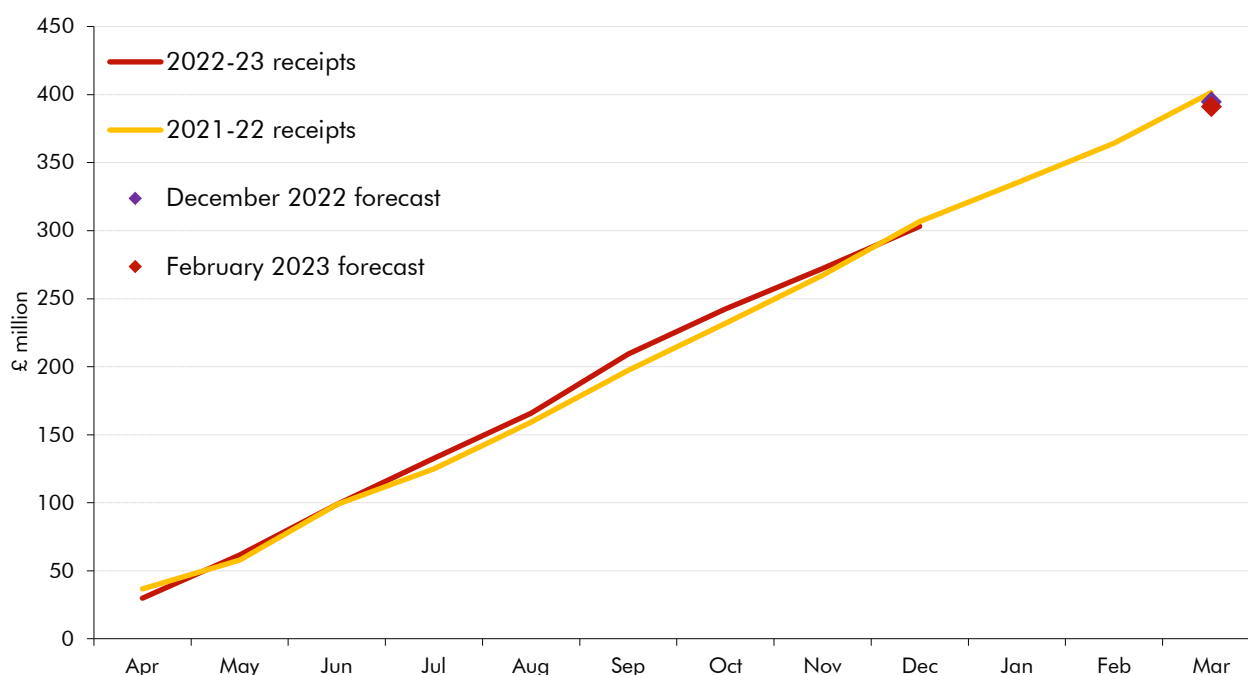
- 1.5 We will provide an initial view on future UK-wide and Welsh income tax in our next UK-wide *Economic and fiscal outlook* and *Devolved tax and spending forecasts* publications on 15 March. These will also reflect our updated UK-wide economy and fiscal forecasts.

Land transaction tax

Recent developments

- 1.6 Chart 1.1 shows recent developments in monthly LTT receipts and compares them to our latest forecast for receipts in 2022-23. In the nine months of outturn data for 2022-23, receipts have largely tracked the previous year, with year-to-date receipts just £3 million below 2021-22 levels. This and the weakening of the property market have led us to revise down our forecast modestly (by £3 million) since December (see Table 1.1).

Chart 1.1: Recent land transaction tax outturns



Source: WRA, OBR

- 1.7 Our LTT forecast starts from our UK-wide property market forecasts and an assessment of whether and how far the Welsh property market is deviating from that outlook in the short term. (In the absence of evidence to the contrary, we assume that Welsh property prices and transactions move in line with those across the UK as a whole.) We have added a 1.5 percentage point wedge between Welsh and UK house prices, based on stronger Welsh house price inflation growth over the first half of 2022-23. We assume that prices rise in line with UK prices thereafter. There are risks around this assumption, as the mortgage rate shock permeates through property markets across the UK.

Latest forecasts

1.8 Table 1.1 shows our updated forecasts for LTT and changes since December. Total receipts have been revised down by £3 million (0.9 per cent) in 2022-23, driven by weaker-than-expected outturn for commercial LTT. We assume around half of this weakness persists in future years, resulting in an average downward revision of £2 million (0.4 per cent) over the remainder of the forecast period.

1.9 Breaking the overall difference down by component, Table 1.1 shows that:

- **Residential main rates** receipts have been revised up by an average of £1 million a year.
- Receipts from **higher rates on additional residential properties** have been revised up by £3 million in 2022-23 and an average of £1 million a year thereafter.
- **Commercial property** receipts have been revised down by £4 million (3 per cent) a year on average reflecting weak outturns in the additional two months of data since our December forecast. Year-to-date receipts are £75.7 million, a 22 per cent fall on the same period in 2021-22 (£97 million). Prices still remain below the 2021-22 level at the end of the forecast period.

Table 1.1: Land transaction tax forecast: February 2023 update

	£ million						
	Outturn 2021-22	Forecast					
		2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Total LTT							
December forecast	402	395	314	301	341	404	455
February update	402	391	312	299	340	403	453
Difference	0	-3	-1	-2	-2	-2	-1
Residential main rates							
December forecast	181	203	149	134	156	194	228
February update	181	203	150	134	157	194	229
Difference	0	1	0	0	1	1	1
Higher rates on additional properties							
December forecast	91	82	64	63	73	89	100
February update	91	85	65	64	75	91	101
Difference	0	3	1	1	1	1	2
Commercial							
December forecast	130	110	100	104	112	121	126
February update	130	103	97	101	108	117	123
Difference	0	-7	-3	-3	-3	-4	-4

Landfill disposals tax

- 1.10 Table 1.2 shows our updated LDT forecast. The £0.8 million upward revision in receipts in 2022-23 reflects the inclusion of stronger-than-expected outturn data for the third quarter of the financial year. This is an effect that we have assumed does not persist in future years of the forecast, as it largely reverses the impact of second-quarter outturn data on our December forecast, which we also did not assume would persist over the forecast period.

Table 1.2: Landfill disposals tax forecast: February 2023 update

	£ million						
	Outturn	Forecast					
	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
December forecast	45	43	41	39	37	35	35
February update	45	44	41	39	37	35	35
Difference	0	1	0	0	0	0	0
of which:							
Data		1	0	0	0	0	0

2 Evaluating previous forecasts

- 2.1** As the Welsh Government's official forecaster, we believe it is important to describe our forecasts in detail. We also explained our forecast methodologies in detail in our first *Welsh taxes outlook (WTO)*, which are now kept up to date on our website. And in each *WTO* we highlight the areas of uncertainty around our central forecasts. We also believe it is important to examine regularly how these forecasts compare to outturn data once it is available. We first produced in-depth evaluations of our forecasts in our March 2022 *WTO* update, looking at the differences between forecast and outturn for our 2019-20 forecast for the Welsh rates of income tax and our 2020-21 forecasts for land transaction tax (LTT) and landfill disposals tax (LDT). We now have 2020-21 outturn data for the Welsh rates of income tax (published in July 2022), and 2021-22 outturn data for LTT and LDT.
- 2.2** Assessing the performance of our forecasts after the event is important for transparency and accountability, but also helps us identify ways to improve them. We carry out similar assessments of our UK-wide forecasts in a *Forecast evaluation report (FER)* each year. In our 2022 *WTO* we presented a high-level analysis of the performance of previous forecasts for the Welsh rates of income tax. In this chapter we deepen that analysis and extend it to LTT and LDT receipts. We have selected forecasts that were used to set the Welsh Government's budget for the most recent years of outturn. This means that we analyse 2020-21 outturn for income tax liabilities (which is published with a long lag) and 2021-22 outturn for LTT and LDT receipts outturns (which are much more timely).
- 2.3** In this chapter we therefore assess the performance of our:
- March 2020 forecast for **2020-21 Welsh rates of income tax**; and
 - December 2020 forecasts for **2021-22 land transaction tax and landfill disposals tax**.

Welsh rates of income tax

- 2.4** In our December 2022 *WTO* we showed how our five most recent forecasts for the Welsh rates in 2020-21 compared with outturn for that year. While we significantly overestimated receipts in the most recent forecast prior to outturn – due to a large over-estimate of UK-wide liabilities – our two preceding forecasts had been progressively more accurate, and we underestimated outturn in three of the five forecasts for 2020-21.
- 2.5** Table 2.1 looks in more detail at the drivers of the £30 million overestimate of revenue from the Welsh rates in our March 2020 forecast for 2020-21. This forecast was the basis for the Welsh Government's Budget for 2020-21. It was based on the Survey of Personal Incomes (SPI) for 2017-18, plus UK-wide tax receipts up to January 2020, which covered PAYE

Evaluating previous forecasts

liabilities for all of 2018-19 and most of 2019-20, and an initial estimate of self-assessment liabilities in 2018-19. This forecast incorporated real time information (RTI) data into our Welsh share modelling, an approach that we first adopted in our devolved forecasts in March 2019. This data only includes information on earnings where tax is paid via PAYE and does not include self-assessed incomes. But our March 2020 forecast did not include our new approach to the population index, where we now weight separate indices for the working-age and pension-age populations by the proportion of non-savings, non-dividend income tax paid in each, which helps capture the effects of the different trend in ageing for Wales.

2.6 Overall, the Welsh rates of income tax raised £30 million (1.4 per cent) less than expected. This is smaller than the historical average absolute year-ahead forecast difference in our UK-wide income tax forecasts of 3.3 per cent. This smaller-than-average difference is quite surprising given the enormous shortfall in UK-wide real and nominal GDP relative to our March 2020 forecasts (as discussed in our 2021 *FER*).

2.7 The £30 million shortfall compared to our forecast can be attributed to two offsetting factors (since none of the differences are associated with **subsequently announced policies**¹):

- The shortfall associated with **economic determinants of income tax liabilities** more than explains the overall shortfall, accounting for £78 million (3.6 per cent) of the difference relative to our forecast. This reflects significant downward revisions to our UK-wide forecasts for wages and salaries relative to our March 2020 *Economic and fiscal outlook (EFO)* as a result of the pandemic (wages and salaries fell short of our forecast by 3.9 percentage points). This was smaller than the shortfall in nominal GDP as a result of the furlough and self-employment income support schemes helping to support the tax base in 2020-21.
- This was somewhat offset by the **fiscal modelling** error, which generated a surplus of £48 million (2.2 per cent). This reflected the Welsh share of UK outturn being materially higher than forecast, at 1.19 per cent versus the 1.16 per cent forecast.

Table 2.1: The Welsh rates of income tax in 2020-21: forecast versus outturn

	£ million					
	Forecast	Outturn	Difference	of which:		
				Economic determinants	Fiscal modelling	Policy changes
Welsh rates of income tax	2,170	2,140	-30	-78	48	0

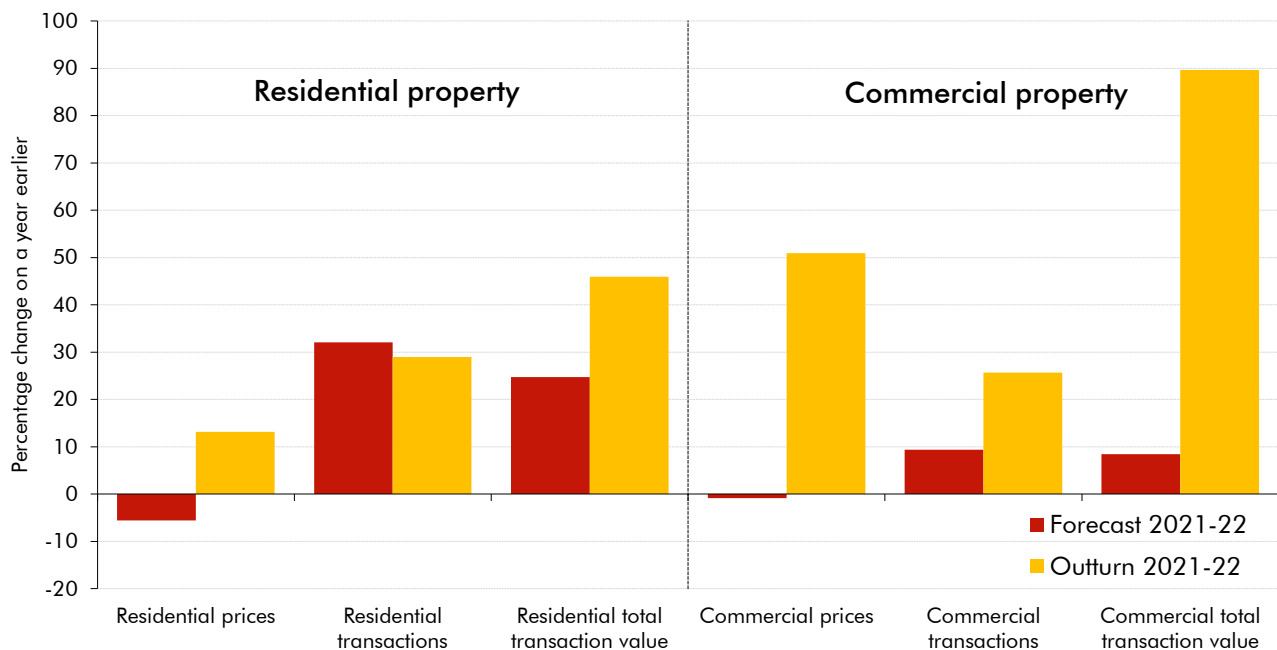
¹ Some policy measures affected the timing of self-assessed income tax payments in 2020-21, but not the timing of the underlying liabilities. As the Welsh rates of income tax revenues are calculated on a liabilities basis, those policies do not feature in this forecast evaluation.

Land transaction tax

2.8 Table 2.2 records the large outperformance of LTT receipts in 2021-22 relative to our December 2020 forecasts. Overall, LTT receipts were £171 million (74 per cent) higher than expected. Most of this reflected UK house prices far exceeding our forecast, as the market was buoyed by several factors including lower interest rates, the ‘race for space’, and excess savings flowing into the property market, as well as the urgency generated by temporary tax holidays that were in place across the UK. Chart 2.1 shows that:

- **Residential property prices in Wales** significantly outperformed our forecast of a 5.6 per cent fall in 2021-22, with prices actually *rising* by 13 per cent (outpacing the 9 per cent rise in the UK as a whole). Growth in residential transactions (29 per cent) was close to forecast (32 per cent). Taken together, growth in the total *value* of residential transactions reached 46 per cent, nearly double our forecast.
- **Welsh commercial property markets** were also significantly stronger than we assumed, as they rebounded strongly from the weakness in 2020-21. Our forecast assumed a slight fall in prices, but they actually rose by 51 per cent, surpassing their pre-pandemic peak. Transactions were also much stronger than we assumed, rebounding from the sharp fall in 2020-21. Taken together, this generated very strong growth in the value of commercial transactions of 90 per cent.

Chart 2.1: Property prices and transactions: forecasts versus outturns



2.9 Looking at receipts performance in the three individual LTT markets:

- **Residential main rates.** Receipts exceeded our forecast by £77 million. This was more than explained by the unexpectedly strong growth in prices described above. Around three-quarters of the price-driven surprise related to our forecast of UK prices, with one-quarter due to prices in Wales rising even faster than those in the UK as a whole. (This forecast did not assume any differences between house price inflation in Wales relative to our UK-wide forecast.) This may have been driven by a greater 'race for space' over the pandemic period than in the rest of the UK. Compositional impacts also contributed a small amount, due to the stronger performance of higher-price transactions for the second successive year. Policy changes announced after this forecast reduced receipts by £14 million) due to the extension of the temporary LTT holiday until 30 June 2021.
- **Higher rates on additional properties.** Receipts exceeded our forecast by £11 million. This was also more than explained by unexpectedly strong growth in prices, which raised receipts by £23 million relative to our forecast assumptions. Fiscal modelling changes offset around half of this, reflecting compositional differences in the distribution of, and changes in, property prices across additional property transactions, relative to those assumed in our forecast model.
- **Commercial receipts.** These exceeded our forecast by £83 million (174 per cent). This is largely thanks to the rapid rebound in prices and transactions in 2021-22 explained above. There were also several very-high-value property transactions in 2021-22 that contributed to the fiscal modelling error. (The scope for such outlier transactions to generate differences between forecast and outturn is quite large in the commercial sector – in 2021-22, just 3 per cent of commercial transactions with capital values in excess of £2 million accounted for 77 per cent of receipts.)

Table 2.2: Land transaction tax receipts in 2021-22: forecast versus outturn

	£ million					
	Forecast	Outturn	Difference	of which:		
				Economic determinants	Fiscal modelling	Policy changes
Total LTT forecast	231	402	171	172	11	-12
of which:						
Main rates residential	104	181	77	84	7	-14
Higher rates residential	80	91	11	19	-10	2
Non-residential	48	130	83	69	14	0

Landfill disposals tax

2.10 Table 2.3 shows that LDT receipts exceeded our December 2020 forecast by £13 million (39 per cent). This is entirely driven by fiscal modelling and reflects a stronger rebound in volumes sent to landfill in 2021-22 than we had assumed – matching trends seen in the rest of the UK – with a large increase in standard-rated waste receipts driving most of the difference (80 per cent).

Table 2.3: Landfill disposals tax receipts in 2021-22: forecast versus outturn

	£ million					
	Forecast	Outturn	Difference	of which:		
				Economic determinants	Fiscal modelling	Policy changes
Total LDT forecast	33	45	13	0	13	0

