



Peredur Owen Griffiths MS
Chair of Finance Committee
Welsh Parliament
Cardiff Bay
CF99 1NA

1 August 2023

Dear Peredur,

You raised an issue relating to income tax allowances and fiscal drag during my oral questions session on 12 July. I said I would write with a response.

I will first set out what has happened with the income tax allowances and thresholds. The income tax personal allowance and basic rate limit were frozen between 2019-20 and 2020-21 but then increased in line with CPI inflation between 2020-21 and 2021-22. Since then, both thresholds have been frozen and are due to remain at the same level until 2027-28. The additional rate threshold remained at £150,000 from its introduction in 2010 until March 2023 - it was never increased in line with inflation. In April this year the threshold was reduced to £125,140.

The freezes to the personal allowance and basic rate limit are likely to have led to increased fiscal drag in total income tax revenues between 2019-20 and 2020-21 and between 2021-22 and 2022-23. However, as the Welsh Rates of Income Tax (WRIT) account for 10 pence in the pound in each tax band, they currently represent a flat rate tax above the personal allowance. The only direct fiscal drag impact on WRIT revenues is therefore via the frozen personal allowance.

There are no published numbers on the impact of freezing allowances and thresholds on income tax revenues in Wales, or specifically on WRIT revenues. However, the policy will tend to increase revenues as wages increase. It is also the case that the frozen allowances and thresholds will increase equivalent revenues in England and Northern Ireland, which will affect the Welsh Government budget via the block grant adjustment.

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Rydym yn croesawu derbyn gohebiaeth yn Gymraeg. Byddwn yn ateb gohebiaeth a dderbynnir yn Gymraeg yn Gymraeg ac ni fydd gohebu yn Gymraeg yn arwain at oedi.

We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding.

The Welsh Government uses Office for Budget Responsibility (OBR) forecasts of devolved tax revenues in its budget setting process. It therefore takes full account of the expected impact of the freeze to the income tax personal allowance. As noted above, because threshold freezes also affect revenues in England and Northern Ireland, they will increase the block grant adjustment associated with WRIT. The net budgetary impact of the threshold freezes will therefore be considerably smaller than the increase to the Welsh rates alone. That said, the OBR's latest forecasts suggest that revenues from the Welsh rates of income tax are likely to grow faster than the associated block grant adjustment over the next few years. As noted by the OBR: "the Welsh share of income tax is expected to increase gently over the next few years, thanks in part to the frozen personal allowance raising proportionately more revenue in Wales than in the UK".

You raised the possibility of the Senedd being able to set Welsh specific tax bands. This would involve seeking further powers, similar to those in Scotland where there is full devolution of non-savings non-dividend income tax. While pursuing the devolution of these powers could be a consideration for Wales in the future, the additional policy levers would be accompanied by considerable additional risk and volatility to the Welsh Government's budget. If the Scottish model were followed, the ability to vary the personal allowance would still not be devolved. It should also be noted that increasing thresholds in line with inflation whilst the UK government did not would also very likely lead to a reduction in the Welsh Government's budget.

Yours sincerely,

A handwritten signature in cursive script that reads "Rebecca".

Rebecca Evans AS/MS
Y Gweinidog Cyllid a Llywodraeth Leol
Minister for Finance and Local Government