

19<sup>th</sup> November 2015



Convener  
Finance Committee  
Room T3.60  
The Scottish Parliament  
Edinburgh  
EH99 1SP

Dear Convener

Thank you again for your letter of August 27<sup>th</sup>, inviting the Scottish Fiscal Commission (SFC) to attend a Committee meeting in order to provide comment to help the Committee's work in its scrutiny of the forthcoming Draft Budget. Specifically, you asked for commentary on the Scottish Government's forecast of both residential and commercial LBTT receipts relative to outturn figures as published by Revenue Scotland, to include also some comment on the impact of forestalling. You also asked for commentary on the Scottish Government's forecast for Scottish Landfill Tax relative to the available outturn figures.

A concise summary of the work we have done is shown below. We would highlight a challenge which we and the Finance Committee share in this, the first period of outturn figures from the recently devolved taxes. There is a challenge in making a judgement about a year's forecast based on part-year data, where assumptions have to be made about the effects of seasonality and/or forestalling on the observed outturn data.

Comparison of the SG forecasts for 2015-16 with Outturns (in millions £)

	Total LBTT	Residential	Non-residential	Landfill
SG, Forecast October 2014	441	295	146	117
SG, Forecast Jan 2015	381	235	-	-
SG, Forestalling Forecast, Jan 2015	-	12-37	-	-
Outturn Data to Date		96.2 (Apr-Sept)	86.6 (Apr-Sept)	37.4 (Q1)
Outturn Data Annualised (est.)		215.5 (min. forestalling) 247.4 (max. forestalling)	173.2	156 (24% SA) 170 (22% SA)
Estimated Annualised Forecast Error		19.5 (min. forestalling) -12.4 (max. forestalling)	-27.2	-38 (24% SA) -53 (22% SA)

## **Residential LBTT**

Initial estimates of the revenues from residential LBTT at the time of the Draft Budget for 2015-16 suggested revenues under the new tax would be £295m. Following the changes to the tax rates and thresholds in January 2015 this forecast fell to £235m with an additional possible fall in revenue estimated to be in the region of £12m-£37m due to forestalling effects arising from the changes to UK Stamp Duty.

Initial outturn data from Revenue Scotland indicate that revenues of £96.2m have been generated over for the period between April and September 2015. In order to make these data comparable to the initial forecast we need to make assumptions about the extent to which these data have been affected by forestalling. We therefore add back the upper and lower bound of the Scottish Government's forecasts of forestalling to get a range of estimates of the revenues that would have been generated in the absence of forestalling.<sup>1</sup> We then scale these estimates by a measure of the seasonality in the housing market which suggests that typically 53% of revenues would be expected to have been raised over this part of the year. This gives rise to an annualised measure of the outturn data after adjusting for a range of potential forestalling effects of £215.5m-£247.4m which can be compared with the pre-forestalling forecast of £235m, giving an implied estimated forecast error of between £19.5m and -£12.4m.

## **Non-Residential LBTT**

Non-residential LBTT revenues were forecast to be £146m in the Draft Budget of 2015-16. Outturn data from Revenue Scotland for the period April-September 2015 imply realized revenues of £86.6m. For this particular tax we are unable to produce an estimate of the seasonality in revenues and therefore simply double the six months outturn data to obtain an annual estimate of £173.2m, which implies an estimated forecast error of £27.2m. Obviously this estimate is highly dependent on the extent of any seasonal pattern in the outturn data which we could not control for.

## **SLfT**

The initial forecast for SLfT revenues was £117m. The outturn data for the first quarter of the fiscal year found that revenues of £37.4m had been generated. For the UK as a whole the Scottish Government estimates revenues in this quarter typically account for 24% of annual revenues (after adjusting for the underlying trend in landfill revenues). While looking directly at data for recent years (without any trend adjustment) suggests that 22% of revenues would typically be attributed to Q1. We therefore scale the outturn data assuming such seasonality also applied in Scotland to obtain an estimate of the annual revenues generated of between £156m and £170m, implying an estimated forecast error of -£39m to -£53m.

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<sup>1</sup> This implicitly assumes that the effects of forestalling have ended by September 2015.

### **Caveats:**

The above analysis is entirely dependent on our ability to move from part-year outturn data to generate an estimate of what that outturn data would imply revenues would be for the whole year. This is highly uncertain and a better measure of forecast accuracy will be obtained when the full year data are released.

### **Forestalling:**

Preliminary analysis by the Scottish Government, prompted by the Commission, suggests that the shortfall in revenues over the period of April to September 2015 is around £30m and although early indications suggested that the gap between outturn and forecast had been eliminated by August 2015 (possibly implying that any forestalling effects had come to an end), this gap has subsequently widened again in September. This suggests that either (1) the forestalling effects are larger and possibly more prolonged than anticipated, (2) that the underlying forecast is over-predicting revenues received for the year to date, or (3) the process of seasonal adjustment in attempting to allocate an annual forecast across individual months is not accurately capturing the monthly variability in revenues observed this year.

We trust this note is useful to the Committee, and look forward to attending the meeting next week.

Sincerely yours,



Lady Susan Rice



Professor Campbell Leith



Prof Andrew Hughes Hallett