

Forecast Evaluation Report September 2017

Executive Summary

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1. Budget planning and decision making require the production of well-informed, unbiased forecasts in order to allocate resources. This can be challenging: the future performance of the housing market, future trends in levels of waste and future changes in business properties are all uncertain and affected by a wide and varying range of factors. This report analyses how and why the forecasts produced for 2016-17 were different from the tax revenue raised.¹

Land and Buildings Transaction Tax (LBTT)

2. Land and Buildings Transaction Tax (LBTT) is the tax paid when land and property is purchased. LBTT operates differently for residential and non-residential transactions. Residential LBTT also includes the Additional Dwelling Supplement (ADS) which is payable on additional residential properties such as second homes or buy-to-let properties. LBTT was devolved in 2015.
3. The Scottish Government produced forecasts for 2016-17 in December 2015 and December 2016, alongside Draft Budgets. Both forecasts are evaluated in this report.
4. The residential LBTT forecast is sensitive to changes in house prices and the volume of transactions (purchases). Any difference in either prices or transactions compared to the forecast will result in an overall forecast error. The forecasts produced in December 2015 overestimated residential LBTT revenues in 2016-17 by £68 million because the house price forecast was too high.
5. In contrast, the forecasts produced in December 2016² underestimated the amount of revenue raised by residential LBTT by £33 million in 2016-17. For this forecast, the

¹ The data for Land and Buildings Transaction Tax and Scottish Landfill Tax represent the actual tax liabilities declared. Due to high collections rates, it is anticipated that the tax received will closely match the tax declared (for example, at the end of the financial year 2015-16, 99.8% of all tax returns submitted had been paid either within the financial year or within five days of the year end). Revenue Scotland is expected to publish its Annual Report and Financial Statements for 2016-17 in late September 2017.

² That is, the forecasts produced for Draft Budget 2017-18. The in-year forecasts made in December 2015 (i.e. forecast for the year 2015-16) and in December 2016 (i.e. forecast for the year 2016-17) are not official Government forecasts and were not published in the Draft Budget documents. However, these forecasts were produced at the time of each Draft Budget and provide useful information for this assessment.

methodology for forecasting prices had been revised, which was one contributory factor in the house price forecast being too low.

6. The Scottish Government used a statistical model to estimate how many residential purchases are in each price bracket. Analysis of the tax raised shows this distribution provides a reasonable estimate of the pattern of residential transactions.
7. Revenue from the Additional Dwelling Supplement (ADS) was significantly higher than initially forecast by the Scottish Government in December 2015. This was because the forecast for the number of purchases liable for ADS was too low. Now that there is more information available about the proportion of purchases that are additional properties, this error should reduce in future forecasts.
8. The non-residential LBTT forecast produced in December 2015 overestimated revenues by £44 million. The most significant factor in this error was the forecast for prices being too high. Previous Commission reports have noted that this element of tax revenue can be changed significantly by a very few high priced transactions, which makes it difficult to forecast accurately. In 2016-17, 35% of non-residential LBTT came from the 1% highest priced purchases.

Table 1: LBTT Forecasts³ compared to Tax Raised (£ millions)

		2015-16	2016-17
Residential LBTT (exc ADS)	Tax Raised	208	214
	SG Forecast December 2015	227	282
	SG Forecast December 2016		181
Additional Dwelling Supplement⁴	Tax Raised (net basis) ⁵		90
	SG Forecast December 2015		36
	SG Forecast December 2016		71
Non-residential LBTT	Tax Raised	217	176
	SG Forecast December 2015	210	220
	SG Forecast December 2016		228

Source: Revenue Scotland statistics ([link](#)), Scottish Government Draft Budget 2016-17 ([link](#)), OBR (2015) Economic and Fiscal Outlook November 2015 Devolved Taxes Forecast ([link](#)), Scottish Fiscal Commission (2016) Report on Draft Budget 2017-18 Table 15 ([link](#)).

Non-Domestic Rates (NDR)

9. Non-Domestic Rates (NDR), commonly known as “business rates”, are paid by owners, tenants or occupiers of non-domestic properties. The ‘rateable values’ for all properties in Scotland are recorded publicly on the Valuation Roll. These properties

³ The in-year estimate produced in December 2016 is not an official Scottish Government forecast. See footnote 2 above.

⁴ The ADS tax raised is not the final figure owing to an 18 month window for transferring main residence, selling the previous main residence property (and subsequently reclaiming paid ADS)

⁵ As at 31st May 2017

are normally revalued every five years, although the latest cycle has been seven years long.

10. The Commission’s previous role on NDR considered only how the tax rate changes due to inflation and how the total rateable value of all properties may change over time (known as ‘buoyancy’). Some changes to this total value, which can be thought of as the tax base, are linked to the economy, such as the addition or removal of properties, but other administrative changes and some types of appeals can also have an impact.
11. Because of the number of different drivers of the changes in the size of this tax base, forecasting can be difficult. The Scottish Government have generally forecast NDR revenue by examining how this has changed in the past over the revaluation cycle. However, 2016-17 was unusually the seventh year in a cycle. The average growth during years three to five in previous cycles was used to forecast growth in the value for 2016-17.
12. Using this approach, the forecast for the growth in total rateable value was 1.0% for 2016-17. The data for 2016-17 now available show the figure was 0.33%. This is a relatively small component of NDR receipts and the difference between forecast and outturn is equivalent to a £10 million difference in revenue; in contrast the latest estimate of NDR revenue in 2016-17 was £2.7 billion.
13. Whilst it is challenging to fully explain the lower than forecast level of growth in the tax base, it appears that contributing factors included several significant removals from the Valuation Roll, a large successful appeal and a lower than average number of significant additions to the Valuation Roll.

Scottish Landfill Tax

14. Scottish Landfill Tax (SLfT) is a tax on the disposal of waste to landfill. The forecast produced in December 2015 underestimated revenue raised by Scottish Landfill Tax in 2016-17 by £14 million, an absolute percentage error of 10%. The forecast underestimated the level of standard rated waste, which generates over 90% of revenue. The decline in waste was not as significant as was implied by the Scottish Government model, which assumed landfill targets would be met by 2025.

Table 2: SLfT Forecasts compared to Tax Raised (£ million)

	2016-17
Tax Raised	147
SG Forecast December 2015	133
SG Forecast December 2016 ⁶	150

Source: Scottish Government (2015) Devolved Taxes Methodology 2016-17 ([link](#)); Scottish Government (2016) Devolved Taxes Methodology 2017-18 ([link](#))

⁶ The in-year estimate produced in December 2016 is not an official Scottish Government forecast. See footnote 2 above.

15. This had been noted as a risk in the approach taken in previous Commission reports and the Scottish Government subsequently revised their forecast methodology. Following this revision, the in-year forecast produced as a baseline for the Draft Budget 2017-18 had a relatively small error at just £3 million. This can be explained due to the seasonality of the waste being different to the previous year.

Commission's Role

16. The Commission found that the approaches used in the production of these forecasts were reasonable in December 2015 and December 2016. The forecast methodologies have evolved and improved, due to the availability of new data, the refinement of techniques given previous forecast error, and as part of the process of Commission scrutiny.
17. The Commission will produce its first independent and official forecasts alongside the Draft Budget 2018-19 later in 2017. The models used by the Government have now been transferred to the Commission and are being developed in preparation for the production of these forecasts. An occasional paper outlining the Commission's Current Approach to Forecasting has been published alongside this report.⁷

⁷ Scottish Fiscal Commission Current Approach to Forecasting September 2017 ([link](#))

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ISBN: 978-1-9998487-0-5

Published by the Scottish Fiscal Commission, September 2017

