Scottish Fiscal Commission

Supplementary Forecast Evaluation Report

August 2021

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ISBN: 978-1-911637-40-0

Published by the Scottish Fiscal Commission, August 2021.

Laying Number: SFC/2021/9

Foreword

In this report we evaluate our December 2018 income tax forecast and our February 2020 Non-Domestic Rates (NDR) forecast. These evaluations are being provided in a supplementary report as when we published our main Forecast Evaluation Report on 15 July 2021 the necessary data for income tax and NDR were not available.

The Scottish Budget for 2019-20 was set using our income tax forecast published in December 2018 of £11,684 million. Compared to the 2019-20 outturn data of £11,833 million, our Budget setting forecast from December 2018 underestimated Scottish income tax revenues by £149 million, or 1.3 per cent. Our inclusion of Real Time Information (RTI) tax data in our January forecast has led to our 2019-20 forecast being very closely aligned to outturn data. We will continue to monitor the effect of RTI tax data in future evaluations.

Our February 2020 forecast of NDR for 2020-21 was published a month before the COVID-19 pandemic was declared and therefore does not account for the Scottish Government's policy response to support businesses during this period. Our forecast overestimated revenues by £933 million or 34 per cent, largely because of the policy response, although COVID-19 restrictions also affected NDR revenues in other ways. These effects make it more difficult to draw conclusions from the data which may increase uncertainty in future forecasts.

We would like to thank HMRC and the Scottish Government who have worked hard to ensure we have the information we need to create our forecasts and evaluations of income tax and Non-Domestic Rates, respectively.

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26 August 2021

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Chapter 1
Income tax

1.1 HM Revenue and Customs (HMRC) published provisional Scottish income tax outturn data for 2019-20 in late July 2021.[1] [2] In this chapter we evaluate our income tax forecasts for 2019-20, focussing particularly on our budget setting forecast, published in December 2018.[3]

1.2 Income tax revenues in 2019-20 will have been largely unaffected by the COVID-19 pandemic. The first lockdown began in late March 2020, only days before the end of the 2019-20 financial year.

1.3 Figure 1.1 shows the headline forecast error from our December 2018 forecast and provides some comparative information on OBR's forecasts of UK income tax.

Figure 1.1: Headline evaluation – income tax December 2018 forecast of 2019-20

	Forecast (£ million)	Outturn (£ million)	Error (£ million)	Error (Relative %) [1]
	11,684	11,833	149	1.3
OBR average absolute error [2]				
One-year ahead error				2.6
Two-year ahead error				4.9

Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link), HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link), OBR (2021) Historical official forecasts database (link).
Figures may not sum because of rounding.
[1] Our definition of forecast error is consistent with how we define it in our main 2021 Forecast Evaluation Report introduction.
[2] The OBR's UK income tax forecasting performance is not a perfect proxy for income tax forecasting in Scotland as the availability and timing of information is quite different. UK income tax is historically more volatile as it includes dividends taxation, which is particularly sensitive to tax rate changes. The Scottish income tax forecast is only for non-savings, non-dividends income. We provide the OBR's one-year and two-year ahead forecast. At the time of compiling our forecasts for the 2019-20 Budget we had access to economy data up to December 2018, but were still reliant on 2016-17 income tax outturn data.

1.4 The Scottish Budget for 2019-20 was set using our income tax forecast published in December 2018 of £11,684 million. Compared to the outturn data of £11,833 million, we underestimated Scottish income tax revenues by £149 million, or 1.3 per cent. The error compares favourably to both the average one-year and two-year ahead forecast error from OBR.

1.5 In the first half of this chapter we start by looking in detail at our December 2018 forecast of 2019-20. We then broaden our scope to look at our other forecasts of 2019-20, to see how our forecast error changed over time. Given we now have outturn data spanning three budget setting forecasts, we also look at how our budget setting forecasts error have changed over time.

1.6 In the second half of this chapter, we look at how our December 2018 forecast error has affected the Scottish Budget.

[1] HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link)
[2] Although these statistics meet the usual standard of Official Statistics, they will not be formally signed off until the National Audit Office (NAO) has completed their annual audit of the HMRC Trust Statement. This is expected to be completed by October 2021 which is when the final adjustments to the Scottish Government's block grant will be confirmed.
[3] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link).

1.7 Overall, we believe that our income tax forecasts have a reasonable forecast error. Data developments have also improved our forecasts considerably. Since we were able to start including income tax outturn data in our forecasts, forecast errors have consistently been around 1 per cent. It is also clear that timely RTI data have helped improve our forecasts.

Understanding our December 2018 forecast error

1.8 Our income tax forecast relies heavily on forecasts of employment and earnings from our economy forecast. When we made our December 2018 forecast, we only had income tax outturn data for 2016-17. Therefore, we had to use economy data and forecasts covering the period 2016-17 to 2019-20 to create our income tax forecasts. Figure 1.4 shows the forecast growth rates of employment and earnings between 2016-17 and 2019-20 compared to outturn.

Figure 1.2: Growth rates of key economic determinants between 2016-17 and 2019-20, SFC

Determinant	Forecast (per cent)	Outturn (per cent) [1]	Difference (percentage points)
Employment	1.3	1.3	0.0
Average earnings	5.8	8.8	3.0
Total earnings	7.8	11.4	3.6

Source: Scottish Fiscal Commission.
[1] Outturn data as available at last forecast. Average earnings are equal to total earnings divided by employees, where employees are equal to total employment less self-employed
Figures may not sum because of rounding.

1.9 Our forecast of employment growth had no significant error. However, growth in earnings over the period was stronger than we expected in December 2018, and we underestimated growth in average earnings by 3.0 percentage points. If our forecast of earnings in December 2018 had matched the latest outturn, we estimate that our income tax forecast would have been £519 million higher at £12,203 million.

1.10 Figure 1.3 shows how errors in our December 2018 economy forecast contributed to our income tax forecast error. We know that if we had had a perfect economy forecast, our total income tax forecast would have been £519 million greater. Therefore, for us to have an overall error of only £149 million, other factors in our income tax model will have contributed to an offsetting error of -£370 million.

Figure 1.3 Disaggregation of 2019-20 Scottish income tax forecast error

£ million	
SFC December 2018	11,684
Economic forecast	519
Other	-370
Total error	*149*
HMRC Outturn July 2021	11,833

Source: Scottish Fiscal Commission (2018) Scotland’s Economic and Fiscal Forecasts – December 2018 (link), HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link).
Figures may not sum because of rounding

Other factors

1.11 The remaining £370 million of the error will have resulted from a number of unobservable factors including unexpected policy effects, individual behaviour changes, minor data and modelling issues, or unobservable changes in the income distribution over time. It is not possible to provide a detailed breakdown of this remaining error. However, a couple of possible factors are discussed below.

1.12 In the Scottish Budget 2019-20, the Scottish Government announced a policy to set the higher rate threshold at £43,430, the same as in 2018-19. At the time of our forecast we estimated this would raise around £72 million. Figure 1.4 compares our original 2019-20 policy costing from our December 2018 forecast, with the latest version of the costing from the January 2021 forecast.

Figure 1.4: Comparison of 2019-20 policy costing

Forecast	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	72	71	75	79	84
January 2021	69	68	71	74	77
Difference	-4	-3	-4	-5	-7

Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link).
Figures may not sum because of rounding

1.13 For the 2019-20 year, Figure 1.4 shows a difference of £4 million between our costings, contributing to a slight reduction in our total forecasts. We can never know for certain the exact effect on tax revenues of a change in tax policy. Outturn data only measures receipts under the existing policy and not under some alternative hypothetical policy. However, given the scale of the policy change, we do not believe that errors in our estimate of the policy costing, including behavioural responses, accounted for much of the overall forecast error.

1.14 Figure 1.5 compares our December 2018 forecast of 2019-20 on the breakdown of taxpayers by band, compared to the outturn data.

Figure 1.5: Comparison of number of taxpayers in 2019-20, December 2018 and outturn

Tax bands	SFC December 2018	Outturn	Error
Starter rate	257,100	249,800	-7,300
Basic rate	1,024,500	1,048,100	23,600
Intermediate rate	863,700	857,400	-6,300
Higher rate	351,200	355,400	4,200
Top rate	15,800	15,500	-300
All	2,512,200	2,526,100	13,900

Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link), Internal information provided by HMRC.
Figures may not sum because of rounding

1.15 Our number of taxpayers forecast in December 2018 was quite close in comparison to the outturn data. The largest difference is from the Basic rate taxpayers where we underestimated the number by 23,600. It is challenging to draw out firm conclusions from our number of taxpayers forecast, but it is a component of our forecast we are monitoring.

Our other forecasts of 2019-20

1.16 Figure 1.6 shows all of our forecasts of 2019-20 income tax revenues. Our December 2018 budget setting forecast is highlighted.

Figure 1.6: Summary of income tax forecasts of 2019-20

Forecast	Forecast (£ million)	Error (£ million)	Error (Relative %)
February 2018	12,647	-814	-6.4
May 2018	12,345	-512	-4.1
December 2018	11,684	149	1.3
May 2019	11,703	129	1.1
February 2020	11,677	156	1.3
January 2021	11,838	-6	0.0
Outturn – July 2021	11,833		

Source: Scottish Fiscal Commission, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link), Scottish Fiscal Commission (2018) Supplementary Publication Updated Income Tax Forecasts - February 2018 (link), Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link), Scottish Fiscal Commission (2019) Scotland's Economic and Fiscal Forecasts – May 2019 (link), Scottish Fiscal Commission (2019) Scotland's Economic and Fiscal Forecasts – February 2020 (link), Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts - January 2021 (link). Figures may not sum because of rounding.

1.17 Our February 2018 and May 2018 forecasts were made before historic income tax outturn data became available, and were instead based on a sample, the Survey of Personal Incomes (SPI), the best information available at the time. The use of the SPI data led to large errors in our early forecasts, which we discuss extensively in our previous forecast evaluation reports.[4]

1.18 In July 2018 HMRC published income tax outturn data for Scotland for the first time, covering 2016-17. Our December 2018 forecast of 2019-20 was based on these 2016-17 outturn data, the first time we had been able to use outturn data in our forecast. The reduction in our forecast error as a result of being able to use outturn data is apparent, with our absolute forecast error falling from 4.1 per cent to 1.3 per cent.

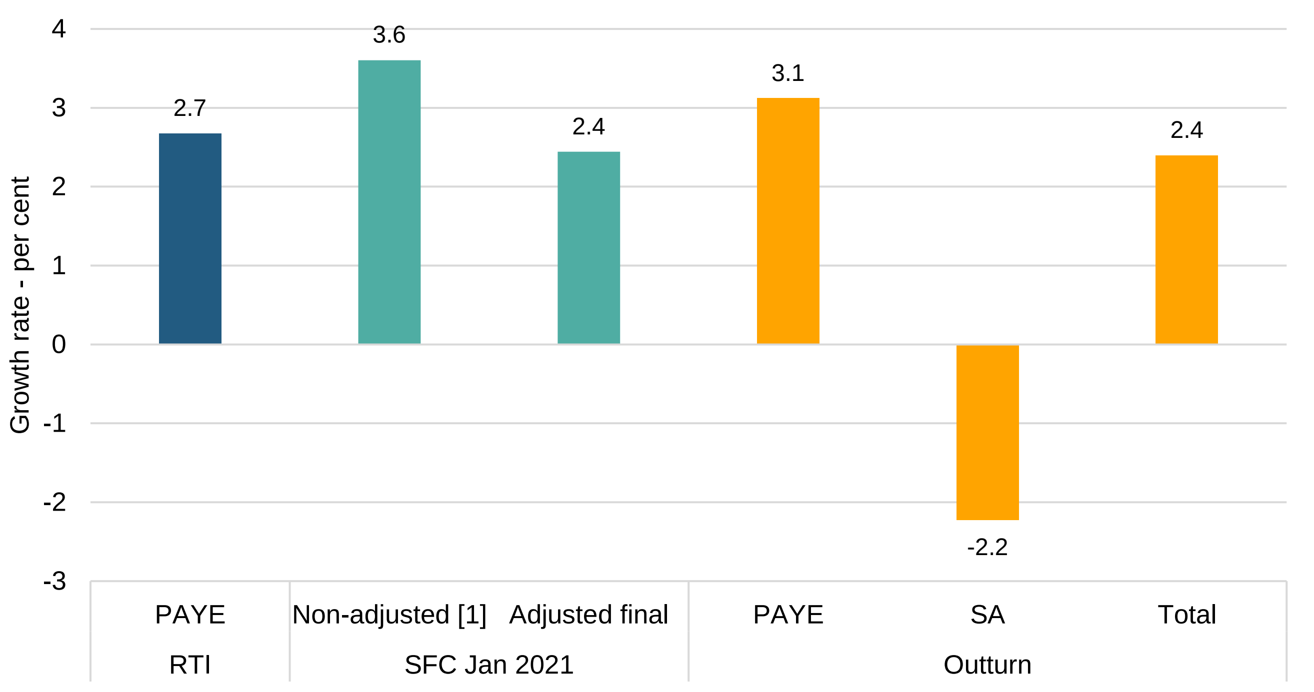
1.19 HMRC's Real Time Information (RTI) data is a timely but partial source of information on Scottish income tax revenues that has been in development over the last few years. In our January 2021 forecast, we used RTI information on Scottish income tax revenues as part of our forecasting process for the first time. This contributed to an exceptionally low forecast error of only -£6 million, or 0.0 per cent. However, even with the benefits of the RTI data, we should not expect such a low forecast error to be typical in the future

1.20 RTI income tax revenue data only cover the PAYE element of income tax, which accounts for around 90 per cent of all income tax revenue. However, RTI is not a perfect predictor of the final PAYE outturn figure, and it does not provide information on those paying income tax via self-assessment (SA) – mostly the self-employed and those earning more than £100 thousand per year. When using RTI data in our forecasts, we make the assumption that the income tax revenues paid via SA grow at the same rate as the income tax revenues paid via PAYE. There is no RTI available for SA records.

[4] Scottish Fiscal Commission (2018) Forecast Evaluation Report – September 2018 (link)

1.21 Figure 1.7 compares the growth rates of income tax revenue from RTI data, our forecasts and the outturn data for 2019-20.

Figure 1.7: Income tax revenue growth in 2019-20 from RTI, SFC Forecast and HMRC outturn



Source: Scottish Fiscal Commission, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link).
[1] Non-adjusted means that we haven't adjusted to account for the effects of the PAYE RTI data.

1.22 When we created our January 2021 forecast of income tax revenues in 2019-20, RTI data indicated that the PAYE element of income tax revenues was growing by 2.7 per cent. Our initial non-adjusted forecast suggested growth in total income tax revenues of 3.6 per cent. On the assumption that SA income tax revenues would grow at the same rate as PAYE, we adjusted our final forecast down to closely match the RTI data – settling on a growth rate of 2.4 per cent after some final adjustments.

1.23 Now that outturn data are available, we can see that both PAYE and SA diverged from the RTI data, with the outturn PAYE element stronger than RTI suggested, and SA income tax revenues actually falling in 2019-20. Fortunately for our forecast, these moved in offsetting directions, with total outturn very close to our forecast. If SA income tax revenues had grown more strongly, we could have had a significantly larger forecast error.

1.24 In conclusion, we think that using RTI data in our forecasting process did improve our forecasts, and we'll continue to use RTI as part of our forecasting process. However, the exceptionally low forecast error of £6 million is partly the result of a chance effect of underlying components of the forecast moving in offsetting directions. We shouldn't expect such low forecast errors to be typical when we are forecasting years for which RTI data are available.

Previous budget setting income tax forecast errors

1.25 Figure 1.8 shows the income tax forecast errors in each of the budget setting forecasts for which we now have outturn data. The February 2017 forecast was published by the Scottish Government, before the creation of the Scottish Fiscal Commission in its present, statutory form. For previous evaluation reports, we have adjusted the forecast errors to strip out the effect of not having had access to outturn data at the time the forecast was made.

Figure 1.8: Summary of budget setting forecast errors

Budget setting forecast	For Budget year	Error (£ million)	Error, adjusted for outturn (£ million)	Relative error, adjusted for outturn (%)
February 2017 (SG)	2017-18	-941	-121	-1.1
February 2018	2018-19	-621	-83	-0.7
December 2018	2019-20	149	149	1.3

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

1.26 Our headline forecast error of £149 million is substantially smaller than previous forecast errors because outturn data were not available when creating the previous forecasts.

1.27 When looking at previous errors adjusted for outturn, we can see that our latest forecast error is of broadly the same scale – albeit slightly greater. For the 2017-18 and 2018-19 budgets, the forecasts slightly overestimated Scottish income tax revenues, whereas in our latest forecasts we slightly underestimated Scottish income tax revenues.

1.28 Overall, budget setting income tax forecast errors, after adjusting for outturn, have consistently been around 1 per cent of total income tax revenues, with no clear bias for over or underestimating revenues. We believe this is a reasonable level of forecast error.

Conclusions

1.29 The Scottish Budget for 2019-20 was set using our income tax forecast published in December 2018 of £11,684 million. Compared to the 2019-20 outturn data of £11,833 million, our Budget setting forecast from December 2018 underestimated Scottish income tax revenues by £149 million, or 1.3 per cent. We believe this is a reasonable level of error. Further analysis shows that there are two offsetting errors – the economic forecast contributes a positive £519 million, and other unobservable factors such as policy costings contribute a negative £370 million.

1.30 It is probable that including RTI tax data in our last January 2021 forecast contributed to the 2019-20 forecast accuracy. The January 2021 forecast of 2019-20 was very closely aligned to the outturn data. Looking ahead we will continue to pay close attention to the outturn data and our decision to align to RTI tax data in January 2021.

Effect on the Scottish Budget

1.31 Income tax funding in the 2019-20 Scottish Budget was based on both our forecasts of Scottish income tax revenues and the corresponding Block Grant Adjustment (BGA), which is based on the OBR's forecast of income tax revenues in the rest of the UK. With the publication of outturn data for 2019-20, we have provisional values for 2019-20 Scottish income tax revenues and the income tax BGA. Differences between our forecasts of income tax revenues and outturn, and similarly differences between the OBR-based forecast of the BGA and the final BGA, will be corrected through reconciliations to the Scottish Budget for 2022-23. The calculation of the reconciliation based on the forecast errors is shown in Figure 1.9. Detailed information on how the Scottish Budget is set, and how reconciliations are calculated can be found on our website.[5]

Figure 1.9: 2019-20 Scottish income tax and BGA forecast errors and reconciliation

£ million	Scottish income tax	BGA	Reconciliation
Budget setting forecast	11,684	-11,501	
Provisional outturn	11,833	-11,685	
Forecast error	149	-184	-34

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding

1.32 Our headline budget setting income tax forecast error was an underestimate of £149 million, or put another way, funding from income tax revenues should have been £149 million higher in the original 2019-20 Budget. At the same time, the income tax BGA was underestimated by £184 million and so the downwards adjustment in funding for the Scottish Budget related to the income tax BGA should also have been £184 million higher. As the forecast errors were in the same direction, they partially offset each other. The combined effect of these forecast errors is a negative income tax reconciliation of -£34 million.

Income tax net effect on budget and reconciliations

1.33 Scottish income tax revenues are a source of funding for the Scottish Budget. The income tax BGA reduces funding in the Scottish Budget to reflect the devolution of income tax to Scotland. The net effect of income tax on the Scottish Budget is how the additional Scottish income tax revenues compare to the income tax BGA. In 2019-20, outturn income tax revenues were £11,833 million, and the income tax BGA was £11,685. Therefore, 2019-20 income tax has a positive net effect on the budget of £148 million, the difference between the two.

1.34 As well as just looking at the individual forecast errors of Scottish income tax and the BGA as in Figure 1.10, reconciliations can also be alternatively presented as the result of errors in the estimated net effect on budget when the budget is first set, based on forecasts of its two components. This is shown in Figure 1.11. When the Scottish Budget for 2019-20 was set, income tax revenues in 2019-20 were forecast to be £184 million greater than the BGA. The outturn data show this difference is smaller with income tax revenues only £148 million greater than the BGA. Therefore a reconciliation of - £34 million will be applied to the Scottish Budget for 2021-22 to account for this difference.

[5] Scottish Fiscal Commission (2020) Explainers – Fiscal Framework (link)

Figure 1.10: Errors in the net effect on budget and reconciliations

£ million	Scottish income tax	BGA	Net effect on budget
Budget setting forecasts	11,684	-11,501	182
Provisional outturn	11,833	-11,685	148
Reconciliation			-34

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding

Evaluating our forecasts of income tax reconciliations

1.35 After the Budget has been set but before the publication of outturn data, we provide estimates of income tax reconciliations based on our latest income tax forecasts and the latest BGAs. Figures 1.11 and 1.12 show how estimates of the income tax reconciliation for 2019-20 have developed over time.

1.36 Figure 1.11 shows forecasts and outturn of Scottish income tax revenue and the income tax BGA for 2019-20. The orange bars in Figure 1.12 show the income tax net position – the difference between income tax revenues and the BGA. For example, in the original budget setting forecasts, Scottish income tax revenues in 2019-20 were forecast to be £11,684 million, compared to a BGA of £11,501 million, with a net position of £182 million.

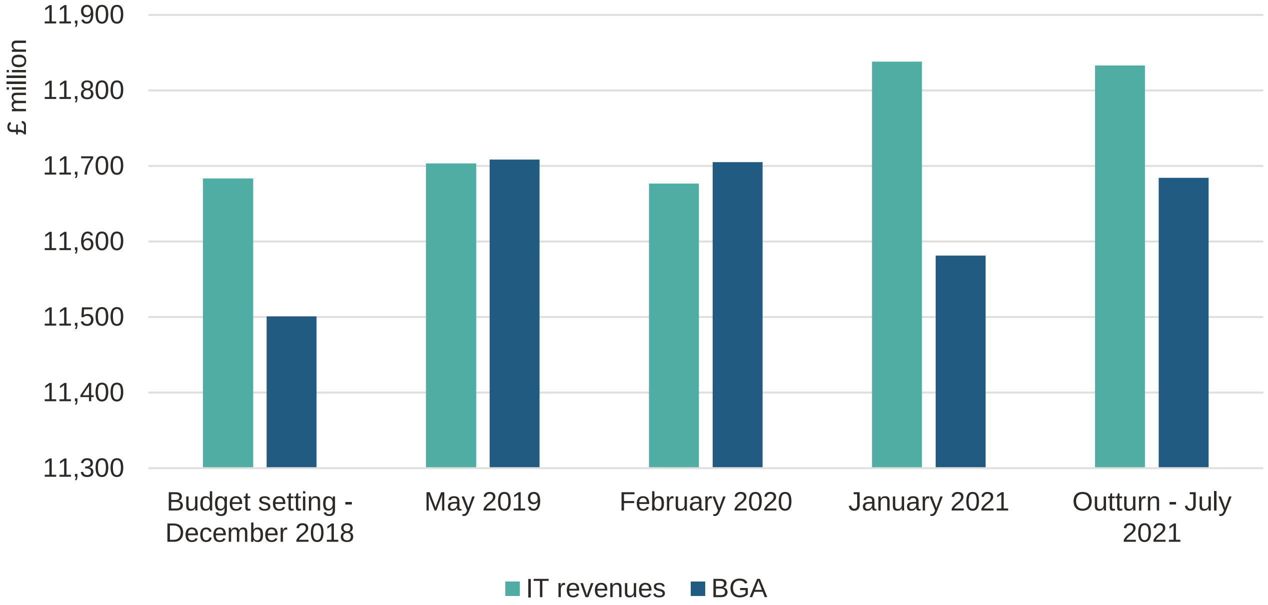
1.37 The purple bars in Figure 1.12 show the interim estimated and final reconciliation, which can also be thought of as estimated changes in the net position since the original budget setting forecast.

1.38 In May 2019 we published our first interim estimate of a reconciliation for 2019-20 of -£188 million. As can be seen in Figure 1.11, this was primarily the result of a significant upward revision in the OBR's forecasts which fed into the BGA, while our forecast of Scottish income tax revenues was relatively unchanged.

1.39 In January 2021, we significantly revised up our forecasts of Scottish income tax revenues. The BGA was revised down as compared to the previous forecast in February 2020, but was still slightly higher than in the original budget setting forecast. All together this led to a higher estimated net budget position in February 2020 and an estimated positive reconciliation.

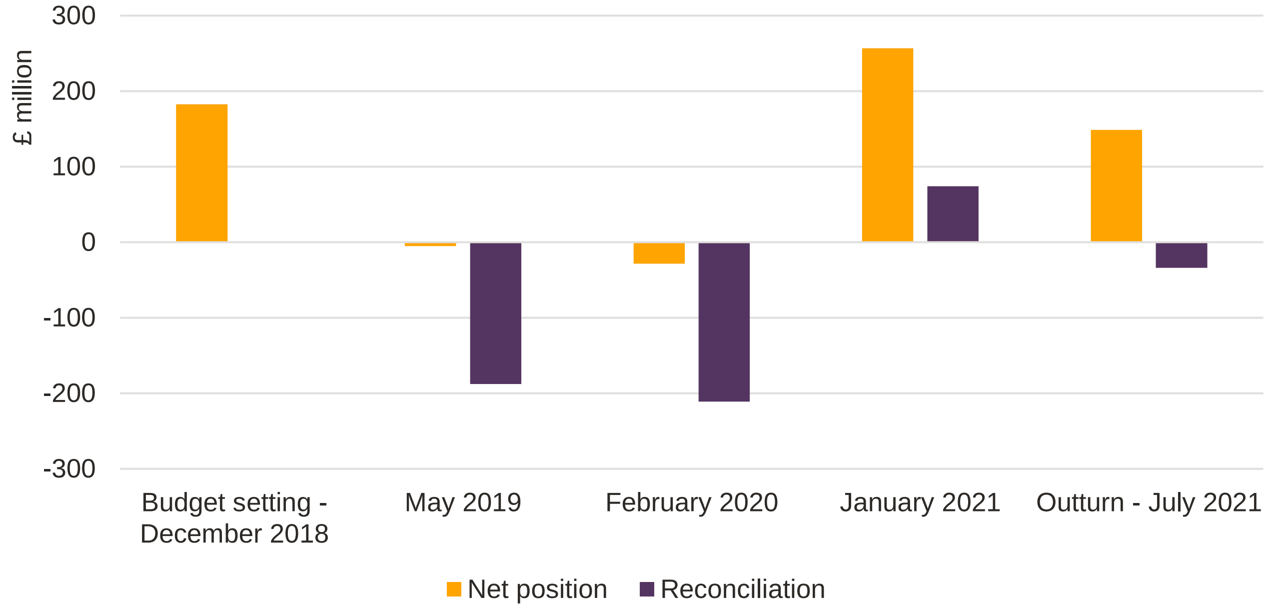
1.40 Compared to outturn data, our January 2021 Scottish income tax revenue forecast was remarkably close to the outturn data. However, the BGA was higher than expected, leading to a lower net position than expected in January 2021 and lower than in the original budget setting forecasts.

Figure 1.11: Forecasts of 2019-20 SFC Scottish income tax revenues and the BGA



Source: Scottish Fiscal Commission, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link). Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link), Scottish Fiscal Commission (2019) Scotland's Economic and Fiscal Forecasts – May 2019 (link), Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts - January 2021 (link).

Figure 1.12: Estimates of income tax reconciliations for 2019-20 at previous forecasts



Source: Scottish Fiscal Commission, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link). Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link), Scottish Fiscal Commission (2019) Scotland's Economic and Fiscal Forecasts – May 2019 (link), Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts - January 2021 (link).

Chapter 2
Non-Domestic Rates

2.1 In this chapter we evaluate our forecast of NDR revenue in 2020-21 which was published on 6 February 2020, a month before the COVID-19 pandemic was declared.

Figure 2.1: Headline evaluation – NDR February 2020 forecast of 2020-21

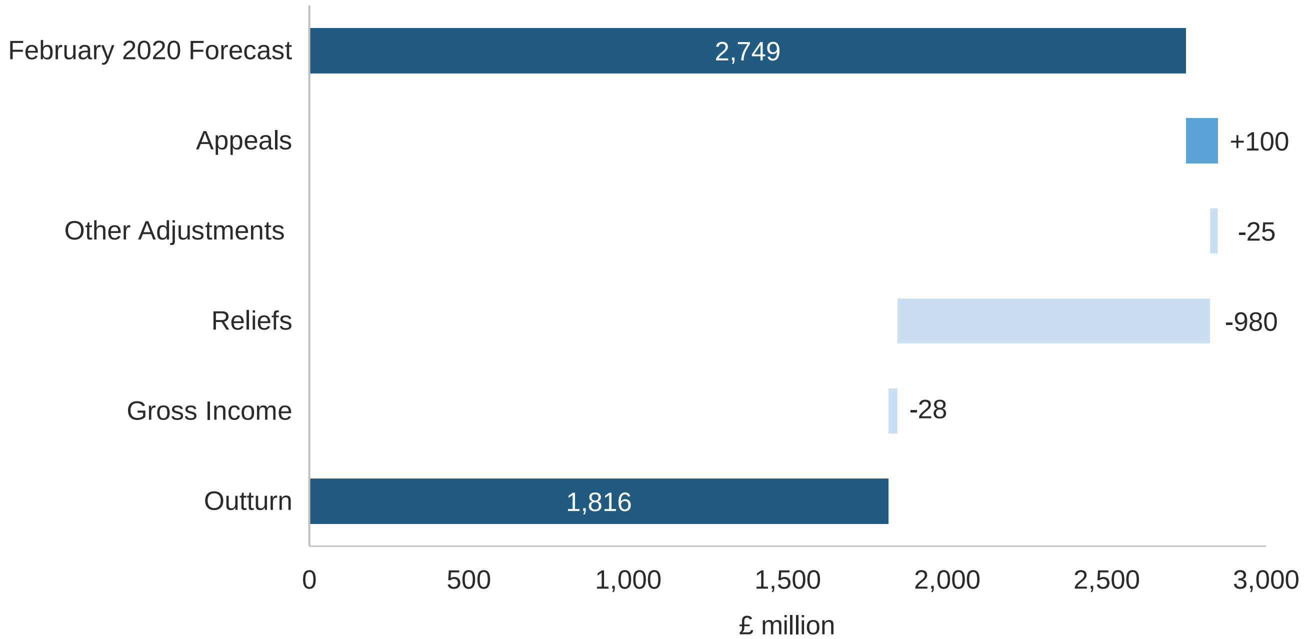
	Forecast (£ million)	Outturn [1] (£ million)	Error (£ million)	Relative Error (%)
	2,749	1,816	-933	-34
OBR average absolute error [2]				
				2

Source: Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), Scottish Government (2021) Non-domestic rates income statistics (link), OBR (2021) Historical official forecasts database (link).
Figures may not sum because of rounding.
[1] The outturn figure may change once the final audited figures are available. The average annual difference between provisional outturn and final audited figures between 2010-11 and 2019-20 was £2.0 million.
[2] The OBR average is based on the average one-year ahead forecast error over the period 2010-11 to 2019-20.

2.2 NDR revenue for 2020-21 was £1,816 million which is £933 million or 34 per cent lower than our February 2020 forecast of £2,749 million. This is considerably larger than both the average one-year-ahead error of 1 per cent from our previous forecasts, and the OBR's average one-year-ahead absolute forecast error of 2 per cent for UK-wide NDR. The main reason for this large forecast error is that NDR revenues were affected by significant policy changes in response to the COVID-19 pandemic. Our forecasts were finalised in February 2020, before these policies were announced.

Understanding our forecast error

Figure 2.2: Decomposition of February 2020 NDR forecast error for 2020-21



Source: Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), Scottish Government (2021) Non-domestic rates income statistics (link).
Figures may not sum because of rounding.

2.3 The largest source of error was our forecast of reliefs, where unanticipated policy changes in response to COVID-19 had a very large effect on NDR revenues. We published our forecast in February 2020. On 18 March 2020, the Scottish Government announced support for businesses in response to the pandemic, including two new reliefs for NDR. The first reduced the gross tax bill for all properties in Scotland by 1.6 per cent, and the second provided 100 per cent relief for retail, hospitality, leisure and aviation (RHLA). The outturn data indicate that the amounts of revenue foregone by providing these reliefs were £60 million and £928 million, respectively.[6] Because these policy changes were not announced at the time, we couldn't have included them in our forecast. This contributed -£988 million to our forecast error for reliefs. Small errors in the forecast of other reliefs offset this by £8 million, giving a total error of -£980 million for reliefs.

2.4 Our forecast of appeals losses overestimated the amount of revenue that would be lost to appeals. In February 2020 we had estimated that £222 million would be lost to appeals in 2020-21 but the outturn data show that only £122 million was lost. Public health restrictions affected the ability of Valuation Appeals Committees to meet, so fewer appeals were resolved than would normally be expected. As the committees return to normal operation, more appeals will be resolved and we expect that lower losses in 2020-21 will be offset by higher losses in future years.

2.5 Our -£28 million error for gross income was not large in relative terms, about -0.7 per cent of forecast gross income. However, the fact that there were lower appeals losses than we forecast should have increased gross income, relative to our forecast. Outturn gross income coming in lower than forecast indicates that there were few net additions to the valuation roll in 2020-21. At this stage it is not clear to what extent this represents a real decline in the number of new properties or simply a delay in new and altered properties being finished and ready for occupation because of public health restrictions.

2.6 The error of -£25 million relating to 'other adjustments' can be largely attributed to the figures for write-offs and bad debts being higher than forecast, by £13 million and £7 million respectively. The figures for both factors are noticeably higher than in previous years, some of which may be attributable to the effects of the pandemic. This could relate to an increase in debts that will not be paid and an increase in the provision for write-offs of bad and doubtful debts made by local authorities where payments are overdue.

Box 2.1: Non-Domestic Rating Account

The Commission forecasts the contributable amount of NDR, which can be described as the amount collected by local authorities that subsequently flows to the Scottish Government. The contributable amount is pooled at a national level, before being redistributed by the Scottish Government as part of the local government finance settlement. The amount of NDR income redistributed to local authorities is known as the distributable amount.

In February 2020, we provided an illustrative projection of the balance of the Non-Domestic Rating Account in 2020-21 based on our forecast of the contributable amount, and the distributable amount

[6] The notified returns show £941 million of RHLA relief was applied but we estimate that £23 million of this was displaced from other reliefs, such as Empty Property Relief and SBBS, as eligible ratepayers were automatically awarded RHLA relief, whereas they would have need to apply for these other reliefs.

that had been set by the Scottish Government. Figure 2.3 shows the difference between our projection and the final balance of the rating account, also known as the pool.[7]

Figure 2.3: Balance of the Non-Domestic Rating Account in 2020-21

£ million	SFC illustrative projection	Outturn	Difference
Provisional contributable amount (A)	2,749	1,916	-833
Net effect of prior year adjustments (B)	-84	-137	-53
Distributable amount (C)	2,790	1,868	-922
Annual balance (D) (A + B - C)	-125	-89	36
Cumulative balance (E) (E from year before + D)	-100	-64	36

Source: Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), Scottish Government (2020) Scottish Budget 2020-21 (link).
Figures may not sum because of rounding.

The balance of the pool is affected by several factors, not just our forecast accuracy. Contributions to the pool are determined by local authorities' own estimates of collections for the year ahead, which are submitted to the Scottish Government shortly after the start of the financial year. The final audited NDR figure only becomes available after the end of the financial year.

Our forecast of the contributable amount was very different to the amount reported by local authorities, as they submitted their returns after the COVID policy changes were announced. However, this did not affect the pool balance as the Scottish Government changed the distributable amount based on our subsequent forecast of the contributable amount, following the policy change and COVID-19 consequentials from the UK Government.[8]

The revised distributable amount was set lower than the contributable amount subsequently estimated by local authorities. Despite this, the balance of the pool was negative because of a large negative prior year adjustment. This arises because, for 2019-20, the provisional contributable amount submitted by local authorities was £137 million higher than the final audited NDR figure. The 2020-21 audited figure is not yet available but the notified figure of £1,816 million is £100 million lower than the contributable amount reported by local authorities in 2020-21, suggesting there may be another large prior year adjustment affecting the pool balance in 2021-22. An updated illustrative projection of the pool balance in 2021-22 can be found in our latest SEFF.[9]

Conclusions

2.7 The COVID-19 pandemic had a significant effect on NDR revenues in 2020-21. The main influence came from the two new reliefs that were introduced. Restrictions put in place to mitigate the effects of the pandemic also had an effect, causing delays in the appeals process. The size and unique nature of these effects means it is difficult to draw conclusions from our 2020-21 forecast error.

2.8 The policy change and the effects on the administration of the tax also make it more difficult to draw conclusions from the data and this may make future forecasts more uncertain. As noted previously,

[7] The provisional balance is based on the most recent figures. The audited pool balance is usually published in late September.
[8] Scottish Fiscal Commission (2020) Fiscal Update – April 2020 (link)
[9] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021(link)

there were few net additions to the valuation roll in 2020-21. It is hard to determine to what extent this will be a temporary effect or whether it might indicate a longer-term trend towards fewer commercial properties. Another example is the lower levels of certain reliefs awarded in 2020-21, assumed to be a result of eligible properties being awarded RHLA relief instead. We assume this will be reversed when the RHLA relief ends but the displacement from other reliefs to RHLA relief could be masking trends in other reliefs. For example, we might have expected to see an increase in empty property relief where businesses were forced to close due to the economic conditions created by the pandemic. So far this has not appeared in the data but it is possible that some affected businesses will continue to occupy their property while claiming RHLA relief and only vacate the property once this comes to an end.

Additional information

Abbreviations

BGA	Block Grant Adjustment
BGAc	Business Growth Accelerator
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
MCC	Material Change of Circumstances
NSND	Non-Savings Non-Dividends
OBR	Office for Budget Responsibility
RHLA	Retail, Hospitality, Leisure and Aviation relief
SEFF	Scotland's Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission

A full glossary of terms is available on our website:

https://www.fiscalcommission.scot/explainers/glossary/

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The Commission is committed to fulfilling our role as an Independent Fiscal Institution, in line with the principles set out by the Organisation for Economic Cooperation and Development (OECD).[10]

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Correspondence and enquiries

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All charts and tables in this publication have also been made available in spreadsheet form on our website. For technical enquiries about the analysis and data presented in this paper, please contact the responsible analyst:

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[10] OECD (2014) Recommendation on Principles for Independent Fiscal Institutions (link)
[11] Scottish Fiscal Commission (2018) Compliance with the Code of Practice for Official Statistics (link)

This publication is available at www.fiscalcommission.scot

ISBN: 978-1-911637-40-0

Published by the Scottish Fiscal Commission, August 2021