

Office for
**Budget
Responsibility**

Welsh taxes outlook

February 2024 update

1 Updated tax forecasts

Introduction

- 1.1 In our December 2023 *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 (Welsh rates), 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 2023 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 2024-25. They are still underpinned by determinants from our November 2023 economy and fiscal forecasts for the UK as a whole.³ We do not for this publication update our December WTO forecast for the Welsh rates of income tax.
- 1.3 The ONS's Public Sector Finances (PSF) bulletin published on 21 February showed that the latest position on in-year self-assessment (SA) income tax receipts for the UK as a whole was £3 billion below our November 2023 forecast profile. We have not yet assessed how much of the weakness relates to non-savings, non-dividend income tax – the element subject to the Welsh rates.⁴ Implications for the Welsh rates for 2022-23 will be presented in the final outturn liabilities that are published by HMRC later this year.
- 1.4 We will provide an initial view on the implication for future UK-wide and Welsh income tax in our next UK-wide *Economic and fiscal outlook* and *Devolved tax and spending forecasts* publications on 6 March. These will also reflect our updated UK-wide economy and fiscal forecasts.

Land transaction tax

Recent developments

- 1.5 Chart 1.1 shows monthly LTT receipts during 2023-24 and compares them to our December forecast. With three-quarters of the year now gone, receipts are 32 per cent (£98

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 2023 *Economic and fiscal outlook*.

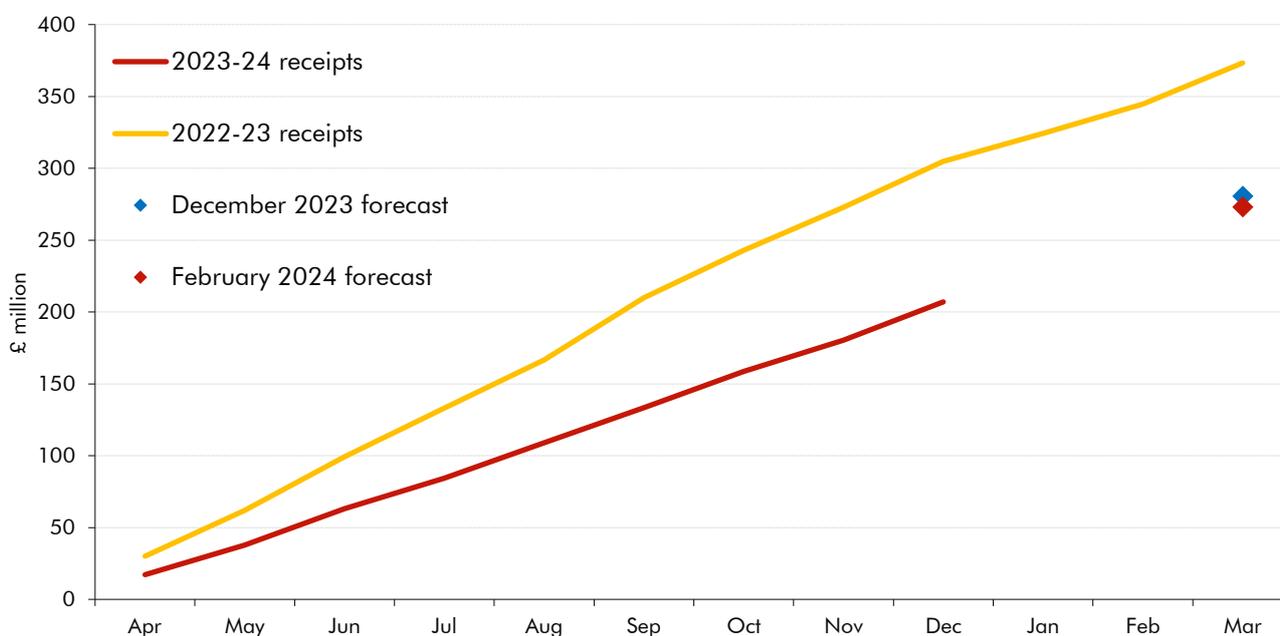
³ Analysts in the Welsh Government produced updated forecasts for LTT and LDT on 14 February 2024. The Budget Responsibility Committee scrutinised and finalised these forecasts on the same day.

⁴ For more details, see: OBR, *Commentary on the Public Sector Finances: January 2024, February 2024*.

Updated tax forecasts

million) down on 2022-23 levels. The three months of outturn data since our December forecast has led us to revise down 2023-24 receipts by £7 million (Table 1.1).

Chart 1.1: Recent land transaction tax outturns



Source: WRA, OBR

1.6 Our LTT forecast is based on our outlook for the UK-wide property market and an assessment of whether and how far the Welsh property market is deviating from that outlook. In the absence of evidence to the contrary, our starting assumption is that Welsh property prices and transactions move in line with those across the UK as a whole. That is the assumption we make in this forecast too, as outturn data has shown that recent house price changes across the two countries have followed a similar path. There are some risks around this assumption, such as the possibility that changes in the interest rates affect the Welsh property market different from the rest of the UK.

Latest forecasts

1.7 Table 1.1 shows our updated forecasts for LTT and the changes since December. Total receipts have been revised down by £8 million (2.4 per cent) a year on average, reflecting weaker outturn data (driven largely by commercial LTT).

1.8 Breaking the overall difference down by component:

- **Residential main rates** receipts have been revised down by an average of £2 million a year (1.5 per cent);
- Receipts from **higher rates on additional residential properties** have been revised up by an average of £5 million a year (6.4 per cent); and

- **Commercial property** receipts have been revised down by £10 million (12 per cent) a year on average, reflecting continuing weakness in the outturn data since our December forecast. Year-to-date receipts are £44.8 million, which is £32.7 million (42 per cent) below the same period in 2022-23. Commercial property receipts tend to be more volatile than residential receipts as they can be affected by one-off large transactions. Given this volatility, we assume around half of the weakness will persist across the forecast period, with receipts in the final year of the forecast remaining £11 million (12 per cent) below the 2022-23 level.

Table 1.1: Land transaction tax forecast: February 2024 update

	£ million						
	Outturn	Forecast					
	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Total LTT							
December forecast	372	280	251	279	325	375	437
February update	372	273	244	271	317	367	429
Difference	0	-7	-7	-8	-8	-8	-8
Residential main rates							
December forecast	196	146	122	136	165	200	238
February update	196	144	120	134	163	197	234
Difference	0	-2	-2	-2	-2	-3	-3
Higher rates on additional properties							
December forecast	82	58	54	62	73	85	106
February update	82	62	58	66	78	90	112
Difference	0	4	3	4	5	5	7
Commercial							
December forecast	94	76	74	80	86	90	94
February update	94	67	65	71	76	79	83
Difference	0	-9	-9	-10	-10	-11	-11

Landfill disposals tax

- 1.9 Table 1.2 shows our updated LDT forecast. The £1 million downward revision in receipts in 2023-24 reflects the inclusion of slightly weaker-than-expected outturn data for the third quarter of the year. The persistence of this shortfall has led us to assume that all of the reduction is permanent and revenues for future years start from the lower base, lowering receipts by £1 million a year from 2023-24 onwards.

Table 1.2: Landfill disposals tax forecast: February 2024 update

	£ million						
	Outturn	Forecast					
	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
December forecast	42	31	29	28	27	26	26
February update	42	30	28	27	26	25	25
Difference	0	-1	-1	-1	-1	-1	-1
<i>of which:</i>							
Data		-1.1	-1.0	-1.0	-0.9	-0.9	-0.9

2 Evaluating previous forecasts

2.1 Assessing the performance of our past forecasts is important for transparency and accountability, and identifies areas for improvement. We routinely evaluate previous forecasts in our *WTO* updates and do so again here, looking at our:

- December 2020 forecast for the Welsh rates of income tax in 2021-22; our
- March 2022 forecast for land transaction tax in 2022-23; and our
- March 2022 forecast for landfill disposals tax in 2022-23.

Welsh rates of income tax

2.2 In our December 2023 *WTO* we showed how our six most recent forecasts for the Welsh rates in 2021-22 compared with the eventual outcome. We significantly underestimated outcome in the three earliest forecasts (due to underestimating the UK-wide forecast for non-savings non-dividend income tax) and then overestimated outcome in the three most recent ones (due to overestimating the Welsh share).

2.3 Our December 2020 *WTO* forecast was notable for taking place at the height of the pandemic with all of its associated economic uncertainties. It was based on the UK-wide economy forecast presented in our November 2020 *Economic and fiscal outlook*, the 2017-18 Survey of Personal Incomes, UK-wide PAYE outcome data to August 2020, an initial estimate for self-assessment outcome data for 2018-19 and the most recent real time PAYE information from HMRC.

2.4 Table 2.1 shows that the Welsh rates outcome for 2021-22 was £2,384 million, £320 million (16 per cent) higher than we forecast in December 2020, the largest absolute year-ahead forecast error since we started forecasting the Welsh rates. The error can be split into two elements:

- **The post-pandemic economic recovery exceeded expectations**, with higher-than-expected average earnings and stronger employee numbers. This element accounts for £179 million (8.7 per cent) of the difference relative to our forecast.
- Stronger-than-expected growth in aggregate pay led to higher-than-expected fiscal drag – the process by which taxpayers move up into higher tax bands. This meant the **effective tax rate was higher than we forecast** in December 2020. This effect was **slightly offset by the eventual Welsh share of UK NSND income tax being lower than forecast** (1.15 per cent compared to 1.16 per cent). Overall, this element contributed to £141 million (6.8 per cent) of the surplus.

Evaluating previous forecasts

- 2.5 A further uncertainty at the time of the December 2020 forecast was that we had not yet had the first year of outturn data for the Welsh rates. It is also worth noting that our December 2020 forecast for the equivalent England and Northern Ireland revenue, which directly affects the Welsh Government's budget, was also lower than outturn.

Table 2.1: The Welsh rates of income tax in 2021-22: forecast versus outturn

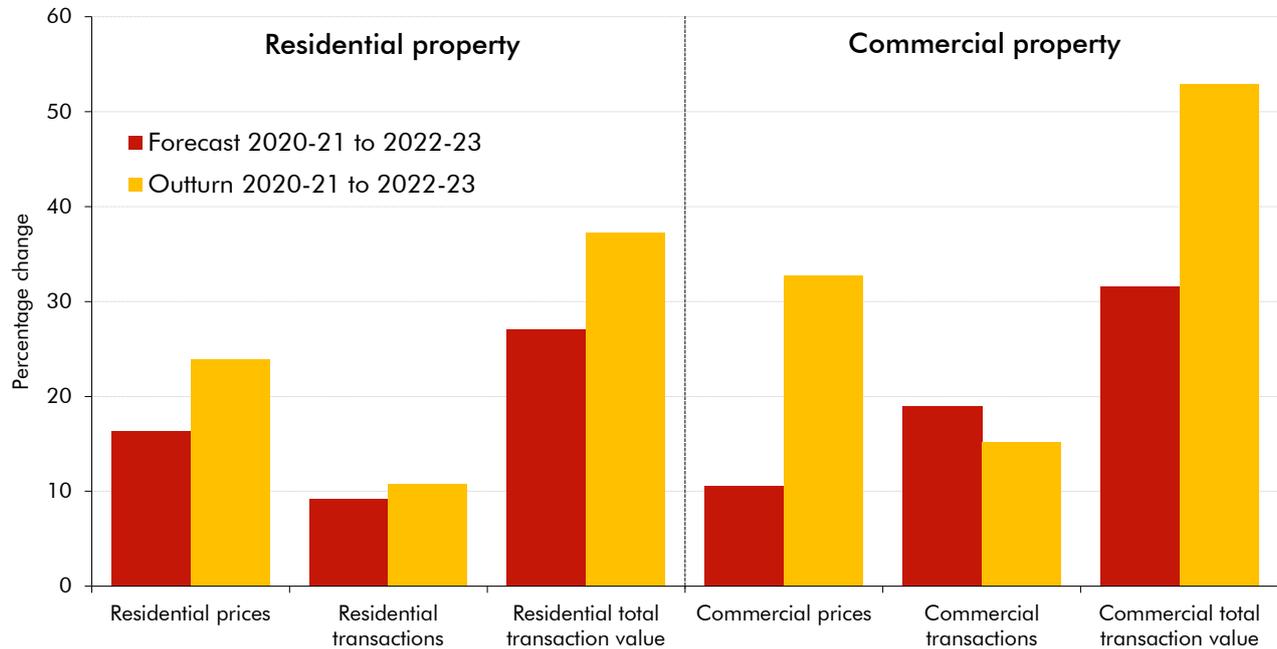
	£ million					
	Forecast	Outturn	Difference	of which:		
				Economic determinants	Fiscal modelling	Policy changes
Welsh rates of income tax	2,064	2,384	320	179	141	0

Land transaction tax

- 2.6 Table 2.2 shows that our March 2022 forecast for LTT receipts in 2022-23 came in close to expectations at £372 million, £8 million (2.2 per cent) lower than forecast. While the total value of transactions was higher than forecast, this was offset by lower-than-expected receipts from these transactions. Chart 2.1 shows that:

- **Residential and commercial property prices both exceeded expectations.** There was a 24 per cent two-year rise in the former (compared to the forecast 16 per cent) while for the latter the equivalent numbers were 33 per cent (compared to the 11 per cent that was forecast).
- **Residential and commercial transactions were both closer to the March 2022 forecast,** slightly higher in the case of residential properties and slightly lower for commercial properties.
- **Taken together, the total value of transactions exceeded expectations for both residential and commercial properties,** which contributes to the £52 million surplus that is attributable to the difference in economic determinants (Table 2.2).

Chart 2.1: Property prices and transactions: forecasts versus outturns



2.7 Table 2.2 shows that the higher receipts due to these economic factors is entirely offset by a shortfall of receipts attributed to fiscal forecasting factors, including:

- **A £37 million shortfall in commercial property receipts**, which largely relates to overestimating the size of the in-year estimate that we made using 2021-22 data, some of which fed through to later years of the forecast. The in-year estimate is based on outturn data to give us the starting point for the forecast, with future years running off determinants, with no 2021-22 economic determinants fed through the model. This therefore meant that the higher-than-forecast in-year prices and transactions were not implicitly captured within the model, instead feeding through via the in-year component of the fiscal modelling error. This shows the importance of considering in-year adjustments, which helped to offset this determinant error.
- **An £18 million shortfall in residential property receipts.** Once again, this is mostly explained in relation to our March 2022 judgement around the in-year estimate for receipts in 2021-22, and shows the importance of reflecting on what the latest in-year data suggests.

2.8 The October 2022 pandemic measure that increased the LTT threshold from £180,000 to £225,000 accounts for the remaining £5 million shortfall when compared to the March 2022 forecast.

Table 2.2: Land transaction tax receipts in 2022-23: forecast versus outturn

	£ million					
	Forecast	Outturn	Difference	of which:		
				Economic determinants	Fiscal modelling	Policy changes
Total LTT forecast	381	372	-8	52	-56	-5
<i>of which:</i>						
Residential (main rates)	187	196	8	23	-9	-6
Residential (higher rates)	87	82	-5	4	-9	1
Non-residential	106	94	-12	25	-37	0

Landfill disposals tax

2.9 Table 2.3 shows that LDT receipts exceeded our March 2022 forecast by £7 million (19 per cent). This is entirely driven by a stronger-than-expected rebound in the amount of standard-rated waste that was sent to landfill in 2022-23. Our March 2022 forecast assumed that half of the strength in standard-rated waste that we were seeing during 2021-22 would persist in future years, which proved to be an underestimate, reflecting some of the forecasting challenges in the aftermath of the pandemic.

Table 2.3: Landfill disposals tax receipts in 2022-23: forecast versus outturn

	£ million					
	Forecast	Outturn	Difference	of which:		
				Economic determinants	Fiscal modelling	Policy changes
Total LDT forecast	35	42	7	0	7	0

