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Agenda - Finance Committee

Meeting Venue:	For further information contact:
Committee Room 4 - Tŷ Hywel	**Bethan Davies**
Meeting date: 11 October 2017	Committee Clerk
Meeting time: 09.00	0300 200 6372
	SeneddFinance@assembly.wales

1 Introductions, apologies, substitutions and declarations of interest

(09.00)

2 Paper(s) to note

(09.00)

2.1 PTN1 - Letter from the Cabinet Secretary for Finance and Local Government: Report on Outturn 2016-17 - 30 September 2017

(Pages 1 - 14)

3 Public Services Ombudsman for Wales Estimates 2018-19: Evidence session

(09.00-10.00) (Pages 15 - 43)

Nick Bennett, Public Services Ombudsman for Wales

Chris Vinestock, Chief Operating Officer

David Meaden, Financial Accountant

Paper 1 - Public Services Ombudsman for Wales Estimate for the Financial Year 2018-19

4 Motion under Standing Order 17.42 to resolve to exclude the public from items 5, 8 and 9

(10.00)

Cynulliad Cenedlaethol Cymru National Assembly for Wales

5 Public Services Ombudsman for Wales Estimates 2018-19: Consideration of evidence

(10.00-10.15)

6 Welsh Government draft budget 2018-19: Evidence session 2 (Bangor University)

(10.15-11.15) (Pages 44 - 110)

Dr Edward Jones, Bangor University

Dr Helen Rogers, Bangor University

Paper 2 - Bangor University: Independent scrutiny and assurance of devolved tax forecasts for Wales

7 Welsh Government draft budget 2018-19: Evidence session 3 (Welsh Treasury)

(11.15-12.15) (Pages 111 - 182)

Andrew Jeffreys, Welsh Treasury, Welsh Government

Dyfed Alsop, Chief Executive, Welsh Revenue Authority (WRA)

Julian Revell, Head of Fiscal Analysis, Welsh Treasury

Paper 3 - Welsh tax policy report

8 Welsh Government draft budget 2018-19: Consideration of evidence

(12.15-12.25)

9 National Assembly for Wales Commission draft budget 2018-19: Consideration of evidence

(12.25-12.30)

Mark Drakeford AM/AC
Ysgrifennydd y Cabinet dros Gyllid a Llywodraeth Leol
Cabinet Secretary for Finance and Local Government

Llywodraeth Cymru
Welsh Government

Ein cyf/Our ref: MA-P/MD/3301/17

Simon Thomas AM,
Chair, Finance Committee,
The National Assembly for Wales,
Cardiff Bay,
Cardiff
CF99 1NA

30 September 2017

Dear Simon,

The Welsh Government's Consolidated Annual Accounts for 2016-17 have now been audited and published on 6 September 2017. In line with my commitment to good practice and transparency I am now able to provide the Finance Committee with a written report on the 2016-17 final outturn for the Welsh Government set against spending plans approved in the Second Supplementary Budget 2016-17.

The final Ambit outturn for 2016-17 is £13.8 billion against the Welsh Government Budget of £14.1 billion. This represents a 2.2% variance against the approved budget.

The report and supporting annexes provide: a summary of expenditure by portfolio within Treasury control totals; variations compared to the budget; an explanation of significant variances; and details of amounts to be carried forward into the current year under HM Treasury's 'Budget Exchange' mechanism.

I'm happy to make officials available for discussion of the detail of the report if that would be helpful.

Best wishes,

Mark

Mark Drakeford AM/AC
Ysgrifennydd y Cabinet dros Gyllid a Llywodraeth Leol
Cabinet Secretary for Finance and Local Government

Bae Caerdydd • Cardiff Bay
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Welsh Government

Report on Outturn 2016-17

A report from the Cabinet Secretary for Finance and Local Government to the Finance Committee on the audited outturn of the Welsh Government 2016-17 set against the planned expenditure contained in the Second Supplementary Budget 2016-17.

1. Introduction

1.1 This report has been produced in accordance with the protocol endorsed by the National Assembly for Wales on 21 March 2012 regarding changes to the Budget motion and their impact on the in-year Budget cycle.

1.2 As part of the protocol the Welsh Government agreed:

In line with the Welsh Government's commitment to working openly and transparently, the Welsh Government will provide a written report to the Committee on final outturn. The report would include a comparison with the spending plans set out in the last Supplementary Budget of the year and an explanation of significant variations.

1.3 This commitment was reaffirmed in the revised protocol approved by the National Assembly on 21st June 2017.

1.4 This report addresses that commitment for the financial year 2016-17.

1.5 The Second Supplementary Budget for 2016-17, was approved by the National Assembly on 7 March 2017. The final outturn follows publication of the Welsh Government's Consolidated Annual Accounts on 6 September 2017. See the attached internet link:

http://gov.wales/about/civilservice/how-we-work/facts-figures/ourfinance/welsh-government-consolidated-accounts/welsh-government-annual-accounts-2016-2017/?lang=en

1.6 The outturn is reported on the basis of the Welsh Government budget structure in force at that time.

2. Main Expenditure Group Outturn 2016-17

2.1 The Consolidated Accounts of the Welsh Government were laid before the Assembly on 31 August 2017. These audited accounts contain a Summary of Resource Outturn against the control totals approved in the Second Supplementary Budget motion of 2016-17 (the 'Ambit').

2.2 This report provides details of outturn against the controls operated and enforced by HM Treasury. These administrative budgets are detailed in the documentation and tables which supported the Second Supplementary Budget.

Departmental Expenditure Limit (DEL) Outturn

2.3 The Welsh Government's audited DEL outturn is £14,707 million. This is an underspend against the budget, as agreed in the Second Supplementary Budget, of £83 million.

2.4 This outturn includes underspends of £9.1 million against the Fiscal Resource budget (near cash revenue) and £0.7 million on the Capital budget. This represents an underspend of 0.07% against Fiscal Resource and 0.05% Capital.

2.5 The Non Fiscal Resource budget (non cash) is underspent by £73.6 million. It is important to note that the Non Fiscal Resource budget is ring-fenced and covers accounting adjustments such as depreciation (see below). Therefore, it could not have been re-directed to Welsh Government spending programmes.

2.6 As in previous years, all overspends and any underspends of greater than 1% of portfolio DEL budgets (Main Expenditure Groups or MEGs) and above a de-minimis level of £0.5 million are explained below. A breakdown of the outturn by MEG is provided in Annex 1.

Fiscal Resource (Revenue)

2.7 MEG level expenditure in this budget classification was again extremely close to budget. Very small underspends were reported in six of the seven MEGs with only one budget exceeding a 1% variance when measured against the Second Supplementary Budget. This provides some assurance that spending within the Welsh Government revenue budget of £13 billion has been maximised.

2.8 There was a revenue overspend of £5 million in the Economy and Infrastructure MEG. An additional payment for work carried out on the Public Sector Broadband Aggregation project was made in order to maximise spend in the current year and release budgetary pressure in future years. This overspend is offset by underspends in other MEGs.

2.9 The Health, Well-being and Sport revenue underspend was £7.2 million. This included a total deficit posted by the NHS bodies in Wales of £147.7 million. The deficit was accommodated through improvements in the NHS position and underspends on Welsh Government central health and social services budgets within the MEG.

2.10 The Local Government revenue budget reported an underspend of £2.3 million. Included within this amount is: £0.9 million on Transformation and Legislation following the adoption of a new approach to the transformation of local government; £0.6 million in relation to Community Support Officers with cost estimates prepared at the start of the year being slightly higher than actual results; and, £0.2 million against Health Inspectorate Wales in relation to peer reviewer fees and associated travel and subsistence costs. There were also a number of smaller underspends that make up the remaining balance.

2.11 A variance in excess of 1% was reported against the Central Services and Administration MEG. A variance of £4.1 million was reported which is due in the main to an underspend against the Invest to Save fund budget. Consideration will be given to deploying the underspend for the intended purpose in future years.

Capital

2.12 Performance against the Welsh Government capital budget of £1.4 billion was close to budgeted with underspends of less than £0.3 million reported by all MEGs.

Non Fiscal Resource (revenue non cash)

2.13 The majority of the Welsh Government DEL underspend relates to non cash budgets (£73.6 million). Non cash budgets are ring-fenced and provided for accounting estimates such as depreciation and adjustment to provisions. An explanation of those underspent by 1% or more is provided below.

2.14 The Health, Well-being and Sport non cash budget reported an underspend of £4.6 million. The budget primarily funds the depreciation charges arising on the NHS estate so forecasts are sensitive to fluctuations in progression of capital schemes, annual valuations and timing of capital additions and disposals.

2.15 The underspend of £37.7 million within the Economy and Infrastructure MEG largely related to depreciation charges arising from changes to the methodology used for the annual roads valuation. The roads network represents the largest Welsh Government asset.

2.16 An underspend of £27.6 million was reported against the Education budget. This budget covers the estimated charge for the annual write-off of student loans. The calculated charge is generated by a statistical model developed by the UK government. The charge is applied to the value of the student loan book. The modelling is complex and takes many social and economic factors into account and as such is difficult to forecast accurately.

2.17 The Welsh Government's Central Services and Administration MEG underspent by £4.6 million on the related non cash budget. This underspend is a result of less than anticipated depreciation charges associated with the Welsh Government estate.

Annually Managed Expenditure (AME) Outturn

2.18 HM Treasury recognise the volatility and demand led basis of certain programmes and the resultant difficulty in estimating costs over a period of time. As a result these programme budgets are managed on an annual basis and funding cover is generally provided by HM Treasury. The majority of our AME budgets cover non cash charges and examples include asset impairments, increases in provisions, student loans issued and repaid and pension valuations of sponsored bodies. The Welsh Government is unable to recycle underspends against AME programmes. The main variances are explained below.

2.19 The Health, Well-being and Sport (HWS) AME budget was £8.2 million overspent. The first element of the overspend is a £15 million overspend covering movements on provisions. The Welsh Risk Pool provision movement was £15.8 million above budget. This was due to the then Lord Chancellor revising the personal injury discount rate in the final quarter of the year, affecting all clinical negligence claim settlements. The rate represented a significant change, from 2.5% to minus 0.75%. The remaining £13.6 million provision overspend relates to additional structured settlements arising and quantum estimate revisions. A £14.4 million underspend across other Health provisions offset this overspend.

2.20 The second element of the HWS variance is a £6.4 million underspend on impairments in the value of NHS assets. These are due to differences between forecast and final valuations or scheme timing changes.

2.21 The AME variance of £39.6 million within the Economy and Infrastructure MEG arose as a result of impairment levels lower than budgeted, as well as the write back of significant provisions from previous years.

2.22 An underspend of £17.2 million was reported on the Education AME budget. This mainly related to the student loans budgets £23.6 million which are demand led and difficult to forecast. Loan issues and repayments in the year were less than anticipated. This was offset by an overspend of £6.4 million due to the year end movement in the Careers Wales pension provision. The movement is based on an actuarial valuation from the pension scheme providers.

2.23 The underspend of £2.4 million against the Environment & Rural Affairs MEG relates to potential pension liabilities arising from the transfer of staff from the Environment Agency Wales to Natural Resources Wales on 1 April 2013. Active members and those eligible to be active members of the Environment Agency Pension Fund (EAPF) retained the right to continue in the EAPF when they transferred. From April 2013 the pension liability transferred to Natural Resources Wales and a budget has been included since then to cover any future deficit in the scheme. Whilst the budget has been included in the four years since the transfer it has not been utilised.

2.24 The Central Services and Administration MEG reported an underspend of £5.9 million. The majority of this variance is in relation to provisions for early retirements and other pension charges of Welsh Government staff. The pension charge represents the difference between benefits accrued during the year and financial contributions made into the fund, the latter being very difficult to forecast.

2.25 Annex 2 to this report provides a summary of outturn against Annually Managed Expenditure (AME) Budgets.

3. Budget Exchange and Carry Forward

3.1 In the Second Supplementary Budget for 2016-17, the Welsh Government reported Fiscal Resource DEL reserves of £69.6 million and Capital DEL reserves of £185.7 million. We planned to carry forward both these reserves along with any underspends up to the agreed caps imposed by HM Treasury under ‘Budget Exchange’. The caps are set at 0.6% of the Wales Resource DEL, 1.5% of Capital DEL and 15% of Capital Financial Transactions DEL.

3.2 During 2016-17, we were given dispensation from the Chief Secretary to the Treasury to carry forward £9 million Fiscal Resource DEL, £60 million Capital DEL and £100 million Capital Financial Transactions DEL over and above the limits imposed. This was to allow for any future support required due to the uncertainty over the future of the steel industry in Wales following announcements made by Tata Steel.

3.3 Table 1 illustrates the final reserves position. The balances to be carried forward for the Wales DEL will be £79.2 million Fiscal Resource, £13.2 million Non-Fiscal Resource and £186 million Capital which are within the revised Treasury limits.

Table 1 Carry forward resulting from Wales DEL outturn

	Fiscal Resource £m	Non Fiscal Resource £m	Capital £m
Reserves as per Second Supplementary Budget 2016-17	69.6	430.0	185.7
2016-17 Welsh Government underspends	9.1		0.7
2016-17 Other Bodies & Direct Charges outturn	0.5	0.4	-0.4
Balance to be carried forward to 2017-18	**79.2**	**13.2**[1]	**186.0**
Treasury Budget Exchange Limits	*87.9*	*4.5*	*210.5*[2]

3.4 As well as the underspends reported by the Welsh Government, the balances to be carried forward take account of the outturns of the other bodies funded from the Welsh DEL i.e. the National Assembly for Wales, the Public Services Ombudsman for Wales and the Wales Audit Office.

3.5 The adjustments to our baseline to reflect the final amount carried forward outlined above will be made later in the financial year through the UK Supplementary Estimate process and will feature in the Welsh Government's Second Supplementary Budget 2017-18.

3.6 Allocations from the Fiscal Resource reserve of £47.4 million and Capital reserve of £2.2 million were made in the First Supplementary Budget of 2017-18.

3.7 From April 2018 the Budget Exchange facility will be replaced by the operation of a new 'Cash Reserve'. From that date DEL underspends will be paid into the reserve for use in future years. The new reserve can hold up to £350 million in aggregate.

[1] In the event that the limit for Fiscal Resource DEL carry forward is not fully utilised the balance can be used to carry additional Non Fiscal Resource DEL forward up to the overall cap on the Resource DEL.
[2] The capital limit is made up of £81.6m traditional and £128.9m financial transactions.

Annex 1 – Departmental Expenditure Limit (DEL) Outturn 2016-17

Main Expenditure Group	Supplementary Budget			Outturn			Underspends / Overspends (-)		
	Fiscal Resource £m	Non Fiscal Resource £m	Capital £m	Fiscal Resource £m	Non Fiscal Resource £m	Capital £m	Fiscal Resource £m	Non Fiscal Resource £m	Capital £m
Health, Well-being & Sport	6,752.0	174.8	276.8	6,744.8	170.2	276.5	7.2	4.6	0.3
Local Government	3,333.3	0.4	20.3	3,331.0	0.2	20.3	2.3	0.2	0
Communities & Children	362.5	0	403.5	362.4	0	403.4	0.1	0	0.1
Economy & Infrastructure	635.6	-212.0	447.8	640.6	-249.7	447.8	-5.0	37.7	0
Education	1,370.4	333.0	175.6	1,370.1	305.4	175.5	0.3	27.6	0.1
Environment & Rural Affairs	277.5	11.8	102.2	277.4	11.8	102.0	0.1	0	0.2
Central Services & Administration	287.5	16.0	21.2	283.4	12.5	21.2	4.1	3.5	0
TOTAL	**13,018.8**	**324.0**	**1,447.4**	**13,009.7**	**250.4**	**1,446.7**	**9.1**	**73.6**	**0.7**

Annex 2 – Annually Managed Expenditure Outturn 2016-17

Main Expenditure Group	Supp Budget £m	Outturn £m	Under/ Over(-) Spend £m
Health, Well-being & Sport	265.6	273.8	-8.2
Local Government	977.0	977.0	0
Communities & Children	33.1	33.1	0
Economy & Infrastructure	26.4	-13.2	39.6
Education	387.6	370.4	17.2
Environment & Rural Affairs	2.4	0	2.4
Central Services & Administration	2.6	-3.3	5.9
TOTAL	**1,694.7**	**1,637.8**	**56.9**

Agenda Item 3

Estimate for the Financial Year 2018/19

INNOVATION IMPROVEMENT INFLUENCE

Contents

Review of 2016-17

I am delighted to be able to report substantial progress in the activities of the office over the past year, with specific reference to our three year strategic themes of innovation, improvement and influence, which have led to substantial increases in outcomes for complainants and, I hope, positive impacts on public services.

In terms of innovation the office made further progress on compliance, working to ensure that recommendations for improvement are implemented and that we ensure that the learning from complaints is acted upon.

The improvement function has started well. All Improvement Officers have developed specific action plans for the relevant bodies in jurisdiction. This has led to a number of specific improvements in their complaint handling cultures.

One area of particular improvement was the improvement on timescales – with a move towards complainant-centred timescales. The establishment of the internal Code Advisory Group has meant the proactive oversight of code of conduct complaints, and a seven per cent reduction in cases taking longer than six months.

I was delighted that my first thematic report on Out of Hours services led to a peer review by the Welsh Government to be implemented throughout 2017. I produced a further thematic report Ending Groundhog Day: Lessons from Poor Complaint Handling in March 2017.

In 2016/17 there was a further increase in the use of Voluntary Settlement, an increase of some 26 per cent on the previous year. However, whilst this can lead to speedier resolution for complainants and cheaper processes for public services, it is important that Early Resolution is not seen as some form of easy escape for bodies in my jurisdiction.

I published six public interest reports in the course of the year, three of which were in relation to Betsi Cadwaladr University Health Board, a number of health reports also related to Out of Hours services.

In terms of our influence and collaboration with other bodies inside and outside Wales 2016/17 was a busy year. We implemented joint Internal Audit arrangements with the Older People and the Children's Commissioners and also implemented payroll arrangements for the Future Generations Commissioner. I was also delighted to participate in Wales Audit Office events on complaints in both North and South Wales. Memoranda of Understanding were signed with a number of Commissioners and the Healthcare Inspectorate Wales.

During 2016/17 we submitted a Regulatory Impact Assessment to the Finance Committee and I am very hopeful that the legislation will now be taken forward in 2017/18.

Finally, 2016/17 was a year of not just positive activity, but of positive outcomes. Despite the challenge of increasing workloads the number of complainants who received a positive outcome from my office, either through voluntary settlement or an upheld complaint, increased by 16 per cent!

Introduction to this estimates submission

I submit this budget estimate as required by paragraph 15 of Schedule 1 of the Public Services Ombudsman (Wales) Act 2005, as amended by the Government of Wales Act 2006. It sets out the resources required from the Welsh Consolidated Fund to carry out my statutory functions apart from my salary, National Insurance and pension costs, which are a separate direct charge on the Welsh Consolidated Fund and do not, therefore, form part of this estimate. However, they are reported in my Annual Accounts in order to ensure that they reflect the total running costs of the office.

This is the second submission of the Public Services Ombudsman for Wales's (PSOW) estimates to the Fifth Assembly. The Finance Committee is responsible for considering this estimates submission. The Equality, Local Government and Communities Committee is responsible for considering the work of the office. The PSOW also appears before the Public Accounts Committee to discuss the Annual Accounts as and when required by that Committee. The information provided in this paper relates particularly to those matters within the remit of the Finance Committee.

The Public Services Ombudsman (Wales) Act 2005 establishes the office of the Ombudsman as a 'corporation sole'. The Ombudsman is accountable to the National Assembly for Wales, both through the mechanism of the annual report, and as Accounting Officer for the public funds with which the National Assembly entrusts the Ombudsman to undertake his functions.

The net resource expenditure sought for 2018/19 without new powers is £4,480k, with a net cash requirement of £4,410k. These figures represent the funding required to manage the workload of the Office at projected levels, whilst keeping my budget at no more than 0.03% of the Welsh Block. It accommodates both staff pay awards and other inflationary pressures, although the annual pension deficit payment is no longer required. The detail in this paper supports this estimate submission.

If new legislation, governing the work of the Ombudsman, is introduced the net resource requirement increases to £4,820k and cash to £4,750k in a full year. The costs associated with new powers are shown in the Annex for completeness but are not part of the formal budget submission.

The role of the Public Services Ombudsman for Wales

As Ombudsman, I have two specific roles. The first is to consider complaints about public service providers in Wales; the second role is to consider complaints that members of local authorities have broken the Code of Conduct. I am independent of all government bodies and the service that I provide is free of charge.

Complaints about public service providers

Under the PSOW Act 2005, I consider complaints about bodies which, generally, are those that provide public services where responsibility for their provision has been devolved to Wales. The types of bodies I can look into include:

- local government (both county and community councils);
- the National Health Service (including GPs and dentists);
- registered social landlords (housing associations);
- the Welsh Government, together with its sponsored bodies; and
- privately arranged or funded social care and palliative care services.

When considering complaints, I look to see whether people have been treated unfairly or inconsiderately, or have received a bad service through some fault on the part of the service provider. Attention will also be given to whether the service provider has acted in accordance with the law and its own policies. If a complaint is upheld I will recommend appropriate redress. The main approach taken when recommending redress is, where possible, to put the complainant (or the person who has suffered the injustice) back to the position they would have been in if the problem had not occurred. Furthermore, if from the investigation I see evidence of a systemic weakness, then recommendations will be made with the aim of reducing the likelihood of others being similarly affected in future.

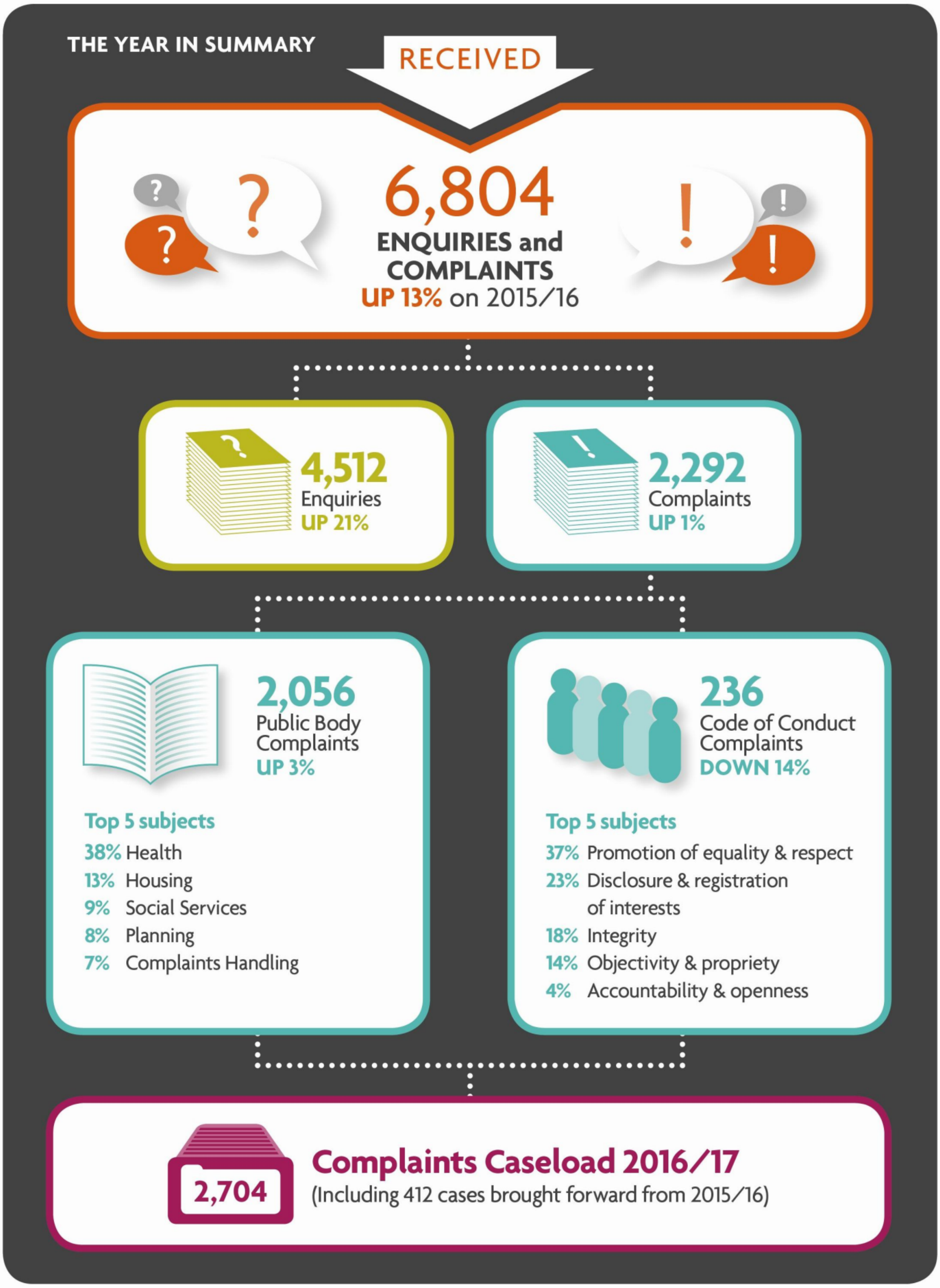
My Complaints Advice Team also provides the Complaints Wales signposting service, which is an independent and impartial telephone and web based service. It offers advice to members of the public on how to complain about a public service and signposts their complaint to the organisation that provides the service that they wish to complain about, or to the appropriate independent complaint handler or ombudsman

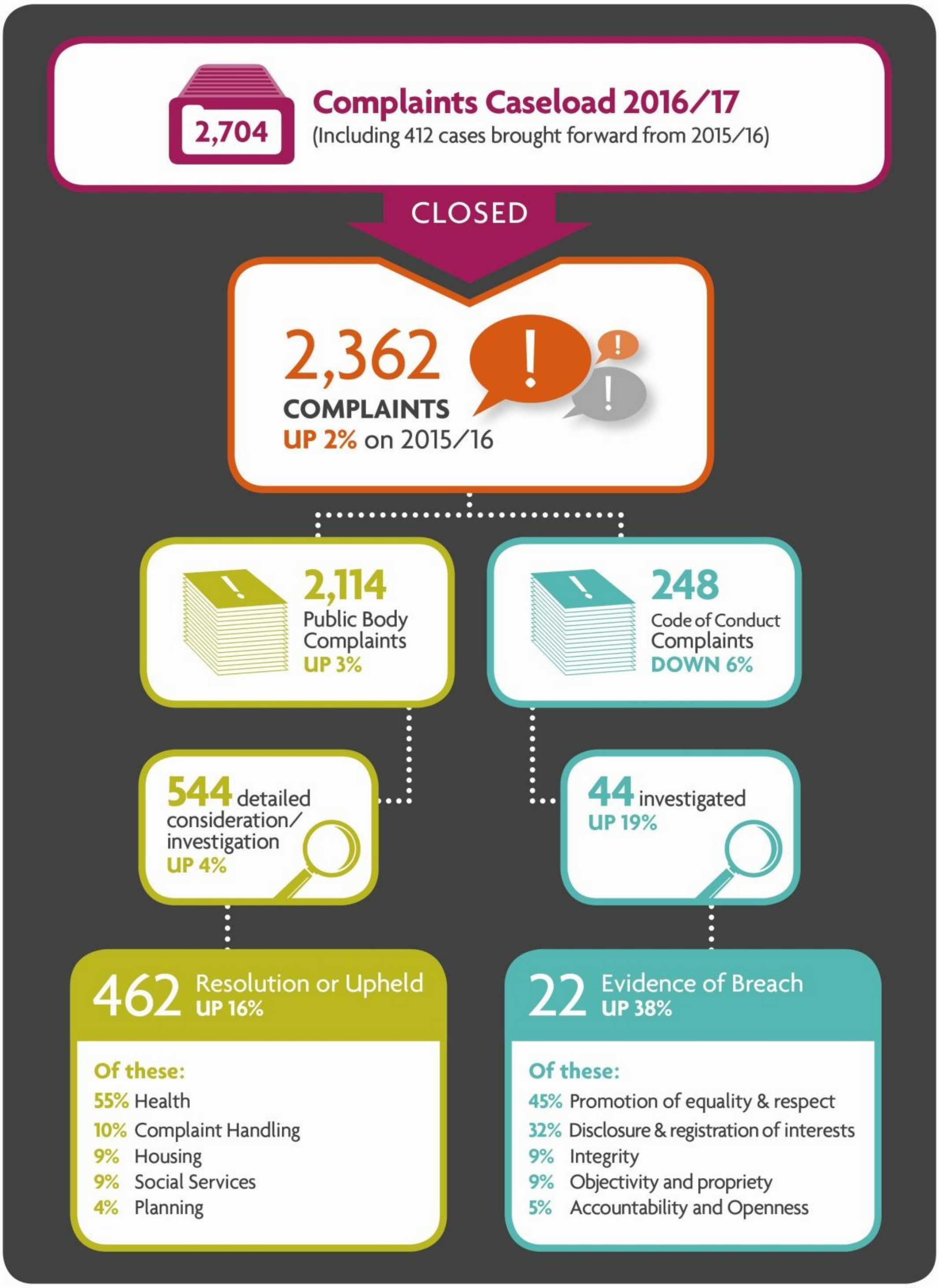
Code of Conduct Complaints

Under the provisions of Part III of the Local Government Act 2000 and also relevant Orders made by the National Assembly for Wales under that Act, I consider complaints that members of local authorities have breached their authority's Code of Conduct. I can consider complaints about the behaviour of members of:

- county and county borough councils
- community councils
- fire authorities
- national park authorities and
- police and crime panels.

The Complaints Service





Complaints Caseload 2016/17
2,704
(Including 412 cases brought forward from 2015/16)
CLOSED
2,362
COMPLAINTS
UP 2% on 2015/16
2,114
Public Body Complaints
UP 3%
248
Code of Conduct Complaints
DOWN 6%
544 detailed consideration/ investigation
UP 4%
44 investigated
UP 19%
462 Resolution or Upheld
UP 16%
Of these:
55% Health
10% Complaint Handling
9% Housing
9% Social Services
4% Planning
22 Evidence of Breach
UP 38%
Of these:
45% Promotion of equality & respect
32% Disclosure & registration of interests
9% Integrity
9% Objectivity and propriety
5% Accountability and Openness

Corporate Governance

The constitutional position of a corporation sole means that responsibility and accountability for the activities carried out by my office must remain with me, as Ombudsman.

Whilst bearing in mind the constitutional position of a corporation sole, I have established an Advisory Panel which provides both challenge and support to me as Ombudsman. There is also an Audit & Risk Assurance Committee, a sub-committee of the Panel, which provides particular support to me in relation to my responsibilities as Accounting Officer. The work of both these for over the past year has been addressed in greater detail as part of the Governance Statement within my Annual Accounts for 2016-17, which was published in July 2017.

Risk Assurance Framework Arrangements

PSOW Framework

- Strategic objectives from Business Plan
- Work programme
- Risk management
- Anti-fraud policy
- Governance framework
- Policies, procedures and code of conduct

Accounting Officer
Governance
Decision making
Financial management
Risk management

Advisory Panel
Provides support and advice in leadership and good governance.
Brings an external perspective.

Audit and Risk Assurance Committee
Reviews and monitors governance, risks and internal controls. Agrees annual governance statement.

Management Team
3 year strategic plan
Operational plan
Performance monitoring
Corporate policies
Risk management
Value for money

Central Guidance
HM Treasury
FReM
Managing Welsh Public Money
Public Sector Internal Audit Standards

PSOW policies, plans and risk register

Annual Governance Statement

Assurance Map Components

1st line of defence
Strategic and operational delivery reporting
KPI reporting
Financial controls/Budget monitoring

2nd line of defence
Risk register reviews
Quality assurance
Information security assurance

3rd line of defence
Internal audit reports
Financial accountant spot checks
Scrutiny by Finance Committee and PAC

Other Assurances
External audit

Financial Performance

The arrangements for financial management and internal control have been independently reviewed by Deloitte as the PSOW's internal auditors. Their reports have highlighted the satisfactory internal control framework within the organisation and made recommendations for improvement where necessary. Their Internal Audit Annual Report in respect of the year 2016/17 stated: "Based on the work we have undertaken during the year we are able to conclude that the Public Services Ombudsman for Wales (PSOW) has a basically sound system of internal control, which should provide substantial assurance regarding the achievement of PSOW's objectives."

The Auditor General gave the annual accounts for the year 2016/17 an unqualified audit opinion in keeping with all previous years.

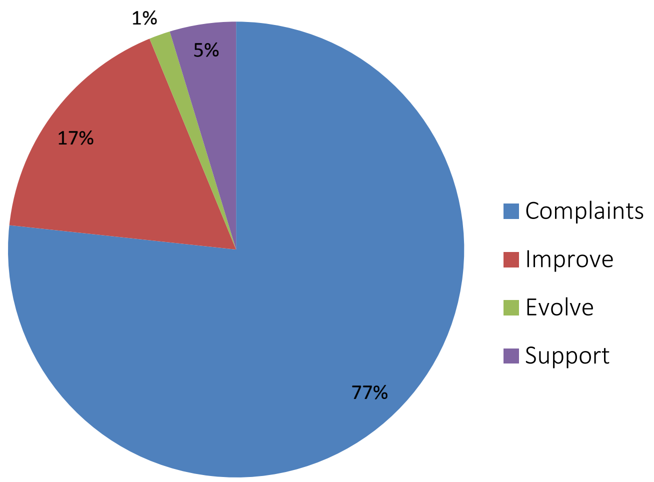
The PSOW has worked on the principle that the overheads of the office should be less than 5% of the total expenditure. This has always been achieved since the office was established under the Public Services Ombudsman (Wales) Act 2005 and is a principle that was derived from good practice within the public sector. This is evidenced in the analysis of expenditure based on the aims and objectives of my Strategic Plan as set out in the Annual Accounts where overheads are identified as 5% of total costs.

Aim 1: To provide a **complaints service** that is of the highest quality, proportionate and effective.

Aim 2: To use the knowledge and insight obtained from the complaints we consider to **improve complaint handling** by public services providers and to have an impact on improving public service delivery and informing public policy.

Aim 3: To continue to **evolve and grow** as an office, specifically planning for implementation of the Ombudsman's new powers should the National Assembly for Wales create a new Public Services Ombudsman (Wales) Act.

Aim 4: To be accountable for the **service and support** we provide and the public money we spend.



Efficiency and Effectiveness

The PSOW has previously reported to the Finance Committee on the concerted effort made to provide a more efficient and effective service at the early stages of the complaints handling process, together with streamlining the investigation stage. These arrangements have continued to be crucial in the context of dealing with the ever increasing number of enquiries and complaints received by my office.

	10-11	11-12	12-13	13-14	14-15	15-16	16-17	Change
Enquiries	1,127	1,866	2,906	3,234	3,470	3,731	4,512	+300%
Public Body Complaints	1,425	1,605	1,790	1,932	2,065	1,992	2,056	+44%
Code of Conduct Complaints	277	412	291	226	231	276	236	-15%
Total Workload	2,829	3,883	4,987	5,392	5,766	5,999	6,804	+140%
Expenditure (£000s)[1]	£3,684	£3,389	£3,672	£3,488	£3,585	£3,677	£3,580	-3%
Unit Cost	£1,302	£873	£736	£647	£622	£613	£526	-60%

Over the period 2010/11 to 2016/17 workload increased by 300% whilst the unit cost reduced by 60%.

Enquiries +300%

Complaints:
Public Body +44%
Code of Conduct -15%

Over the same period resource expenditure decreased from £3.7m to £3.6m when adjusted for inflation – a reduction of 3%.

[1] Adjusted for inflation

PSOW Vision, Mission, Strategic Aims and Values

Our Vision is:

A public service culture that values complaints and learns from them to improve public service delivery.

Our Mission is:

By considering complaints, to put things right for service users and contribute to improved public service delivery and standards in public life.

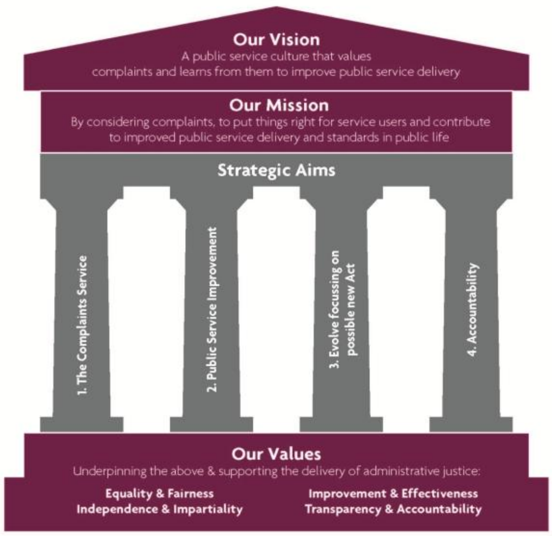
Our Four Strategic Aims are:

1. To provide a complaints service that is of the highest quality, proportionate and effective throughout the various stages through the complaint journey.

2. To use the knowledge and insight obtained from the complaints we consider to improve complaint handling by public services providers and to have an impact in improving public service delivery and informing public policy.
3. To continue to evolve and grow as an office, specifically planning for implementation of the Ombudsman's new powers should the National Assembly for Wales create a new Public Services Ombudsman (Wales) Act.
4. To be accountable for the service we provide and the public money we spend.

Our Values, underpinning the above and to support our delivery of administrative justice, are:

- Equality and Fairness
- Independence and Impartiality
- Improvement and Effectiveness
- Transparency and Accountability.



Budget Submission

Enquiries and complaints increased by 13% in 2016-17. Enquires for the first four months of 2017-18 show an increase of 12% whilst, although complaints overall have fallen over the same period, NHS complaints have risen by 15%. Our assumption is that enquiries and complaints will rise between 5% and 12% in 2018-19.

Staff pay is linked to Local government National Joint Council pay negotiations. Although the latest pay submission by Unite is for over 5% we have included a 1% pay increase for2018-19. This budget will also provide full year funding for a finance officer post (allowing an existing member of staff to focus on IT developments and IT security). The proposed budget reflects the full year cost of planned appointments to vacant posts during the current year, maternity pay and maternity cover, and small sums to support staff development in key investigative roles.

The Pension Fund deficit was eliminated at the end of March 2017 and £292k was returned to the Welsh Consolidated Fund in 2017-18. It is anticipated that with the move to a low risk pension funding strategy no further deficit payments will be required. This has an effect on cash only.

We continue to rent our offices in Pencoed at a low cost of £9 per square foot, providing value for money for office space, but are subject to inflationary pressures on business rates, insurance and utilities.

IT contracts will be re-tendered during 2017-18 and there is a need to continue to invest in IT to increase efficiencies. The total cost of £225k includes costs to manage the transition of suppliers or processes and estimated increased costs for systems and support. It also includes a further increase of £25k to bring planned expenditure on IT to around 5% of resource budgets. Whilst there is no universal proportion of budget that organisations should expect to spend on IT, it is generally accepted that between 4% and 6 % is appropriate. In view of the PSOW focus on moving to paper-light and paperless working, and the need to enhance IT resilience and recovery arrangements (in view of internal audit recommendations and concerns expressed by the Audit & Risk Assurance Committee), this is considered appropriate. The budget would support development of our critical IT systems to provide updated and effective systems that are flexible but secure. This additional funding is anticipated to be required also in future years.

Income of £17k represents the recharged costs of managing the Future Generations Commissioner's payroll as well as staff secondments.

Our training budget includes participation in the All Wales Public Service Graduate Programme, coordinated by Academi Wales, at a cost of approximately £15k per annum.

This budget estimate does not include any contingency provision for meeting unexpected items of expenditure, such as legal challenges to my casework decisions.

In view of the additional powers included in the draft Public Services Ombudsman (Wales) Bill, the Annex shows, as well as the submission for the 2018/19 financial year, an indication of the full year budget requirement once the legislation is in place. This is for completeness and does not imply any assumption that the legislation will proceed in its current form or at all. The costs included in the final column include the costs of staff and associated office and IT costs arising from the additional powers to consider oral complaints, to undertake own initiative investigations and introduce a complaints standards function. (No costs are included in respect of the proposed limited extension of powers to investigate health complaints that include an element of private health treatment. It is expected that these can be absorbed within the existing resources available to the office.)

The costs associated with the additional powers in the new legislation are those included and explained in the draft Regulatory Impact Assessment, which will be considered in detail as part of the legislative process.

Annex

Public Services Ombudsman for Wales - Estimate for 2018-19

	Actual 2016/17	Budget 2017/18	Estimate 2018/19	New Powers Estimate 2018/19
	£000s	£000s	£000s	£000s
A Capital	**27**	**25**	**25**	**25**
B Fiscal Revenue				
Salaries and related costs	2,827	2,934	3,107	3,372
LGPS related costs	280	292	0	0
	3,107	**3,226**	**3,107**	**3,372**
Leases, including premises	435	416	435	435
Computer systems and support	177	191	225	243
Office costs	113	130	130	151
Professional fees	230	294	300	320
Communications	57	78	70	70
Training and recruitment	45	30	55	62
Travel and subsistence	39	31	40	49
Audit fee	20	20	20	20
Sub total	**4,223**	**4,416**	**4,382**	**4,722**
Income	-5	-1	-17	-17
Total Revenue	**4,218**	**4,415**	**4,365**	**4,705**
C Non cash DEL				
Depreciation	82	80	70	70
Revenue DEL (B+C)	**4,300**	**4,495**	**4,435**	**4,775**
Total DEL (A+B+C)	**4,327**	**4,520**	**4,460**	**4,800**
D Annually Managed Expenditure				
Movement on LGPS	**-280**	**-292**	**0**	**0**
Provisions movement	21	20	20	20
Total AME	**-259**	**-272**	**20**	**20**
E Total Managed Expenditure	**4,068**	**4,248**	**4,480**	**4,820**
Resources Required	**4,068**	**4,248**	**4,480**	**4,820**
Depreciation	-82	-80	-70	-70
Annually Managed Expenditure	259	272	-20	-20
Other non-cash movements	0	20	20	20
Total cash requirement from the WCF	**4,245**	**4,460**	**4,410**	**4,750**

Document is Restricted

PRIFYSGOL BANGOR UNIVERSITY

BANGOR UNIVERSITY

INDEPENDENT SCRUTINY AND ASSURANCE OF DEVOLVED TAX FORECASTS FOR WALES

FINAL REPORT

OCTOBER 2017

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Wales

** Numbers in the tables may not equal to the total due to rounding.*

EXECUTIVE SUMMARY

This report sets out the methodologies and assumptions relating to the Welsh Government's forecasts for devolved taxes which underpin the Welsh Government Draft Budget 2018/19, together with Bangor Business School's conclusion on their suitability for use in the budgeting process.

The Welsh Government, under the terms of the fiscal framework, committed to putting in place arrangements for the independent scrutiny of its devolved tax revenue forecasts. Following a competitive procurement exercise, Bangor Business School, Bangor University was appointed to undertake this work. The aims of this work are:

- The provision of independent scrutiny and assurance about the Welsh Government's forecasts for devolved taxes – land transaction tax, landfill disposals tax and non-domestic rates – for inclusion in the Welsh Government's Budget for 2018/19,
- The provision of advice about improving methodologies for future years' forecasts.

The overall aim of the report is to show how each of the forecasts have been calculated to provide greater transparency on how devolved tax forecasts have been incorporated into the Draft Budget 2018/19 and to explain the independent scrutiny and assurance of the process.

By its very nature, forecasting tax revenues is subject to margins of error. Assumptions are built into forecasts based on the best available information at the time. However these assumptions are often proven too optimistic or pessimistic as new economic events continuously unfold. Such uncertainty is particularly high in the current economic climate. For example, the outcome of the EU referendum, coupled with the lack of clarity on the future relationship between the UK and EU, inevitably increases the economic uncertainty faced in Wales and, in turn, the future path of tax revenues. These uncertainties need to be considered when appraising the devolved tax revenue forecasts.

Section 2 presents the economic scenario which underpins the tax revenue forecasts. The UK has an important role in determining the path of the Welsh economy, and therefore the work of the Office for Budget Responsibility (OBR) in providing independent forecasts for the UK economy is of relevance in constructing the profile and composition of economic activity in Wales. These OBR forecasts and assumptions are part of a broader macro-economic picture and set of assumptions. In the absence of alternative information, such as detailed Wales-specific information, it is considered appropriate to make use of these OBR determinants.

Sections 3 and 4 set out revenue forecasts for the two newly devolved taxes – Landfill Disposals Tax and Land Transaction Tax – for the period up to 2021/22. This coincides with the current range of forecasts published by the OBR. The methodology for the Landfill Disposals Tax is based on forecasting the amount and type of waste sent to Welsh landfill sites and applying the appropriate tax rate to derive a tax revenue. The Land Transaction Tax forecast for residential main rates, non-residential main rates, and non-residential leasehold is based on a bottom-up methodology which utilises all available information to create a base-year price distribution. This is adjusted to reflect changes in economic conditions and behavioural effects, and tax revenues are derived from future distributions. The Land Transaction Tax forecast for additional properties is based on a top-down methodology given limited data availability, forestalling behaviour, and anticipated refunds.

Section 5 sets out the revenue forecast for Non Domestic Rates, a tax which has already been financially devolved to the Welsh Government since April 2015. The forecasting of Non Domestic Rates revenues is not derived from a specific model, but from aggregate data from the administrative exercise undertaken to determine the distributable amount for local authorities. A number of reliefs and other adjustments need to be taken into account before the final forecast amount available to distribute back to local authorities can be derived.

For each of these taxes Bangor Business School has worked with the Welsh Treasury to review and test their methodology, and is making recommendations on how these methods could be improved. This has been an iterative process developed over each phase of our work. A summary of this development work is provided in the next section and discussed further in each section. We have also made a number of recommendations for the future development of the methods. These recommendations could not be actioned by the Welsh Government as part of this process as many can only be incorporated once further information is available or development work is undertaken.

Based on the economic scenario described in Section 2 and the methodologies discussed in this report, the Welsh Government revenue forecasted from Landfill Disposals Tax, Land Transaction Tax, and Non Domestic Rates is given below.

Welsh Government tax revenue forecasts for 2018/19 to 2021/22 (£ millions)

Period	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Landfill Disposals Tax	28	26	23	22
Land Transaction Tax	266	291	318	348
Non Domestic Rates	1,052	1,078	1,112	1,146
Total	**1,346**	**1,395**	**1,453**	**1,516**

The forecasts for the devolved taxes and their underlying methodology and assumptions have been scrutinised by Bangor Business School. **Based on the information provided by the Welsh Government Treasury, discussion with academics and practitioners on the theoretical assumptions of the models (including factor selection) and analytical examination of the tools and models, Bangor Business School concludes that the forecasts are based on robust and appropriate methodologies and assumptions.** Expected variation in the revenue forecast for different economic scenarios and model assumptions support the suitability of the forecasts' inclusion in the budget setting process.

DEVELOPMENT OF METHODOLOGY AND FUTURE RECOMMENDATIONS

Development of methodology

Through the process of working with the Welsh Government to scrutinise their forecasting methodologies, Bangor Business School made a number of recommendations which have then been incorporated in order to develop the methodology.

For example, with regard to the Landfill Disposals Tax forecast, one of the main challenges is the lack of Welsh revenue data for the predecessor tax. Based on a suggestion from Bangor Business School, the Welsh Treasury carried out further assessment work on the forecasting methodology to make sure it was making best use of the available data. The impact on the forecast of varying some of the key assumptions which affect the prospects for future revenues from landfill was also looked at.

On Land Transaction Tax, the Welsh Treasury was asked to look at alternative sources for forecast determinants for both residential and non-residential revenues, providing assurance that it was using the most appropriate sources available. Independent back testing of the methodology and testing of the stability of the price distributions of transactions underpinning the forecast was also carried out.

The Non Domestic Rates forecast methodology has been established longer than the others, but as a result of this scrutiny, it has been simplified and made more accessible and transparent.

Future recommendations

The following is a list of recommendations which it was not appropriate to fully implement in this first forecasting year. These are matters which are advised to be explored and implemented as part of subsequent forecasting work.

No.	Model	Recommendation
1	General	Forecasting of revenues from these newly devolved taxes is in the early stages. Subsequently, any forecast errors from these forecasts should be scrutinised to appraise how well the models coincide with the outturns. Evaluating forecast accuracy can be a crucial element of forecasting procedures: it is relevant for monitoring purposes and allows for improving forecasts by learning from past errors.
2	General	Consideration should be given to the possibility of undertaking further work to provide Welsh specific data to help to inform the forecasting exercise. However, it is acknowledged that this is challenging and time-consuming, and therefore the costs and benefits of any in-depth work on this should also be appraised.
3	Landfill Disposals Tax	It is recommended that the forecasts incorporate some of the potential tax revenue from unauthorised disposals and determine how landfill waste volume will respond to an increase or decrease in the number of illegal waste sites.
4	Landfill Disposals Tax	Work should be done to link waste from sources other than local authorities to economic determinants, in order to provide estimates of what this will be in the future.
5	Landfill Disposals Tax	It is recommended that in-year data is used to monitor tax revenues and to inform forecasts, once Landfill Disposals Tax becomes operational.
6	Landfill Disposals Tax	Close links with local authorities should be further developed and maintained in order to capture and leverage information on future waste management plans which could affect tax revenues.
7	Land Transaction Tax	The model used to forecast additional residential property revenue will require further refinement once more relevant information is available on transactions subject to this rate and on those which are refunded.
8	Land Transaction Tax	It is recommended that Welsh specific elasticities should be calculated when suitable data becomes available.
9	Non-Domestic Rates	Work should be undertaken to investigate and to incorporate a probability element of successful appeals into forecast calculations.

CONTENTS

SECTION 1 – INTRODUCTION

This report sets out the work undertaken in the independent scrutiny and assurance of the Welsh Government's forecasts of devolved taxes. In April 2015, financial responsibility for non-domestic rates (NDR) was devolved to the Welsh Ministers and Land Transaction tax (LTT) and Landfill Disposals Tax (LDT) are due to replace UK Stamp Duty Land Tax (SDLT) and UK Landfill Tax (LfT) in April 2018. This is to be followed by the partial devolution of income tax from April 2019. Most aspects of income tax will remain the responsibility of the UK Government and the tax will be administered and collected by HMRC. Work is underway between the Welsh Government and HMRC to implement Welsh rates of Income Tax. This work will inform the development of tax revenue forecast models with those forecasts being incorporated into future Welsh Government budgets. Therefore the Welsh Government budget will increasingly depend on Welsh taxes and forecasts of tax revenue will become a more significant component of the budget setting process in Wales.

The Welsh Government has undertaken a forecasting process in order to forecast revenues from these devolved taxes. The forecasting of revenues from the new LTT and LDT is undertaken within the Treasury team of the Welsh Government. The forecasting of NDR revenues is undertaken by the Local Government Strategic Finance Division, with input from the Welsh Treasury. All forecasts are presented on a financial year basis.

These forecasts have been developed by using economic models and accounting tools, drawing on different data sources for inclusion in the models. These models and forecasting tools have been designed with the objective of forecasting tax revenues, and to act as an analytical tool to help analyse the revenue implications of future changes in the taxes.

Contract objectives

The main objectives of this independent review are:

- The provision of independent scrutiny of the forecasting models and tools used to forecast tax revenue (from NDR, LTT and LDT) to be included in the 2018/19 Budget;
- The provision of advice on improving the methodologies for future years' forecasts.

Methodology

As part of this scrutiny Bangor University Business School worked with the Welsh Treasury, firstly to gain an understanding of the forecasting process and then to review their economic models and accounting tools, and the different sources of input data used. The quality of the input data was appraised and alternative data was considered; data not currently being used in the forecasting process, but which merits consideration. Sensitivity analysis to help highlight some of the areas where the impact on revenues could be most significant was done. This also assisted in recognising the uncertainty involved in economic forecasting and provide an insight into possible alternative tax revenue paths.

In recognising the uncertainty involved in economic forecasting we made use of sensitivity analysis to help to highlight some of the areas where the impact on revenues could be most significant.

Process

The scrutiny work by Bangor Business School commenced at the end of March 2017, when the Welsh Treasury made their forecasting information and supporting documents available for review. Further information was provided on an on-going basis as it became available. The models and the forecasts were updated and continuously reviewed during the process. There were four distinct phases to the contract specification for this work and the output from each phase is described below. This report covers phases 1 to 3 and, and as outlined below, a further written submission will be produced following the UK autumn 2017 Budget (phase 4).

Phase	Summary description
Phase 1	Initial work to gain an understanding of the approach being adopted for the production of devolved tax forecasts, including a context setting meeting; Appraisal work to assess these methodologies; Production of an interim report setting out the assessment of the methodologies, including highlighting areas for improvement or modification; End of Phase meeting to discuss the report and any other issues.
Phase 2	Undertake on-going appraisal work as the Welsh Government works on Budget allocations and interim developed tax forecast; Appraise this process and consider revised forecasts; Production of updated interim report; End of Phase meeting to discuss the report and any other issues.
Phase 3	Continue to consider the on-going Welsh Government work prior to the publication of the Draft Budget and be responsive to any revisions in forecasts; Production of a report drawing on the processes and outcomes of the previous phases; End of phase meeting to discuss the report and any other issues.

Phase	Summary description
Phase 4	Assess forecasts published by the OBR and any other relevant information; An exercise to consider whether any changes are required to the forecast figures proposed by the Welsh Government; Work to conclude an agreed statement to be published with the Final Budget, including any changes between the Draft Budget Forecast and the Final Budget Forecast that are required due to changes in data inputs; Production of guidance for improving methodologies for forecasts in future years; End of contract meeting to discuss the suggestions for the future and to finalise the agreed statement.

Bangor Business School worked alongside the Welsh Treasury, reviewing new material and the revised forecasts, and considering different potential approaches and scenarios. During this iterative process recommendations were made by Bangor Business School and incorporated into the forecasting process by the Welsh Treasury. This work is summarised in the Executive Summary and in the discussion of the methodology in each section. There are a number of further recommendations for the future development of the forecast methodology and these are set out after the Executive Summary.

Knowledge exchange

Forecasting tax revenues is a new function for the Welsh Government. As part of the review work Bangor Business School had communications with representatives from the OBR and the Scottish Fiscal Commission (SFC), discussing their approaches to forecasting tax revenues. The OBR produces forecasts for the UK as a whole and the SFC reports on devolved taxes in Scotland. There are currently more devolved taxes in Scotland than in Wales, including income tax and air departure tax. A representative from the Business School attended the 9th Annual Meeting of the Organisation for Economic Co-operation and Development (OECD) Parliamentary Budget Officials and Independent Fiscal Institutions, where current methodologies and best practices were presented and discussed.

Summary information on knowledge exchange and communications can be found in Appendix 1. These communications provided a useful opportunity to discuss the approaches of different institutions with respect to forecasting tax revenues and insights from these were integrated into the scrutiny of devolved tax forecast for Wales.

SECTION 2 – FORECASTING UNCERTAINTY, THE WELSH ECONOMY, AND THE BLOCK-GRANT ADJUSTMENT

Introduction

The purpose of this section is to explain the background to the independent scrutiny of the Welsh Government's forecast of Welsh tax revenues, and the challenges of forecasting these tax revenues.

The Wales Act 2014 gave new powers to the National Assembly relating to taxation and borrowing: powers to introduce Welsh taxes to replace UK stamp duty land tax and UK landfill tax, partial devolution of income tax, powers to introduce other devolved taxes on a case by case basis and borrowing powers. Financial responsibility for Non-domestic rates was devolved from April 2015 and from April 2018 Land Transaction tax and Landfill Disposals tax will replace UK stamp duty land tax and landfill tax. Subsequently, from April 2019 income tax will be partially devolved, with rates set by the Welsh Government.

The tax revenue forecast is an essential component of the government budget, and of short and medium term fiscal policy. However, research on appropriate techniques for forecasting detailed tax revenues is under-developed and it is recognised that some types of taxes might be more difficult to predict than others. For example, with respect to Wales' devolved taxes, the OBR has reviewed volatility-adjusted fiscal forecasting errors for a range of different UK taxes over the last five years[1]. This showed that, historically, Non Domestic Rates and SDLT were similar in this regard, with below 1.5% volatility of average fiscal forecasting errors. Landfill tax is listed at over 5% volatility of average fiscal forecasting errors, which is classed as well above average errors.

Given the prevailing uncertainty in preparing medium and long-term forecasts, the OBR now produces a fiscal risk report that identifies possible shocks or pressures to projections[2]. According to the OBR, the biggest peacetime fiscal risks over the medium term relate to the economy with the chance of a recession in any five-year period is circa. one-in-two. Recessions associated with financial crises are typically the most costly, especially when their economic effects persist. These

[1] Forecast Evaluation (October 2016) report by the Office for Budget Responsibility available at www.gov.uk/government/publications.
[2] See Fiscal Risk Report (July 2017) by the Office for Budget Responsibility for the most recent report available at www.gov.uk/government/publications.

long-term costs are generally much more significant, and the chance of a financial crisis in any five-year period is circa. one-in-four. The likelihood of these uncertainties need to be taken into account when reflecting on the forecasts presented in this report.

Forecasting uncertainty

Uncertainty is inherent in forecasting as the future cannot be known with certainty and any forecast is unlikely to be completely accurate. Forecasts of future tax revenues, or wider economic variables are, by their very nature, subject to margins of error. There is considerable uncertainty in attempting to predict the economy, and economic uncertainty is heightened following the uncertainty linked with the EU referendum result. The OBR report that "risks to financial stability remain, particularly associated with: the global environment; the commercial real estate market; the financing the UK's large current account deficit; and the high level of household debt"[3].

In reviewing forecasts and considering forecasting errors, identified as differences between the forecast and the outturn, Bangor University share the approach of the OBR's stated view of forecasting errors as being an arithmetic difference and "this does not imply that it would have been possible to avoid them given the information available at the time of the forecast. Differences with outturns may reflect unforeseeable developments after the forecast was made. It does not mean the errors could necessarily have been avoided given the information available at the time."[4]

There is also uncertainty related to new policy measures and these forecasts relate to new taxes and a new tax administration. Preparing revenue forecasts involves not only predictions about the macroeconomic development, but also predictions about the functioning of the tax law and its enforcement.

Uncertainty about revenues also stems from changes in the tax law: changes or adaptations in the tax law have the potential for behavioural effects, with revenue consequences that are hard to quantify. This suggests that revenue forecasts tend to be more difficult in the presence of tax law changes as there is a risk that some taxpayers may respond by changing their behaviour, and this requires judgement in the forecasting process. The Welsh Revenue Authority (WRA) is being

[3] Economic and Fiscal Outlook (March 2017) report by the Office for Budget Responsibility available at www.gov.uk/government/publications.
[4] Forecast Evaluation (October 2016) report by the Office for Budget Responsibility available at www.gov.uk/government/publications.

established to collect and manage the new devolved taxes. As the WRA is not currently fully operational this adds additional uncertainty to predictions about the functioning of the tax law in practice. Over time the approach, actions and public statements of the WRA will help to set precedents and inform expectations as to its approach to administration and enforcement, thus lessening this uncertainty.

In developing these forecasting models, the Welsh Treasury was reliant on data from HMRC. Annual Wales level data were only made available for SDLT, and in-year data was not available in time for the development of these methods. Very little information is available for UK Landfill tax in Wales from HMRC over and above HMRCs estimate of annual revenues. A comparison of actual and expected tax revenues, along with ongoing scrutiny of model performance, would be limited if HMRC continued to be the only data source for the required information. However, the establishment of the WRA will ensure that appropriate data is available in a timely manner to appraise how well the models coincide with the outturns and so aid future model developments. Therefore, over time it is expected better data will be available to inform the development of tax revenue forecasts in Wales.

The Welsh economy

A view of the future of the economy as a whole informs the broader macro-economic picture and the assumptions that are the context for these forecasts. Forecasts of tax receipts are particularly dependent on the profile and composition of economic activity. If there were to be significant changes or differences in the profile or composition of economic activity there would be an impact on the assumptions used in the models for the devolved Welsh taxes covered in this report, for example the Multiplier for the NDR forecasts is increased by the OBR's forecast for Retail Price Index (RPI), and a number of OBR forecasts are incorporated into the other models.

The UK has an important role in determining the path of the Welsh economy; therefore the work of the OBR in providing independent analysis of the UK's public finances, and forecasts for the UK economy, is of relevance in constructing the profile and composition of economic activity. These OBR forecasts and assumptions are part of a broader macro-economic picture and set of assumptions. In the absence of alternative information, such as detailed Wales-specific information, it is considered appropriate to make use of these OBR determinants.

A summary of the wide ranging determinants of the OBR forecast is set out below. Any changes to these by the OBR or any updated in-year forecasts will have an impact on Welsh revenue projections. In addition to setting out the determinants specifically drawn on for these forecast, these determinants also provide an indication of the future direction of the economy. This is one of improving economic activity associated with improved consumer spending and improved average earnings. The forecast incorporates employment growth and growth in GDP in the years to 2019/20. Determinants directly drawn on to produce the Welsh Government's forecasts in this report are marked by ●. 2015/16 are outturn data.

Table 2.1: Key determinants of the OBR Fiscal Forecast to 2021/22 (published March 2017)

Period	2017/18	2018/19	2019/20	2020/21	2021/22
GDP and its components					
Real GDP (%)	1.8	1.6	1.8	1.9	2.0
Nominal GDP (%)	3.3	3.3	3.5	3.8	4.0
Nominal GDP (£ billion)	2,029	2,095	2,168	2,251	2,340
Consumer spending (%)	4.3	3.2	3.7	3.7	3.9
Prices and earnings					
GDP deflator (%)	1.6	1.6	1.7	1.9	1.9
● RPI (%)	3.9	3.4	3.1	3.1	3.2
CPI (%)	2.6	2.2	2.0	2.0	2.0
Average earnings (%)	2.6	2.8	3.0	3.5	3.7
Key fiscal determinants					
Claimant count (millions)	0.85	0.87	0.88	0.88	0.88
Employment (millions)	31.9	32.1	32.2	32.4	32.5
Property sector					
● Residential property prices (%)	5.8	4.0	4.5	4.5	4.7
● Residential property transactions (000s)	1,280	1,294	1,305	1,315	1,322
● Commercial property prices (%)	-2.8	1.6	1.7	1.9	1.9
● Commercial property transactions (%)	1.7	1.7	1.8	1.9	2.0
Interest rates and exchange rates					
Short term interest rate (%)	0.4	0.6	0.8	1.0	1.2
Euro/Sterling exchange rate	1.16	1.16	1.15	1.14	1.14

There are many uncertainties underpinning the forecasts in Table 2.1. The OBR's key assumptions underpinning the forecast are:

- the UK leaves the EU in April 2019, that the trading regime will be less open than before and that the UK adopts a tighter migration regime than is currently in place;
- monetary policy remains highly accommodative, reflecting slightly higher expectations of Bank Rate on the part of market participants;
- there will be little change in credit conditions given the orientation of macro-prudential policy, while the financial system will continue on a path of gradual normalisation;
- fiscal policy follows a broadly similar path, with fiscal consolidation set to continue throughout the forecast period;
- slight increase in sterling's strength;
- dollar oil prices are higher than currently observed. Beyond the two-year horizon they are assumed to remain constant in real terms; and
- global GDP and the demand for UK exports increases steadily.

The OBR fiscal outlook and fiscal determinants are for the UK as a whole. In different ways the economy of Wales does not track the UK average, but where OBR determinants have been used Bangor Business School have worked with the Welsh Treasury to test their suitability for Wales. There is little in the way of Wales-specific economic forecast data and it is also recognised that there are significant variations and regional differences within Wales. A macro-economic model for the Wales economy is being studied and developed at Cardiff University, overseen by Prof. Max Munday. This draws on work done at Cardiff University on input-output tables for Wales. As regards other economic information there is a lack of Wales-specific information; a significant difficulty is the lack of information on Welsh trade flows and cross border trade. Given this, it will be important to assess the costs and benefits in any development of Welsh specific determinants for the purposes of forecasting tax revenues.

Block grant adjustment

The Welsh and UK Governments reached agreement on the Welsh Government's fiscal framework in December 2016. This framework establishes a mechanism for adjusting the Welsh Government's block grant to reflect the devolution of tax powers: the block grant will be determined via the Barnett formula plus a new 'needs-based factor' as recommended by the Holtham Commission.

A provisional baseline for the adjustment will use the OBR's autumn 2017 forecast of receipts in Wales in 2017/18, which will be published alongside the UK autumn 2017 Budget. The Welsh Government has used the OBR's forecasts from March 2017 for SDLT and LfT in 2017/18 as the baseline for both the estimated block grant adjustment and the devolved tax revenue forecast for subsequent years. This is consistent with terms of the fiscal framework and is appropriate because the OBR currently has access to more detailed information to forecast tax revenues for the current UK taxes to be devolved to Wales from April 2018[5]. If the OBR 2017/18 forecast for the taxes to be devolved is changed in the autumn 2017, then both the block grant adjustment and the Welsh Government forecast for the devolved taxes should change in a similar fashion and so minimise the net impact on the Welsh Government Budget.

Bangor Business School view

There is uncertainty around all such economic forecasts and this is acknowledged in this scrutiny work. As there is a lack of Welsh specific data, the forecasts use a number of OBR determinants that are only available at the UK level. Given the information available and the work undertaken to test their suitability, the use of the OBR determinants is considered appropriate.

[5] The agreement between the Welsh Government and the United Kingdom Government on the Welsh Government's fiscal framework (December 2016) report by HM Government and the Welsh Government available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/578836/Wales_Fiscal_Framework_Agreement_Dec_2016_2.pdf.

Recommendation 1

Forecasting of revenues from these newly devolved taxes is in the early stages. Subsequently, any forecast errors from these forecasts should be scrutinised to appraise how well the models coincide with the outturns. Evaluating forecast accuracy can be a crucial element of forecasting procedures: it is relevant for monitoring purposes and allows for improving forecasts by learning from past errors.

Recommendation 2

Consideration should be given to the possibility of undertaking further work to provide Welsh specific data to help to inform the forecasting exercise. However, it is acknowledged that this is challenging and time-consuming, and therefore the costs and benefits of any in-depth work on this should also be appraised.

SECTION 3 – LANDFILL DISPOSALS TAX

Introduction

The Landfill Disposals Tax (LDT) will be introduced as a fully devolved tax in Wales from 1 April 2018, replacing the UK Landfill Tax (LfT). Like LfT, LDT is an environmental tax aimed at helping to reduce the amount of waste sent to landfill sites in Wales. The tax is payable by the landfill site operators and there were around 20 landfill sites registered with HMRC as of May 2016.

Different tax rates apply for two different type of waste; standard and lower rate. The lower rate applies to waste disposals that are non-hazardous, have a low potential for greenhouse gas emissions, and have low polluting potential in the landfill environment. The standard rate applies to all other taxable waste.

Some 9.5 million tonnes of standard rate waste and 10.6 million tonnes of lower rate waste was sent to UK landfill sites in 2016/17. Despite similar amounts of waste, the difference in the rates shown has a significant effect on the amount of revenue collected from both waste types. The UK revenue from standard waste in 2016/17 was around £800 million and £28 million from lower rate, before adjusting for any tax reliefs and credits.

The Draft Budget 2018/19 proposes that the LDT rates for standard and lower rate waste remain consistent with the UK LfT rates (the UK government has not yet set the rate for 2019/20. The rate in table 3.1 uprates the 2018/19 rate by a forecast for the retail price index). The Welsh Government has also introduced a rate for disposals made at sites other than an authorised landfill site – known as the unauthorised disposals rate.

The rates will be as set out below in Table 3.1.

Table 3.1: LDT rates for standard and lower rate waste for 2018/19 and 2019/20 (£ per tonne)

Period	**2018/19**	**2019/20** *Assumed rate*
Standard waste	88.95	91.70
Lower waste	2.80	2.90
Unauthorised disposals	133.45	137.55

LfT revenue forecast

The OBR's forecast for the UK LfT in Wales is set out in table 3.2 below.

Table 3.2 OBR March 2017 forecast for Landfill Tax in Wales, 2016/17 – 2017/18 (£ millions)

	2016/17	2017/18
OBR forecast (£ millions)	33	28

In 2016/17, LfT is estimated to raise a total of £33 million in Wales under the UK Landfill Tax system, then fall to £28 million in 2017/18 as an increasing amount of waste is diverted away from landfill[6].

The Welsh share of landfill tax receipts is not available from HMRC administrative systems, since landfill operators submit data returns that cover sites across England, Wales and Northern Ireland combined. Therefore, the OBR's current approach to forecasting Welsh landfill tax is to apply an assumption about the path of the Welsh share of landfill tax to the UK forecast. The UK forecast is compiled using a forecast for the tonnage of waste sent to landfill, which is multiplied by the appropriate tax rate. An adjustment is made for the landfill communities fund.

LDT revenue forecast

The Welsh Government's forecasts for LDT as contained in the Draft Budget 2018-19 are set out below in Table 3.3. These forecasts are not on the same basis as those produced by OBR as they do not make an adjustment for the landfill communities scheme, as the scheme does not operate as a tax credit in Wales.

Table 3.3: LDT forecasts for 2018/19 to 2021/22 (£' millions)

Period	2018/19	2019/20	2020/21	2021/22
Landfill Disposals Tax forecast	28	26	23	22

[6] 2016/17 and 2017/18 Welsh revenues are estimated as a proportion of revenues from UK Landfill Tax.

In overall terms LDT revenues are forecast to decrease from £28 million in 2018/19 to £22 million in 2021/22, a decrease of 26 per cent. The fall in the revenue generated by standard rate waste is the main driver of the decrease, which is forecasted to fall from around 275,000 tonnes in 2018/19 to 190,000 tonnes in 2021/22. This decrease in standard rate waste is driven by Welsh Local Authorities' strategies to reduce the amount of waste sent to landfill.

Methodology

The LDT forecast is produced by using a model based on the estimated standard rate waste and lower rate waste to be sent to Welsh landfill sites in the future. The forecasts are based on the bottom-up methodology to utilise all available information. As there is no information available on historical landfill tax revenues in Wales, information from Natural Resources Wales (NRW) and Welsh local authorities has been drawn on to produce a base year of the waste received by landfill sites in Wales during the 2015/16 period.

All the waste information from NRW is categorised according to European Waste Catalogue (EWC) codes, which are used to determine if the waste is standard or lower rate waste. This method has been developed by the Welsh Government as there is no information available on the split in standard and lower rate waste in Wales under LfT; therefore Bangor University suggested carrying out further work to assess the method's suitability. Following this work, the method was considered to be suitable.

Standard rate waste

The model divides standard rate waste into waste coming from Welsh local authorities and waste from other sources. The model assumes that all waste coming from Welsh Local Authorities is standard rate waste. 285,000 tonnes of standard waste is reported to have come from Welsh Local Authorities in 2015/16 with the remaining 164,000 coming from either the Welsh private sector or outside of Wales.

Welsh Local Authorities also provide information on their waste management strategy and how the amount sent to landfill sites will be reduced (e.g. through the export or incineration of waste) over the forecasted years. The ability of Local Authorities to achieve future targets on landfilling will depend, in part, on the development of new incineration capacity in Wales, which is built into the model. Bangor Business School suggested that the Welsh Government assess the risk that there is a delay to new incineration capacity coming online. If this were to happen, Welsh Government analysis suggested this would lead to a small increase in LDT revenue. If no waste management strategy is provided by the Local Authority, it is assumed that their landfilled waste reduces in-line with their trend over the previous three years.

Standard rate waste from non-Welsh Local Authorities is assumed to decline by 10% per annum over the forecast period, in line with the UK trend for waste disposed of at landfill. Bangor Business School suggested that the Welsh Government explores whether economic determinants could be used to forecast this amount of waste in future.

Lower rate and exempt waste

The amount of lower rate waste is assumed to reduce by 1.1% per annum over the forecasted period, which is the average decline between 2012/13 and 2015/16.

Some landfill sites in Wales do not pay the current UK landfill tax as they qualify for exemptions. All waste disposed of at these sites is classed as exempt waste in the model. Some waste which is disposed of at other sites is also likely to be exempt from tax, but it is not possible to identify this waste using the available data sources. Bangor University asked the Welsh Government to consider the impact an increased amount of exempt waste might have on the forecast. As exempt waste can only be made up of lower rate material, this work concluded that the impact on the forecast is likely to be small.

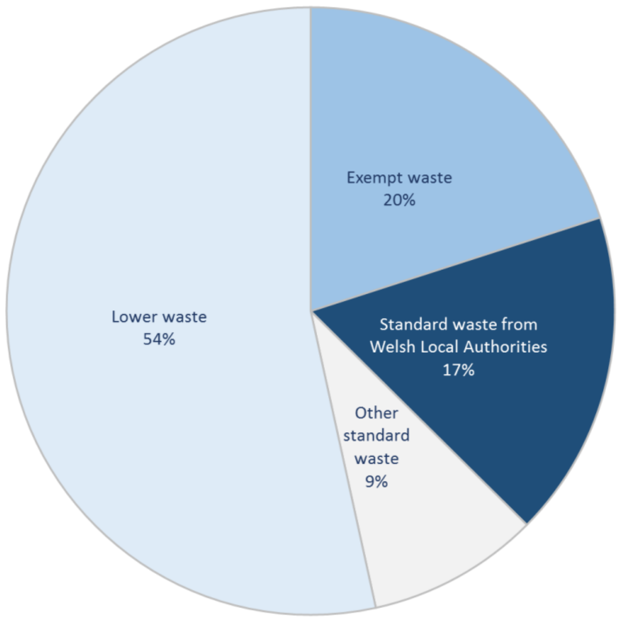


Figure 3.1 – Estimated breakdown of 2015/16 waste sent to Welsh landfill sites

Figure 3.2 shows estimates of the historical (pre-2015/16) and forecasted (post-2015/16) trends for standard rate waste (Welsh Local Authorities and non-Welsh Local Authorities) and lower rate waste.

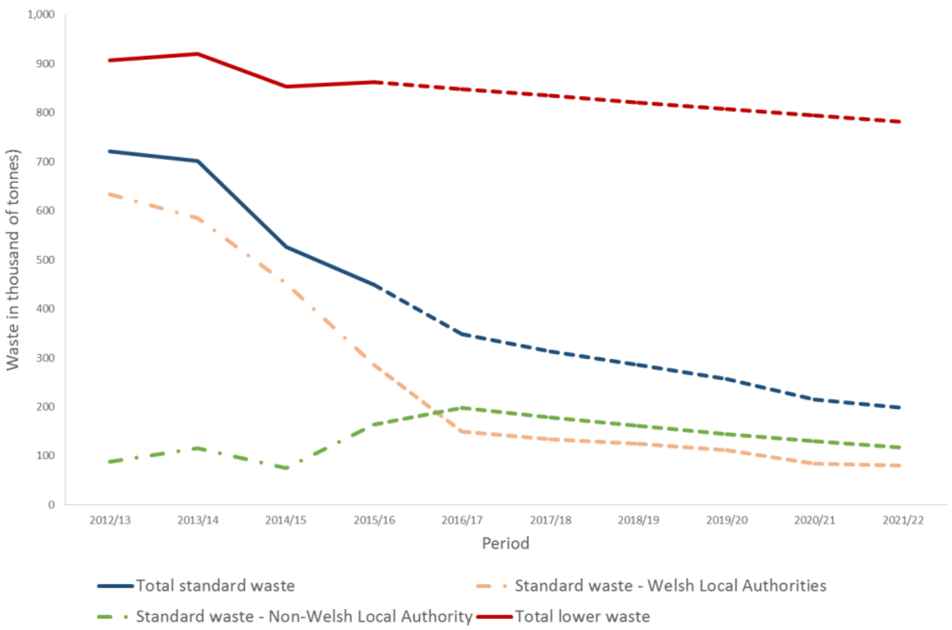


Figure 3.2 - Historical and forecasted estimates for standard rate waste and lower rate waste

Unauthorised disposals

The model has the capacity to include potential revenue from unauthorised disposals but does not currently do so as there is very limited evidence on which to base a forecast. The Welsh Government should consider incorporating revenue from unauthorised disposals in future, when information on the operation of this element of the tax is available.

Tax revenues

The LDT forecast uses OBR's 2017/18 forecast for LfT as a baseline. Tax revenues for 2018/19 onwards are calculated by applying the tax rates stated in Table 3.1 to the forecasted standard rate waste and lower rate waste amount. These tax rates are adjusted for future years based on the RPI forecasted in Table 2.1.

Table 3.4 – Final forecasted revenues (£ millions)

Period	2018/19	2019/20	2020/21	2021/22
Final forecasted revenues	28	26	23	22

Sensitivity Testing

The sensitivity of the LDT model is analysed by assuming no change from 2015/16 waste sent by Welsh Local Authorities to landfill sites and by varying the RPI input. The results of this sensitivity analysis is shown in Table 3.5.

Table 3.5a – Forecasted revenues (£ millions) if there is no change from 2015/16 waste sent by Welsh Local Authorities to landfill sites

Period	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Forecasted revenues	29	29	29	29
Original revenues	*28*	*26*	*23*	*22*

Table 3.5b – 1.5 percentage point increase in UK RPI (£ 'millions)

Period	**2018/19**	**2019/20**	**2020/21**	**2021/22**
RPI	4.9%	4.6%	4.6%	4.7%
Forecasted revenues	28	27	24	23
Original revenues	*28*	*26*	*23*	*22*

Table 3.5c – 1.5 percentage point decrease in UK RPI (£ 'millions)

Period	**2018/19**	**2019/20**	**2020/21**	**2021/22**
RPI	1.9%	1.6%	1.6%	1.7%
Forecasted revenues	28	26	22	21
Original revenues	*28*	*26*	*23*	*22*

In addition, the sensitivity of the forecasts to changes in the assumed annual changes in non-Welsh Local Authority waste was tested (this is currently assumed to be -10% in the model). An increase (or decrease) of 50% in this assumption would have less than +/- 7.3% impact on the total forecasted revenues raised between 2018/19 and 2021/22.

Back-testing

There is limited opportunity to back-test the LDT model as there is no information on historical tax revenues from landfill tax in Wales.

A major driver of LDT revenue forecast is the amount of waste sent by Welsh Local Authorities to landfill sites. This account for 64% of standard waste in 2015/16 and account for £23.6 million of the revenue raised in that period. The waste management plans of Welsh Local Authorities is known by the Welsh Government, which limits the benefit of back-testing of the model.

The Welsh Government has used the model to produce estimates of LfT revenues in Wales back to 2007/08. These have been compared with published HMRC estimates of landfill tax in Wales. Despite using different methods, the two sets of estimates are broadly comparable up until 2013/14, after which the two begin to diverge. This is when there was an acceleration in the amount of waste diverted away from landfill in Wales.

Bangor Business School view on the forecast

Based on the information provided by the Welsh Government Treasury Team, Bangor Business School views the methodology described in Section 3 as an appropriate approach for forecasting Welsh LDT revenues. This decision is based on the discussion with academics and practitioners on the theoretical assumptions of the models (including factor selection), analytical analysis of the models, and the variation in revenue forecast for different scenarios.

All of the models used by the Welsh Government Treasury Team to produce this forecast have been independently reproduced by Bangor Business School as part of the validation process. The final LDT forecast is set out in Table 3.2.

Recommendation 3

It is recommended that the forecasts incorporate some of the potential tax revenue from unauthorised disposals and determine how landfill waste volume will respond to an increase or decrease in the number of illegal waste sites.

Recommendation 4

Work should be done to link waste from sources other than local authorities to economic determinants, in order to provide estimates of what this will be in the future.

Recommendation 5

It is recommend that in-year data is used to monitor tax revenues and to inform forecasts, once Landfill Disposals Tax becomes operational.

Recommendation 6

Close links with local authorities should be further developed and maintained in order to capture and leverage information on future waste management plans which could affect tax revenues.

SECTION 4 – LAND TRANSACTION TAX

Introduction

The Land Transaction Tax (LTT) will be introduced as a fully devolved tax in Wales from 1 April 2018, replacing Stamp duty land tax (SDLT) in Wales. Like SDLT, LTT is a tax applied to residential and commercial land and buildings transactions (including commercial purchases and commercial leases) where a chargeable interest is acquired. In 2015/16, SDLT raised a total of £151 million under the UK system[7]. Different rates and thresholds apply for the four different segments; main residential (main rates), additional residential property, non-residential main rates and non-residential lease rent transactions.

The Draft Budget 2018/19 proposes LTT rates which differ from the current SDLT rates and thresholds. The LTT rates and thresholds are set out below in Table 4.1.

Table 4.1a: LTT rates and bands for residential transactions, 2018/19

Purchase price/lease premium or transfer value	LTT rate	Additional property rate
Up to £150,000	Zero	3.0%
Above £150,000 to £250,000	2.5%	5.5%
Above £250,000 to £400,000	5.0%	8.0%
Above £400,000 to £750,000	7.5%	10.5%
Above £750,000 to £1,500,000	10.0%	13.0%
Above £1,500,000	12.0%	15.0%

Table 4.1b: LTT rates and bands for non-residential property transactions, 2018/19

Price/value	LTT rate	Net present value of rent	LTT rate
Up to £150,000	Zero	Up to £150,000	Zero
Above £150,000 to £250,000	1.0%	Above £150,000 to £2,000,000	1.0%
Above £250,000 to £1,000,000	5.0%	Above £2,000,000	2.0%
Above £1,000,000	6.0%		

[7] Revenues relate to 2015/16 apart from the additional residential property rate which applies from 2016/17.

SDLT revenue forecast

The OBR forecasts for the various elements of SDLT in Wales up to the devolution of SDLT in 2018/19 are set out below in Table 4.2.

Table 4.2: OBR (March 2017) SDLT forecasts for 2016/17 to 2017/18 (£' millions)[8]

Period		2016/17	2017/18
Residential	Main rates	96	126
	Additional[9]	44	53
	Total	140	179
Non-residential	Total[10]	64	64
Total		203	243

In overall terms SDLT revenues are forecast to rise from £203 million in 2016/17 to £243 million in 2017/18, an increase of 20 per cent. The revenue generated by the residential main rates is the principal driver of this increase, which is forecasted to increase from £96 million in 2016/17 to £126 million in 2017/18. Revenues from residential main rates accounts for 47 per cent of total SDLT revenue in 2016/17 but this increases to 52 per cent in 2017/18. This is increase is driven by the strong residential price and transaction growth forecasted during the period.

LTT revenue forecast

From 2018/19 SDLT will no longer apply in Wales and LTT will replace it. The LTT revenue forecasts for 2018/19 to 2021/22 by the Welsh Government as contained in the Draft Budget 2018/19 are set out below in Table 4.3.

[8] Forecasts available at http://budgetresponsibility.org.uk/download/march-2017-devolved-taxes-forecast/.
[9] Additional residential properties are forecasted by the OBR on a cash basis. The years forecasted show less refunds and therefore a higher net revenue than if estimated on an accruals basis. The Welsh Government forecast is based on an accruals basis.
[10] OBR do not produce a separate forecast for the main non-residential rate and the leasehold rent elements.

Table 4.3: Four year LTT forecasts for 2018/19 to 2021/22 (£' millions)

Period		2018/19	2019/20	2020/21	2021/22
Residential	Main rates	142	161	182	205
	Additional	53	56	59	62
	Total	195	217	241	267
Non-residential	Main rates	64	66	68	71
	Lease	7	8	9	9
	Total	71	74	77	80
Total		266	291	318	348

In overall terms LTT revenues are forecast to rise from £266 million in 2018/19 to £348 million in 2021/22, an increase of 31 per cent. The revenue generated by the residential main rates is the principal driver of this increase, which is forecasted to increase from £142 million in 2018/19 to £205 million in 2021/22. Revenues from residential main rates accounts for 53 per cent of total LTT revenue in 2018/19 but this increases to 59 per cent in 2021/22. This increase is driven by the strong residential price growth forecasted between 2018/19 and 2021/22.

Methodology

The Welsh Government's LTT forecast is produced by using four separate models; main residential model, additional residential property rates model, non-residential main rates model, and a non-residential leasehold rent model.

Main rates residential model

The main residential model uses a bottom-up methodology to forecast the revenues generated from this segment of LTT. A bottom-up methodology is used to utilise all available information and ensure that the price distribution is captured by the model.

Information from HMRC's Datalab (administrative datasets) is used to produce a distribution from frequency price bins of the residential main rates properties sold in Wales during the 2015/16 period. This distribution contains information on the number of taxable (excludes relieved and exempt) transactions, the total taxable value and the total amount of tax paid during the period. The data contains 53,202 properties in Wales during 2015/16 with an average value of £162 thousands. The total value of these properties was £8.6 billion, which raised £82 million in tax revenues[11].

The price bins are selected to extract the maximum information from the price distributions while still maintaining its shape. This price distribution is analysed in terms of 5 thousand and 10 thousand bins. While the price bins become wider as the price increases this does not significantly affect the performance of the model[12].

The price distribution is used to produce a base year from which future revenues will be derived. Figures 4.1 shows the shape of the distribution in terms of number of transactions, total property values per bin, and the amount of tax revenue.

[11] Calculations based on HMRC administrative datasets, which may differ from the 2015/16 HMRC SDLT Statistics.
[12] The price bins change size towards the top-end of the distribution.

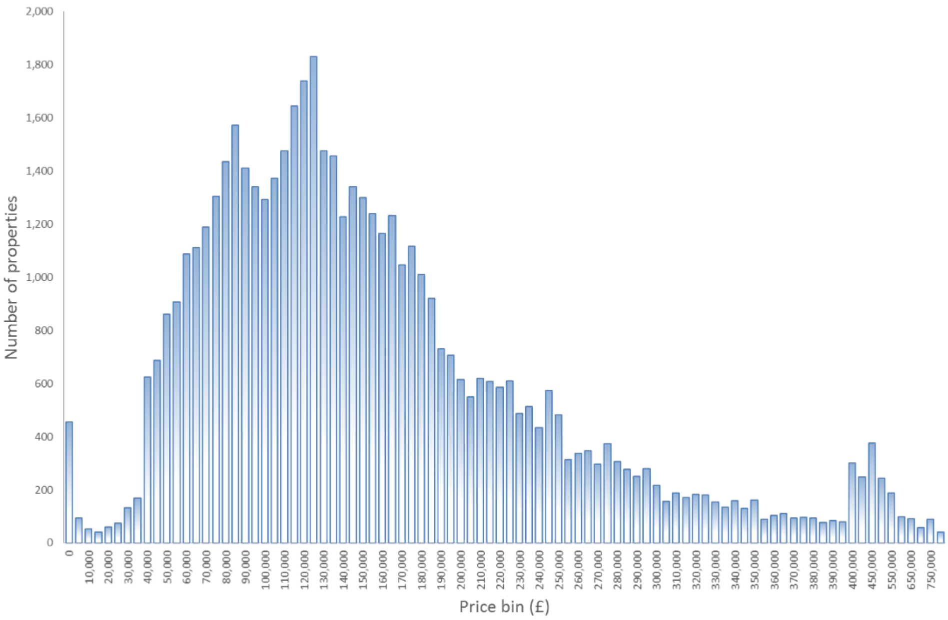


Figure 4.1a – Base year distribution (number of transactions per bin)

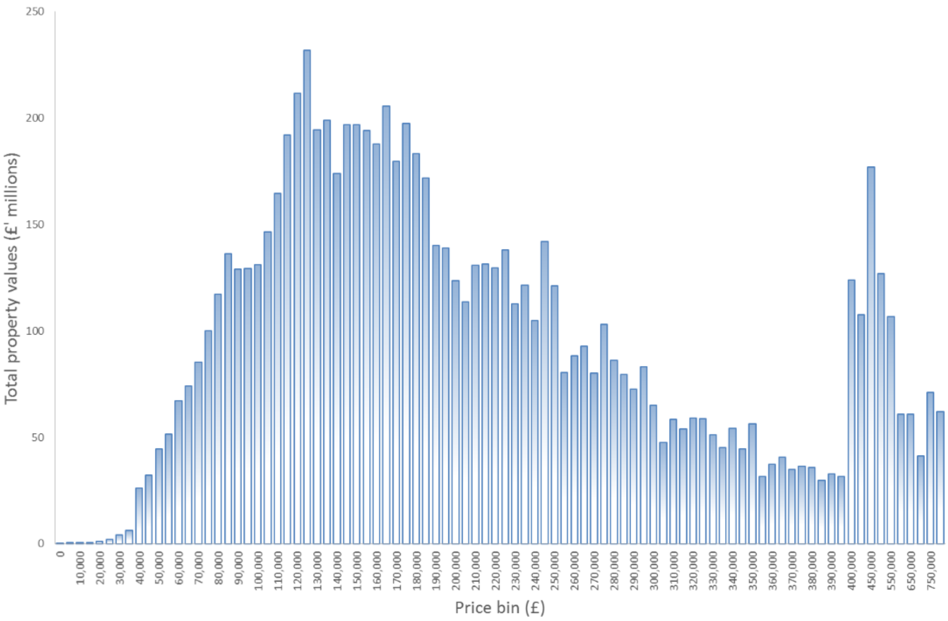


Figure 4.1b – Base year distribution (total property values per bin)

The distributions in Figure 4.1a and Figure 4.1b are adjusted to take account of forecasted residential property price growth and forecasted residential property transaction growth. The number of transactions per bin (Figure 4.1a) is adjusted to take account of future growth in transactions. Total property values per bin (Figure 4.1b) is adjusted to take account of future growth in transactions and growth in residential property prices.

The OBR's residential transactions and price growth forecast for the UK as a whole are used as inputs into the main residential model. Wales' residential transactions follow a similar trend to those in the UK. Correlation analysis is used to show the strength of this relationship using information from the Office for National Statistics (ONS)[13]. The correlation between UK and Wales' residential transactions growth is 0.99, which implies a strong relationship between both series[14]. The UK residential property market is likely to be heavily influenced by London's property market, which is likely to be influenced by global trends and not national economic fundamentals. Despite this, the correlation between UK and Wales' residential price growth is 0.98, which implies a strong relationship between both series[15].

Bangor Business School requested the Welsh Government Treasury to consider economic determinants from alternative sources for this model. Given the strong positive relationship between the different series and the economic rationale, the OBR forecasts are considered suitable inputs into the main residential model. The OBR's forecasts are given in Table 4.4.

Table 4.4 – OBR UK residential transaction and price growth forecasts 2016/17 to 2021/22

Period	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Transaction growth	-11.8%	10.0%	1.1%	0.9%	0.7%	0.6%
Price growth	7.4%	5.8%	4.0%	4.5%	4.5%	4.7%

Tax revenues are calculated by applying the tax rates stated in Table 4.1a to the forecasted transaction and value distributions. The model has the functionality to incorporate the impact of

[13] Correlation is a measure of relationship strength between two series and can take any value between +1 and -1. A correlation of +1 indicates a perfect positive relationship between the two series while a correlation of -1 indicates a perfect negative relationship.
[14] This correlation is calculated using annual house transaction growth on a quarterly basis in the UK and Wales between Q2 2006 and Q4 2016.
[15] This correlation is calculated using annual house price growth on a quarterly basis in the UK and Wales between Q1 2006 and Q4 2016.

behavioural change through transaction elasticity, price elasticity, and forestalling activity. These three capture changes in behaviour due to changes in tax rates and bands.

The transaction and price elasticities are based on the OBR's estimates and are applied at a granule level (i.e. bin level) [16]. The forestalling factors are estimated based on observations in Scotland during the transition from SDLT to LBTT system. While it is anticipated that these elasticities could be higher in Wales, whilst there are no Welsh specific elasticities available, the empirical driven OBR elasticities and forestalling factors are the preferred inputs into the model. The behavioural effects used in the model are given in Table 4.5.

Table 4.5 – Behavioural effects (semi-elasticities)

Tax band	£0k - £250K	£250K - £500K	£500K - £1MM	£1MM - £2MM	£2MM+
Transaction elasticity	-3.7	-2.5	-2.0	-2.8	-3.2
Price elasticity	-2.2	-1.7	-1.7	-1.7	-1.7
Forestalling	-6.0	-6.0	-6.0	-6.0	-10.7

Due to the limited information currently available, the behavioural effects in Table 4.4 are taken from research done by the OBR on behavioural effects within the UK[17]. These represent the most suitable elasticities available for use in the main residential model.

Two adjustments are made to the revenue forecasts which are applied to all future years. The first adjustment takes account of the difference between Wales' SDLT outturn revenue for 2015/16 (the base year) and the calculated amount based on the methodology used for the LTT model for 2015/16. The second adjustment ensures that the LTT model can match the OBR forecast of SDLT in 2017/18 SDLT (£126 million) when run from the base year of 2015/16 for this element. This adjustment is made to baseline the LTT forecast to the OBR's forecast of SDLT in Wales 2017/18. Any movements in the OBR forecast in the autumn will then feed through to both the forecast for LTT and the block grant adjustment.

[16] See OBR (2014) http://budgetresponsibility.org.uk/docs/dlm_uploads/SDLT-costing-elasticities.pdf

[17] The elasticities in Table 4.4 are taken from the work done by the OBR on elasticities for use in the costing of the reform of stamp duty land tax, which is available here http://budgetresponsibility.org.uk/docs/dlm_uploads/SDLT-costing-elasticities.pdf.

The sensitivity of the main residential model is analysed by varying the economic inputs (Table 4.4) of the model. These sensitivity analyses give an indication how revenue will vary if the economic scenario changes. The results of these sensitivity analyses are shown in Table 4.6.

Table 4.6a – 2.5 percentage point increase in UK residential transaction and price growth forecasts

Period	2018/19	2019/20	2020/21	2021/22
Transaction growth	3.6%	3.4%	3.2%	3.1%
Price growth	6.5%	7.0%	7.0%	7.2%
Forecasted revenues	155	191	233	284
Original forecast	*142*	*161*	*182*	*205*

Table 4.6b – 2.5 percentage point decrease in UK residential transaction and price growth forecasts

Period	2018/19	2019/20	2020/21	2021/22
Transaction growth	-1.4%	-1.6%	-1.8%	-1.9%
Price growth	1.5%	2.0%	2.0%	2.2%
Forecasted revenues	129	135	140	145
Original forecast	*142*	*161*	*182*	*205*

Sensitivity analysis has also been performed for changes in the behavioural effects. Changes in the behavioural effects had little impact on the revenue forecast.

Additional property model

The additional property model uses a top-down methodology to forecast the revenues generated from this segment of LTT. A top-down methodology is used due to the limited data available. Any available data is likely to have been affected by forestalling behaviour, and also due to refund anticipated for this segment.

The OBR 2016/17 revenue forecast from additional property in Wales is £44 million[18] and this is used as base point for the LTT forecast. Assumptions are made regarding the refund rate (8 per cent for cash and 15 per cent for accruals) applied to the OBR 2016/17 revenue forecast to transform the

[18] In cash terms.

amount from cash to accruals. The gross revenue of £41 million is calculated for 2016/17 by taking into account the refund rates assumption.

Revenue forecasts from additional property need to take into account the forestalling behaviour in the OBR 2016/17 forecast. A forestalling factor is estimated based on HMRC's experience with revenue from additional property between Q2 2016 and Q1 2017. The revenue anticipated from additional property without forestalling is calculated and the difference between this and the actual revenue collected is used as the forestalling factor. The forestalling factor used to adjust the 2016/17 gross revenue is 0.86.

This 2016/17 gross revenue post forestalling is adjusted to take account of forecasted residential property price growth and forecasted residential property transaction growth (as per Table 4.3). The forecasted gross revenues are adjusted to take account the 15 per cent refund assumption.

The sensitivity of the additional property model is analysed by varying the economic inputs (Table 4.4) of the model[19]. These sensitivity analyses give an indication how revenue will vary if the economic scenario changes or they are different to that anticipated. The results of these sensitivity analyses are shown in Table 4.8.

Table 4.8a – 2.5 percentage point increase in UK residential transaction and price growth forecasts

Period	**2018/19**	**2019/20**	**2020/21**	**2021/22**
Transaction growth	3.6%	3.4%	3.2%	3.1%
Price growth	6.5%	7.0%	7.0%	7.2%
Forecasted revenues	56	62	68	75
Original forecast	*53*	*56*	*59*	*62*

[19] Given the severity of the transaction growth fall in 2016/17 (-11.8%) this is not changed in the sensitivity analysis.

Table 4.8b – 2.5 per centage point decrease in UK residential transaction and price growth forecasts

Period	2018/19	2019/20	2020/21	2021/22
Transaction growth	-1.4%	-1.6%	-1.8%	-1.9%
Price growth	1.5%	2.0%	2.0%	2.2%
Forecasted revenues	51	51	51	51
Original forecast	*53*	*56*	*59*	*62*

Non-residential main rates model

The non-residential main rates model uses a bottom-up methodology to forecast the revenues generated from this segment of LTT. A bottom-up methodology is used to ensure that the price distribution is captured by the model.

Information from HMRC's Datalab (administrative datasets) is used to produce frequency price bins of the price distribution based on the non-residential properties relevant for the main non-residential rates sold in Wales during the 2015/16 period. This distribution contains information on the number of taxable transactions (excluding exempt and relieved), the total taxable value and the total amount of tax paid during the period. 3,908 properties were sold in Wales during 2015/16 with an average value of £480 thousand. The total value of these properties sold was £1.9 billion, which raised £63 million in tax revenues[20].

The price bins are selected to extract the maximum information from the price distributions while still maintaining its shape. This price distribution is analysed in terms of 25 thousand, 500 thousand, and 3 million bins. While the price bins become wider as the price increases this does not significantly affect the shape of the distribution. The price distribution is used to produce a base year from which future revenues will be derived. Figures 4.2 shows the shape of the distribution in terms of number of transactions, total property values per bin, and the amount of tax revenue[21].

[20] Calculations based on HMRC administrative datasets, which may differ from the 2015/16 HMRC SDLT Statistics.
[21] The price bins change size towards the top-end of the distribution.

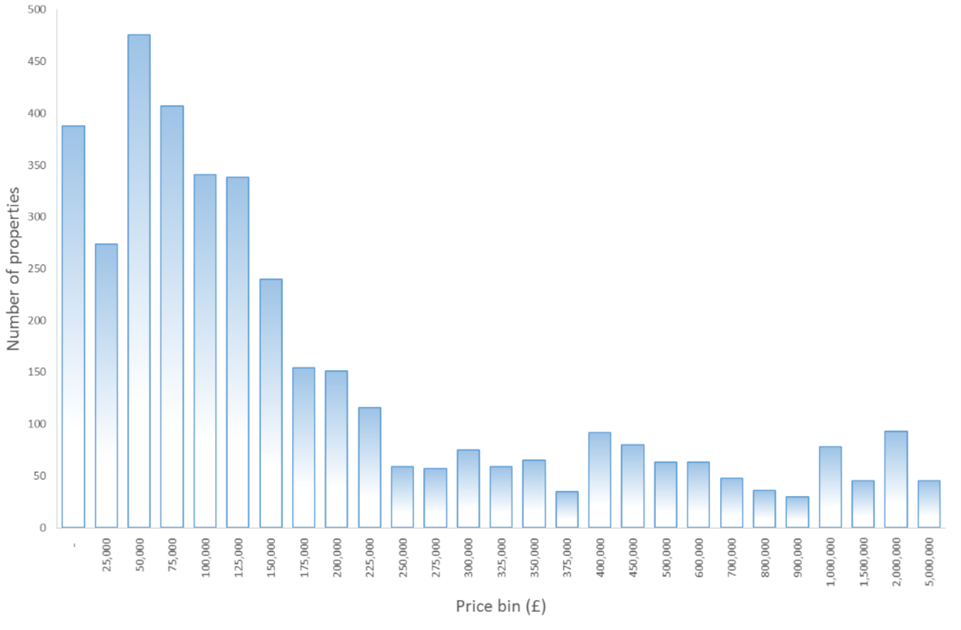


Figure 4.2a – Base year distribution (number of transactions per bin)

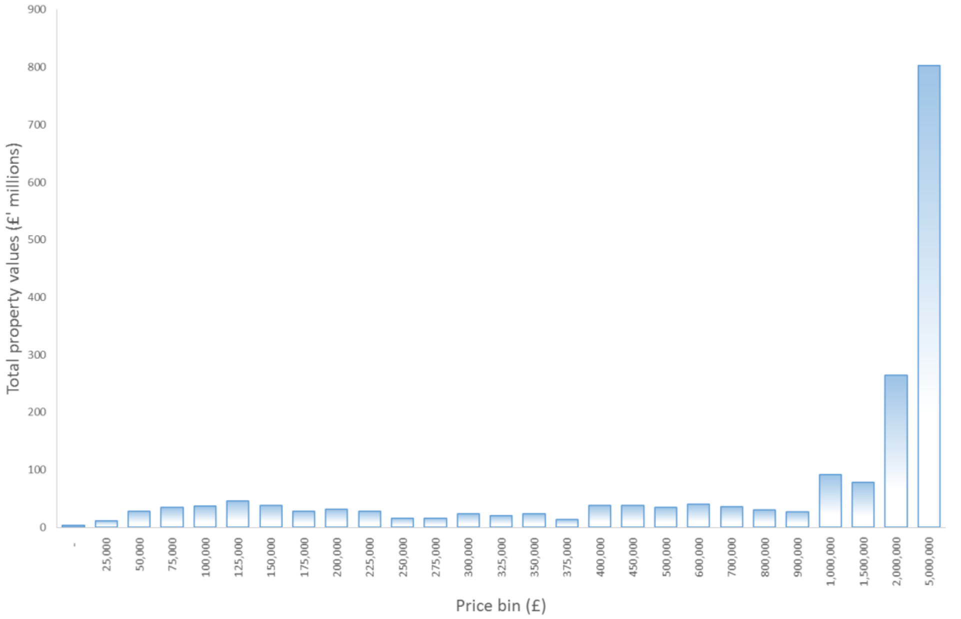


Figure 4.2b – Base year distribution (total property values per bin)

The distributions in Figure 4.2a and Figure 4.2b are adjusted to take account of forecasted non-residential property price growth and forecasted non-residential property transaction growth. The number of transactions per bin (Figure 4.2a) is adjusted to take account of future growth in transactions. Total property values per bin (Figure 4.2b) is adjusted to take account of future growth in transactions and growth in non-residential property prices.

The OBR's non-residential main rates transactions and price growth forecast for the UK as a whole are used as inputs into the non-residential main rates model. Wales' non-residential main rates transactions follow a similar trend to those in the UK. The correlation between UK and Wales' commercial transaction growth is 0.94, which implies a very strong relationship between both series[22]. No non-residential price time series is available for Wales and therefore no correlation measure can be calculated. Further economic determinants from alternative sources were considered, as suggested by Bangor Business School. However, there are limited sources for these, at least at a Wales level. In the absence of a macroeconomic model for Wales and given the economic rationale, the OBR forecasts are suitable inputs into the non-residential main rates model. The OBR's forecasts are given in Table 4.10.

Table 4.10 – OBR UK non-residential transaction and price growth forecasts

Period	2018/19	2019/20	2020/21	2021/22
Transaction growth	1.7%	1.8%	1.9%	2.0%
Price growth	1.6%	1.7%	1.9%	1.9%

Tax revenues are calculated by applying the tax rates stated in Table 4.1b to the forecasted transaction and value distributions. The model has the functionality to incorporate the impact of behavioural change through transaction elasticity and price elasticity measures.

The transaction and price elasticities factors are taken from the OBR and are applied at a granule level (i.e. bin level). The OBR elasticities factors are estimated based on observations during the transition from UK non-residential main tax rates reform from slab to marginal tax rates in March 2016[23]. While it is possible that these elasticities may be higher in Wales than at the UK level, the empirically driven OBR elasticities and forestalling factors are the preferred inputs into the model

[22] This correlation is calculated using annual commercial transaction growth on a quarterly basis in the UK and Wales between Q1 2006 and Q4 2016.
[23] See OBR (2017) http://budgetresponsibility.org.uk/docs/dlm_uploads/SDLT-elasticities.pdf.

whilst there are no Welsh specific elasticities available. While no information is available to calculate the impact, forestalling is assumed to occur in the forecast equivalent to 5 per cent of revenues. The behavioural effects used in the model are given in Table 4.11.

Table 4.11 – Behavioural effects (semi-elasticities)

Band	£0k - £250K	£250K - £500K	£500K - £1MM	£1MM - £2MM	£2MM+
Transaction elasticity	-5.4	-5.4	-5.4	-5.4	-5.4
Price elasticity	-2.0	-2.0	-2.0	-2.0	-2.0
Forestalling[24]	-5.0	-5.0	-5.0	-5.0	-5.0

The base year price distribution is based on the former SDLT slab tax rate system while forecasts are required for a marginal tax rate system.

Two adjustments are made to the non-residential revenue forecasts, similar to those applied to the residential main rates forecast. The first adjustment takes account of the difference between the SDLT revenue outturn data 2015/16 (base year) for Wales and the calculated amount based on the methodology used for this model for the same year. The second adjustment ensures that the LTT model can match the OBR forecast of non-residential SDLT in 2017/18 SDLT (£64 million) when run from the base year of 2015/16 for this element. These adjustments are applied to the leasehold and main rates revenue forecasts combined because the OBR only reports at this level.

The sensitivity of the non-residential main rates and lease rent models are analysed together as they use the same determinants and the relative size of the lease rent revenue is small.

Non-residential leasehold rent model

The non-residential leasehold rent model uses a bottom-up methodology to forecast the revenues generated from this segment of LTT. A bottom-up methodology is used to ensure that the price distribution is captured by the model.

Information from HMRC's Datalab (administrative datasets) is used to produce frequency price bins of the price distribution based on the non-residential leasehold properties traded in Wales during the 2015/16 period. This distribution contains information on the number of taxable transactions

[24] Unlike transactions and price elasticities, forestalling is a percentage of revenues and not a semi-elasticity.

(excludes exempt and relieved), the total taxable value and the total amount of tax paid during the period. 2,231 leases were traded in Wales during 2015/16 with an average value of £384 thousand. The total value of these leases was £856 million, which raised £6 million in tax revenues[25].

The price bins are selected to extract the maximum information from the price distributions while still maintaining its shape. Appropriate bin widths are selected to analyse this price distribution[26].

The price distribution is used to produce a base year from which future revenues will be derived. Figures 4.3 shows the shape of the distribution in terms of number of transactions, total property values per bin, and the amount of tax revenue.

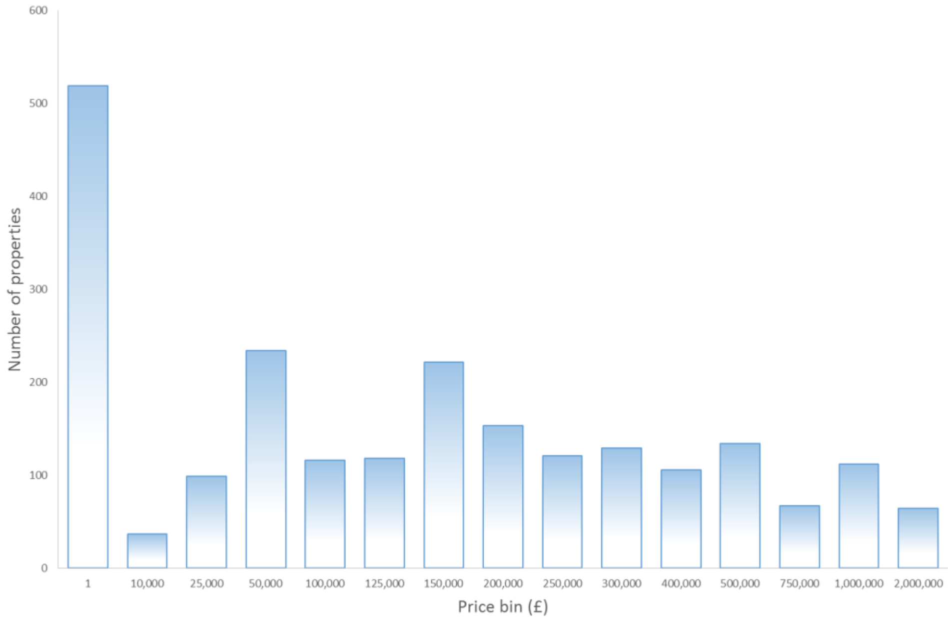


Figure 4.3a – Base year distribution (number of transactions per bin)

[25] Calculations based on HMRC administrative datasets, which may differ from the 2015/16 HMRC SDLT Statistics.
[26] The price bins change size towards the top-end of the distribution.

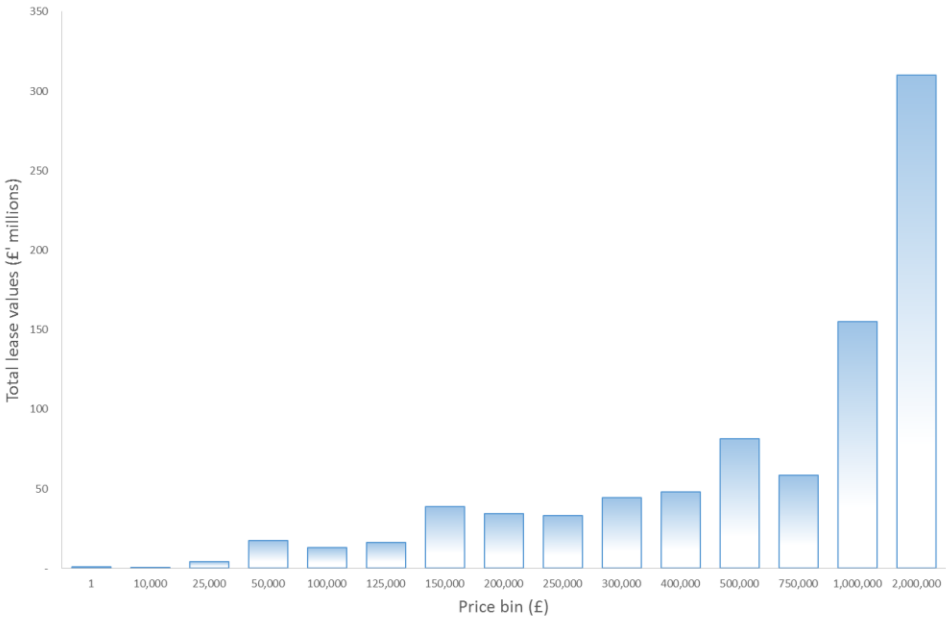


Figure 4.3b – Base year distribution (total lease values per bin)

The distributions in Figure 4.3a and Figure 4.3b are adjusted to take account of forecasted price and transactions growth, which are the main drivers of changes in leases. The price of leases per bin is adjusted by the OBR's forecast of commercial price growth. The number of transactions per bin (Figure 4.3a) is adjusted by the OBR's forecast of commercial transaction growth. Total lease values per bin (Figure 4.3b) is adjusted to take account of increased transaction activity and price growth.

In the absence of a macroeconomic model for Wales, the OBR forecasts are suitable inputs into the non-residential main rates model.

Tax revenues are calculated by applying the tax rates stated in Table 4.1b to the forecasted transaction and value distributions. The model has the functionality to incorporate the impact of behavioural change through transaction elasticity and price elasticity measures. No forestalling effects are applied to these forecasts as the revenues are relatively low and the forestalling estimate for non-residential main rates is more of a judgement at this stage.

Given that the OBR reports non-residential main rates and leasehold revenues combined, no adjustments are made to the non-residential leasehold rent revenue forecast. These are incorporated into the adjustments of the non-residential main rates model.

The sensitivity of the non-residential main rates and lease rent models are analysed together as they use the same determinants and the relative size of the lease rent revenue is small. The sensitivity is undertaken by varying the economic inputs (Table 4.10). These sensitivity analyses give an indication how revenue will vary if the economic scenario changes or behaviour is different to that anticipated. The results of these sensitivity analyses are shown in Table 4.14.

Table 4.14a – 2.5 percentage point increase in UK non-residential transaction and price growth forecasts

Period	2018/19	2019/20	2020/21	2021/22
Transaction growth	4.2%	4.3%	4.4%	4.5%
Price growth	4.1%	4.2%	4.4%	4.4%
Forecasted revenues	75	82	91	100
Original forecast	*71*	*74*	*77*	*80*

Table 4.14b – 2.5 percentage point decrease in UK non-residential transaction and price growth forecasts

Period	2018/19	2019/20	2020/21	2021/22
Transaction growth	-0.8%	-0.7%	-0.6%	-0.5%
Price growth	-0.9%	-0.8%	-0.6%	-0.6%
Forecasted revenues	67	66	66	65
Original forecast	*71*	*74*	*77*	*80*

Sensitivity analysis has also been performed for changes in the behavioural effects. Changes in the behavioural effects had little impact on the revenue forecast.

Back-testing

Staff from Bangor Business School have performed independent back testing of the Welsh Government's LTT models to test their suitability, stability and give assurance about forecasts for devolved taxes.

A key driver of the forecast for all four models is the base-year distributions for the number of transactions per bin and the total property values per bin. These distributions are adjusted to take account of future growth in transactions and prices/inflation and tax revenues are calculated from these adjusted distributions. It is therefore important that the base-year distributions reflect the property market at that time and are stable.

As part of this, Bangor Business School suggested the Welsh Government Treasury to analyse past years' data of Land Registry's house price paid data to confirm the shape and stability of the distribution over time. Although this data is not an exact set of those transactions which were also subject to SDLT, it can act as a guide on the stability of the house price distribution in Wales over time. This analysis confirmed that between years the distribution is stable.

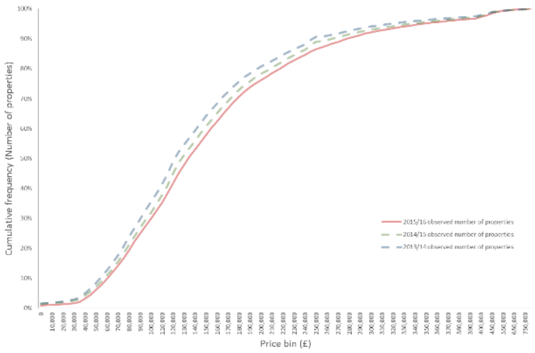
In addition, Figures 4.4 show how the distributions for residential (main rates), non-residential (main rates), and non-residential (leasehold) have changed between 2013/14 and 2015/16 (the base-year) using data from HMRC's Datalab (administrative datasets). The cumulative frequency of each distribution is shown in Figures 4.4 to illustrate how the proportion of transactions and values vary across bins and periods. Despite changes in the tax system (from slab to marginal rate), there is little variation in the distributions across the different periods, with the exception of non-residential (leasehold) transaction per bins. This difference is driven by the substantial increase in the number of leases in the first bin (519 in 2015/16 compared with 78 in 2014/15 and 70 in 2013/14)[27]. Despite this, there is little change in the distribution of total lease values per bin between 2013/14 and 2015/16.

A two-sample Kolmogorov-Smirnov statistical test can be used to test whether two samples come from the same distribution. This test considers the maximum deviation between the distributions in addition to the characteristics of the individual distributions. By testing each base-year distribution against historical distributions, the results show no significant change in distributions across time[28].

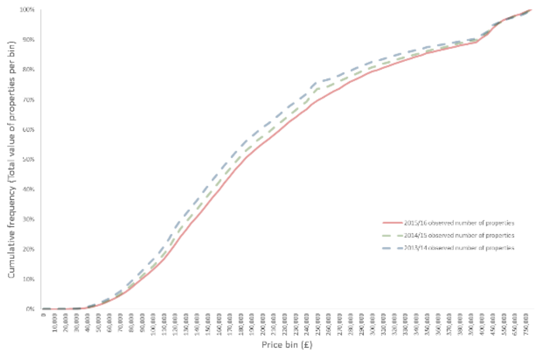
This analysis by Bangor Business School supports the view that the models are appropriate for forecasting Welsh LTT revenues.

[27] It is worth noting that the first bin are below the tax liabilities, therefore, would not affect the tax revenue forecast.
[28] This is despite a difference in the tax system (from slab to marginal rate) during the periods.

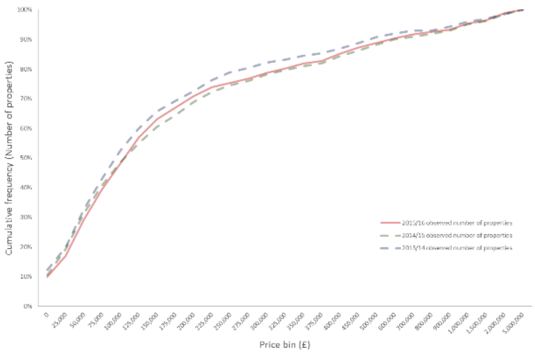
Figure 4.4 – Cumulative frequency of transaction and values



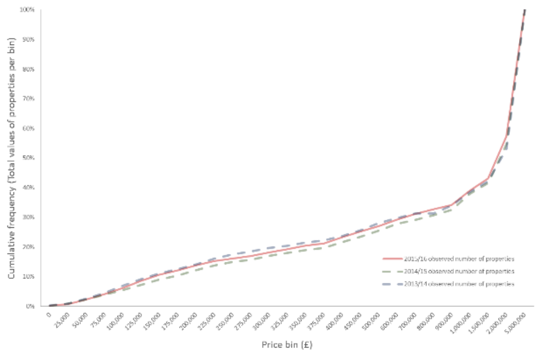
Changes in number of transactions per bin (main residential rates)



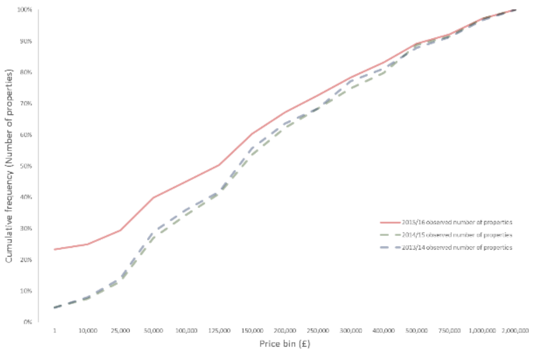
Changes in total property values per bin (main residential rates)



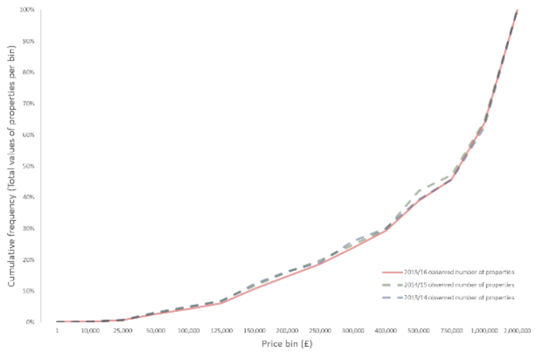
Changes in number of transactions per bin (non-residential (main rates))



Changes in total property values per bin (non-residential (main rates))



Changes in number of transactions per bin (non-residential (leasehold))



Changes in total lease values per bin (non-residential (leasehold))

Bangor Business School view on the forecast

Based on the information provided by the Welsh Government Treasury Team, Bangor Business School views the methodology described in Section 4 as an appropriate approach for forecasting LTT revenues. This decision is based on the discussion with academics and practitioners on the theoretical assumptions of the models (including factor selection), analytical analysis of the models, and the expected variation in revenue forecast for different scenarios.

All of the models used by the Welsh Government Treasury to produce this forecast have been independently reproduced by Bangor Business School as part of the validation process. The final LTT forecast is set out in Table 4.2.

Recommendation 7

The model used to forecast additional residential property revenue will require further refinement once more information is available on transactions subject to this rate and those which are refunded.

Recommendation 8

Welsh specific elasticities should be calculated when suitable data becomes available.

This work contains statistical data from HMRC which is Crown Copyright. The research datasets used may not exactly reproduce HMRC aggregates. The use of HMRC statistical data in this work does not imply the endorsement of HMRC in relation to the interpretation or analysis of the information.

SECTION 5 - NON DOMESTIC RATES

Introduction

In an important step in fiscal devolution, in April 2015, financial responsibility for NDR was devolved to Welsh Ministers. This section sets out some background to the operation of NDR, and the forecasting of NDR revenue, and Bangor University's assessment of this approach.

NDR is a way of taxing business and other non-domestic properties, with all the tax revenue raised being pooled and then distributed back to local authorities (principal councils and Police and Crime Commissioners) based on a needs formula. In 2016-17 the distributable amount contributed in respect of NDR revenue was £977m. The tax is based on the rateable value of non-domestic property in Wales. The rateable value is multiplied by the multiplier to calculate the rates for the property. The VOA (Valuation Office Agency for England and Wales) assesses the rateable value. The Welsh Government sets the multiplier every year, usually according to the Retail Prices Index for September in the preceding financial year (which it cannot exceed).

Non-domestic properties in Wales are normally revalued every 5 years. The latest revaluation came into effect on 1 April 2017, based on rental values at 1 April 2015, and the next revaluation is due to take place in 2022. A rise in rateable value at a revaluation does not lead to a rise in overall NDR revenue: the multiplier must be adjusted to ensure that the overall yield remains the same. Therefore, as revaluations are required to be overall revenue neutral, a fall in rateable values may not translate into a fall in NDR for an individual property. The multiplier is provisionally set in September of each year, up to the RPI limit. Therefore, in most years, tax bills increase or decrease in line with the RPI measure of inflation. However, NDR revenues can rise more quickly due to a changing tax base: the value of properties added to the tax base exceeding the value of properties removed from the tax base (such changes in the tax base are referred to as buoyancy).

A number of reliefs and other adjustments need to be taken into account before the final amount available to distribute back to local authorities can be derived. There are a number of reliefs (both mandatory and discretionary) in respect of NDR. These include Small Business Rates Relief, charitable relief, relief on empty properties and hardship relief. The profile of these reliefs is not constant.

Appeals can have a significant impact on the final amount of NDR revenue available to redistribute to local authorities. In Wales, there has been a relatively high proportion of challenges received in relation to the number of hereditaments on the list, around 40% for the 2010 list over the lifetime of the list. However, of these challenges, only around a third have resulted in changes to the list, meaning approximately two-thirds of challenges result in no change to a hereditament's rateable value. Appeals are processed by the VOA and successful appeals may be backdated over a number of years (until the beginning of the relevant list).

NDR revenue forecast

The forecasts for NDR revenues are set out below:

Table: 5.1 Forecast for NDR revenues – distributable amount 2018/19 to 2021/22 (£ millions)

Period	2018/19	2019/20	2020/21	2021/22
Distributable amount	1,052	1,078	1,112	1,146

The figure for 2018/19 is derived from the forecasting procedure discussed in this chapter, and forecast figures for later years are derived by increasing forecast receipts, less any prior year adjustments, in line with the OBR forecast for RPI.

Forecasting approach

The forecast of NDR revenues is not derived from a specific NDR economic model, but from aggregate data from the administrative exercise undertaken to determine the distributable amount for local authorities. Each year, the Welsh Government must determine the amount of Annually Managed Expenditure (AME) which will be available for distribution to local authorities in the following year. As part of this there are two ways of collecting NDR tax; approximately 90% of the net yield is collected by local authorities (local list), with the remainder being collected centrally by the Welsh Government (central list) from large organisations, typically utilities, that span a number of local authorities. The yield is pooled and centrally redistributed by the Welsh Government.

Local List

Prior to knowing how much will be collected, local authorities are requested at the beginning of the financial year to report how much NDR revenue they expect to collect to contribute to the pool. A best estimate is given in February by each local authority, along with other estimates, for example, for reliefs, and calculations of costs of collections, in line with the Notes for guidance issued by the Welsh Government. At this stage no detailed information is provided on the expected effect of appeals as local authorities would not have information on this as they are dealt with by the VOA.

While best estimates are given in February by the local authorities, the Welsh Government needs to confirm by the previous December how much money it will be distributing for the following year. As such there is a disparity between when information becomes available and when tax revenues need to be distributed among local authorities. The forecast of NDR revenues is a by-product of this process, rather than being derived from a separate economic forecast carried out with the sole purpose of determining NDR revenue. Those preparing the AME forecast do not hold taxpayer level data and so the forecast of NDR revenue is derived from the reported aggregates. This process has operated in a similar way for many years, including the years prior to the devolution of financial responsibility of NDR in 2015 and there are some difficulties due to the timing of the receipt of information. The in-year schedule for when information becomes available is as follows:

> February – NDR1 completed by local authorities, in accordance with the Notes for guidance and returned to Welsh Government. The NDR1 is a forecast for the coming financial year based on the information on the local rating lists and this information is used to calculate the amount distributed back to local authorities.
>
> April / May– NDR3 made available by local authorities which report the unaudited actual amount of their NDR tax contribution to the pool for the previous year, and includes impact of appeals.
>
> November – Audited NDR3, showing actual income collected completed by local authorities.

Therefore 14 months elapse between the submission of an NDR1 (forecast) and NDR3 (actual) to the Welsh Government. (NDR2 forms, completed by local authorities, are used to notify any significant deviance expected from their initial forecast). As such, a correction is always made to balance the over/under amount of funds distributed to local authorities. The difference between the NDR3 income and the NDR1 forecast forms the basis of a balancing payment or prior year adjustment for each local authority.

The distributable amount for 2018-19 is based upon the information made available in 2017 and a number of assumptions about factors which might affect the amount to be collected. Estimates for the following reliefs are included in the NDR1: reliefs for charities, community amateur sports clubs, Small Business Rate Relief scheme, partly occupied and empties. If a property is occupied by a registered charity or community amateur sports club, relief between 80% and 100% is granted. Relief for partly occupied properties is available where part of a property is temporarily empty due to the need to vacate or occupy a property over a period of time. Empty business properties are exempt from paying Non Domestic Rates for at least 3 months after the property becomes vacant. A new scheme for Small Business Rates Relief (SBRR) is due to be in place from April 2018.

Central List

This is a set list of businesses, with infrastructure spanning local authority boundaries. The figure for the distributable amount net yield for the central list is uprated by RPI each year, unless the VOA provides specific information, such as in a year of revaluation. In recent years (since 2013/14) previous forecasts of the central list have not given rise to significant forecasting errors (with the exception of one large appeal).

Components of the forecasting tool

The gross yield is the total rateable value, adjusted for buoyancy, less reliefs, losses in collection, costs of collection and “in year reductions”, which are predominantly appeals (and any revised information subsequently provided). There is scope for uncertainty, and so forecasting error, in respect of each of these adjustments.

In this forecasting process an estimate of buoyancy is used to take changes in the tax base into account and applied to the local list. (The businesses on the central list, and their properties are not likely to expand). This is derived from the rateable value at the start of the year as a percentage of the average rateable value. (The start year and end year rateable value are provided by VOA). In recent years this has been virtually static in this forecasting exercise, with buoyancy factors employed of 1.000 or 0.999. With regard to the tax base of the Central List, the possibility of increasing this in line with a measure of economic growth was considered. However the Central List businesses are not ones that would typically track economic growth and therefore RPI is considered to be appropriate.

Local authorities forecast the reliefs expected to be given in the year, and are considered to be best placed to forecast this. Their initial returns do not include appeals. These are unpredictable and are processed by the VOA, so not much information is available until appeals are resolved. Predicting the outcome of appeals is difficult and commercially sensitive.

For losses in collection, the initial NDR1 forecast from local authorities provides for a 1% allowance, with the figure for losses in collection included on the NDR 3. In recent years, the initial provision of 1% has proved to be slightly higher than the outturn losses.

The figure for NDR revenues forecast by this accounting tool are after deducting notional costs of collection and prior year adjustments. The costs of collection are calculated, without specific reference to the costs directly incurred in collecting NDR revenue, but in accordance with a prescribed allowance (£39.50 per hereditament and the aggregate rateable value for the authority's rating list multiplied by 0.00087). Each local authority withholds this amount, contributing NDR revenues, net of these notional costs of collection, to the pool.

Analysis of the forecast and sensitivity analysis

A review of the forecasts of NDR revenue compared with actual revenues indicates that this is an approach which has not produced significant forecast errors in NDR revenue in recent years.

Sensitivity analysis was undertaken to consider the impact on total NDR revenue of a change in some of the components of the forecasting tool. Of the reliefs available the most significant is SBRR. Sensitivity analysis was not undertaken in respect of this as details are not yet known about the new SBRR scheme, to be in place from April 2018. Sensitivity analysis was carried out in respect of two areas: a change in the profile of NDR contributed from different local authorities and a fall in the number of properties with a high rateable value.

Change in the profile of revenues from local authorities

A breakdown of the local list, showing the returns from the 22 local authorities was analysed, to consider the potential impact on total NDR revenue of a fall in NDR revenue from a particular geographical region or local authority. Of the NDR revenue from the local list, the most significant is in respect of Cardiff, 20% in 2015/16 (the share of Cardiff NDR revenue as a percentage of total local authority NDR revenue has stayed fairly constant, between 19% and 20.3% since 2005-06). Therefore, should there be a significant change in the Cardiff tax base, with a consequent impact on NDR revenue, this would have a significant impact on total NDR revenue. For example, in 2015/16, a 10% rise or fall in NDR revenue from Cardiff (£19 million) would have led to a 2% change in total local authority NDR revenue.

Change in the number of properties with a high rateable value

The range of rateable values from across the local authorities was appraised. There is a wide range of rateable values for non-domestic properties, but only a very small number with a high rateable value (just under 200 hereditaments with a rateable value over £1m). Should there be a drop in the number of these high rateable value properties (for example, due to closure or relocation) the loss of revenue from them will have a consequent impact on total NDR revenues. For example, with respect to the 2018/19 forecast, if there were to be a loss of revenue from 10 properties with a rateable value of £3m each, this would lead to a 1.5% fall in the total distributable amount for the year.

Bangor Business School view of the forecast

Based on the information provided by the Welsh Government Treasury Team, Bangor Business School views the methodology described in this chapter as an appropriate approach for forecasting Welsh NDR revenues.

The forecast of NDR revenues is not derived from a specific NDR economic model, which couldbe reproduced, but from aggregate data from the administrative exercise undertaken to determine the distributable amount for local authorities. This data was reviewed, including a review of how it is collated, and the steps in the forecasting process, including the Notes of Guidance. This is an established process that has operated for many years by experienced staff, and, in recent years, the divergence of actual figures from the forecast has been small, suggesting this is a well understood procedure undertaken by those experienced in making judgments in this area. The final NDR forecast is set out in Table 5.1.

Recommendation 9

Work should be undertaken to investigate and to incorporate a probability element of successful appeals into forecast calculations.

SECTION 6 – CONCLUSION

This report presents the assumptions and methodologies underlying the Welsh Government's forecasts for the devolved taxes, and Bangor Business School's work and conclusion on their suitability for inclusion in the budget setting process in Wales.

The Wales Act 2014 gave new powers to the Welsh Assembly relating to taxation and borrowing: powers to introduce Welsh taxes to replace UK stamp duty land tax and UK landfill tax, partial devolution of income tax, powers to introduce other devolved taxes on a case by case basis and borrowing powers. Non domestic rates have been devolved in April 2015.

The work completed in this report involved a review of the projections and approach for determining the projections in respect of these three taxes; LDT, LTT, and NDR. Different methodologies are used to forecast the revenue collected by each tax. The difference in methodologies reflect available information and the economic activity relating to the tax.

Based on the information provided by the Welsh Government Treasury Team, discussions with academics and practitioners on the theoretical assumptions of the models (including factor selection) and analytical analysis of the models, Bangor Business School conclude that forecasts are based on robust and appropriate methodologies and assumptions.

The absence of large variation in the revenue forecast for different economic scenarios and model assumptions support the suitability of the forecasts inclusion in the budget setting process. In addition, all models used by the Welsh Government Treasury Team to produce this forecast have been independently reproduced by Bangor Business School as part of a validation process.

The Welsh Government Treasury Team has taken actions to address the advice and recommendations from Bangor Business School on ways to improve the methodologies made during the process.

As further outturn data becomes available for the devolved taxes in 2016/17, this report will be updated to reflect the comparative performance of the outturn revenues in relation to the 2016/17 forecast. The report will also be updated to reflect revisions to economic expectations and the impact of these for the Draft Budget 2018/19.

APPENDIX 1 – SUMMARY OF KEY COMMUNICATIONS

Date	Meeting
24 Mar. 2017	Meeting between Welsh Government and Bangor Business School
06 to 07 Apr. 2017	Bangor Business School attend OECD 9th Annual Meeting of OECD Parliamentary Budget Officials and Independent Fiscal Institutions
19 Apr. 2017	Conference call between OBR and Bangor Business School
26 Apr. 2017	Conference call between Scottish Fiscal Commission and Bangor Business School
28 Apr. 2017	Meeting between Welsh Government and Bangor Business School
05 May 2017	E-mail correspondence between National Bank of Belgium Research Department and Bangor Business School
19 May 2017	Meeting between Welsh Government and Bangor Business School
8 Jun. 2017	Conference call between Prof. Max Munday (Cardiff University) and Bangor Business School

Subsequent phone calls and ad-hoc communications are not detailed.

Document is Restricted

Llywodraeth Cymru
Welsh Government

Welsh Government

Welsh Tax Policy Report

Autumn 2017

gov.wales

Content

Foreword

A few short months ago, the Welsh Government's tax policy framework and the accompanying work plan for this year were published. This document provides an initial report on progress to date. The work is at an early stage but it is my intention this programme of research will, over time, become a valuable resource for informing taxation policy in Wales – and perhaps further afield. Its publication alongside the draft Budget is intended to be a step towards better alignment of tax policy and spending – a process which will develop further in future years.

Taxes are the entry fee to a civilised society, enabling us to achieve collectively what we cannot accomplish alone. They underpin the policies which governments are elected to deliver – they are not an end in themselves.

The aim of Welsh taxes is to:

- Raise revenue to fund public services as fairly as possible;
- Deliver Welsh Government policy objectives, in particular supporting jobs and growth;
- Be clear, stable and simple;
- Be developed through collaboration and involvement;
- Contribute directly to the Wellbeing of Future Generations Act goal of creating a more equal Wales.

The next 18 months will see the introduction of land transaction tax and landfill disposals tax – from April 2018 – and Welsh rates of income tax, from April 2019.

During the development of land transaction tax and landfill disposals tax, stakeholders were clear they wanted to see continuity with the current England and Wales tax regime wherever possible. I also want a transparent and evidence-based approach to change to create a stable taxation system, which will evolve steadily and rationally. As we look ahead to how Welsh taxes might develop over time, we must recognise that the Welsh tax system exists against a background of UK and international taxation which must be taken into consideration.

The evidence gathered via this work plan will inform the Welsh Government but I hope it will also provide businesses and other organisations, communities and citizens with a useful resource about how we could use taxes to support the wider ambitions of government in Wales. This will be a transparent process and public engagement will be an integral part of the Welsh Government's work on understanding how our taxes can contribute to a better Wales. I hope people from all walks of life – from tax experts to those who have not previously considered the role of taxes – will contribute their views about what we are considering and let us know how they feel the tax system could be improved in Wales.

Over the next few months, we will assess what we have learned so far and firm up the workplan for 2018; drawing on the expertise of the Tax Advisory Group, which is made up of tax experts and representatives from business, local government and third sector organisations. An outline of our plans is provided at the end of this report.

I hope this first report provides some useful insights into the potential to use tax to enhance Welsh society.

Mark Drakeford
Cabinet Secretary for Finance and Local Government

Welsh tax policy

1. From April 2019, £5bn of devolved and local tax revenue will be collected in Wales to spend on Welsh public services. This will come from the new devolved Welsh taxes – land transaction tax (LTT) and landfill disposals tax (LDT) – Welsh rates of income tax and local taxes (council tax and non-domestic rates).

2. The devolution of tax powers provides the Welsh Government with an opportunity to work with the National Assembly for Wales, local government, businesses, tax professionals, taxpayers and other stakeholders to develop a distinctive Welsh approach to taxation. It enables the Welsh Ministers to set out how they intend to use their tax powers and what they expect to achieve.

3. The first step in this process was the publication by the Cabinet Secretary for Finance and Local Government of the Welsh Government's tax policy framework and supporting tax policy work plan.

Tax policy framework

4. The tax policy framework confirmed the Welsh Government's strategic tax objectives:

    - Welsh Ministers believe the range of devolved tax powers from April 2019 enables the political parties at the National Assembly to offer people in Wales a choice about the level of taxes paid and the corresponding quality and quantity of devolved public services;

    - It is important the level of taxation is appropriate to the prevailing economic conditions. The Welsh Government has committed to not increase Welsh rates of income tax during this Assembly term and will carefully consider tax rates and their impacts for the other Welsh taxes to ensure they continue to generate sufficient revenue to fund public services while remaining fair and supporting economic growth;

    - The Welsh Government will look at the Welsh tax system as a whole and in the context of the UK system, to consider the impact of changes on households and individuals in Wales. The Welsh Government is committed to developing a fairer society in Wales and will use the tax system to promote fairness and economic growth;

    - There is a role for taxation in influencing behaviour and the Welsh Government will consider whether new Welsh taxes could be introduced in an efficient way to operate alongside existing or new policy tools;

    - The Welsh Government will continue to review Welsh taxes in the context of our legislative powers to ensure they are aligned to our priorities;

    - The Welsh Government expects the Welsh Revenue Authority (WRA) to work in partnership with local authorities and other UK tax authorities, to build a more comprehensive picture of the delivery of tax services; of compliance and of tax policy development and to join up activity, where possible, for the benefit of taxpayers.

5. The tax policy framework confirmed the tax policy principles which will be used in considering tax policy proposals.

Tax policy work plan

6. Published alongside the tax policy framework in June 2017, the tax policy work plan identified 13 areas which the Welsh Government is investigating to inform thinking about tax policy and to deliver the objectives set out in the framework. Some of these actions will be completed in 2017 but others will require longer-term consideration.

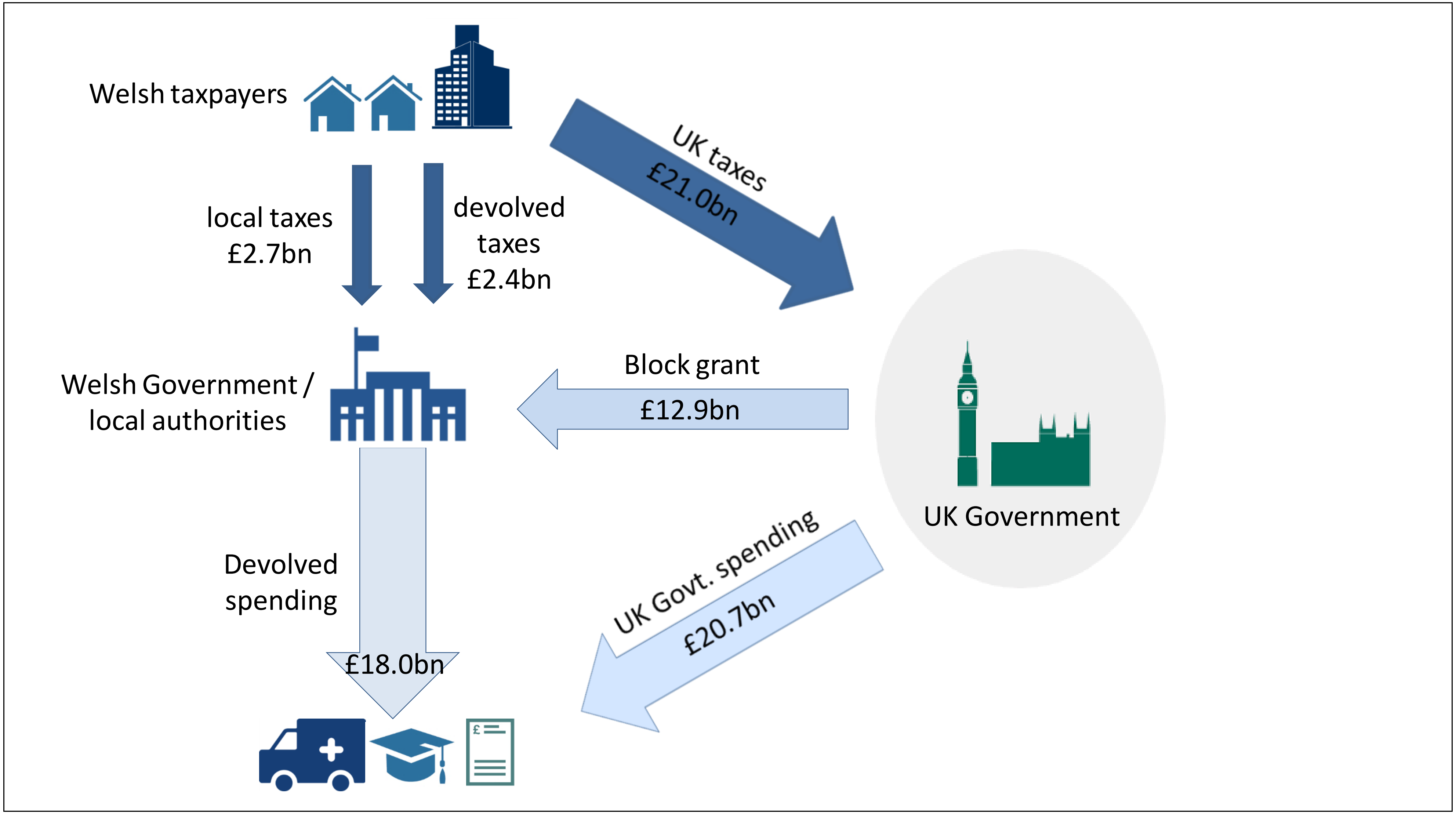
7. The analysis set out in this document provides an update about the government's current tax policy thinking and progress. By issuing this alongside the Welsh Government's draft Budget for 2018-19, we are taking the first step towards better aligning tax policy and the Budget; a process which will continue in future years.

8. This tax policy report, which is intended to be the first in an annual series, provides updates on 12 of the areas (the 13th is being developed with the Public Policy Institute for Wales and will be a longer-term item for 2017-18 and 2018-19[1]). By providing the background to each of these; reviewing the emerging evidence and, where applicable, summarising any early outcomes, the Welsh Government hopes to stimulate debate and encourage further engagement.

9. The 12 items are listed in the contents page. For convenience, three areas which address aspects of local taxation have been presented together. Changes to local tax policy are being developed as part of a broader reform of the funding arrangements supporting local services. More detailed information about the Welsh Government's reform of local government finance will be provided alongside the 2018-19 local government settlement on 10 October 2017.

[1] '13. From October, work with the Public Policy Institute for Wales to review the socio-economic factors and trends which may impact on the Welsh tax base, and the factors which could help grow the tax base in Wales'.

Figure one: How public services in Wales will be funded in 2019-20



Figures relate to projections for 2019-20. Devolved spending only includes spending financed by tax revenues and the block grant.

Progress report on the tax policy work plan 2017

1) By October 2017, announce the rates and bands for land transaction tax, including the higher rates surcharge, and the rates for landfill disposals tax

Background

10. The Wales Act 2014 provided for the devolution of the first Welsh taxes in almost 800 years. The first taxes to be devolved to Wales will be land transaction tax (LTT) and landfill disposal tax (LDT). The Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 and the Landfill Disposals Tax (Wales) Act 2017 provide for LTT and LDT to replace stamp duty land tax and landfill tax, respectively, in Wales from April 2018.

11. It is important to ensure the overall level of tax paid by individuals and businesses is appropriate to prevailing economic conditions. The tax rates will therefore be set by regulations closer to April 2018. In setting the first rates of Welsh taxes, it is important to provide certainty for taxpayers. Announcing the rates and bands balances the need to reflect economic conditions at the time the taxes will come into effect, with the need to provide certainty for taxpayers.

12. The revenues from the two new devolved taxes will be used to directly fund public services in Wales, replacing part of the funding the Welsh Government receives from the UK Government. Announcing the tax rates alongside the draft Budget allows for tax and funding decisions to be scrutinised together.

13. The Welsh Government has committed to a fair and transparent approach to taxation. The paper at annex one provides further details about the issues considered in setting the tax rates and further analysis about the impact for taxpayers and revenues.

Evidence and analysis

14. As devolved taxes will help to fund public services within Wales, the revenue the taxes will raise is an important consideration in setting the tax rates. The funding provided by the UK Government to the Welsh Government will be reduced by approximately the amount stamp duty land tax and landfill tax generate in Wales at the time of devolution and what these taxes are forecast to generate for future years. The revenues from LTT and LDT will directly fund the Welsh Government budget and these tax rates will help to determine whether the Welsh Government has less, more or the same overall funding. In the context of reducing Welsh Government budgets in real terms as a result of the UK Government's ongoing policy of austerity, the approach to setting the tax rates has been guided by the principle that there should be no less funding available for public services as a result of tax devolution.

15. Providing stability and certainty is a key aim in transitioning to the new taxes. This has meant the predecessor tax rates have been a relevant factor in setting the devolved tax rates. To provide stability, the approach taken has been that any changes to the rates of the predecessor taxes should not be more than is necessary to reflect Welsh circumstances and priorities.

16. In setting the tax rates it is also important to consider the context in which the taxes operate. The two devolved taxes – LTT and LDT – operate within different contexts and therefore the issues which need to be considered are different for each tax.

17. For LTT, the residential and non-residential property markets provide the context in which the tax operates. Both the number of transactions and property prices has helped to inform the rates for Wales, as well as the impact the rates will have on the market. The level of integration with the wider UK economy and property markets has also informed the approach to setting tax rates. The legislation requires LTT to be a progressive tax, therefore tax rates will be higher for higher-priced properties than for lower-priced properties; the level of progressivity is also an important consideration and the approach taken has been to increase progressivity.

18. LDT is an environmental tax, which seeks to influence positive environmental behaviours. It aims to ensure that disposal of waste to landfill is properly priced to reflect its environmental cost and promote a more sustainable approach to waste management by encouraging greater prevention, re-use, recycling and recovery of waste. Wales is at the forefront of waste policy and LDT is a useful additional lever to support Welsh Government waste policies and achieve our ambitious goal of a zero waste Wales. In setting the rates, the objective of reducing landfill disposals in Wales has been a key consideration, along with providing consistency, certainty and stability for businesses.

19. In addition, the Landfill Disposals Tax (Wales) Act 2017 enables the Welsh Revenue Authority (WRA) to charge tax on taxable disposals made at places other than authorised landfill sites (unauthorised disposals). This is intended to provide a financial deterrent and make unauthorised disposals of waste more financially risky, thereby making them a less attractive option for those tempted to ignore their environmental obligations and evade tax.

20. The paper at annex one provides further details about the considerations made in setting the tax rates.

Outcome and next steps

21. Taking into account the factors outlined in paragraph 16, LTT rates and bands will be as follows.

22. Residential rates:

Price threshold	**Main residential rates**
£0 - £150,000	0%
£150,000 - £250,000	2.5%
£250,000 - £400,000	5.0%
£400,000 - £750,000	7.5%
£750,000 - £1.5m	10.0%
£1.5m-plus	12.0%

23. To increase the progressivity of the residential rates, the property price at which the tax becomes payable is higher for LTT than for stamp duty land tax. Adjusting the rates and bands for higher-priced transactions maintains revenues. To support a smooth transition to the new tax, the degree of difference between LTT rates and the current stamp duty land tax rates has been kept relatively small.

24. With these main residential rates, it is forecast that 45% of transactions will not be liable for LTT – an increase from stamp duty land tax regime. The average first-time buyer will pay no tax and the average buyer will pay less tax than under stamp duty land tax. All buyers of residential properties which cost up to £400,000 will pay the same or less tax than under stamp duty land tax. Around 90% of residential transactions which would have been taxed under stamp duty land tax will pay the same or less tax with LTT.

25. For additional residential properties, the higher rate of tax payable will be an additional 3% on top of the main residential rate in each band – this is the same as the current stamp duty land tax regime. As the higher rate was only introduced recently, there is limited evidence on its impact in Wales, therefore consistency with stamp duty land tax has been maintained.

Non-residential rates

Price threshold	**Rates**
£0 - £150,000	0%
£150,000 - £250,000	1%
£250,000 - £1m	5%
£1m-plus	6%

26. Adopting a lower tax rate than stamp duty land tax for the first band for non-residential properties where tax is payable, increases the progressivity of the LTT non-residential rates. To maintain revenues, a new top band has been added. Reflecting the integration of the Welsh economy with the rest of the UK economy and to support a smooth transition to the new tax, the degree of difference between LTT rates and stamp duty land tax rates is relatively small.

Non-residential lease rates:

Net present value threshold	**Rates**
£0 - £150,000	0%
£150,000 - £2m	1%
£2m-plus	2%

27. To reflect the property market in Wales, the top LTT rate will apply from a lower net present value threshold than the top stamp duty land tax rate. As the non-residential lease rate applies to a fairly small number of transactions overall and generally lease rates are lower in Wales than in parts of England, such as London, very few

transactions would pay the top rate of tax in Wales if it was consistent with stamp duty land tax.

28. For freehold purchases and transactions with lease premiums, it is forecast that 60% of taxable transactions will pay no tax. For freehold purchases and transactions with lease premiums, buyers will pay less tax on all non-residential freehold or leasehold premium transactions where the price is less than £1.1m.

Landfill Disposals Tax rates

29. Taking into account the factors outlined at paragraph 17 and 18 above, LDT rates will be as follows.

Rate	**2018-19**	**2019-20** *Assumed rate*
Standard	£88.95	£91.70
Lower	£2.80	£2.90
Unauthorised disposals	£133.45	£137.55

30. It is intended that the standard and lower rates will remain consistent with the tax rates for landfill tax for the first two years of LDT. This provides consistency, certainty and stability for businesses and reduces the risk of waste moving across the Wales-England border.

31. The unauthorised disposals rate is set at 150% of the standard rate. This reflects the increased negative impact on the environment of unauthorised disposals. It provides a financial deterrent and helps create a level playing field for legitimate waste businesses. It reflects that penalties and interest, which would have been applied in normal circumstances for a registered landfill site operator, will have been avoided and recognises the compliance and enforcement costs of the WRA.

32. The UK Government is yet to announce its rates for landfill tax in 2019-20. Therefore an assumed rate is given in the above table, which increases the 2018-19 tax rates by the Office for Budget Responsibility's forecast for RPI. This is in line with the UK Government's stated policy on setting landfill tax rates.

33. A determining factor in setting the tax rates for both LTT and LDT has been the principle that there should be no less funding available for public services as a result of tax devolution. The funding the Welsh Government receives from the UK Government will be reduced to account for the new tax revenues the Welsh Government will receive. The method for determining this reduction has been agreed but the size of the reduction will be set at the time of the UK Government Autumn Budget. If the UK Government alters stamp duty land tax or landfill tax policy in a way which affects tax revenues, the size of the block grant adjustment will change and the Welsh Government's net resources will also change. If this happens, the Welsh Government will need to consider whether the above tax rates remain appropriate and, if necessary, the rates may be changed.

34. Following the UK Government's Autumn Budget 2017, the Welsh Government will lay regulations to bring the tax rates into effect from April 2018. These regulations will be scrutinised and determined by the National Assembly. From April 2018, LTT

and LDT will replace stamp duty land tax and landfill tax in Wales; the new tax rates set in the regulations will apply.

2) Reforming local government finance

35. Council tax and non-domestic rates are the two local taxes which help to fund the delivery of public services to local communities in Wales. Evolving local tax policy is an integral part of a phased reform of the wider funding framework for local government. A more detailed discussion paper *An Update on the Reform of Local Government Finance*, will be published alongside the annual local government settlement on 10 October 2017.

Background

36. A multi-billion pound finance framework underpins all forms of local government – a complex mix of county councils, the police service, fire and rescue authorities, town and community councils, national park authorities and smaller bodies. These are autonomous from the Welsh Government; democratically elected and directly accountable to their local populations. The funding arrangements reflect this, in an interconnected system of government grants, locally-raised revenues (including local taxes), capital funding, borrowing and investment.

37. Figure 2 illustrates the wider context within which local taxes sit. Together, council tax and non-domestic rates raise around £2.4bn annually, representing about 27% of annual revenue spending on local services, including education, social care, local transport, housing provision, leisure and waste management.

38. Changes to one component of the finance system have a direct impact on other parts of the framework. Therefore, there is a need to ensure that any package of reforms to local government finance is holistic and maintain clear accountability for service performance. On 31 January 2017, we outlined our approach to reforming the way local government operates[2]. Alongside this document, we made a statement about our intention to approach changes to local government finance in a phased and managed way, developing a system that meets future needs.

Evidence and analysis

39. In March 2016, the Independent Commission on Local Government Finance Wales[3] published its conclusions about possible ways to reform the finance system for local government. Prior to this, the Scottish Commission on Local Tax Reform[4] considered radical changes to the design and operation of local taxes as important elements of the available funding for local services. We are considering all the available evidence to explore reforms for Wales. The challenge for the Welsh Government is the need to reconcile the many different stakeholder viewpoints in a package of reforms that places the needs of citizens at its heart. We also need to balance the aspirations with the costs and risks of making changes, ensuring we do not ignore the strengths of the current arrangements.

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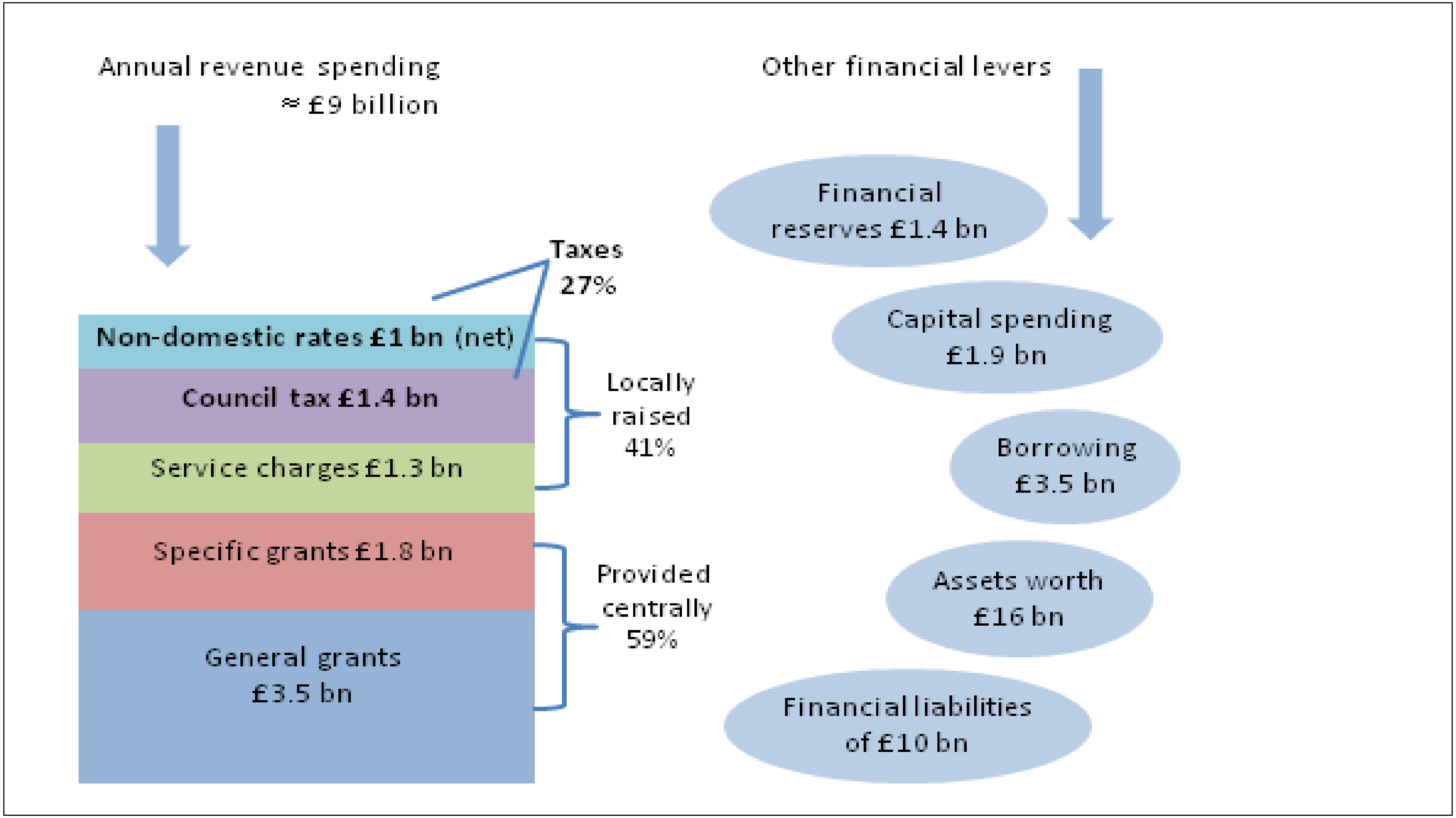
[2] *Reforming Local Government: Resilient and Renewed* published January 2017. https://consultations.gov.wales/consultations/reforming-local-government-resilient-and-renewed

[3] *Ambition for Change – Aiming Higher* published March 2016. http://www.cipfa.org/partners/independent-commission-on-local-government-finance-wales/final-report

[4] *Just Change: A New Approach to Local Taxation* published December 2015. http://localtaxcommission.scot/download-our-final-report/

Figure two: The funding arrangements for local services



Source: Local government annual returns, StatsWales

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Making council tax fairer

40. The Welsh Government's Programme for Government, *Taking Wales Forward,* and tax policy work plan include a commitment to work with local government to review council tax and identify how it could be made fairer. This involves examining how the tax is designed and how it operates. Our main aim is to increase the progressivity of the current system by looking at changes which would benefit those households which are less able to pay their council tax bills.

41. A number of options are being examined, including changes to the tax relativities charged between the nine council tax bands; exploring ways to improve the council tax reduction scheme and renewing efforts to ensure those who are eligible for the scheme are benefitting from it. Property valuations for the purposes of council tax in Wales are based on values set at 1 April 2003. While this is more recent than in England and Scotland (where council tax is charged on the basis of property values set in 1991), this has a bearing on our ability to improve and maintain fairness. We are exploring property valuation more generally from the perspective of fairness but also in relation to practical operation and future revenue stability.

42. Our commitment to improve fairness also extends to reviewing the procedures through which council tax is administered and managed. We undertook research earlier in the year to consider what can be done to improve collection and arrears management[5].

A more effective non-domestic rates system

43. The Valuation Office Agency (VOA) carried out a property revaluation exercise for non-domestic rates in 2015. Regular revaluation exercises are undertaken to redistribute the amount of tax payable across the tax-base, reflecting changes in property market conditions since the previous exercise in 2010.

44. It is right that ratepayers are able to challenge the rateable value of their property if they have reason to believe it may be inaccurate. Currently, more than 40% of ratepayers appeal their property valuation, but two-thirds of these challenges result in no change to rateable values. A significant proportion of appeals are thought to be speculative, which result in a costly and resource-intensive process. The UK Government has introduced the Check, Challenge, Appeal process, which it believes will enable the VOA to better manage the flow of appeals in England; improve data accuracy and encourage ratepayers to take informed decisions about proceeding through the different stages of an appeal. The Welsh Government is considering whether a similar approach or other reforms to the appeals process would better serve Welsh ratepayers.

45. The Welsh Government is also committed to helping authorities tackle fraud and avoidance in relation to non-domestic rates. Ensuring the correct rates are paid provides stability and certainty to ratepayers by reducing the potential for backdated liabilities. The extent of avoidance in Wales, whether unintended or deliberate, is

[5] Government Social Research 'Research into local authorities' approach to council tax collection in Wales', published 28 September 2017. http://gov.wales/statistics-and-research/local-authorities-approaches-council-tax-debt-recovery/?lang=en

not currently known and requires further investigation. Supporting compliance, and taking a robust approach to avoidance and is a key strategic policy for the Welsh Government for tax administrations across all five Welsh taxes.

Better targeted support for small businesses

46. Our Programme for Government and tax policy work plan included a commitment to review small business rates relief (SBBR), and develop permanent arrangements from 2018. The aim is to deliver a scheme which targets support towards those businesses that would benefit most. Relief from non-domestic rates should also support the delivery of wider Welsh Government objectives, while protecting the tax-base and the revenue raised to fund local services. In developing a new scheme, we are seeking to minimise the administrative burden on ratepayers and billing authorities, while limiting as far as possible avenues for abuse.

Local tax administration

47. The Welsh Government continually considers the range of procedures involved in tax administration. There will be administrative implications resulting from reforms to council tax, council tax reduction, non-domestic rates and SBRR. Improved information-sharing is key to effective tax administration.

Supporting local government reform

48. In *Taking Wales Forward*, we committed to reviewing the local government finance framework to help councils become more sustainable and self-sufficient. The proposals for reform and our collective work to drive forward city and growth deals will contribute to economic growth, financial resilience and improved services. As a result of the developing city and growth deals, the Independent Commission on Local Government Finance Wales and some local authorities have called for a different approach to the way non-domestic rates revenue is distributed.

49. Changes to local tax policy have a direct impact on the distribution of core funding through the annual local government settlements. A greater focus on regional working in future years could also change spending patterns in local authorities. The funding formula for the annual settlements for local authorities and police has become more complex since its inception and there is merit in exploring the scope for simplification or changes to methodology to aid transparency and operation. The distribution subgroup, a subgroup of the Partnership Council for Wales, is engaged in the development of the funding methodology.

Outcome and next steps

A fairer council tax

50. During autumn 2017, the Welsh Government will continue to improve the evidence base and assess the impact of proposals before making changes, working with stakeholders through the various consultative forums and through an expert-led working group. It is intended to consult on initial proposals to make council tax fairer in early 2018.

A more effective non-domestic rates system

51. A set of updated rateable values took effect across Wales and England from 1 April 2017. The VOA engaged with its stakeholders and businesses regarding the revaluation. The Welsh Government is providing transitional rate relief and high street rate relief to eligible businesses to aid the transition as part of its £210m package of annual relief.

52. The Welsh Government has introduced initial changes to the operation of the Valuation Tribunal for Wales and will be launching a consultation on proposals to make changes to the appeals system, designed to improve efficiency and ensure it is easier for ratepayers to navigate.

53. In relation to non-domestic rates avoidance, a working group of local government stakeholders and tax experts has been established to share experiences of avoidance activity and explore the barriers to investigating it successfully. The Welsh Government will consult in autumn 2017 on a package of measures including powers of property inspection and changes to the eligibility criteria for reliefs and exemptions.

Better targeted support for small businesses

54. A consultation about the Welsh Government's proposals for a permanent SBRR scheme will close on 13 October[6]. It discusses a number of possible reforms including:

- Restricting the amount of relief available to businesses that occupy multiple small properties, for example, large national chains;
- Exceptions from SBRR for business activity that does not align with Welsh Government objectives;
- Reverting the existing enhanced relief for retail premises to a standard level;
- Re-investing the revenue released from the above proposals to provide more generous relief to small businesses through amending the eligibility criteria, for example rateable value thresholds;
- Targeting support to certain sectors that help to meet Welsh Government objectives, for example, our commitment to deliver 30 hours of free childcare for working-age parents of three to four-year-olds.

55. The Welsh Government is working with its partners to test the practical implications of the proposals. Following initial changes in 2018, the permanent scheme will continue to be developed as there are a number of potential reforms outlined in the consultation that will take longer to explore and assess. Those ideas include time-limited relief as growing businesses become self-sustaining, and potentially doing

[6] Delivering a tax cut for small businesses: A new small business rates relief scheme for Wales. Published 21 July 2017. https://consultations.gov.wales/consultations/delivering-tax-cut-small-businesses-new-small-business-rates-relief-scheme-wales

more to help businesses that support the Welsh Government's social, economic or environmental priorities.

Local tax administration

56. To ensure the changes resulting from reforms to council tax do not risk the effectiveness of a tax that has enjoyed good collection rates for two decades, the Welsh Government will explore the implications of the changes for tax administration through a consultation in 2018 and by working with stakeholder groups.

57. A new information-sharing gateway between local authorities and the VOA was established in April 2017 with the aim of reducing administrative burden for taxpayers having to provide similar information to different organisations. The gateway will also aid collection and fraud investigation by billing authorities.

Supporting local government reform

58. The Welsh Government is working with local government to assess the merits of a share-gain arrangement that could allow authorities working on a regional basis to retain a portion of additional non-domestic rates collected where there is genuine economic growth as a result of their collaborative actions. As an initial step, we have invited local government to prepare proposals that work for all regions while ensuring the risks and volatility of the funding stream are managed.

59. As we take forward reforms that have implications for the distribution of the annual local government settlement, we will discuss and agree any potential changes required to the methodology with local government through the distribution subgroup.

Exploring the potential for longer term reforms

60. There have been a number of wide-ranging reviews of how local government should be funded. The Welsh Government is exploring whether different approaches to the taxation of non-domestic property, such as some form of tax based on land value, may benefit Wales. There is theoretical research suggesting other approaches to raising income from property may be economically more efficient and more progressive. However, the administrative implications of different tax designs have in the past presented barriers to change. The first stage in 2018 will involve exploring the feasibility of a land value tax as a replacement for raising non-domestic rates revenue in Wales.

61. Working with the consultative groups, the Welsh Government intends to assess the possibilities so a number of tested scenarios can be presented in readiness for the next National Assembly elections.

3) Continue to press the case for the devolution of Air Passenger Duty, and further develop the evidence base to support the case

Background

62. Air passenger duty (APD) is an excise duty, which is levied on the carriage, from a UK airport, of chargeable passengers on chargeable aircraft[7]. APD is paid by the operator of an aircraft and the amount of tax is dependent on the final destination and class of travel of the chargeable passenger[8]. Table one summarises the current UK rates. It is estimated that APD raises £10m in Wales, including approximately £1m from direct long haul (destinations of more than 2,000 miles from London).

Table 1: Air passenger duty rates

Destination bands and distance from London	Reduced rate (lowest class of travel on aircraft)	Standard rate (all other classes of travel)	Higher rate (for travel in aircraft with fewer than 19 passengers)
Band A (1-2,000 miles) 'short haul'	£13	£26	£76
Band B (2,000-plus miles) 'long haul'	£76	£150	£450

63. In 2010 the Holtham Commission recommended devolution of APD to Wales and in 2012 the UK Government's Silk Commission recommended APD should be devolved for direct long-haul flights initially, followed by full devolution as part of the UK Government's future work on aviation taxation.

64. To date, the UK Government has rejected devolution of APD to Wales. The UK Government rejected the Silk Commission's recommendation stating: “Having now given this recommendation careful consideration, the government is not convinced by the case for devolving APD to Wales. In particular, HMRC published a report in autumn 2012 highlighting that different rates either side of the Wales-England border would be likely to redistribute passengers between airports rather than significantly increasing the overall demand within the UK.”

65. This was despite the Silk Commission reviewing the evidence about the potential competitive impact and concluding: “If APD were to be devolved and then reduced in Wales this would lower the price that passengers from Welsh airports pay. This could be regarded as an economic distortion creating an uneven playing field. However, international evidence on the factors that influence airport choice in multi-airport locations shows that non-price factors such as airport access times, airport delay and flight frequency are important factors in determining airport choice with airport access times being the dominant factor. Price, while important, does not appear to be a decisive factor in determining airport choice.”

[7] Definitions are available from Gov.uk:
https://www.gov.uk/guidance/air-passenger-duty
[8] While the duty is paid by the airlines this is passed on to consumers in the price they pay for the ticket.

66. In the meantime, the UK Government has agreed to devolve APD to Scotland and Northern Ireland. APD will be a fully devolved tax in Scotland from April 2018[9] and APD is devolved in Northern Ireland for direct long-haul flights. The Welsh Government's position remains that there is no reason why Wales should be treated differently to the other Devolved Administrations. At the very least, and in line with the position in Northern Ireland, APD should be devolved for direct long-haul flights from airports in Wales.

67. In Scotland, APD will be replaced with air departure tax (ADT) in April 2018. The rates and bands for the new tax will be announced in autumn 2017, however the Scottish Government has indicated it is seeking a 50% reduction in ADT on the basis this would encourage the establishment of new routes; enhance business connectivity and help generate sustainable growth.

Evidence and analysis

68. The Welsh Government continues to make the case for devolving APD to Wales, submitting evidence to HM Treasury's latest review of APD in summer 2015[10]. Contrary to the position of the UK Government, the Welsh Government believes the devolution of APD would benefit individuals and businesses in Wales and support greater access to international markets in England, particularly in the South West. This is supported by the same HMRC analysis[11] the UK Government highlighted in its response to the Silk Commission. This analysis shows that a price reduction for flights from Cardiff Airport equivalent to the prevailing rate of APD would increase combined passenger numbers from Cardiff and Bristol airports by 46%.

69. It is well established that the presence of an airport which offers access to key global markets provides significant economic benefits across the economy[12]. Businesses value ready access to international transport links and therefore choose to locate in areas where that access is available. Aviation also plays a crucial role in contributing to the growth of the wider economy through facilitating the movements of goods and services, workers and tourists, investment and ideas[13].

70. The presence of a well-connected airport attracts foreign direct investment and generates positive spill-over impacts, which improve an economy's productive capacity. As such, thriving airports contribute to the development of economically-successful cities by supporting agglomeration effects, which provide increasingly important benefits for cities and wider regions. Connections to other agglomerations can help to deepen labour and capital markets, as well as increasing competition and innovation.

[9] The devolution of APD was first recommended by the Calman Commission and then again by the Smith Commission.

[10] HM Treasury discussion paper on the options for supporting English regional airports from the impacts of air passenger duty devolution:
https://www.gov.uk/government/publications/discussion-paper-on-options-for-supporting-english-regional-airports-from-the-impacts-of-air-passenger-duty-devolution

[11] HMRC, Modelling the impact of price differentials at UK Airports
https://www.gov.uk/government/publications/modelling-the-effects-of-price-differentials-at-uk-airports

[12] For example, see Oxera (2009) *What is the Contribution of Aviation to the UK economy?* and Oxford Economics (2011) *Economic Benefits from Air Transport in the UK.*

[13] Airports Commission, Discussion Paper 02 Aviation Connectivity and the Economy

71. The Welsh Government's tax policy framework is clear that devolved tax policies should deliver Welsh Government policy objectives, in particular supporting jobs and growth. The devolution of APD would align with the Welsh Government's responsibility for economic development. At a time when the Welsh (and UK) Government is looking to foster stronger economic links with world markets, the UK Government's decision not to devolve APD will impact on the Welsh Government's efforts to attract new inward investment and support Welsh exports.

72. To help inform the debate, the Welsh Government has commissioned independent evidence into the potential impact of devolving APD to Wales. The aim of this research is to re-examine the potential market, competitive and economic implications of devolving APD. This will be published later in the autumn.

Outcome and next steps

73. The Welsh Government continues to argue for APD to be devolved and is working with Cardiff Airport and stakeholders to further develop the evidence base to present to the UK Government. In the UK Government's summary of the responses to its discussion paper on the options for supporting regional airports in England from the impacts of APD devolution[14] it committed to "continue to work closely with local stakeholders to discuss any relevant further evidence or analysis". The Welsh Government wants to work with the UK Government to consider the independent evidence available.

74. There are no strong reasons for not devolving APD to Wales when it has already been devolved to Scotland and for direct long-haul flights to Northern Ireland. The devolution of APD does not require new primary legislation from the UK Government. Devolution can be achieved through secondary legislation[15] and we will be encouraging the UK Government to introduce secondary legislation to devolve APD for long-haul flights to Wales as soon as possible.

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[14] HM Treasury discussion paper on the options for supporting English regional airports from the impacts of air passenger duty devolution: Summary of responses https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/576225/air_passenger_duty_devolution_responses_web.pdf

[15] The Command Paper for the Wales Act 2014 states that the power could be used for two purposes: Enabling the Welsh Government to introduce specific new taxes in Wales, with the agreement of each House of Parliament and the Assembly; or allowing the UK Government to devolve further existing or new UK taxes, again with the agreement of each House of Parliament and the National Assembly.

4) Explore whether the devolved tax system could help to incentivise more energy efficient homes

Background

75. The Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 establishes a new tax on land transactions to replace stamp duty land tax from April 2018. The Act includes a regulation making power that enables the creation of new reliefs. During the passage of the Bill, the Cabinet Secretary for Finance and Local Government made a commitment to further explore whether the devolved tax system could help to incentivise energy efficient homes.

76. The tax policy framework stated that the introduction of any new relief for devolved taxes needs to be carefully considered to ensure it achieves the desired policy objectives of the Welsh Government. It should also be affordable and not create opportunities for avoidance. The policy approach to changing reliefs or introducing new reliefs in the future will replicate the Welsh Government's approach to considering new taxes. This involves a clear process and evidence-gathering stage, which includes ensuring potential new taxes should be aligned with the Welsh Government's policy aims; are cost-effective and reach their intended policy target.

77. There are already levers and schemes in Wales to incentivise energy efficiency in homes however, these are predominantly aimed at low-income households. These include:

- A statutory duty to eradicate fuel poverty, as far as is reasonably practicable, in all households in Wales by 2018;
- The flagship Welsh Government Warm Homes programme, which focuses on improving the energy efficiency of vulnerable low-income households at risk of fuel poverty;
- Addressing energy efficiency in social housing through the Welsh Quality Housing Standard, with a requirement for all existing social homes to be brought up to an energy rating of EPC D or above;
- Home Improvement Loans are a 15-year UK scheme delivered by local authorities in Wales, which can be used to install home energy efficiency improvements.

78. Energy efficiency in the residential sector also needs to be considered in the context of supporting the transition to a low carbon society. The Welsh Government has introduced a statutory framework through the Environment (Wales) Act 2016 to reduce emissions from Wales by 80% in 2050 compared to the baseline.

Evidence and analysis

79. The Welsh Government has explored whether there is a need for tax-based intervention to complement existing levers to incentivise energy efficient homes. This work has involved contributors from across the sectors and has focused on understanding the existing evidence base and identifying whether there is a case for change. Analysis has also been undertaken of existing or historic schemes within the UK and internationally where taxation has been used as a lever to incentivise energy efficient homes.

Outcome and next steps

80. The Welsh Government provides significant financial support to the residential sector to support and enable energy efficiency improvements – this is largely targeted at low-income households.

81. The initial evidence gathered has indicated that there is a case for further action to drive residential energy efficiency improvements, particularly in the able-to-pay sector. However, it was concluded that more targeted grants and improved government communication would be the priority to ensure a co-ordinated approach that creates long term change, and that more detailed analysis in this area is needed.

82. More detailed analysis of existing evidence in this complex area will continue. This will include continued analysis of the effectiveness of new and existing schemes in the UK and internationally. This evidence-gathering will need to be set in the context of supporting the transition to a low carbon society.

83. We will continue to analyse all levers available to promote more energy efficient use of housing, including taxation. This will be taken forward in the context of the commitment made by the Cabinet Secretary for Environment and Rural Affairs in June to set out proposals in the autumn to increase activity in home energy efficiency. This work will explore how to broaden and accelerate investment for energy efficiency across Wales. The proposals will also look at all opportunities for innovation, both in energy efficiency products and in financial models which can help support the uptake of energy efficiency improvements by able-to-pay households and low-income households.

5) Consider the case for introducing new taxes in Wales, exploring the policy and administrative elements and the mechanism for change

Background

84. In addition to being an important source of revenue to support public services, taxation can be a powerful lever for behavioural change and an opportunity to stimulate economic growth.

85. Part 4A of the Government of Wales Act 2006 (as amended by the Wales Act 2014) allows additional devolved taxes to be specified by Order in Council. This requires the approval of the National Assembly for Wales and of each House of Parliament. Once a new devolved tax is specified, the National Assembly will have the competence to legislate in the usual way.

86. The devolution of tax powers provides the Welsh Government with an opportunity to engage with the National Assembly for Wales, local government, businesses and other stakeholders to develop a distinctive Welsh approach to taxation. It also provides the opportunity to build capability and expertise within the Welsh Treasury.

87. The publication of the tax policy framework and work plan in June set the standard for how the Welsh Government would undertake public engagement and debate, with the intention of following international best practice. The Welsh Government will continue to engage with tax experts, ensuring they are involved in highly-technical tax issues, but it has also been important to engage with member organisations and the public on how taxes can be used to achieve policy objectives.

88. The Welsh Government has a clear set of tax policy principles for the development of new taxes. To test the mechanism, the Welsh Government expects to provide information to the UK Government on whether a new tax is within the competence of the National Assembly for Wales; whether a policy case exists for such a tax and whether it has harmful effects for UK macro-economic or fiscal policy.

Evidence and analysis

89. Ideas for new taxes in Wales have been put forward by a number of individuals and organisations since the Wales Act 2014 achieved Royal Assent. The Bevan Foundation's 2016 report - *Tax for Good* – highlighted eight possible new Welsh taxes, from public health taxes, such as a sunbed tax and a takeaway packaging tax to taxes aimed at stimulating economic growth, such as a land value tax and innovation tax credits.

90. The Welsh Government has taken the Bevan Foundation's report as a starting point for analysing potential new taxes and has researched international innovations.

91. As with all areas of tax policy, the Welsh Government's approach to the development of new taxes is to be as consultative as possible. Transparency can lead to more robust policy making, a better understanding of the taxpayers' needs, and improved trust and collaboration between the public and the Government.

92. The Cabinet Secretary for Finance and Local Government led a debate in the National Assembly about new taxes on 4 July. The Welsh Government received a

considerable public response to the call for ideas about proposals for new taxes – 45 direct letters and emails and more than 260 tweets and news story comments. The discussion has been widely welcomed from all areas and suggestions have been varied, with more than 60 new tax ideas and policy challenges being proposed.

Outcome and next steps

93. The public responses to the debate have been used to identify the areas where a tax can be further explored to meet policy priorities. The Welsh Government has looked at the extent to which proposals address the priority areas in the Prosperity for All national strategy, analysed how they might meet our framework criteria, and conducted initial engagement with the relevant departments to select the new taxes with the most potential. The result of this work is the following shortlist:

94. **Longer-term challenges to finance social care:** exploring potential financial levers including taxation to support social care provision in Wales.

95. **A national tax on vacant land:** exploring the efficiency of a tax to deliver the Welsh Government's policy objective to bring land identified as suitable for development into productive use.

96. **A tax on disposable plastic to meet environmental objectives:** exploring options for a tax or levy on disposable plastic to help the Welsh Government to achieve its waste reduction and recycling targets.

97. **A tourism tax to support local businesses:** exploring provisions for permissive powers for local government taxation.

98. The Welsh Government will continue to develop these ideas throughout the autumn, with a view to writing to the UK Treasury next year. Our work in 2018 will include ongoing consultation with the public, extended analysis of the consequences of any new tax, and an exploration of the administrative implications.

99. This is an ongoing process and we will continue to consider uses of fiscal levers across government priority areas. In future the Welsh Government may return to exploring a tax idea that has been suggested in the past or look at new ideas beyond those mentioned to date.

6) In 2017 and 2018, work with the UK Government to help support the successful introduction of the Soft Drinks Industry Levy in Wales

Background

100. The UK currently has one of the highest obesity rates amongst developed countries[16]. The evidence shows sugar consumption is a major factor in childhood obesity and sugar-sweetened soft drinks are now the single biggest source of dietary sugar for children and teenagers[17].

101. In the 2016 Budget, the UK Government announced the introduction of a soft drinks industry levy. The levy will come into effect from April 2018 and will operate on a UK basis. The levy is not a policy of the Welsh Government.

102. The UK levy will apply to the production and importation of soft drinks containing added sugar. The UK Government's policy intention is to encourage producers of added sugar soft drinks to:
   - Reformulate their products to reduce the sugar content;
   - Reduce portion sizes for added-sugar drinks and import reformulated drinks with reduced added sugar to encourage consumers of soft drinks to move to healthier choices.

103. The levy will have a main rate of 18p per litre, which will apply to added sugar drinks with a total sugar content of 5g or more per 100ml and a higher rate of 24p per litre for drinks with 8g or more per 100ml. It will not apply to any drink where no sugar is added. Milk-based drinks with a milk content of 75% or more and milk substitute drinks will not be subject to the levy. While alcoholic drinks with an ABV of up to 1.2% are within scope of the levy, the UK Government is making provision to exclude certain drinks that fall within this category. There will be an exemption for small producers. A small producer is defined as one that produces less than one million litres of produce in the given year.

104. The Welsh Government has long called on the UK Government to take stronger action on sugar consumption at a UK level. In principle, the Welsh Government supports the introduction of the soft drinks industry levy, although it is important the levy does not have any unintended consequences and the impact on the soft drinks industry is proportionate. Prior to the UK Government's announcement introducing the soft drinks industry levy, the Welsh Government supported a motion in the National Assembly for Wales which called on the Welsh Government to bring forward proposals to introduce a levy on sugary drinks.

105. The Bevan Foundation, which had earlier proposed a sugar tax, concluded there remained a case for a Welsh sugar tax to operate alongside the soft drinks industry levy, covering a wider range of products than soft drinks.

106. As highlighted by the Bevan Foundation, the Command Paper published alongside the Wales Bill in 2014 stated: “If the UK Government intends to introduce a new tax

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[16] *Healthy Weight, Healthy Lives: A toolkit for developing local strategies*, Dr Kerry Swanton for the National Heart Forum/Cross Government Obesity Unit/Faculty of Public Health, 2008.
[17] *Sugar Reduction: the Evidence for Action*, Public Health England, October 2015

that has a degree of alignment with areas of devolved responsibility, it will consult with the Welsh Government about the scope for that tax to be devolved."

107. The soft drinks industry levy is clearly a tax with a close degree of alignment with areas of devolved responsibility. The UK Government did not consult the Welsh Government about the scope for the soft drinks industry levy. Following the announcement to introduce the soft drinks industry levy the previous Minister for Finance and Government Business wrote to the Chancellor of the Exchequer raising concerns that this consultation did not happen.

108. The tax policy framework recognises that Welsh taxes sit within the wider UK tax context and one of our main principles is that Welsh taxes should be "simple, clear and stable". The introduction of the soft drinks industry levy is a major change for the industry and represents a new approach at the UK level to influence the consumption of sugar. Given this, we do not believe a new Welsh tax on sugar would be clear or simple for producers and consumers. Our priority at this stage is to work with the UK Government to implement the soft drinks industry levy in Wales and continue to support individuals to lead healthier lifestyles[18].

Evidence and analysis

109. At this stage, it is not possible to estimate the health benefits from the levy and it will only be through the realisation of these benefits that the success can be measured. According to research by Oxford University's Nuffield Department of Primary Care Health Sciences[19] the levy is expected to have a positive impact on health outcomes.

110. The Welsh Government supports action to encourage healthier diets. However, it is important that the levy does not have any unintended consequences and the impact on the soft drinks industry is proportionate.

111. The Welsh drinks industry has seen a period of strong growth and supports valuable economic activity across Wales. While data on the number of businesses which will be affected by the levy is not available due to disclosure rules associated with the small number of individual enterprises, there are 19 water and soft drinks enterprises in Wales[20].

112. According to industry research[21] the soft drinks industry levy will have a differential impact across the sector with the energy and still drinks market most likely to be affected (see figure four).

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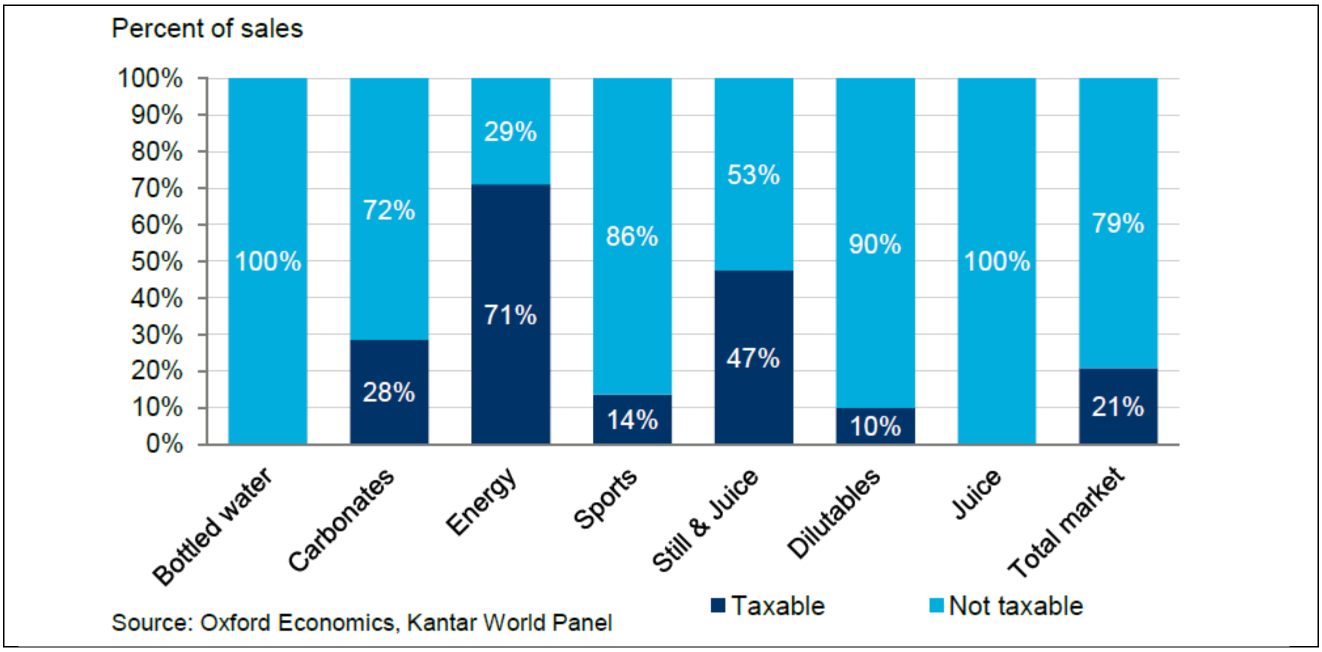
[18] For example, through its All Wales Obesity Pathway 2010, the Welsh Government has provided a framework of expected services to be delivered by Health Boards and other key stakeholders in this area. The pathway focuses on rebalancing services towards early interventions to tackle obesity. Public Health Wales is also taking forward work on its 10 steps programme to address childhood obesity, focusing on fostering healthy habits in parents and children at an early stage.

[19] Health impact assessment of the UK soft drinks industry levy: a comparative risk assessment modelling study. Briggs, Adam D M et al. *The Lancet Public Health* , Volume 2 , Issue 1 , e15 - e22

[20] Analysis and overview of the Welsh drinks industry March 2017, Brookdale Consulting

[21] Published in Analysis and overview of the Welsh drinks industry March 2017, Brookdale Consulting

Figure four: Taxable sales volume by category of drink



113. Discussions with the soft drinks industry in Wales suggest many producers were already reformulating their products to reduce sugar content prior to the introduction of the soft drinks industry levy. This is in response to consumers changing their purchasing decisions due to the growing public debate about obesity and diet.

114. At this early stage the view of the soft drinks industry in Wales is that the soft drinks industry levy will accelerate the reformulation of products already underway. However, it is not possible at this stage to estimate the impact of the levy on consumption patterns.

Outcome and next steps

115. Following the introduction of the levy in April 2018, the Welsh Government will continue to work with the health sector and the soft drinks industry in Wales to better understand the impact of the levy in Wales.

7) Once the WRA holds sufficient data, it will analyse land transaction tax data in relation to the higher rate surcharge on a local authority basis. This could be used to inform discussions with local authorities about the operation of the higher rate.

Background

116. The Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 provides for LTT to replace stamp duty land tax from April 2018. The Act provides for a higher rate surcharge on additional residential properties bought by individuals who already own a residential property – for example, second homes, buy-to-let properties – and on the purchase of any residential property where the buyer is not an individual, such as a company.

117. The higher rate of tax on additional properties was introduced for stamp duty land tax in April 2016 and since its introduction revenues have increased. When LTT replaces stamp duty land tax the block grant provided to the Welsh Government from the UK Government will be reduced by approximately the amount of revenue which will no longer be collected from stamp duty land tax. The higher rate has therefore been replicated for LTT in order to protect revenues to fund public services in Wales.

118. During scrutiny of the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017, it was raised that local authorities should be able to make representations to Welsh Ministers about the higher rate surcharge to help to meet the needs of different communities in Wales. Local authorities may already make representations to Welsh Ministers and the Cabinet Secretary for Finance and Local Government has written to the leaders of all local authorities in Wales inviting their engagement about the operation of the higher rate surcharge in their area once sufficient data is available to inform these discussions.

Evidence and analysis

119. Beyond revenue implications, the higher rate may also have an impact on the availability of housing. For example, the higher rate may mean that fewer second homes and buy-to-let properties are purchased, which may mean there are more properties available for those who want to buy their first home. However, fewer buy-to-let purchases may also lead to reduced availability of rented accommodation. The effects might be different in different areas. Even where the effects are the same, it may be a positive effect in some communities and a negative effect in other communities, depending on housing availability and housing needs in that area.

120. As outlined in the tax policy framework, our approach to tax policy requires careful consideration of the effects on policy objectives and affordability, informed by evidence. To begin to consider the impact of the higher rate in different parts of Wales it will be important to have data about the operation of the higher rate, which can be analysed by local authority area.

Outcome and next steps

121. The main element of the work will commence once the WRA has collected sufficient data. From April 2018, the WRA will start to collect LTT data, including that relating to the higher rate surcharge. A full year of data will have been collected after March 2019, which may provide sufficient information to begin to analyse the operation of the higher rate surcharge on a local authority basis.

122. Ahead of April 2018, preparatory work by the Welsh Treasury and WRA is already underway. This includes ensuring the WRA's data and collection systems will be able to accommodate this requirement. The WRA will only share information where doing so meets legal obligations regarding taxpayer confidentiality.

123. Beyond understanding the impact of the higher rates of LTT on additional residential properties, there are important wider considerations about data sharing and evidence. We will further consider how the WRA can use its powers to effectively support Welsh Ministers in making robust tax policy decisions, in discussion with the WRA and others.

8) During 2017, consult on the use of criminal powers by the Welsh Revenue Authority as part of the approach to the enforcement of Welsh tax

Background

124. The Tax Collection and Management (Wales) Act 2016 (TCMA) received Royal Assent in 2016. TCMA sets out the governance framework for the effective and efficient collection of devolved taxes, establishing the WRA and making provisions for the collection and management of devolved taxes. It also establishes a Welsh tax regime to support and enable taxpayer compliance.

125. In the majority of cases, the Welsh Government expects taxpayers to pay the right amount of tax at the right time. There will be occasions however, when additional measures will be necessary to ensure compliance, such as undertaking civil investigations and imposing penalties.

126. TCMA provides the WRA with a comprehensive range of civil investigation and enforcement powers. These include civil powers to:
- Require taxpayers and certain third parties to provide specified information and documents;
- Inspect premises to check a person's tax position;
- Impose penalties for non-cooperation with a tax investigation.

127. The civil powers already provided by TCMA will probably be sufficient to deal with the majority of cases of non-compliance in Wales, however, based on HMRC's experience and that of other Welsh public bodies, there are likely to be some cases where the existing powers will not be sufficient to encourage compliance.

128. HMRC currently operates in Wales and has access to a wide range of criminal powers to tackle tax crime connected with stamp duty land tax, landfill tax and other taxes. These powers have been used in a number of cases and the Welsh Government considers there is a strong case that some of these powers will be needed to enable the WRA to investigate tax offences such as fraud or cheating the revenue, when they are devolved in April 2018. HMRC has a clearly-defined set of safeguards to ensure that these powers are used proportionately and appropriately which Wales would also have in place. Landfill tax is susceptible to tax evasion. Evidence shows that this is partly due to the high rate of tax and the significant difference between the current lower rate (£2.65) and the current higher rate (£84.40).

129. If LDT retains the same difference between the rates, we can assume the same incentive to evade the tax will exist and people will attempt to do so. In 2016, the estimated tax gap – the amount of tax that was collected compared to what should have been collected – totalled approximately £150m, with the equivalent in Wales approximately £3.24m.

130. Land transactions do not lend themselves as readily as disposal of waste to tax evasion. Professionals are usually heavily involved in the transaction representing the buyer. Cases have been known however, whereby the professional has assisted in falsifying a return by adjusting the property value to evade paying the correct level of tax. There have also been cases where the legal representative has taken the payment of tax but not forwarded it to HMRC (by fraudulently claiming a

relief or understating the consideration given for their clients purchase), thereby defrauding the purchaser of the tax paid.

Evidence and analysis

131. A consultation was undertaken over the summer: *Welsh Revenue Authority access to criminal powers*[22]. It asked respondents to provide views on the benefits and dis-benefits of the WRA having access to certain criminal powers.

Outcome and next steps

132. The Welsh Government will respond to the consultation later this month and a decision will be taken about whether to lay regulations to provide the WRA with access to certain criminal powers.

133. If the regulations are laid and if the National Assembly decides to confer these powers on the WRA, clear policies and procedures will need to be put in place to safeguard against abuse of the legislation. For example, in relation to surveillance powers under the Regulation of Investigatory Powers Act, the WRA will be subject to audit and inspection by the UK Surveillance Commissioner.

[22] https://consultations.gov.wales/consultations/welsh-revenue-authority-powers-tackle-tax-crime

9) Develop analytical tools to support the development of income tax policy in Wales

Background

134. Welsh rates of income tax are due to be introduced from April 2019. The UK rates of tax on non-savings non-dividend income will each be reduced by 10p and the Welsh Government will set its own rates in the standard, higher and additional bands. If it were to set a rate of 10p in each band, the overall income tax rate faced by Welsh taxpayers would be unchanged (see figure five).

135. The Welsh Government will receive the revenues from its own tax rates and there will be a corresponding reduction in the block grant from the UK Government. The initial size of this reduction will reflect the UK Government's loss of revenue from reducing tax rates in each band in Wales. Thereafter the block grant adjustments for each band will increase with the growth in equivalent revenues elsewhere in the UK.

136. HMRC will retain responsibility for the administration of the income tax system, including the Welsh rates, and will be assisted in its preparations for the partial devolution of income tax by the lessons it has learned in Scotland.

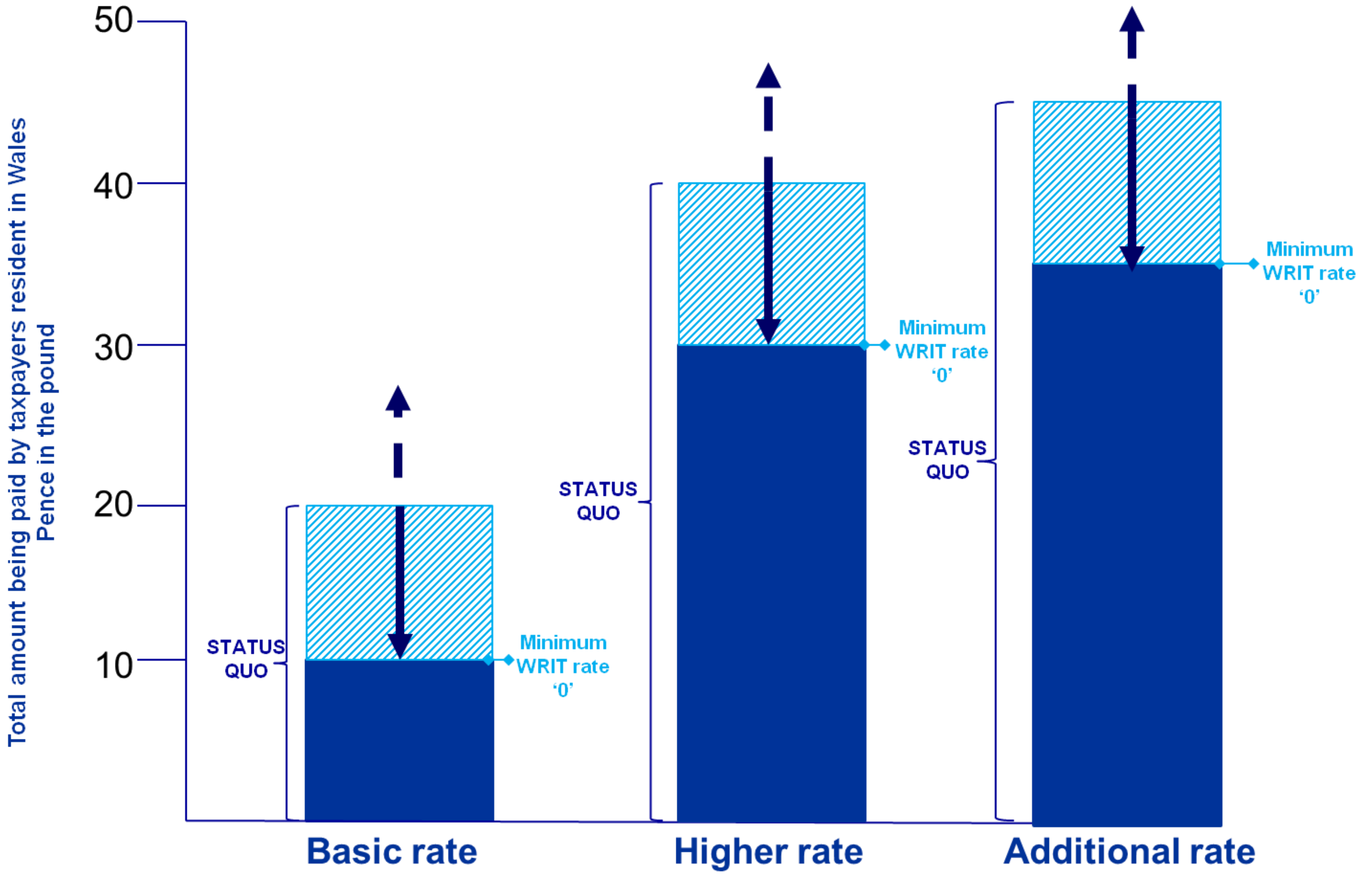
137. As a first step, HMRC will need to identify Welsh taxpayers as defined in the Wales Act 2014. The Welsh Government will support HMRC in this task, identifying data sources that could be used to cross-match HMRC records.

138. The Welsh Government has begun work on a number of analytical areas to prepare for the introduction of Welsh rates of income tax. It has started to develop modelling and forecasting tools to inform tax policy development and the wider budgetary process. It is also working to ensure that these tools are informed by the best possible data sources and that its budgetary adjustments properly reflect the fiscal framework agreement reached between the Welsh and UK governments in December 2016. The next few paragraphs describe the availability of data on Welsh income tax payers and how this might be improved.

139. HMRC compiles a dataset for analytical purposes called the Survey of Personal Incomes (SPI) covering each tax year. It is generated from a sample of pay-as-you earn, self assessment and claims system tax records. The SPI provides a rich source of information about income tax payers in the UK. It forms the basis of HMRC's policy simulation model and is used in the UK forecasting process.

140. The SPI is based on a sample of around 560,000 income tax payers in the UK and around 20,000 in Wales. The Welsh Government has access to a version of the SPI known as the public use tape, which is published at the UK Data Archive hosted by Essex University. This has the same sample size as HMRC's internal version but includes less detailed information about taxpayers. For example, it does not include any geographical information below UK country and English region. It also includes composite records for certain very high income taxpayers which are shared across countries and regions. (These restrictions are in place to ensure that individual taxpayers cannot be identified from the data.)

Figure five: What does Welsh rates of income tax (WRIT) mean for our rate setting capability from 2019-20?



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141. The public-use version of the SPI is published over two years after the end of the reference period. For example, the 2014-15 data set was published in July 2017. The Welsh Government, together with the Scottish Government and the Scottish Fiscal Commission, is engaging with HMRC to see whether it can improve the timeliness of access to the SPI and whether more detailed information might be made available.

Evidence and analysis

142. The Welsh Government is developing a forecasting and costing tool for income tax using the income distribution of taxpayers in Wales from the SPI. Because of the time lag in the availability of the SPI, the distribution is updated for subsequent years using data on employment and earnings growth. OBR forecasts of employment and earnings are then used to produce projected income distributions for future years. The appropriate income tax parameters for each year are applied to this distribution to estimate revenues from both the Welsh and UK income tax rates.

143. Further work will be carried out to determine whether there are any other data sources which could be used to update the income distribution. The Scottish Government has developed a model which forecasts revenues separately for the public and private sectors and for different age groups. The Scottish Fiscal Commission is likely to adopt the same approach as it takes over the forecasting function. The Welsh Government will investigate whether a similar approach would be worthwhile in Wales. It will also develop the model further to take account of behavioural effects on the revenue estimates where appropriate.

144. The Welsh Government is also developing the capacity to analyse the impact of taxes and benefits on households in Wales. This distributional analysis makes use of micro-simulation techniques to investigate how taxes and benefits affect different types of households across the income distribution. It enables the analysis of income tax changes in conjunction with other taxes and with the UK benefit system. This supports the tax policy framework objective of raising revenue as fairly as possible by using new models to analyse data effectively and identify any issues.

145. The distributional analysis is carried out using *Euromod*, designed to model the effects of taxes and benefits on household incomes for each country of the EU, including the UK. The model was created and is maintained by the Institute for Social and Economic Research (ISER) at the University of Essex.

146. The Welsh Government is working with the Office for Budget Responsibility and HMRC to ensure the forecasts used to estimate the block grant adjustments for future years are well founded and reflect the approach set out in the fiscal framework agreement. This requires forecasts of revenues in England and Northern Ireland separately for each income tax band. These are not readily available from the current forecasting methodology so work is underway to implement the necessary analytical developments.

Outcome and next steps

147. In autumn 2018, the Welsh Government will set the first Welsh rates of income tax. The analytical tools described above will be developed to inform the decision on tax rates and ensure that partial income tax devolution is integrated smoothly into the budgetary process in Wales.

10) Review the evidence on the case for shifting the balance of taxation between income and property

Background

148. LTT will be introduced in April 2018 and Welsh rates of income tax will follow in April 2019. Together with taxes raised to fund local services (council tax and non-domestic rates), more than £2.5bn of tax revenue based partly or wholly on property value will be managed by central or local government in Wales. For the first time there will be an opportunity to consider the balance of Welsh taxes between income and property.

Evidence and analysis

149. There is an emerging body of evidence to suggest a more efficient and effective tax system – conducive to economic growth – could be achieved by shifting the burden of taxation away from income and towards property. The most frequently-cited study on this subject, published by the OECD[23], ranks different tax instruments with respect to their relationship to economic growth. The results suggest that income taxes are generally associated with lower economic growth than taxes on consumption and property. Tax reforms towards property taxes are therefore likely to enhance the prospects for economic growth.

150. There may be a case for shifting the balance of taxation from income toward property. This could align with our principle to deliver Welsh government policy objectives, in particular, supporting jobs and growth.

151. However, the Welsh Government is also committed to ensuring Welsh taxes help create a more equal Wales. The current UK income tax system is highly progressive with a tax free allowance currently set at £11,500 and income tax rates that increase with higher income tax bands. The Welsh Government is committed to making council tax fairer, recognising the scope to make the current system more progressive.

152. Figure six shows the current tax burden for UK income tax and council tax in Wales across households grouped by income quintiles. The analysis for council tax includes the council tax reduction scheme, which provides financial support with council tax bills for those who need it most. However, we also know that there is only partial take-up of the scheme[24]. Figure six shows income tax represents an increasing share of gross household income as people move into higher income groups. The opposite is true for council tax, even after including the council tax reduction scheme.

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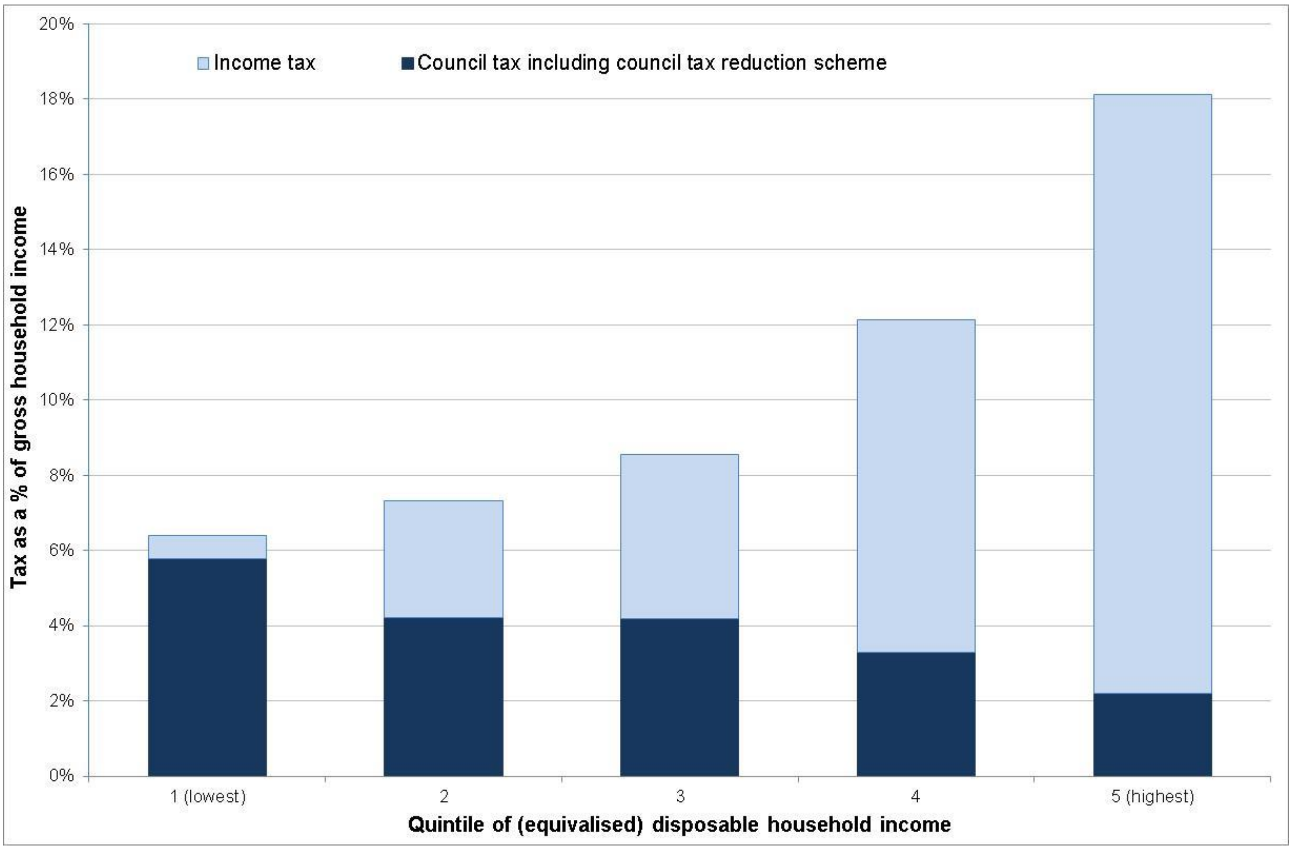
[23] J. Arnold, *Do tax structures affect aggregate economic growth? Empirical evidence from a panel of OECD countries'* OECD Economics Department Working Paper 643, 2008
http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?doclanguage=en&cote=eco/wkp(2008)51

[24] As discussed in the section on local taxes, the Welsh Government is committed to ensuring those who are eligible for the council tax reduction scheme benefit from it.

Figure six: Income tax and council tax in Wales as a percentage of income by quintile, 2016-17



Source: FRS 2013-14 and modelled using EUROMOD version G4.0
NB Council tax is shown net of council tax reduction scheme, with partial take-up applied.

Outcome and next steps

153. There are a range of issues, which need to be explored when considering the balance of taxation between income and property in Wales. While the theoretical evidence would support a shift from income to property taxation to support economic growth, the impact of such reform would need to be considered in the Welsh context. The current Welsh property taxes are integral to the current system of financing local government and local authorities are accountable to their local electorate for the rates set for council tax. In addition, the property sector is also a significant contributor towards economic growth in Wales. Shifting the balance of taxation between income and property is also likely to have implications on the progressivity of the Welsh tax system.

154. With the range of Welsh taxes under control of central or local government in Wales it is appropriate to consider the balance of taxation between income and property. This is a longer term piece of research that will require a detailed consideration of the issues including the impact of any reform against the policy objectives of the Welsh Government.

Conclusion

155. The Welsh Government will continue to draw on all its levers to support delivery of the five priority areas in Prosperity for All:
    - Early years
    - Housing
    - Social care
    - Mental health
    - Skills and employability.

156. We will develop capacity and capability in our own organisation and with our partners to enable us to better align taxation with Welsh Government strategic and policy objectives, looking at how Welsh taxation can be made more progressive and fair while supporting jobs and growth.

157. We will collaborate and engage transparently to ensure our tax policy proposals are robust and meet our tax policy principles, recognising the wider UK and international context.

158. We will look to develop and publish evidence and data to support our decisions and potential trade-offs in meeting our objectives.

159. We intend to publish a new work plan in early 2018, which will set out the key elements to progress towards our Welsh tax policy objectives. It will include the next steps from the existing work plan as set out in this report. The emerging themes include:

    a. Setting rates and bands including the first rates for the Welsh rates of income tax;
    b. Delivering policy objectives, including promoting fairness and economic growth; through Welsh tax levers;
    c. Progressing the local government tax agenda;
    d. Improving tax administration for the benefit of taxpayers and citizens in Wales.

Annex: Devolved Taxes Rates and Bands

Introduction

A1. From April 2018, land transaction tax (LTT) and landfill disposals tax (LDT) will replace stamp duty land tax and landfill tax, respectively in Wales. This paper outlines the key issues considered in setting the tax rates for LTT and LDT and provides information about the impact of adopting the rates for taxpayers and the revenue the rates are forecast to raise.

A2. The devolution of tax powers provides a range of opportunities for the Welsh Government to develop a Welsh approach to taxation to meet the needs and preferences of citizens in Wales. The Welsh Government's tax policy framework[25] outlines our strategic approach to Welsh taxes. The framework and its tax principles have guided the development of the tax rates and bands.

A3. In developing the new taxes, a primary objective has been to provide stability for taxpayers. The tax rates of the predecessor taxes are therefore relevant considerations in setting the rates of the devolved taxes. In order to provide stability, the approach taken to setting the rates has been that the devolved tax rates should only diverge from those of the predecessor tax rates as much as is necessary to reflect Welsh circumstances and priorities.

A4. It is important to recognise devolved taxes will help to fund public services within Wales. Accordingly, decisions about tax rates and bands need to be made with this in mind, considering the revenue impact of any proposal. The revenues from LTT and LDT will form part of the Welsh Government's overall budget from 2018-19. At the same time, the funding the Welsh Government receives from the UK Government will be reduced to account for the tax revenues the UK Government will forego as a result of devolving stamp duty land tax and landfill tax to Wales. Therefore, the overall effect of LTT and LDT on the Welsh Government's budget is the difference between the tax revenues and the block grant adjustment.

A5. The block grant adjustment method was agreed between the UK and Welsh governments in December 2016 as part of the fiscal framework. For the first year of devolution, this will be estimated by using a forecast of stamp duty land tax and landfill tax revenues in Wales for 2017-18 increased by forecast growth in the two tax revenues in the rest of the UK between 2017-18 and 2018-19. The forecasts used will be those published by the Office for Budget Responsibility (OBR) at the time of the UK Government's Autumn Budget 2017.

A6. For the Welsh Government's draft Budget 2018-19, the latest OBR (March 2017) forecast of revenues has been used to estimate the block grant adjustment. It is anticipated these forecasts will be revised for the Autumn Budget on 22 November and there could be a substantial change if the UK Government alters stamp duty land tax or landfill tax policy in a way which affects revenues – for example by altering the tax rates. Such a change would alter the block grant adjustment and therefore the Welsh Government's net resources. In the event the block grant adjustment is substantially changed, it would be appropriate to look again at the tax

[25] http://gov.wales/docs/caecd/publications/170612-framework-en.pdf

rates for LTT and LDT. The Welsh Government would reassess how taxpayers will be affected by the transition to LTT and LDT rates and look at how the tax change affects its overall resources. After considering these issues, the Welsh Government will then determine if and how the devolved tax rates should change.

A7. This is what happened ahead of stamp duty land tax devolution in Scotland. The Scottish Government announced land and building transactions tax (LBTT) rates ahead of the UK Government's 2014 Autumn Statement, which altered stamp duty land tax rates. The Scottish Government then changed LBTT rates in January 2015, ahead of LBTT replacing stamp duty land tax in April 2015.

A8. Other than revenue to fund public services, the relevant considerations in setting tax rates are influenced by the context in which the tax operates. Therefore, the following sections provide further information about each tax in turn, outlining the issues considered in setting tax rates appropriate for Wales and the impact of adopting the rates specified for taxpayers and revenues.

A9. Following the UK Government's Autumn Budget, the Welsh Government will lay regulations to set the rates and bands, which will be scrutinised and determined by the National Assembly. The rates and bands in this paper are those which the Welsh Government intends to set by regulations, subject to no changes being necessary following the UK Government's Autumn Budget; National Assembly approval of the Welsh Government's budget and National Assembly approval of the regulations.

Land transaction tax

A10. Land transaction tax (LTT) is a tax on land and property transactions which is payable when a person or company:

- Buys a freehold property;
- Buys a new or existing non-residential leasehold; or
- Transfers land or property in exchange for payment (for example, buying a share in a house).

A11. It will replace stamp duty land tax when it is devolved to Wales in April 2018 to enable public services in Wales to continue to receive the benefit of the revenues raised by the tax. As with stamp duty land tax, there are separate rates for residential and non-residential transactions. For residential transactions there is a main rate and a higher rate for purchases of a residential property where the buyer already owns one or more residential properties. For non-residential transactions, there is a main rate for freehold transactions and lease premiums and a separate rate for lease rents.

A12. The Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017 requires LTT to be a progressive tax. For each set of rates, there must be a zero rate band and the tax rate for each band above the zero rate band must be higher than for the band below it. This means the tax rates must be higher for high-priced properties than for low-priced properties. In setting the rates, there is an opportunity to extend the progressivity of LTT compared to stamp duty land tax.

A13. In September 2016, the Welsh Government published the Treasury paper *Land Transaction Tax: setting rates and bands,* which outlined key issues and set the framework for our approach to setting rates and bands appropriate for Wales.[26]

A14. The approach to setting the rates and bands for LTT has been guided by three overarching concerns relative to stamp duty land tax. These are:

- LTT rates should reflect Welsh circumstances and priorities,
- Overall revenues should be maintained to continue to fund public services;
- LTT should be more progressive, where possible.

A15. The approach to setting tax rates was explored with stakeholders as part of the 2015 consultation, *Tax Devolution in Wales - Land Transaction Tax*, and in further engagement events during the development of the tax. Stakeholder views were also captured during the passage of the Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017. There was general consensus that setting the rates is a matter for the Welsh Government but that consideration should be given to the nature of the property market in Wales and the potential impact of any changes to tax rates.

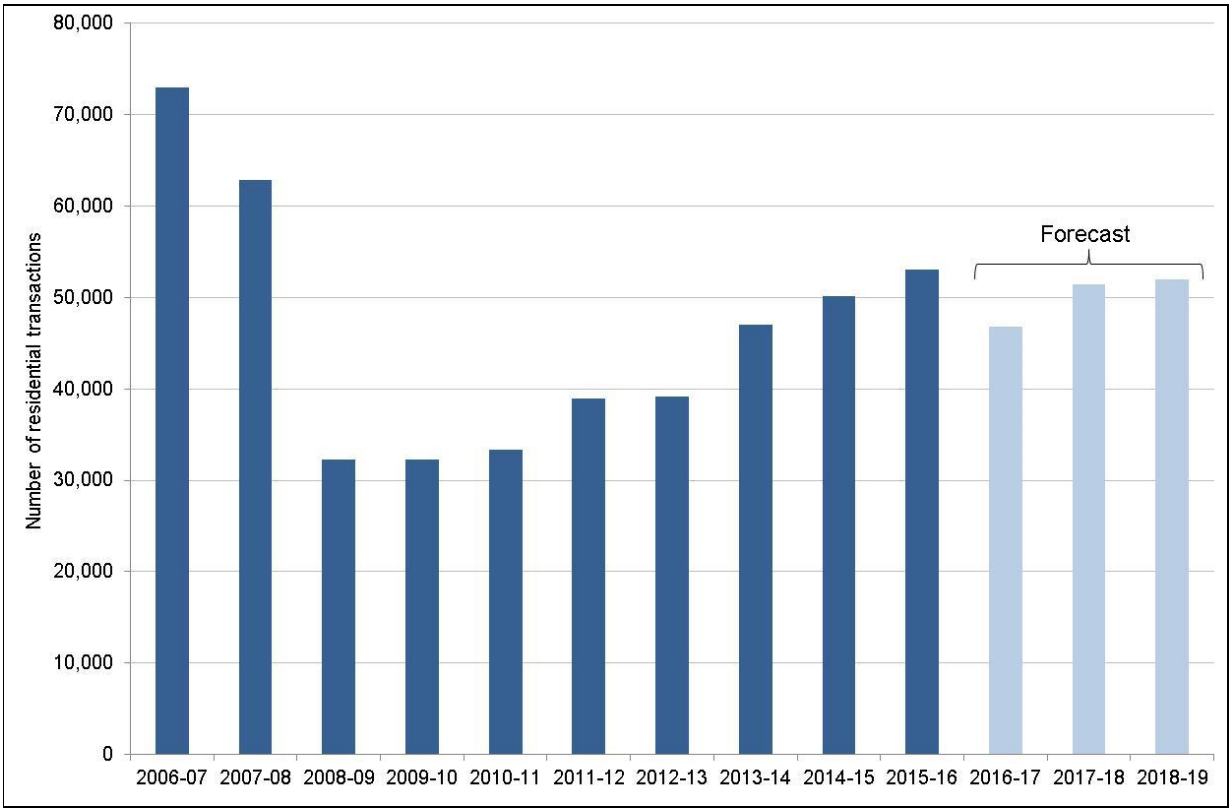
Residential rates and higher rates on additional residential properties

A16. As LTT is a tax on land and property transactions, the important aspects of the tax base are the number of transactions and their prices. These are also important considerations in setting the appropriate rates and then estimating the resulting revenue from these rates.

A17. Figure one shows the latest data and forecasts for the number of residential transactions in Wales. In 2015-16, there were 53,000 transactions. At the time of the tax devolution in 2018-19, the forecast number of transactions is slightly lower at 52,000. This represents a marked recovery since the financial crisis of 2008-09 but is still substantially lower than 2006-07[27] when there were more than 70,000 residential transactions in Wales. During this period there have also been some effects from changes to tax rates within stamp duty land tax; the adoption of LTT tax rates is forecast to have some effect on the number of transactions. This is discussed in more detail below.

[26] Available at http://gov.wales/docs/caecd/publications/160915-ltt-bands-en.pdf
[27] The first year for which data is available from HMRC.

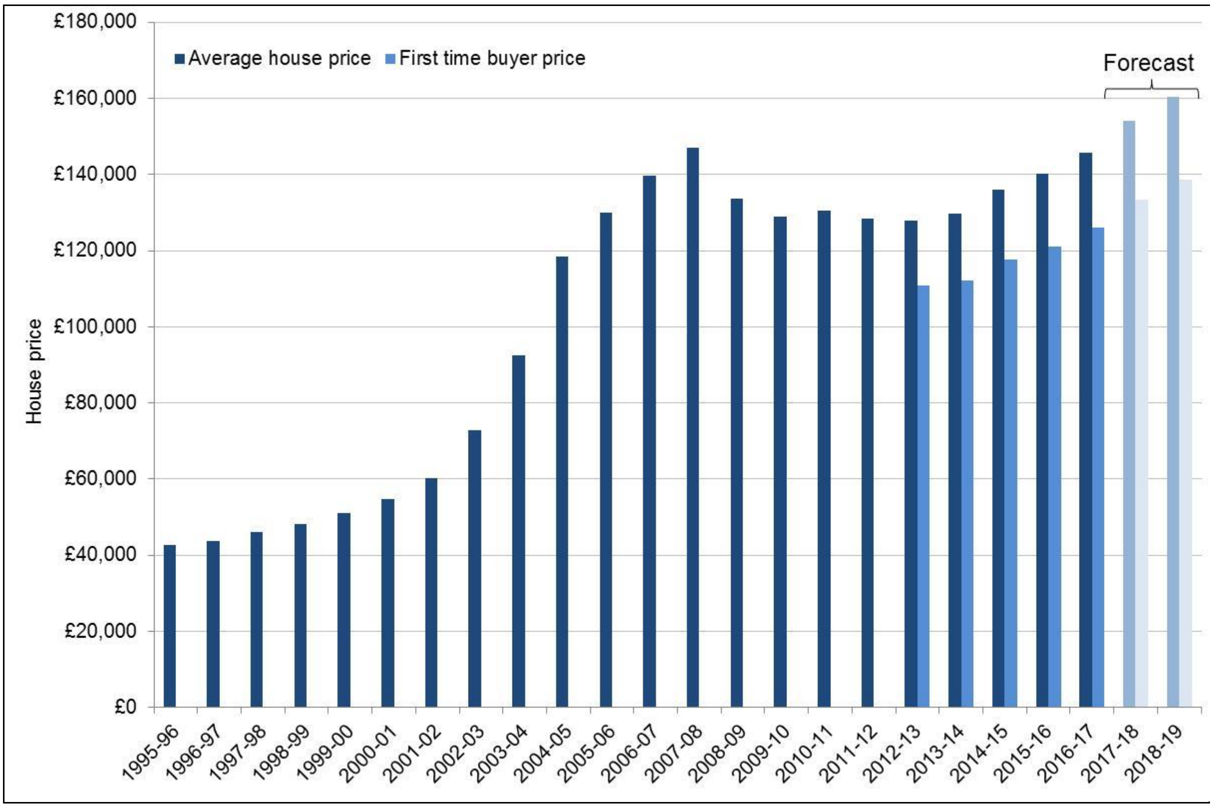
Figure A1: Residential transactions in Wales 2006-07 to 2018-19



Source: HMRC Annual Stamp Tax Statistics, 2007 to 2016.
Forecast of transactions 2016-17 to 2018-19 based on OBR's UK residential growth, see Table 4.1 from OBR (2017) available at http://budgetresponsibility.org.uk/download/march-2017-economic-and-fiscal-outlook-charts-and-tables-fiscal/

A18. The other important determinant for LTT rates is residential property prices. House prices have risen considerably from around £42,000 in 1995-96 to £146,000 in 2016-17, according to data from the ONS House Price Index for Wales. The average price in 2016-17 was just below the peak of 2007-08. The near recovery in the average property price (in nominal terms) contrasts with transactions which are still well below their pre-recession levels. UK house prices are forecast to continue to grow by the OBR. Applying this rate to Wales increases the average house price to around £160,000 by 2018-19 – beyond the peak nominal price in 2007-08.

Figure A2: Average house price in Wales 1995-6 to 2018-19



Source: ONS House price index, data available at http://landregistry.data.gov.uk/app/ukhpi
Forecast of house prices 2017-18 to 2018-19 based on OBR's UK residential growth, see Table 4.1 from OBR (2017) available at http://budgetresponsibility.org.uk/download/march-2017-economic-and-fiscal-outlook-charts-and-tables-fiscal/

A19. As house prices continue to rise, there is significant interest in the affordability for people to buy their first home. The latest annual data from the ONS's house price index shows the average first-time buyer price was £126,000 in 2016-17 in Wales, up from around £110,000 in 2012-13 (earliest data available). Using the OBR's general UK house price forecast (March 2017) this is estimated to rise to £139,000 in 2018-19.

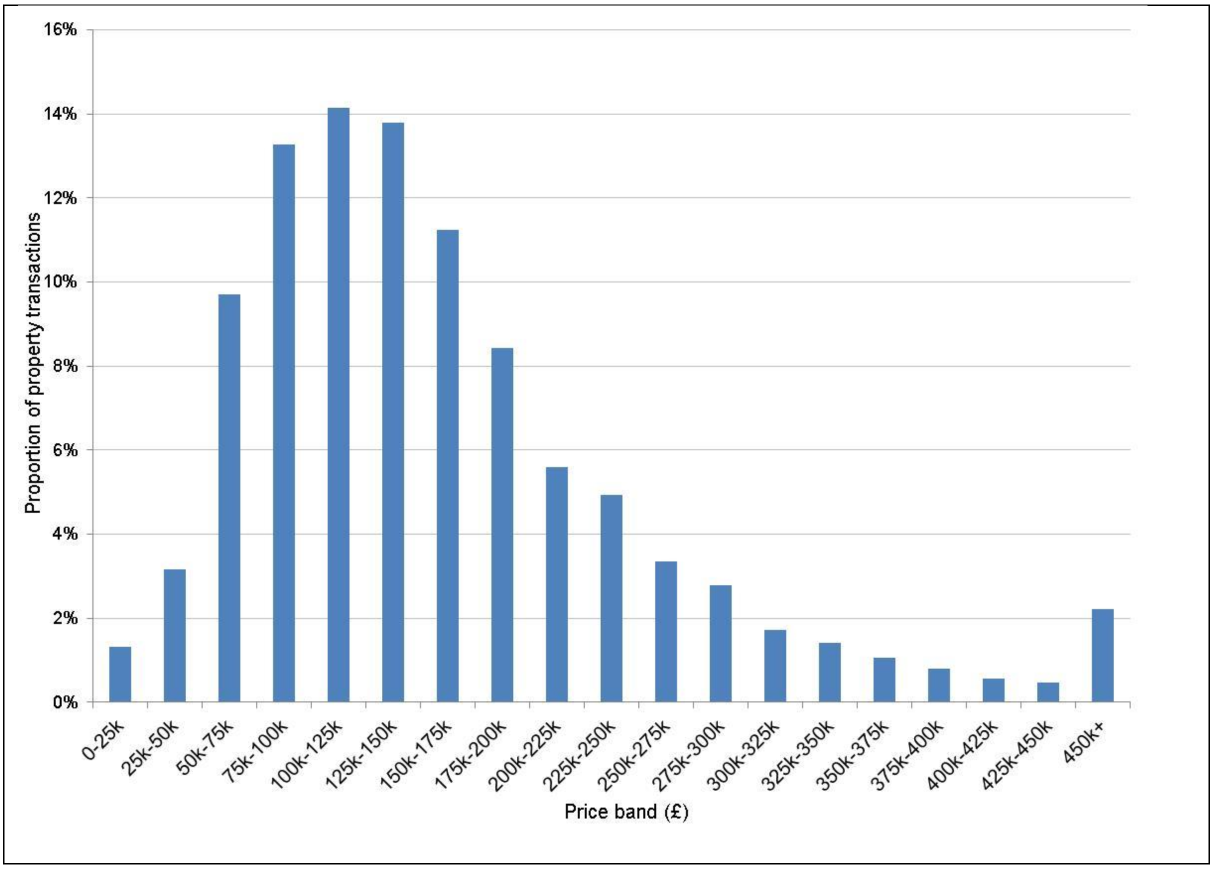
A20. Figures one and two show that both transactions and prices have moved sharply over recent years, indicating the potential for revenue volatility, making forecasting tax revenue challenging.

A21. In addition to the average house price, the spread of transactions across the price distribution is also important. This is especially so for progressive tax systems – such as stamp duty land tax and LTT – where tax rates are higher for high-priced properties than for low-priced properties: the proportion of high-priced transactions has a greater impact on revenues.

A22. Figure three shows the distribution of prices for residential transactions in Wales in 2015-16 (latest data available). This shows that just over 75% of transactions were below £200,000; therefore most transactions were in the lower end of the price distribution. However, there was a long tail of high priced transactions, with fewer than 10% of transactions above £300,000 and just over 2% priced £450,000 or more.

A23. With price growth forecast over the next few years, these percentages will change as more properties move into the higher price bands. However, the overall profile of residential property transactions in Wales is unlikely to alter much over the next few years.

Figure A3: Residential property price distribution in Wales, 2015-16



Source: Calculations based on HMRC administrative datasets

A24. The tax rates for residential LTT have been set to take into account the features of the Welsh residential property market, as outlined above. We have used the principle that tax should be levied more progressively with respect to house prices and the prevailing stamp duty land tax rates. The tax rates for the main rates of residential transactions are shown in table A1, below.

Table A1: LTT residential tax rates

Price threshold	LTT rate
£0-£150k	0%
£150k-£250k	2.5%
£250k-£400k	5.0%
£400k-£750k	7.5%
£750k-£1.5m	10.0%
£1.5m-plus	12.0%

A25. As LTT is replacing stamp duty land tax, the impact of adopting these rates is most clearly articulated by comparison to the current stamp duty land tax rates, which are shown for reference in table 2 below.

Table A2: stamp duty land tax residential tax rates

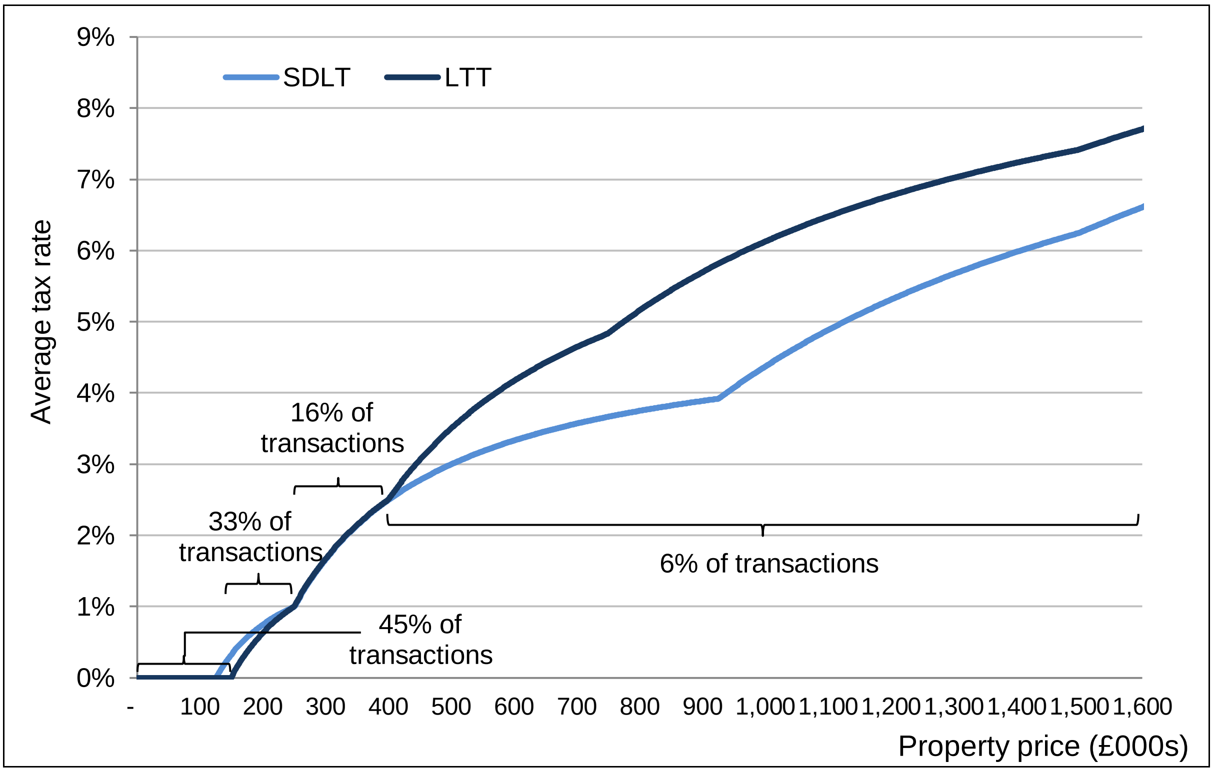
Price threshold	SDLT rate
£0-£125k	0%
£125k-£250k	2%
£250k-£925k	5%
£925k-£1.5m	10%
£1.5m-plus	12%

A26. To increase the progressivity of the residential rates, the property price at which the tax becomes payable is higher for LTT than for stamp duty land tax. Adjusting the rates and bands for higher-priced transactions maintains revenue. To help support a smooth transition to the new tax, the difference between LTT rates and the current stamp duty land tax rates has been kept relatively small.

A27. As both stamp duty land tax and LTT use marginal tax rates – where the relevant tax rate only applies to the value of the property which is within the band – it is not straightforward to compare tax systems by looking at the marginal rates.

A28. An alternative way to compare tax rates is by property price and the average tax rate. The average tax rate is the total amount of tax divided by the property price. This is shown in the below figure.

Figure A4: Average tax rates of residential SDLT and LTT



A29. The figure shows both stamp duty land tax and LTT have a zero average tax rate below £125,000, as the zero rate thresholds for both taxes applies here. In Wales, it is forecast that around 30% of transactions will be in this band in 2018-19 when LTT rates will first apply.

A30. For purchase prices between £125,000 and £150,000, stamp duty land tax would be liable up to a maximum of £500. With LTT, no tax will be liable. As the average first time buyer price in Wales is forecast to be £139,000 in 2018-19, no LTT will be payable at the average first time buyer price, whereas £280 would be payable under stamp duty land tax.

A31. From £150,000, LTT becomes liable. In 2018-19, it is forecast that 45% of residential transactions will not be liable for LTT. This means that the number of transactions paying no tax will increase by around 7,000 or 50% compared to stamp duty land tax.

A32. For residential transactions between £150,000 and £250,000, the tax liable under LTT will be lower than stamp duty land tax, despite the higher tax rate of 2.5%. This is because the tax rate is only applicable on the value above £150,000. For example, at the forecast average house price of £160,000 the LTT payable will be less than stamp duty land tax. The LTT due will be £250 (2.5% of the difference between £150,000 and £160,000), whereas stamp duty land tax would be £700 (2% of the difference between £125,000 and £160,000).

A33. For all transactions between £250,000 and £400,000 the tax liability will be the same for LTT and stamp duty land tax. For example, for a transaction of £250,000 the tax due would be £2,500 for both LTT and stamp duty land tax. Similarly, a purchase of £400,000 would be taxed at £10,000 in both cases.

A34. For transactions from £400,000 upwards, the tax liability will be higher under LTT than stamp duty land tax. In 2018-19 this is forecast to affect the top 6% of transactions. For a transaction at £500,000, the tax liability under LTT will be £17,500 compared to £15,000 under stamp duty land tax. Transactions from £500,000 upwards are expected to account for 3% of all transactions in 2018-19.

A35. The top 1% of transactions is forecast to be priced at £650,000 and above. At £650,000 the LTT due will be £28,750 compared to £22,500 under stamp duty land tax. From £925,000 upwards, the difference between stamp duty land tax and LTT is £17,500.

A36. Overall in 2018-19 it is estimated that 69% of transactions which would have been taxed under stamp duty land tax (25,000 transactions) will pay less tax under LTT and 8% (3,000 transactions) will pay more.

A37. Changes in tax rates are expected to affect both prices and transactions. The impact will be counter to the change in the tax liability between stamp duty land tax and LTT. For example, if LTT is lower than stamp duty land tax, then both prices and transactions are expected to be higher than they otherwise would have been, and vice versa.

A38. The effect on prices and transactions of the change in tax rates from stamp duty land tax to LTT is calculated using OBR estimates. These are based on the behavioural impact of the reforms and changes to the stamp duty land tax rates in December 2015.[28] The effect of the tax change is calculated at each £5,000 interval across the whole residential price distribution as it varies across the price distribution.

A39. Between £125,000 and £250,000, where LTT is lower than stamp duty land tax, the LTT rates are expected to increase prices and transactions. The estimated effect is small for both prices and transactions and the overall impact on revenue is less than £0.5m. There is no effect on prices and transactions between £250,000 and £400,000 as the tax due is the same with LTT and stamp duty land tax.

A40. From £400,000 upwards, LTT is higher than stamp duty land tax. As a result the effect is to slightly reduce the number of transactions and prices. The reduction in transactions is estimated to be less than 0.1% of the total number of transactions in 2018-19. However, unlike low-value transactions, these transactions generate a significant proportion of tax so the combined transaction and price effect is estimated to reduce revenues by approximately £3m. Overall the net effect of increasing the tax rates for properties worth more than £400,000 is to increase revenues by around £10m, even once the negative effects on transactions and prices are included.

A41. Overall in 2018-19, the residential LTT rates are expected to generate revenues of £145m before considering behavioural effects. Those effects reduce this total by £3m.

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[28] See OBR (2015) http://budgetresponsibility.org.uk/download/stamp-duty-land-tax-policy-costing-elasticities-december-2014/

A42. There is anticipated to be some forestalling as a result of announcing the rates and bands ahead of April 2018. This form of behavioural change should only affect 2018-19, as transactions are expected to be brought forward into 2017-18 in order to apply the stamp duty land tax rates and use the familiar HMRC administration system. This effect is expected to be neutral in budgetary terms as the reduction in LTT revenues will be offset by extra stamp duty land tax revenue in 2017-18. It is assumed that the UK Government will reimburse the Welsh Government with these additional stamp duty land tax revenues resulting from forestalling.

A43. Taking all these factors into account, the net revenue from the residential main rates is forecast to be £142m in 2018-19 (table A3).

Table A3: LTT residential main rates revenue estimate for 2018-19

Element	£m
Before behavioural effects	145
Behavioural effect on transactions and prices	-3
Net	**142**

Higher tax rates for additional residential properties

A44. Under both stamp duty land tax and LTT, a higher rate will apply when someone purchases an additional residential property. The higher rates for stamp duty land tax were introduced in April 2016 – there is therefore currently limited evidence about the effect of the higher rates in Wales. The LTT higher rate will be an additional 3% on top of the prevailing main residential tax rates – the same as the current higher rate for stamp duty land tax. However, the total tax paid on additional residential properties will be different to that paid under the stamp duty land tax regime as the higher rates are in addition to the main rates of tax, which are different under the new LTT regime from those applied under stamp duty land tax (see tables A1 and A2 above).

A45. For additional residential property transactions up to £400,000, the LTT due will be the same or less than stamp duty land tax and for transactions at £400,000 and above, the LTT due will be higher than stamp duty land tax.

A46. For example, for an additional residential property transaction liable for the higher rates at £160,000 the LTT due will be £5,050, compared to £5,500 under stamp duty land tax. For an additional residential property transaction at £500,000, the LTT due will be £32,500 compared to stamp duty land tax of £30,000.

A47. In 2018-19, the higher rates are estimated to generate revenues of £63m, taking account of some small behavioural effects but before considering refunds.

A48. The additional tax paid under the higher rates can be refunded if the purchaser sells what was their main residence and the property which the higher rates relate to becomes their main residence within 36 months of purchasing the property (the same as with stamp duty land tax). It is estimated that 15% of each year's revenues from the higher rates will be refunded over the following 36 months. Therefore, of the revenue collected in 2018-19, it is estimated that £9m will be refunded over the following three years. This is accounted for in 2018-19 as it relates to the transactions which occurred in that year. The overall net revenue from the higher rates is therefore estimated to be £53m in 2018-19 (table A4).

Table A4: LTT residential higher rates revenue estimate for 2018-19

Element	**£m**
Revenue before refunds	63
Refunded revenue	-9
Net revenue	**53**

(May not sum due to rounding)

Non-residential rates

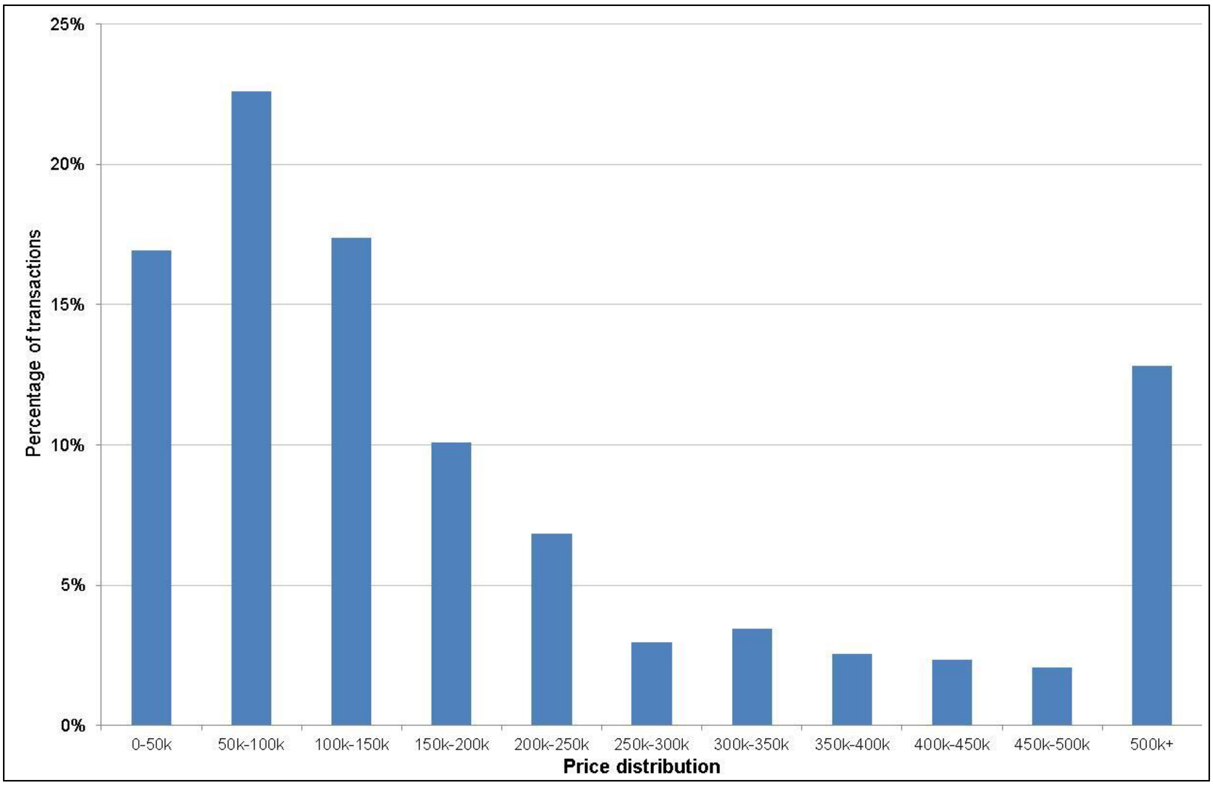
A49. There is a high degree of uncertainty in the economic outlook for commercial activity, which is likely to reduce business investment, including the transfer of property and land. This is a UK-wide issue but needs to be borne in mind when considering tax rates in Wales, especially those which apply to the acquisition and leasing of property and land.

A50. As with residential rates, the number of transactions and property prices are important considerations for setting non-residential LTT rates. There are two further considerations which are of particular importance – the price distribution of non-residential transactions and the level of integration the Welsh economy has with the rest of the UK.

A51. The price distribution of non-residential transactions has two distinct features. There is a large share of relatively low-priced transactions, most of which are below the stamp duty land tax threshold of £150,000. This in part reflects the composition of transactions, many of which will be new leasehold properties with some payment or premium paid upfront, in addition to the regular lease rent payment. In most instances, the premium is likely to be relatively low in value. This large share of relatively low-value transactions will also reflect the fact that a large proportion of businesses are small and medium-sized and tend to operate from relatively small properties.

A52. The second distinct feature is the large share of transactions which are priced at £500,000 or more. Of those priced £150,000 or more – the current stamp duty land tax non-residential tax threshold – 30% of transactions in Wales in 2015-16 were priced at £500,000 or more. Therefore, very high-priced property transactions represent a significant share of the market and will also represent a large share of tax revenue. This is different to residential transactions in Wales, where the vast majority of transactions are at the lower end of the price distribution.

Figure A5: Price distribution of non-residential transactions in Wales, 2015-16



Source: Calculations based on HMRC administrative datasets
NB Transactions exclude new leasehold transactions where only tax is paid on leasehold rents

A53. The Welsh economy is highly-integrated with the rest of the UK's economy, which means businesses investing in the UK can be more mobile and geographically indifferent to which UK nation or English region they are located in. Therefore, significant changes to taxes in one area could act as a disincentive to investment, with businesses choosing to locate in a similar or neighbouring area which levies a lower tax. This implies there are limits to which LTT and stamp duty land tax rates can diverge for non-residential transactions without having a significant impact on the market, revenues and the wider economy.

A54. The tax rates for non-residential LTT take into account the features of the Welsh economy and the principle that the tax should be levied progressively with respect to property values and considering the prevailing stamp duty land tax rates. The main rates for non-residential LTT are shown below.

Table A6: LTT non-residential property main rates

Price threshold	LTT rate
£0-£150k	0%
£150k-£250k	1%
£250k-£1m	5%
£1m-plus	6%

A55. The main rates for non-residential stamp duty land tax, for comparison, are below:

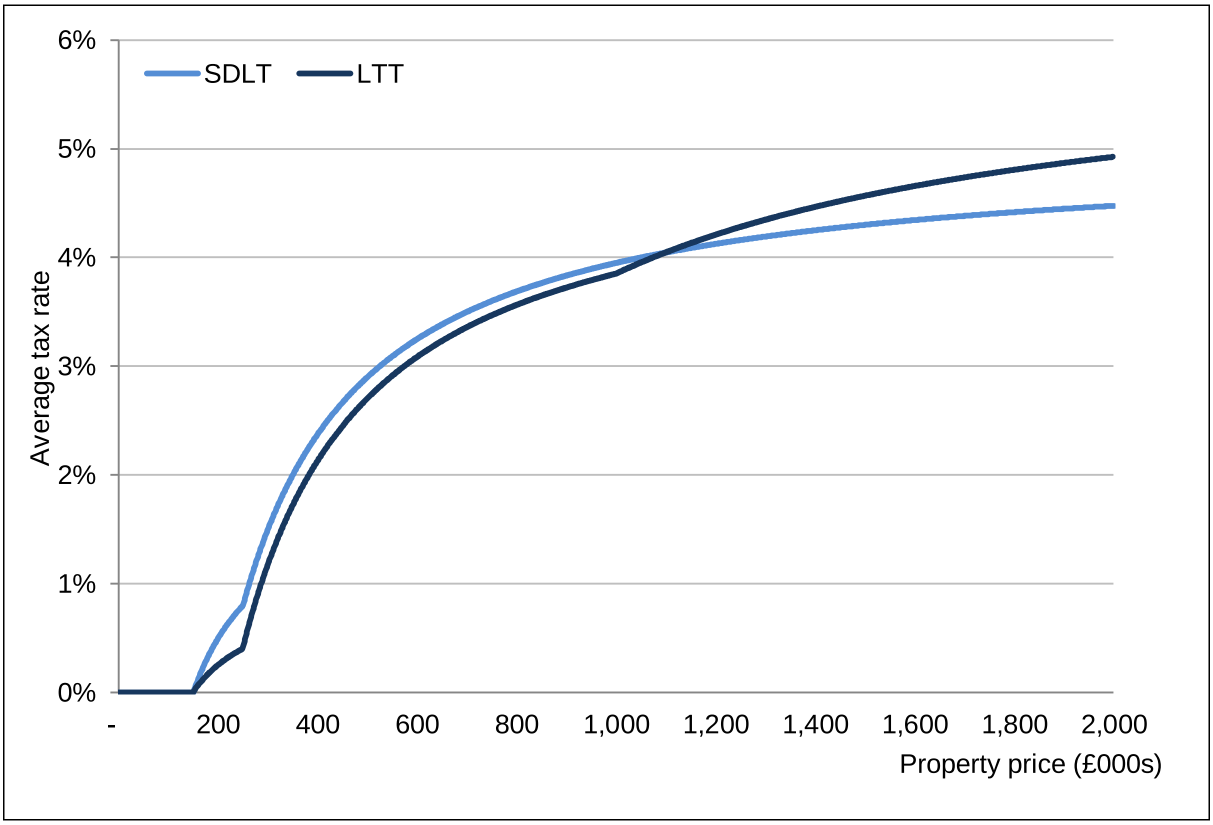
Table A7: Stamp duty land tax non-residential property main rates

Price threshold	SDLT rate
£0-£150k	0%
£150k-£250k	2%
£250k-plus	5%

A56. Adopting a lower tax rate than stamp duty land tax for the first band where tax is payable increases the progressivity of the LTT non-residential rates. To maintain revenue, a new top band has been added. Reflecting the integration of the Welsh economy with the rest of the UK economy and to support a smooth transition to the new tax, the degree of difference between non-residential LTT rates and the stamp duty land tax rates is relatively small. The tax changes also achieve consistency with the starting threshold for residential transactions and the starting rate and threshold for non-residential lease rents.

A57. To assist in comparing the LTT tax rates with the relevant stamp duty land tax rates, the figure below shows the average tax rate paid by property price.

Figure A8: Average tax rates of residential stamp duty land tax and LTT



A58. Under both stamp duty land tax and LTT, no tax is paid on non-residential freehold, assignment transfers or leasehold premium transactions under £150,000. It is estimated around 60% of taxable non-residential transactions will be below the £150,000 threshold in 2018-19.

A59. As LTT starts with a lower tax rate, all transactions from £150,000 up to £1.1m will pay less tax – by up to £1,000 – compared to stamp duty land tax. Therefore around 30% of taxable transactions will pay less under LTT than stamp duty land tax. For example a £250,000 transaction would have a tax liability of £2,000 under stamp duty land tax but will only be taxed £1,000 under LTT and a £500,000 transaction will see its tax liability fall from £14,500 under stamp duty land tax to £13,500 under LTT.

A60. From £1.1m, LTT will be higher than stamp duty land tax. It is estimated that less than 10% of non-residential transactions in 2018-19 in Wales will be paying more tax compared to stamp duty land tax. For example, a £2m transaction would have a tax liability of £89,450 under stamp duty land tax and will pay £98,440 under LTT; and a £5m transaction would see its tax liability rise from £239,500 under stamp duty land tax to £278,500 under LTT.

A61. As with changes to the residential tax rates, increases in tax rates from stamp duty land tax to LTT will reduce both prices and the number of non-residential transactions, or vice versa where tax rates decrease.

A62. The size of these effects is estimated using the OBR's behavioural effects[29] along with an estimate of the tax change across the non-residential price distribution.

A63. For transactions where there is a tax decrease from stamp duty land tax to LTT (between £150,000 and £1.1m) both the price and number of these transactions will increase. However, the estimated effects are very small for both prices and transactions and the overall effect on revenue is less than £0.1m.

A64. For transactions where there is an increase in tax, the effects work in the opposite direction, reducing prices and the frequency of transactions. Although there are relatively few transactions which will have increased tax, because they are high value, the tax liabilities will also be relatively high so the impact on revenues of fewer transactions is likely to be greater. It is estimated the combined transaction and price effect will reduce revenues by around £7m. Overall, the net effect of increasing the tax rates for property worth more than £1.1m is to increase revenues by around £5m even once the negative effects on transactions and prices are included.

A65. Overall in 2018-19, the non-residential LTT rates are expected to generate revenues of £71m before considering behavioural effects. The effect of the change in tax between stamp duty land tax and LTT on both prices and transactions is estimated to decrease this revenue by £7m.

A66. There is expected to be some forestalling as a result of announcing the rates and bands ahead of April 2018. This form of behavioural change is expected to be limited to 2018-19, as transactions are brought forward into 2017-18 to apply the stamp duty land tax rates and use the HMRC administration system. This effect is expected to be neutral in budgetary terms as it is assumed the UK Government will reimburse the Welsh Government with the extra revenues in Wales it receives in 2017-18 as a result of the forestalling.

A67. The overall net revenue from the non-residential main rates is forecast to be £64m in 2018-19 (table A9).

Table A9: LTT non-residential revenue estimate for 2018-19

Element	**£m**
Before behavioural effects	71
Behavioural effect on transactions and prices	-7
Net	**64**

Non-residential lease rent

A68. A separate rate applies to lease rents. The value of lease rents is assessed by adding the value over the duration of the lease, discounting future years to derive a net present value on which the tax is charged.

A69. The lease rent is the smallest element of the LTT tax, with around 2,500 transactions (excluding relieved transactions) estimated for 2018-19. This element

[29] See OBR (2017) http://budgetresponsibility.org.uk/docs/dlm_uploads/SDLT-elasticities.pdf

of stamp duty land tax has generated revenue of between £5m and £10m in Wales over the recent years.

A70. The LTT rates for non-residential lease rent net present value (NPV) are:

Table A10: LTT non-residential property lease rent NPV rates

NPV threshold	LTT rate
£0-£150k	0%
£150k-£2m	1%
£2m-plus	2%

A71. The stamp duty land tax rates for comparison are:

Table A11: SDLT non-residential property lease rent NPV rates

NPV threshold	SDLT rate
£0-£150k	0%
£150k-£5m	1%
£5m-plus	2%

A72. To reflect the property market in Wales, the top LTT rate will apply to a lower NPV than the top stamp duty land tax rate. As the non-residential lease rate applies to a fairly small number of transactions overall and lease rates are generally lower in Wales than in parts of England, such as London, very few transactions would pay the top rate of tax in Wales if it remained at the same value as stamp duty land tax.

A73. Like stamp duty land tax, no tax will be paid on transactions below £150,000. It is estimated in 2018-19 around half of transactions will be below £150,000 and not liable for tax.

A74. Between £150,000 and £2m, the tax liability is the same for LTT and stamp duty land tax. From £2m, the tax due will be higher under LTT than under stamp duty land tax. It is estimated there will be fewer than 100 transactions in Wales with an NPV of £2m or more in 2018-19.

A75. The effects on the market are estimated using the OBR's behavioural effects[30] along with an estimate of the tax change across the non-residential price distribution. The combined effect on transactions and prices is estimated to be very small. As the tax change is very modest, this is expected to reduce revenues by £0.1m, mainly through the small negative effect on the number of very high-priced leasehold transactions.

A76. The revenue forecast from the LTT non-residential lease rents is estimated to be £7m before consideration of any behavioural effects. The behavioural effects for this

[30] See OBR (2017) http://budgetresponsibility.org.uk/docs/dlm_uploads/SDLT-elasticities.pdf

element of the tax – in terms of prices, transactions and forestalling – are all expected to be very small due to the very few transactions which are liable to a different amount of tax under LTT compared to stamp duty land tax. The overall revenue in 2018-19 is therefore unchanged, at an estimated £7m.

Table A12: LTT non-residential revenue estimate for 2018-19

Element	**£m**
Before behavioural effects	7
Behavioural effect on transactions and prices	<-1
Net	**7**

(May not sum due to rounding)

Profile of revenue

A77. Forecasts of LTT revenues for the next three years are shown in the table below. This is estimated using the latest OBR (March 2017) UK determinants for residential and non-residential prices and transactions over the forecast period, net of forestalling and other behavioural effects and on an accrual basis.

Table A13: Land transaction tax revenue forecast

	2018-19	**2019-20**
Residential main rates (£m)	142	161
Residential higher rates (£m)	53	56
Non-residential (£m)	71	74
Total (£m)	**266**	**291**

NB Non-residential includes revenue from lease rent rates.

A78. For more details about the forecast please see the accompanying draft Budget documents by the Welsh Government's independent assurer of the tax revenue forecast.

A79. The forecasts and impacts of LTT have been estimated relative to the current stamp duty land tax rates. If stamp duty land tax rates change ahead of April 2018, the impact of LTT; the revenue generated and the block grant adjustment are also likely to change. This may require a change to LTT tax rates before April 2018.

Landfill Disposals Tax

A80. Landfill disposals tax (LDT) is a tax on the disposal of waste to landfill, charged by weight. It is payable by landfill site operators, who pass on these costs to waste operators through their gate fees.

A81. It will replace landfill tax in Wales in April 2018, enabling public services in Wales to continue to receive the benefit of the revenues raised by the tax. In common with landfill tax, it aims to ensure the landfill disposal method is properly priced to reflect its environmental cost and to promote a more sustainable approach to waste management. Its devolution offers a further lever with which to support Welsh

Government priorities and policies, including the ambitious goal of zero waste[31] and our efforts to reduce carbon emissions and tackle climate change.

A82. Remaining consistent with the UK and Scotland, there will be a lower and a standard rate of tax, which will apply to disposals at authorised landfill sites. The lower rate will apply to qualifying materials as defined in the Landfill Disposals Tax (Wales) Act 2017 and the standard rate will apply to all other materials. In addition, the Landfill Disposals Tax (Wales) Act 2017 introduced a third rate of tax for waste disposed of at places other than authorised landfill sites – the unauthorised disposals tax rate.

A83. The approach to setting tax rates has been guided by the principles in the tax policy framework[32] and the objective to reduce landfill disposals in Wales, as required by section 91 of the Landfill Disposals Tax (Wales) Act 2017. Delivering stability and certainty for taxpayers and the wider waste industry, noting the desire of business to be able to plan ahead and make investments has also been a key factor in setting the rates. The principle that there should be no less revenue available to fund public services has also been applied.

A84. The approach to setting tax rates was explored with stakeholders as part of the 2015 consultation *Developing a landfill disposals tax* and in further engagement events. These events involved landfill site operators, Natural Resources Wales, the Welsh Local Government Association and the LDT Technical Experts Group, which has representation from tax professionals and the wider waste industry. Stakeholder views were also captured during the passage of the Landfill Disposals Tax (Wales) Act 2017.

Lower and standard tax rates

A85. Since the introduction of landfill tax in 1996, the standard tax rate has risen from £7 per tonne to £86.10 per tonne in 2017-18. The lower tax rate has remained broadly constant - it was £2 per tonne when the tax was introduced and it is currently £2.70 per tonne. In 2014, the UK Government confirmed the standard and lower tax rates would be maintained in real terms (by the rate of inflation as measured by the Retail Price Index). This approach is expected to continue until at least 2018-19. The Scottish Government has kept its landfill tax rates consistent with the UK Government's landfill tax since its introduction in 2015.

A86. The amount of waste disposed of at landfill sites in Wales has fallen significantly over the last decade as re-use, recycling, composting and incineration has increased. As figure A14 shows; the decrease has been particularly significant for waste subject to the standard rate of tax, which provides the vast majority of landfill tax revenues. Qualifying material, which is subject to the lower tax rate, has fallen much more slowly[33].

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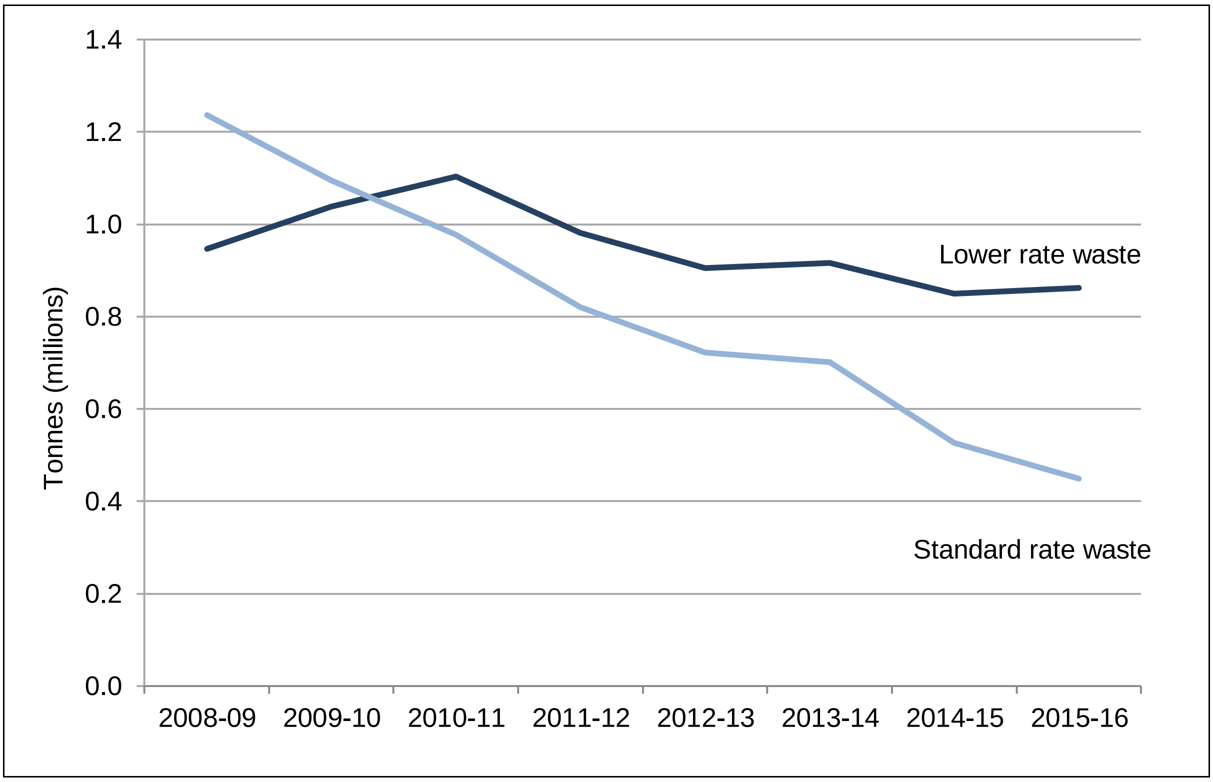
[31] http://gov.wales/docs/desh/publications/100621wastetowardszeroen.pdf
[32] Available at http://gov.wales/docs/caecd/publications/170612-framework-en.pdf
[33] Landfill site operators do not submit tax returns which separately identify waste disposed of in Wales. Therefore the split in standard and lower rate waste has been estimated using data from Natural Resources Wales.

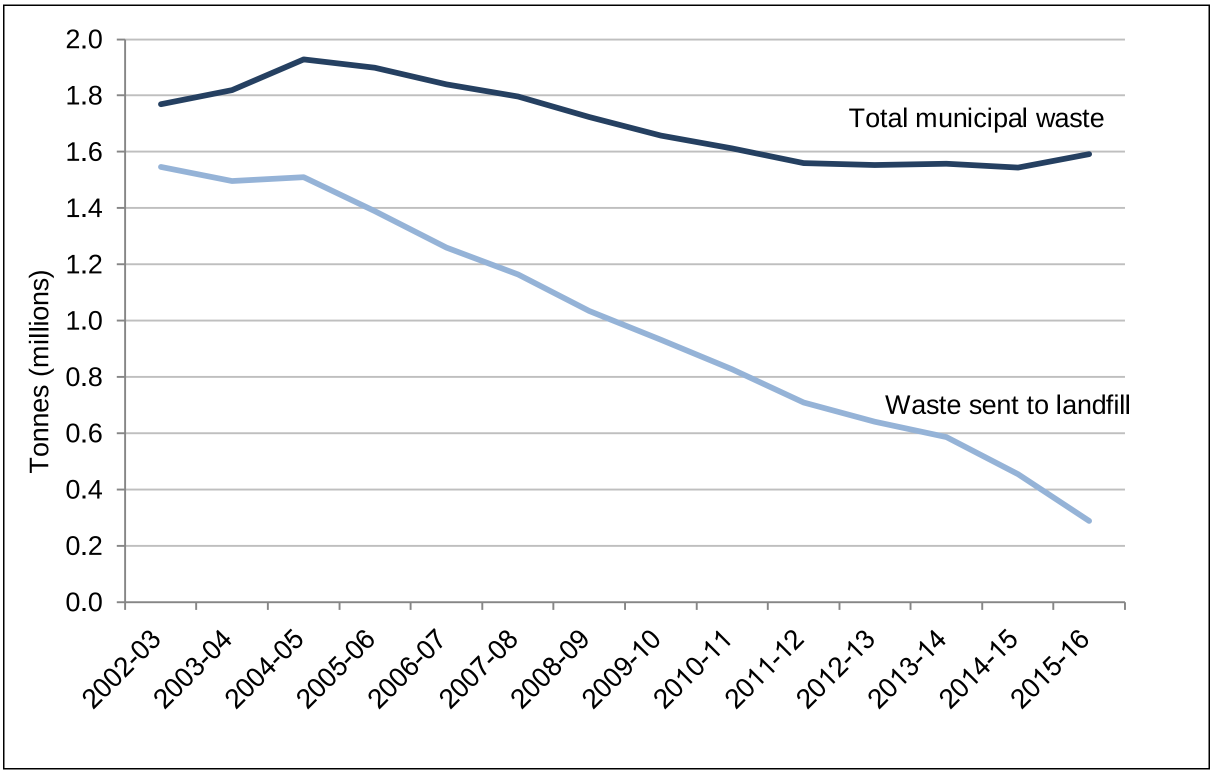
Figure A14: Estimates of waste landfilled in Wales, by tax rate



Source: Welsh Government estimates using data from Natural Resources Wales

A87. The decrease in standard rate material has been driven, in large part, by changes in local authority waste management practices. Local authorities have a statutory target to re-use, recycle or compost 70% of the waste they collect by 2024-25. As figure A15 shows, the amount of waste local authorities send to landfill has been falling rapidly over the last decade.

Figure A15: Local authority municipal waste, Wales



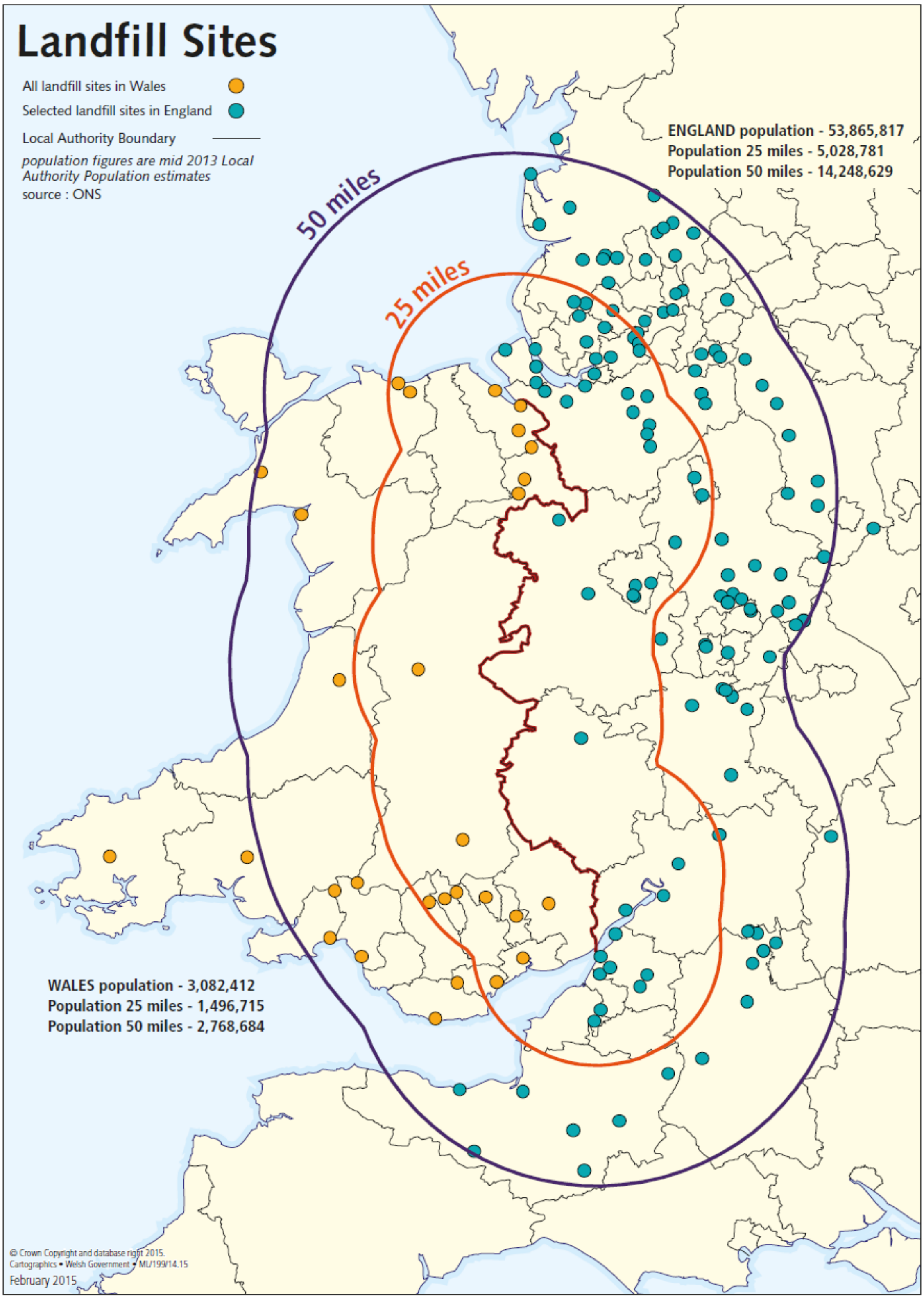
Source: StatsWales

A88. Waste sent to landfill in Wales is expected to continue falling in future. Local authorities are likely to gradually increase the amount of waste that is re-used, recycled and composted in order to meet statutory targets. In addition, increased incineration capacity will become available in North and South Wales, either through the expansion of existing facilities or the opening of new facilities. This suggests that large quantities of waste, largely taxed at the standard rate, will be diverted away from landfill over the coming years.

A89. A key priority for the Welsh Government is a smooth transition to LDT in 2018. Any changes to tax rates can be expected to have behavioural effects. A specific area of concern among stakeholders was the impact on business if there was a material difference between the tax rates charged in Wales and England, with several highlighting the potential for waste to cross the border if it was more economically advantageous to travel further to dispose of it.

A90. The majority of landfill sites in Wales are within 25 miles of the Wales-England border and there are more landfill sites within 25 miles of the border on the English side.

Figure A16: Landfill Sites and Populations – Wales/England Border[34]



[34] Location of landfill sites based on HMRC data 2012
http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageExcise_ShowContent&id=HMCE_PROD_009941&propertyType=document

A91. Analysis of haulage rates suggests that a relatively small differential of less than £10 in rates between Wales and England could introduce a significant financial incentive to move waste across borders.

A92. A reduction in LDT rates may encourage greater landfill disposals in Wales, which is not consistent with our aim to reduce landfill disposals. An increase in waste being disposed of in Wales would also have wellbeing and environmental impacts for communities. For example, it would:

- Increase waste, including potentially hazardous waste, travelling further distances on major roads and through residential areas;
- Increase disruption for residents near landfill sites and waste transfer stations;
- Increase the carbon footprint of waste disposal;
- Increase pressure on existing landfill capacity, with potential calls for new landfill sites to be developed.

A93. Conversely, an increase in LDT rates may encourage less waste to be disposed of to landfill in Wales than if landfill tax were to continue to apply, reducing the amount of revenue collected. This is inconsistent with our principle that there should be no less revenue available to fund public services.

A94. Stakeholders have suggested that the standard rate has reached its optimum level where landfilling these materials is the most expensive, and therefore least attractive, means of waste disposal. Increasing tax rates may incentivise unauthorised disposals of waste. Some stakeholders have made the case for increasing the lower rate to encourage greater recycling, re-use and recovery of these materials but the majority wanted consistency with UK rates to minimise the risk of waste tourism, including, at least initially, for the lower rate.

A95. Engagement with taxpayers and the waste industry has also indicated it will be helpful for them to know rates in advance in order to inform their business plans and investments, in light of this, the rates will be set for two years.

A96. In summary, for the first two years of LDT, the standard and lower rates are intended to mirror the rates for the UK Government's landfill tax.

A97. Table A17 shows the rates for 2018-19. The UK Government is yet to announce its rates for landfill tax in 2019-20. Therefore an assumed rate is given below, which increases the 2018-19 tax rates by the OBR's forecast for RPI. This is in line with the UK Government's stated policy on setting landfill tax rates.

Table A17: Landfill disposals tax rates (rate per tonne)

Rate	**2018-19**	**2019-20** *Assumed*
Standard	£88.95	£91.70
Lower	£2.80	£2.90

A98. During the development of landfill disposals tax, there was a clear message from stakeholders about the need to implement a tax which provides consistency, certainty and stability for businesses. This has been the driving factor behind the decision to set rates that are consistent with the rest of the UK. By setting rates that are consistent with landfill tax, public services in Wales will continue to benefit from tax revenue, while ensuring the risk of the movement of waste across borders is reduced.

A99. As the proposed tax rates are consistent with landfill tax, there is not expected to be any significant change in the amount of waste disposed of at authorised landfill sites in Wales. Revenue from landfill disposals tax is expected to continue to fall as an increasing amount of waste is diverted away from landfill in future.

Table A18: Landfill disposals tax revenue forecast

	2018-19	2019-20	2020-21	2021-22
Landfill disposals tax (£m)	28	26	23	22

Unauthorised disposals

A100. Tax will also be charged on waste disposed of at places other than an authorised landfill site – known as unauthorised disposals. Any person who makes the disposal or who knowingly causes or knowingly permits the disposal to be made, will be liable to the tax.

A101. Taxing unauthorised disposals is intended primarily as a deterrent. At September 2016, Natural Resources Wales reported that there were 60 known illegal waste sites in Wales with approximately 55,000 tonnes of waste across these sites.

A102. This policy has been developed to dovetail with existing environmental regulations and complement wider Welsh Government initiatives including its approach to tackling fly-tipping.

A103. Our approach aims to bring benefit to the communities who are affected by unauthorised disposals by seeking to deter this activity in future. It also aims to minimise opportunities to evade tax and thus protect revenue for investment in public services in Wales.

A104. It intends to ensure unauthorised disposals are more financially risky and so a less attractive option for those tempted to ignore their environmental obligations and evade tax. It therefore seeks to realign the balance of risk, so that the consequences of making unauthorised disposals outweigh the perceived benefit of evading tax.

A105. Consistent with the purpose of the tax as a lever to influence positive environmental behaviours this approach seeks to encourage individuals to make efforts to take up sustainable methods of waste disposal or, as a minimum, to take waste to a registered landfill site and pay a fair share of tax.

A106. The unauthorised disposals rate will be set at 150% of the standard rate.

Table A19: Unauthorised disposals tax rate (rate per tonne)

	2018-19	2019-20 *Assumed*
Unauthorised disposals rate	£133.45	£137.55

A107. Setting the rate at 150% provides a suitable financial deterrent. It ensures a level of fairness, proportionality, and transparency. It reflects that in normal circumstances registered landfill site operators bear administrative costs relating to registration, filing, paying and record-keeping and these would have been avoided along with penalties and interest, which would have been applied to a registered landfill site operator for failure to do these. Setting the rate at 150% therefore helps to create a level playing field for legitimate waste businesses. The unauthorised disposals rate also recognises the compliance and enforcement costs of the Welsh Revenue Authority (WRA).

A108. The introduction of a separate tax rate for unauthorised disposals is aimed primarily at deterring unauthorised disposals rather than raising tax revenue. The WRA will be responsible for determining the level of compliance and enforcement activity it undertakes in relation to unauthorised disposals. It is expected that its approach will be proportionate and cost-effective and be considered in the context of the wider initiatives being taking forward by the Welsh Government, NRW and local authorities to tackle unauthorised disposals. It is anticipated the WRA's focus will be on larger unauthorised waste sites and may also extend to regular and persistent fly-tippers where significant tonnages of wastes have been deposited and tax evaded.

A109. An industry report[35] in 2015 highlighted that every £1 spent on waste crime enforcement is expected to return between £3.60 and £5.60 to government. This clearly makes the enforcement of these powers a valuable tool and one which could be a worthwhile investment in the long term. The WRA's operating costs include costs for compliance and enforcement activity.

A110. LDT will only apply to unauthorised disposals made after the introduction of the tax on 1 April 2018 – at this stage, levels of non-compliance are not known and so compliance and enforcement costs and the level of potential revenue cannot be quantified. Potential revenue from the unauthorised disposals rate is therefore not included in the LDT revenue forecast.

A111. Tax collected from unauthorised disposals will support the delivery of public services in Wales, with some revenue allocated to NRW and local authorities where they have been instrumental in assisting the investigation and pursuit of tax and to incentivise future action.

A112. An evaluation framework is being developed to assess the impact of this new approach and the implementation of the unauthorised disposals rate will be monitored closely.

[35] http://www.esauk.org/esa_reports/ESAET_Waste_Crime_Tackling_Britains_Dirty_Secret_LIVE.pdf

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