FINANCE COMMITTEE

AGENDA

30th Meeting, 2015 (Session 4)

Wednesday 25 November 2015

The Committee will meet at 9.30 am in the Mary Fairfax Somerville Room (CR2).

1. **Decision on taking business in private:** The Committee will decide whether to take item 4 in private.

2. **Devolved Taxes:** The Committee will take evidence from—
   
   Kennedy Foster, Policy Consultant, Council of Mortgage Lenders;
   
   Philip Hogg, Chief Executive, Homes for Scotland;
   
   Chris Stewart, Chairman, Scottish Property Federation;

   and then from—
   
   Lady Susan Rice C.B.E, Chair, Professor Andrew Hughes Hallett, and Professor Campbell Leith, Scottish Fiscal Commission.

3. **Scottish Fiscal Commission Bill:** The Committee will take evidence on the Bill at Stage 1 from—

   Lady Susan Rice C.B.E, Chair, Professor Andrew Hughes Hallett, and Professor Campbell Leith, Scottish Fiscal Commission.

4. **Private Housing (Tenancies) (Scotland) Bill:** The Committee will consider a draft report on the Financial Memorandum to the Infrastructure and Capital Investment Committee.
The papers for this meeting are as follows—

**Agenda Item 2**
Devolved Taxes paper  
FI/S4/15/30/1

**Agenda Item 3**
SFC Bill paper  
FI/S4/15/30/2

**Agenda Item 4**
PRIVATE PAPER  
FI/S4/15/30/3 (P)
Finance Committee

30th Meeting, 2015 (Session 4), Wednesday 25 November 2015

Devolved Taxes

1. Following the Scotland Act 2012, the Land and Buildings Transaction Tax (LBTT) replaced UK Stamp Duty Land Tax in Scotland with effect from 1 April 2015. The Committee’s call for evidence on LBTT along with all written submissions received is available on line.

2. At this meeting the Committee will take oral evidence on the LBTT from a panel comprising—
   
   - Kennedy Foster, Council of Mortgage Lenders;
   - Philip Hogg, Homes for Scotland; and
   - Chris Stewart, Scottish Property Federation.

3. This will be followed by oral evidence from the Scottish Fiscal Commission—
   
   - Lady Susan Rice C.B.E;
   - Professor Andrew Hughes Hallett; and
   - Professor Campbell Leith.

4. Written submissions from both sets of witnesses can be found at Annex A. The Committee’s budget adviser has produced a summary of all written evidence received and this is attached at Annex B. A SPICE briefing is also attached at Annex C.

Alexandra Balcan,
Committee Assistant
ABOUT HOMES FOR SCOTLAND

Homes for Scotland is the voice of the home building industry.

With a membership of some 200 organisations together providing 95% of new homes built for sale in Scotland each year as well as a significant proportion of affordable housing, we are committed to improving the quality of living in Scotland by providing this and future generations with warm, sustainable homes in places people want to live.

Visit www.homesforscotland.com for further information and follow us on twitter @H_F_S

Submission from Homes for Scotland

Homes for Scotland (HFS) welcome the opportunity to provide the Finance Committee with evidence regarding the impact of the introduction of Land and Buildings Transaction Tax.

This response draws on evidence provided by some of our member companies, including home builders and other organisations with an interest in the operation of the housing market in Scotland. It is focused on the impact of LBTT on the residential market.

Impact of the Rates and Bands

Feedback from members suggests that the impact of the new rates and bands has varied in different locations and markets.

On a positive note, it was suggested that the changes have given a small benefit to the majority of people purchasing a new home, although not one that is sufficiently significant to influence their decision as to whether or not to buy. It was also highlighted that the changes have allowed for a smoother pattern of prices in the market, instead of having an artificial step at the £250,000 mark as was previously the case.

Set against this early indications are that the revised rates are having an adverse effect on the sale of properties in the middle to higher end of the residential new build market, where activity has diminished. This may particularly be the case for properties with a value above £500,000.
Anecdotal evidence was reported that potential buyers of properties in higher bands are deferring the decision to move because of the additional sums payable under LBTT compared to SDLT. If homeowners opt to stay rather than move to a new home due to concerns over cost, it would have implications over time for other parts of the market. To ensure a healthy and well functioning housing market, it is essential that the LBTT framework allows scope for movement up and down price levels without any artificial barriers.

In terms of the commercial market, a concern was expressed that the changes may make Scotland less attractive than other places for those looking to invest in residential property.

**Impact of Changes on the Timing of Transactions**

Members reported that in the period leading up to the introduction of LBTT some customers either requested that their transactions be brought forward to before April or delayed until after introduction of LBTT, depending on the tax implications. Given the nature of the home building process, requests to bring forward purchases could not always be accommodated.

In relation to the timing of transactions, one company noted that for their business:

- the proportion of transactions with a value of more than £333k was 12.7% in Q1 2015, compared to 4.9% in the same period in 2014.
- The average selling price in Q1 2015 was 13.4% higher than in the comparable period in 2014.
- The average selling price of homes in Q2 2015 was 9.5% lower than Q1 2015. In 2014, the drop between Q1 and Q2 was 3%.
- 16.9% of all transactions in Q1 2015 were below the £145,000 starting point for LBTT, compared to 28.4% in 2014.

**The Need for Changes to the Rates and Bands**

In previous responses, Homes for Scotland expressed concern that the arrangements for LBTT would place a disproportionate burden on mid to higher value purchases. Our view was this could impact on growing families and aspirational movers, resulting in them deciding not to move and leaving others unable to progress onto or up the housing ladder. Buyers at this level remain constrained by the total funds available to meet the costs of purchase, including LBTT.
It is too early to offer a definitive view as to the impact of the introduction of LBTT on the new build market. Based on evidence received, we remain concerned however about the potential impact of the arrangements on the sale of mid to higher value homes and, consequently, the functioning of the wider housing market. We would therefore call for the impact of the new arrangements to be reviewed, taking account of market impact, in order to determine the need for e.g. a more stepped approach above £325,000.

With regard to this, it was noted that whilst in Scotland the 5% band applies between £250,000 and £325,000, it applies between £250k and £925k in the rest of the UK.

Another member noted that their forecasts for the year suggested that LBTT generated from the sale of their properties above £325,000 would equate to over 91% of the expected total. In terms of the impact on the public purse, this demonstrates the importance of maintaining a buoyant sales rate at all levels of the market.

**Role of Revenue Scotland**

One member highlighted their understanding that the changeover from SDLT to LBTT had been quite smooth and that the online system works well.

Concern was however expressed about the approachability of Revenue Scotland, in particular with regard to the organisation’s willingness to discuss its approach regarding complex or unclear LBTT issues on an informal basis. It was also suggested that the formal opinion process has been quite slow, which does not assist when an answer or e.g. informal guidance is required quickly.

Finally, it was noted that Revenue Scotland will not necessarily follow the HMRC guidance, which has been built up over a period of years, even where the statutory provisions within LBTT and SDLT are effectively identical. We understand that this can cause great uncertainty, particularly in the absence of informal routes of enquiry.
Call for evidence: The Land and Buildings Transaction Tax (LBTT)

Finance Committee

Submission from Council of Mortgage Lenders

Introduction

1. The Council of Mortgage Lenders (CML) is the representative trade association for mortgage lenders. Our 132 members comprise banks, building societies, insurance companies and other specialist mortgage lenders who, together, lend around 95% of the residential mortgages in the UK. In addition, the CML’s members have lent over £60 billion UK-wide for new-build, repair and improvement to social housing of which just under £4 billion is in Scotland.

2. We welcome the opportunity to respond to call from evidence from Scottish Parliament Finance Committee on the operation of LBTT from 1 April 2015.

The impact on both the residential and commercial property market of the various rates and bands

3. We are not involved in the commercial property market and cannot comment upon that. The data which we have for residential mortgage lending in Scotland in the quarter to 30 June 2015 shows that 16,700 loans for house purchase were granted with a total value of £2.13 bn. This represented a 39.2% increase in the number of loans and 27.5% in value on the first quarter of 2015. The number of loans increased by 3.1% on the corresponding quarter of 2014 and in value by 4.4%. Within these figures there were 8,000 first time buyer loans an increase of 50.9% and 5.3% on the first quarter of 2015. While these figures are positive they could have benefited from an element of transactions being held back where the LBTT rate was lower than Stamp Duty Land Tax (SDLT). It is also the case that purchasers could have been taking advantage of competitive deals in the mortgage market. We believe it will be some time yet before the full impact of LBTT on the residential property market is understood but the first quarter following the introduction of LBTT appears to have been a positive one for the residential property market in terms of mortgage lending.

The level of receipts for residential and non-residential transactions in relation to the forecasts

4. We have no knowledge in this regard and would suspect that the Scottish Government/Revenue Scotland is best placed to provide evidence on this.
The extent to which higher paid transactions were brought forward to avoid the higher rates

5. Estate agents and Solicitors who are directly involved in the sale and purchase of residential property are probably best placed to comment upon this but we have heard anecdotal evidence that this was the case and it would not be surprising as when changes in SDLT were previously announced well in advance they caused short term distortions in the level of transactions in the housing market.

The extent to which lower-priced transactions were delayed until after 1 April

6. Our comments in 5. above equally apply.

Whether there should be any changes to the rates and bands for residential transactions in the draft budget for 2016-17

Before commenting upon this we believe the full impact of LBTT needs to be better understood and whether it will have a long term adverse impact on the higher end of the residential property market where purchasers are paying more than they did under SDLT.

The performance of Revenue Scotland in administering and collecting the tax

7. Our members are not directly involved in the payment of LBTT and that is usually arranged by the Solicitor acting for the purchaser. We have not heard any “noise” of issues in the collection and administration of LBTT and in many ways it would be surprising if there was as fundamentally the system has not changed with Registers of Scotland acting as agent for collection for LBTT on behalf of Revenue Scotland in the same way as they did previously for HMRC in respect of SDLT.

Further contact

8. This response has been prepared by the CML in conjunction with its members. Any comments or enquiries should, in the first place, be directed to:

Kennedy C Foster

1 October 2015
Introduction

1. We are pleased to respond to this call for evidence on the impact of LBTT rates and thresholds on the Scottish property markets. Our key points are bullet pointed below but in general we would make the point that the fact that there has been an impact should not be a surprise – this is always likely with a radical change in tax structure, policy and rates. And as the new tax system for property transactions beds in there will be a growing familiarity with the system.

Our key points therefore are:

- In the residential sector the main impact has been in the market above £400,000 where a significant reduction in transactions has occurred.
- In particular, transactions of residential properties above £750,000 have reduced markedly.
- The commercial sector has not seen this level of impact, due to a closer alignment to the previous tax regime as well as a rising market.
- LBTT revenues are reduced compared to the previous year’s SDLT revenue. The commercial LBTT revenue is only slightly below its expected performance for this time of the tax year but the residential revenue is significantly reduced.
- We believe that the rates in the intensely competitive commercial sector should either remain the same or be re-aligned to be the same as the UK SDLT top rate for the sector.
- The key proposal we have to support the residential market and to revive Scottish Government LBTT revenue is to increase the 5% rate threshold to £500,000 and to abolish the 12% rate which we believe is making little positive contribution to LBTT revenues.

The impact on both the residential and commercial property market of the various rates and bands

2. The introduction of the progressive approach to LBTT as opposed to the previous SDLT ‘slab tax’, since of course reformed for residential property transactions, has been welcome for the residential property market in particular. There is no longer a distortion in the market at £250,000. However, we will discuss later that
we feel this distortion has been replaced by a new distortion at the point where a 10% rate begins to be applied to a property transaction.

**Commercial**

3. In the commercial property market the move to a progressive rate of taxation with a less radical change in rates and thresholds has acted to make the change in tax structure less marked and this appears to have contributed to a smoother conversion from SDLT to LBTT, supported by enhanced revenue for the Scottish Government in line with the strengthening wider economy. The rising level of economic activity has also of course helped to influence this outturn. The quarters below are based on calendar quarters and not the public finance year – therefore Q1 is January to March 2015 and not April to June as it would be for the public sector financial year.

![Scottish Commercial Property Sales Q3 2013 - Q2 2015](image)

**Residential**

4. The major market impact has therefore clearly been in the residential property sector at the higher value end. We will see later how this has impacted upon the LBTT revenue anticipated by the Scottish Government. One telling statistic is that despite an overall increase in house prices recorded by Registers of Scotland during April to June 2015\(^\text{ii}\), in 11 out of 32 local authority areas house prices actually fell during this period. These areas included Aberdeen, Aberdeenshire, City of Edinburgh Council and East Renfrewshire -all areas that would previously supply a significant level of SDLT revenue via mid to higher market value transactions, perhaps particularly in the £500,000 to £1mn range and especially above £750,000 where property experts Savills\(^\text{iii}\) reported a 31% drop in activity in their recent Scotland’s residential Property market report (see table 1).
5. However, overall residential transaction numbers are up and this is reported by both reties and Savills.

<table>
<thead>
<tr>
<th>Prime market retreats under LBTT (April – July 2015)</th>
</tr>
</thead>
<tbody>
<tr>
<td>£400K-750K</td>
</tr>
<tr>
<td>Of which £750K-£1mn</td>
</tr>
<tr>
<td>Of which £1mn+</td>
</tr>
</tbody>
</table>

*Employment mobility*

6. The impact of the higher rates on residential values at a relatively low threshold is also having a circuitous effect upon the property market with fewer high value properties coming onto the market meaning there is less potential revenue. Our members have also raised a wider impact upon the Scottish economy. High rates and lack of available accommodation at the £325,000 plus level causes issues for labour mobility within Scotland, never mind attracting appropriate labour skills and experience to Scotland from other parts of the UK. In time this will have a deleterious effect on the attractiveness of Scottish employment and will undermine the competitiveness of the wider Scottish economy.

*The level of receipts for residential and non-residential transactions in relation to the forecasts*

7. A clear differential has emerged between the commercial and residential property markets in relation to the receipts thus far raised from the new LBTT rates and thresholds. The commercial sector is performing close to the level of anticipated receipts for this time of the year at £71mn. By contrast the residential sector has seen increased activity overall but a relative lack of receipts thus far (£77mn) compared to forecasted expectations.

8. The Scottish Government planned on receiving some £381mn from LBTT in its first year - £235mn from residential and £146mn from commercial property. To date it has received £148mn (up to end August 2015, five months into the year). With only one or two months left before the traditionally quiet residential transaction period over Winter, the concern is that the residential sector will significantly undershoot the Scottish Government’s tax receipt forecast for the sector. This may be offset to some extent by a traditionally strong final (calendar) quarter for commercial property transactions.

*Commercial and Residential SDLT/LBTT Receipts – 2013 to August 2015*
The extent to which higher priced transactions where brought forward to avoid the higher rates

Residential

9. There is substantive evidence that a number of higher value residential property transactions were brought forward in order to avoid the significantly higher rates introduced for higher value residential properties under LBTT. This will have distorted the figures for final year SDLT (at the cost of LBTT receipts). For example Rettie & Co reported in July that there had been a significant ‘front-loading’ of the residential property market in the £500,000 and above sector in Edinburgh. In fact retie reported a 266% increase in the number of properties listed in the £500-750,000 sector in January 2015.

Commercial

10. There was less of an issue in the commercial market because of the smoother transition between the tax rates and thresholds. However, as noted earlier, pricing in the commercial property market is reported to have adjusted to take account of the change in tax rates and structure. We believe that the key higher rate for commercial property should not be increased any further and ideally should remove any negative differential with the rest of the UK by re-aligning to the UK rate. There is already a reported negative comparison between commercial yields for comparable properties between Scotland the rest of the UK. Tax is only a part of that equation but nonetheless we would not wish to see any further negative comparison between investment property in Scotland and the rest of the UK.
The extent to which lower-priced transactions were delayed until after 1 April

11. Evidence is less clear cut that lower priced transactions were delayed until after the introduction of LBTT. If anything there appears to be a continued level of economic activity across the changeover. We expect that the impact of support schemes such as Help to Buy were more of an influence on lower level transactions than the change in tax regime.

Whether there should be any changes to the rates and bands for residential transactions in the draft budget for 2016-17

12. If the current distortions in the residential property market are to be resolved then we would argue that major changes to thresholds are essential for 2016-17. The 5% threshold needs to be radically increased to £500,000 at least. We believe the higher rates at £750,000 would also benefit from being scrapped. The tax is achieving little revenue whereas under SDLT it was raising several millions. We see little benefit to the Scottish exchequer from a tax rate that brings in no revenue.

The performance of Revenue Scotland in administering and collecting the tax

13. The tax appears to be performing well in terms of collection at this point with the low revenue on the residential side due in our view to rate and threshold policy rather than lack of collection. However, there are some concerns that have been referred to us by members. First, there is a feeling that the guidance and administrative support side Revenue Scotland remains weak at this stage. Members report that if they make detailed enquiries seeking to identify the correct course of action for their client then they find it difficult to obtain the necessary direction from RS. Furthermore, members feel restricted in being able to voice criticism because they need to have an on-going relationship with RS in order to serve their clients' interests.

14. There remains a further concern that Revenue Scotland and are underestimating the scope of commercial lease events which may become an issue for them in three years’ time at the point of the reassessment. With so many lease events per year this will not be a small task and yet there is little evidence of preparation for the task of ensuring taxpayers are aware of their liabilities. We feel it would be wrong for Revenue Scotland – who are the only body that will have the requisite data – to simply allow taxpayers to fall into the trap of tax penalty charges.

i SPF Quarterly Commercial property Sales report, figures extrapolated from the Registers of Scotland, August 2015
ii Quarterly Housing Statistics, Registers of Scotland, July 2015
iii Scotland’s Residential Property market, Savills, Autumn 2015
iv Sources – HMRC UK Stamp Taxes publication, 30 September 2015 and Revenue Scotland, monthly LBTT revenue statistics
v Market briefing, Rettie & co. summer2015
Dear Convener

Thank you again for your letter of August 27th, 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 £)

<table>
<thead>
<tr>
<th></th>
<th>Total LBTT</th>
<th>Residential</th>
<th>Non-residential</th>
<th>Landfill</th>
</tr>
</thead>
<tbody>
<tr>
<td>SG, Forecast Oct 2014</td>
<td>441</td>
<td>295</td>
<td>146</td>
<td>117</td>
</tr>
<tr>
<td>SG, Forecast Jan 2015</td>
<td>381</td>
<td>235</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>SG, Forestalling Forecast, Jan 2015</td>
<td>-</td>
<td>12-37</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Outturn Data to Date</td>
<td>96.2 (Apr-Sept)</td>
<td>86.6 (Apr-Sept)</td>
<td>37.4 (Q1)</td>
<td></td>
</tr>
<tr>
<td>Outturn Data Annualised (est.)</td>
<td>215.5 (min. forestalling)</td>
<td>247.4 (max. forestalling)</td>
<td>173.2</td>
<td>156 (24% SA) 170 (22% SA)</td>
</tr>
<tr>
<td>Estimated Annualised Forecast Error</td>
<td>19.5 (min. forestalling)</td>
<td>-12.4 (max. forestalling)</td>
<td>-27.2</td>
<td>-38 (24% SA) -53 (22% SA)</td>
</tr>
</tbody>
</table>
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.1 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.

1 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
Inquiry into the Land and Buildings Transaction Tax

Summary of evidence submitted

1. In preparation for its scrutiny of the Draft Budget for 2016-17, the Finance Committee issued a call for evidence on the operation so far of LBTT and asked whether there should be changes to rates and bands for the forthcoming Draft Budget. Thirteen responses were received and these are summarised below in sections based on the questions asked by the Committee. Few of the respondents addressed all the questions and Audit Scotland indicated that they were preparing a report for the Auditor General on the implementation and management of financial powers, including LBTT, by the Scottish Government and Revenue Scotland. They would welcome the opportunity to provide evidence to the Committee at the time of publication in December. To put the responses in context, I first set out the rates and bands for LBTT and some statistics on receipts so far and on the property market.

2. LBTT rates and bands for 2015-16

Residential transactions

<table>
<thead>
<tr>
<th>Purchase price</th>
<th>LBTT rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to £145,000</td>
<td>0%</td>
</tr>
<tr>
<td>Above £145,000 to £250,000</td>
<td>2%</td>
</tr>
<tr>
<td>Above £250,000 to £325,000</td>
<td>5%</td>
</tr>
<tr>
<td>Above £325,000 to £750,000</td>
<td>10%</td>
</tr>
<tr>
<td>Over £750,000</td>
<td>12%</td>
</tr>
</tbody>
</table>

1 Tables from the Revenue Scotland website
Non-residential transactions

<table>
<thead>
<tr>
<th>Purchase price</th>
<th>LBT rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to £150,000</td>
<td>0%</td>
</tr>
<tr>
<td>Above £150,000 to £350,000</td>
<td>3%</td>
</tr>
<tr>
<td>Above £350,000</td>
<td>4.5%</td>
</tr>
</tbody>
</table>

3. Numbers of transactions and tax collected to 30 September 2015

Table 2: Notifiable Residential Transactions

<table>
<thead>
<tr>
<th>Residential Returns Received</th>
<th>Total Residential Tax Liabilities</th>
<th>Total Residential Tax Received By 5th Working Day of Following Month</th>
<th>Total Residential Tax Received By Month To Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-2015”</td>
<td>6,880</td>
<td>£7,000,000</td>
<td>£7,000,000</td>
</tr>
<tr>
<td>May-2015”</td>
<td>7,810</td>
<td>£11,400,000</td>
<td>£11,400,000</td>
</tr>
<tr>
<td>Jun-2015”</td>
<td>10,030</td>
<td>£18,500,000</td>
<td>£18,500,000</td>
</tr>
<tr>
<td>Jul-2015”</td>
<td>9,940</td>
<td>£19,400,000</td>
<td>£19,400,000</td>
</tr>
<tr>
<td>Aug-2015”</td>
<td>95,40</td>
<td>£21,400,000</td>
<td>£21,400,000</td>
</tr>
<tr>
<td>Sep-2015”</td>
<td>9,040</td>
<td>£18,700,000</td>
<td>£18,700,000</td>
</tr>
</tbody>
</table>

1: All valid residential returns received during the stated month.
2: Total self-reported tax due on residential returns received during the stated month.
3: Total payments received by the 5th working day of the following month, related to returns received during the stated month.
4: Total payments received by date of data extraction relating to returns received during the stated month.
5: Provisional
6: Corrected

Table 3: Notifiable Non-Residential Transactions

<table>
<thead>
<tr>
<th>Non-Residential Returns Received</th>
<th>Total Non-Residential Tax Liabilities</th>
<th>Total Non-Residential Tax Received By 5th Working Day of Following Month</th>
<th>Total Non-Residential Tax Received By Month To Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-2015”</td>
<td>610</td>
<td>£10,900,000</td>
<td>£10,900,000</td>
</tr>
<tr>
<td>May-2015”</td>
<td>810</td>
<td>£12,600,000</td>
<td>£12,600,000</td>
</tr>
<tr>
<td>Jun-2015”</td>
<td>950</td>
<td>£13,800,000</td>
<td>£13,800,000</td>
</tr>
<tr>
<td>Jul-2015”</td>
<td>970</td>
<td>£18,100,000</td>
<td>£18,100,000</td>
</tr>
<tr>
<td>Aug-2015”</td>
<td>900</td>
<td>£15,500,000</td>
<td>£15,500,000</td>
</tr>
<tr>
<td>Sep-2015”</td>
<td>970</td>
<td>£15,700,000</td>
<td>£15,700,000</td>
</tr>
</tbody>
</table>

1: All valid non-residential returns received during the stated month.
2: Total self-reported tax due on non-residential returns received during the stated month.
3: Total payments received by the 5th working day of the following month, related to returns received during the stated month.
4: Total payments received by date of data extraction relating to returns received during the stated month.
5: Provisional
6: Revised

Source: Revenue Scotland Tax Monthly Statistics, September 2015.²

² https://www.revenue.scot/who-we-are/publications/statistics
4. Performance against forecast for 2015-16

<table>
<thead>
<tr>
<th></th>
<th>Forecast for year</th>
<th>Six month liability</th>
<th>Percentage of forecast</th>
<th>Six month collection</th>
<th>Percentage of liability</th>
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</thead>
<tbody>
<tr>
<td>Residential</td>
<td>£235m</td>
<td>£96.4m</td>
<td>41.02%</td>
<td>£96.2m</td>
<td>99.79%</td>
</tr>
<tr>
<td>Non-residential</td>
<td>£146m</td>
<td>£86.7m</td>
<td>59.38%</td>
<td>£86.6m</td>
<td>99.88%</td>
</tr>
</tbody>
</table>

Forecast from Table 1, Scottish Budget 2015-16 as adjusted following the SDLT changes in December 2014 and subsequent changes to LBTT rates.

In the first half of the year revenue from residential LBTT is less than half of the forecast. The residential property market is generally more buoyant in summer than winter so this must give some concern. A key question is the extent to which this shortfall is the result of one-off behaviour due to the introduction of LBTT (forestalling) and the extent to which it results from unforeseen general market conditions.

5. Market data shows a significant market reaction to the introduction of LBTT. Average house prices in Scotland have been similar to those in the North of England and in Wales in recent years. Average house prices in England and Wales in total have shown a more marked rising trend. However, Scotland alone shows a sharp increase in average price in the first quarter of 2015 followed by a fall in the second quarter after the introduction of LBTT.
6. That this relates primarily to higher value properties, where LBTT liabilities exceed the replaced SDLT, can be seen in the following table showing the average prices in Scotland's seven cities. With £335,000 being the point at which LBTT starts to exceed SDLT, those cities where the average house price is well below that show little change in average price in the months before and after the introduction of LBTT. Those where the average price rises towards that figure show a marked increase in average price before the introduction of LBTT with a fall thereafter. This suggests relatively fewer sales of higher value properties, either by a slowing of the market or a reduction in prices or both.

Figure 5. Scotland house prices, compared with England & Wales, Wales and the North for the period January 2005 - August 2015

http://www.acadata.co.uk/Your%20Move%20Acad%20Scotland%20HPI%20News%20Release%20August%2015.pdf, p. 8
7. The data on sales of properties priced at £1 million or more illustrates the impact at the very top of the market. The average number of properties sold in this category in 2014 was 12 per month. In January to March 2015, the number of such houses sold was 112. In the three months following the introduction of LBTT, ten such houses were sold and in the five months to the end of August, 21 were sold. Of the 133 houses in this category sold in 2015 up to the end of August, 84% were sold before the introduction of LBTT. Assuming that there was a similar, if lesser impact, in house sales in the band from £335,000 to £1 million, and noting no other major factors differentiating trends in the Scottish housing market from that, say, in Northern England, we may conclude that forestalling is the major reason for the shortfall in LBTT receipts.
The impact on both the residential and commercial property market of the various rates and bands.

8. The Council of Mortgage Lenders consider that it may be some time before the full impact of LBTT on the Scottish residential property market is understood but noted some positive features of the period April to June 2015. The number of loans increased by 39.2% over the previous quarter and by 3.1% over the corresponding quarter in 2014. In value, the increases were 27.5% over the previous quarter and 4.4% over 2014. These figures included 8,000 first time buyer loans, an increase of 50.9% and 5.3% respectively. They consider that these figures may have benefitted from purchases postponed to take advantage of lower LBTT rates at £330,000 and below but there were also competitive deals available in the mortgage market during this quarter.

9. The members of Homes for Scotland are clearer about the impact of the introduction of LBTT. With respect to the majority of house buyers, the new LBTT rates have provided a small benefit, although in their judgement it is insufficient on its own to influence a decision to buy. Members also considered that the change has allowed for a smoother pattern of prices in the market by removing the artificial step at the £250,000 mark. Set against this, they detect diminished activity with respect to properties with a value over £500,000. Buyers at this level are deferring their decision to move and, if this continues, it will adversely affect the functioning of the market which depends on movement up and down price scales without artificial barriers. In terms of the commercial market, members expressed concern that Scotland now appeared less attractive to those seeking to invest in residential property.

10. The National Association of Estate Agents note a small decrease in the average house price over the last year which they attribute to reduced sales of high value properties as a result of the introduction of LBTT. While first time buyers have been more active in 2015, they
attribute this to the availability of mortgage lending rather than to tax savings at the lower end of the market. They cite figures from a member organisation that show a fall in number of sales for the period April to August 2015 in comparison with 2014 in both the sub £145,000 and in the next band to £250,000. There is a small increase in the band from £250,000 to £325,000 where LBTT is still less than SDLT and an increase of one property in the range above £325,000. Confusingly, this last minor increase is put forward by them as an example of there being fewer transactions amongst the most expensive homes following the introduction of LBTT. With no indication of the geographical area or market segment served by the member reporting these numbers, the significance is not clear other than to illustrate that the savings or increases from the introduction of LBTT are not the only factors impacting the market.

11. The Scottish Property Federation report that the market has welcomed the removal of the 'slab' system of SDLT, particularly for residential property where there is no longer a distortion in the market at £250,000. On the other hand they note that despite an overall increase in house prices during April to June 2015 prices actually fell in 11 out of 32 local authority areas. The areas where prices have fallen include Aberdeen, Aberdeenshire, Edinburgh and East Renfrewshire where there are a greater proportion of houses in the £500,000 to £1 million range. They note that Savills recently reported a 31% drop in activity in respect of houses over £750,000 despite an overall increase in residential transactions. Their members have raised concern that higher tax costs and the lack of availability of accommodation on the market at the £325,000 plus level is impacting on labour mobility, both within Scotland and in attracting skills to Scotland. For commercial property, the move to a progressive rate of taxation with less radical changes in rates has gone smoothly and a strengthening economy has lifted the value of sales. However, pricing in this market is reported to have adjusted to take account of the change in tax rates and structure.
12. The Scottish Property Federation produce a bar chart comparing LBTT receipts for April to August 2015 with SDLT receipts for 2013-14 and 2014-15. Comparing the LBTT receipts to a five month proportion of the SDLT receipts for the previous two years shows a shortfall of approximately 5% against 2013-14 but of the order of 25% against 2014-15. Given the changes to residential SDLT introduced in December 2014 and the consequential reduction in the residential LBTT forecast, the total forecast for 2015-16 is £381 million, significantly less than the SDLT receipts for the previous year. Similar to the six month figures in paragraph 4 above, the five month residential LBTT receipts are below forecast while non-residential are a little above. The Federation comment that this is concerning, given that residential transactions are traditionally quiet over the winter, although this may be offset in part by a traditionally strong final calendar quarter for commercial property. No other respondents commented on the question of receipts against forecast.

13. The Council of Mortgage Lenders report anecdotal evidence of transactions being brought forward and members of Homes for Scotland report that some customers facing a higher LBTT charge requested earlier completion of their homes, not always a practical request. One member of Homes for Scotland produced figures for their business comparing the first and second calendar quarters of 2015 with 2014. These support the perception that customers brought forward higher value transactions. The proportion of transactions over £333,000 was 12.7% in Q1 2015 compared to 4.9% in Q1 2014. The average selling price in Q1 2015 was 13.4% higher than in Q1 2014. The average selling price of homes in Q2 2015 was 9.5% lower than in Q1 2015 compared to a drop of 3% in 2014.
14. The National Association of Estate Agents report that, outside Edinburgh, the number of properties sold for £750,000 or more in March 2015 was 113 while only 3 were sold in April and 9 in May. June showed an increase to 19 but this fell back to 3 in July. In Edinburgh the figures were 115 in March, none in April, 5 in May, 7 in June and 3 in July. These figures follow the same pattern as those produced for properties of £1 million and above by Your Move / Acadata and quoted in paragraph 7 above.

15. The Scottish Property Federation refer to substantive evidence that a number of high value residential property transactions were brought forward to avoid higher LBTT rates. They quote a report from Rettie & Co, Estate Agents, of a 266% increase in the number of properties listed in the £500,000 to £750,000 sector in January 2015. This the price range below that highlighted in paragraph 15 above by the National Association of Estate Agents but within the range where SDLT offered a saving over the incoming LBTT. In the commercial market the Federation considers that there was less of an issue due to the smoother transition between rates and thresholds.

The extent to which lower priced transactions were delayed until after 1 April

16. The Council of Mortgage Lenders reported anecdotal evidence of delay in lower value transactions to take advantage of LBTT rates and Homes for Scotland's members reported customers requesting delay in lower value transactions until the new LBTT rates were effective. One of their members observed that 16.9% of all transactions in the first three months of 2015 were below the £145,000 stating point for LBTT while, in the same period in 2014, 28.4% of transactions were at this level.

17. Members of The National Association of Estate Agents report fewer properties sold in the band up to £145,000, and also in the band from there to £250,000, in the period from January to March 2015 than in
the corresponding period in 2014. The Scottish Property Federation, on the other hand, think the evidence of delay at the lower end of the market is less clear cut than that for advancing higher value transactions. They expect that the impact of support schemes such as Help to Buy had more impact than tax issues in this part of the market.

**Whether there should be any changes to the rates and bands for residential transactions in the draft budget for 2016-17**

18. The Chartered Institute of Taxation draw to the Committee’s attention that in an earlier submission they emphasised the need for regular review of the bands for LBTT to ensure that they remain appropriate and are in line with policy objectives. In matching rates and bands to its policy objectives, the Scottish Government must be aware of the likely direct and indirect impact on taxpayer behaviour and tax revenues. As changes are a policy matter, they decline to give any specific recommendations.

19. The Council of Mortgage Lenders believe that a better understanding of the impact of LBTT, particularly whether there is a long term adverse effect at the higher end of the market, is required before recommending change. While Homes for Scotland also consider that it is too early to come to a definitive view, in their case on the impact of LBTT on the new build market, they do express concern. The available evidence suggests that sales of mid- to higher-value homes have been depressed and this will have consequences for the functioning of the wider housing market. They call for a review to determine, for example, whether there should be a more stepped approach above £325,000. They note that the upper limit of the 5% band in Scotland is £325,000 while in the rest of the UK it is £925,000. A member commented that 91% of the LBTT yield from their sales would be generated by sales of properties costing over £325,000 which demonstrates the importance of higher value properties in revenue generation.
20. The National Association of Estate Agents express some concern at the lack of stimulus provided by LBTT to the lower end of the market where there have been fewer transactions since the introduction of LBTT than in comparable periods in the previous two years. They suspect some short-term factors and see flexible lending criteria, more building of affordable homes and measures such as the Help to Buy ISA, rather than LBTT, as key to stimulating this market. North Ayrshire Council would welcome a reduction in LBTT at any level and make the specific suggestion of inserting a further band between £500,000 to £1 million to stimulate the residential market. It is not entirely clear what they intend here as the current bands are 10% from £325,000 to £750,000 and 12% above that. They may mean replacing these two bands with three starting at £325,000, £500,000 and £1 million with rates to be determined.

21. The Scottish Property Federation has clear recommendations for LBTT rates in 2016-17. With LBTT at current rates depressing the higher end of the residential market, they do not believe the 12% rate above £750,000 will contribute significant revenue. Previously, this end of the market contributed significant SDLT. They recommend increasing the upper threshold of the 5% band to £500,000 and abolishing the 12% rate altogether. This would mean that the 10% band would start at a point £425,000 lower than for SDLT but there would be no rate matching the 12% top rate of SDLT paid on residential property transactions from £1.5 million.

22. With regard to commercial property, the market makes a negative comparison between investment yields in Scotland compared with the rest of the UK. While tax is only part of that, the Federation would not wish any further negative comparison to be created in this intensely competitive market. Consequently, they recommend either no change in non-residential rates and bands or realigning the LBTT top rate of 4.5% with the top SDLT rate of 4%.
23. West Lothian Council considers it too early to make a balanced judgement on whether any changes should be made for 2016-17 and recommend reviewing 12 months of operation before considering changes. Two other Councils, Aberdeenshire and Highland, request an extension of an LBTT relief. When acquiring affordable housing units or the land on which to build them, Councils incur LBTT unless the acquisition is under a developer's obligation contained in a S75 agreement.\(^5\) Housing Associations delivering affordable housing do not have to pay such LBTT.\(^6\) In constrained financial circumstances, Councils could better apply the money spent on LBTT elsewhere. They suggest that the relief available to Housing Associations should be extended to Local Authorities.

The performance of Revenue Scotland in administering and collecting the tax

24. Revenue Scotland (RS) have set up an LBTT forum to focus on practical and technical issues specific to the administration and operation of LBTT. In advance of the first meeting, the Chartered Institute of Taxation gathered the views of its members. The general view, both of the Institute's members and of participants in the forum, is that for day-to-day conveyancing the system is working well. The LBTT forms are generally simpler and quicker to complete than their SDLT equivalents. There is a requirement for additional returns in respect of leases which may prove burdensome for those occupying a large number of properties, however.

25. RS's communication channels are primarily digital but there is provision for communication by telephone or letter, a provision that the Institute consider essential. There is an email enquiry facility for questions which are 'in principle' or are queries of a general nature.

\(^5\) Relief for compliance with planning obligations under Schedule 15, LBTT(S)A 2013

\(^6\) Relief for certain acquisitions by registered social landlords under Schedule 6, LBTT(S)A 2013
Currently, the responses to such enquiries refer to the relevant RS guidance. Both the Institute and other members of the LBTT forum consider that the responses should be referenced to the LBTT legislation since alternative interpretations of the legislation may be possible.

26. There is also online provision for RS to provide opinions on certain situations and on specific transactions. RS report that they have received a steady stream of such enquiries from taxpayers and agents. Currently, RS’s target for answering these is 25 working days. Both the Institute and other LBTT forum members would like greater resources put into this facility as a 25 working day turnaround is not commercial. The Institute understands that the majority of queries relate to leases, transitional provisions, partnerships and Multiple Dwellings Relief and they recommend that the relevant guidance is reviewed to see if amendments to improve clarity in these areas is possible. Roadshows around Scotland are already a communication tool for RS and the Institute would like to see this commendable initiative extended to further locations and supplemented by webinars to reach as wide an audience as possible.

27. RS provide guidance both on legislation and of a practical nature and the Institute suggest that this could be improved by clearly indicating on the website when guidance has been updated or new material added and such updates should be made regularly in the light of experience. Areas where the current guidance is inadequate include lease variations and ‘substantial performance’. With respect to SDLT, HMRC have indicated that 90% consideration or 90% possession constitutes ‘substantial’. RS have suggested that, for LBTT, each taxpayer must look at the specific facts of each transaction to determine what is or is not substantial. But practically a clear ‘rule of thumb’ is required and the Institute understand that, following from forum discussions, RS is now considering whether percentages can be issued as a guide.
28. With regard to collection, the Institute understands that by the end of August approximately 48,000 returns had been submitted with tax outstanding beyond the deadline in only approximately 300 cases, less than 1%. The LBTT forum has suggested to RS that any breach of payment deadlines should be referred not only to the agent submitting the return but also to that firm's LBTT administrator. In most cases the agent will belong to a professional body and breaches of professional conduct will be taken seriously and escalated appropriately.

29. Homes for Scotland reported a member as highlighting a smooth changeover from SDLT to LBTT and that the online system works well. There is concern, however, over RS's reluctance to discuss complex or unclear LBTT issues on an informal basis and this is exacerbated by the slowness of response under the alternative formal opinion process. RS does not necessarily follow HMRC guidance, built up over a period of years, even where the statutory provisions concerned are effectively identical. This causes great uncertainty particularly in the absence of informal routes of enquiry.

30. The Institute of Chartered Accountants of Scotland have found RS professional, helpful and responsive to comments and feedback. Their use of multiple channels of communication is welcomed and their use of 'town hall' style meeting is helpful. Their website is well laid out and a good source of information. Feedback from members is that operational implementation has gone well and that LBTT returns are more straightforward than SDLT ones. Anecdotal evidence suggests that the working relationships and boundaries of LBTT legislation in the more complex commercial transaction have still to be tested and fully established.

31. The Institute considers that RS's publication of specific areas where it will not provide an opinion, for example, on the possible application of the GAAR, is unhelpful and possibly inefficient. Accepting such enquiries will give early warning of tax planning gambits. The taxpayer
should have the right to request an opinion in any circumstance and it will always be open to RS to disagree with a view expressed or to decline to give an opinion in the circumstances. In broad terms, RS’s opinions have been helpful and bring together primary and secondary legislation and forms. However, in restating legislation the guidance does not help taxpayers and their advisers to understand how RS interprets the provisions in practice. A particular example is the treatment of leases. They also refer to an IFS discussion paper on the legal status of HMRC guidance which may be relevant to determining the status and certainty of RS’s guidance.\footnote{7 The Tax Rewrite Committee of the IFS, (December 2014) \textit{HMRC’s Discretion: The Application of the Ultra Vires Rule and the Legitimate Expectation Doctrine.}}

32. PricewaterhouseCoopers find the 'Guidance' and 'Forms' sections of the RS website easy to navigate and providing useful information. The portal for submitting LBTT returns is also easy to navigate and user friendly. On the other hand they report an example of a significant delay and difficulty in obtaining a conclusive response to request for an opinion. In this particular case, the relevant LBTT provisions mirrored the SDLT provisions, HMRC had provided a non-statutory clearance on the application of the SDLT provisions to the same structure and a copy of this clearance was given to RS. The reasons for the delay appeared to be a request for further information in response to the original submission which already included all the information in RS’s checklist. This was compounded by a lack of communication regarding the reason for the delay and no indication of when a response might be expected. PwC suggest that RS could improve communication and knowledge sharing with HMRC in regard to the non-statutory clearance process.

33. The Scottish Property Federation judge that RS is performing well in the collection of LBTT, with the shortfall against forecast in residential LBTT due to rate and threshold policy, not collection. However, some
members have expressed concern at the weakness of guidance and administrative support. When attempting to determine the correct course of action for their client they find it difficult to obtain the necessary direction from RS. They feel inhibited in voicing criticism of performance because of their need to build an on-going relationship with RS. There is also a concern that RS are underestimating the level of recurring 'commercial lease events' and there is little evidence that they are preparing to educate taxpayers on their three yearly liability.

34. On a practical level, both Aberdeenshire and Highland Councils find it frustrating that logging in to the LBTT portal can take longer than completing the Return. On the other hand, North Ayrshire and West Lothian Council have no administrative issues to report.

Gavin McEwen
10 November 2015
Introduction

Scotland Act 2012 devolved Stamp Duty Land Tax and Landfill Tax to the Scottish Parliament. Stamp Duty was substantially changed to the Land and Buildings Transaction Tax (LBTT) and the Landfill tax regime remained largely unchanged with a Scottish Landfill Tax (SLfT). The new devolved taxes have been collected in Scotland since April 2015.

This briefing considers first the forecasts for devolved taxes and then the first six months of outturn data for devolved tax receipts. The focus is largely on the outturn information for LBTT.

Scottish Government Forecasts

The Scottish Government set out its forecasts for the newly devolved taxes during Parliamentary scrutiny of the 2015-16 Budget. Initial rates and revenue forecasts were presented in the Draft Budget 2015-16, published in October 2014. The LBTT residential tax rates and revenue forecasts were subsequently adjusted during passage of the Budget Bill in January 2015.

The final forecasts for the various elements of LBTT and SLfT are presented in table 1. These are the numbers upon which the Scottish Government has based its budget planning. As such, if these forecasts are less than outturn, the Scottish Government will have a budgetary surplus, and if these forecasts are more than outturn, the Scottish Government will have a budgetary shortfall.

Table 1: Final LBTT and SLfT revenue forecasts for 2015-16

<table>
<thead>
<tr>
<th></th>
<th>Forecast revenue (£m)</th>
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<tbody>
<tr>
<td>Land and Buildings Transaction Tax of which</td>
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<tr>
<td>Residential Transaction</td>
<td>235</td>
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<tr>
<td>Non-residential transactions</td>
<td>146</td>
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<tr>
<td>Scottish Landfill Tax</td>
<td>117</td>
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<tr>
<td>Total</td>
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</table>
OBR forecasts

The Office for Budget Responsibility (OBR) produce revenue forecasts for devolved Scottish taxes at each UK fiscal event (typically in March for the UK Budget, and in November/December for the UK Autumn Statement). The most recent OBR forecast was published in July at the time of the post-election Summer Budget\(^1\). New forecasts will be published at the Spending Review on 25 November 2015, but were not available at the time of writing. The latest OBR forecasts for the two devolved taxes are presented in table 2.

**Table 2: OBR forecasts for devolved Scottish taxes (£m)**

<table>
<thead>
<tr>
<th>£m</th>
<th>2015-16</th>
<th>2016-17</th>
<th>2017-18</th>
<th>2018-19</th>
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<td>616</td>
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<td>974</td>
</tr>
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<td></td>
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<td>291</td>
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<td>87</td>
<td>90</td>
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</tr>
<tr>
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<td>704</td>
<td>776</td>
<td>870</td>
<td>970</td>
<td>1,077</td>
</tr>
</tbody>
</table>

Source: OBR 2015

The OBR’s latest forecasts for 2015-16, will have no practical impact on the Scottish Government’s budget, because the Block Grant Adjustment (BGA) for 2015-16 has already been agreed and set.

However, no agreement has yet been reached for the BGA beyond 2015-16. As such, the OBR forecasts beyond 2015-16 could have a material impact on the BGA in subsequent years. We currently do not have Scottish Government forecasts beyond 2015-16, and these will not be available until the Scottish Draft Budget 2016-17 is published. As can be seen in table 2, the OBR’s latest LBTT forecasts for 2015-16 are significantly higher (+£159m) than the Scottish Government, but the OBR’s SLfT forecasts are lower (-£23m) than the Scottish Government.

If, as seems likely, the OBR’s combined forecasts for devolved taxes are higher than the Scottish Government forecasts in 2016-17, then there is potential for a BGA that is higher than the Scottish Government’s forecast tax receipts (depending on how agreement over a suitable BGA is reached).

Block Grant Adjustment

The combined devolved taxes BGA finally agreed with the UK Government in advance of the Scottish budget being set for 2015-16 was £494m – the midpoint of the Scottish Government and OBR forecasts. This was a one-year

\(^1\) Summer budgets have taken place after the last two UK elections, in 2010 and 2015.
BGA agreement. This meant that assuming receipts come in as forecast by the Scottish Government, there would be a small £4m surplus in tax receipts over the final BGA. In his letter to the Finance Committee of 22 January 2015, the Cabinet Secretary stated:

“I have assessed revenue neutrality for 2015-16 in terms of the headline one-year BGA agreed with the UK Government of £494 million, which as you know represents the mid-point of the Scottish Government and OBR forecasts of the aggregate tax revenues foregone by the UK Government. My 2015-16 tax revenue forecasts for non-residential LBTT and Scottish Landfill Tax remain unchanged from the Draft Budget - at £146 million and £117 million respectively. This leaves a remaining balance of £231 million to be raised from residential LBTT in 2015-16, before forestalling effects are taken into account. I considered it prudent to build some modest headroom into the pre-forestalling revenue to be generated by residential LBTT in order help manage the risk that the forestalling adjustment which the UK Government is prepared to agree to the BGA falls short of my assessment of the likely revenue losses to the Scottish Budget, as scrutinised by the Scottish Fiscal Commission. Should there be any remaining flexibility once forestalling effects have been agreed and calculated, I would intend to use this to make the first payment into the cash reserve at the end of 2015-16.”

John Swinney letter to the finance Committee, 22 January 2015.

Forestalling

The no detriment principle agreed in the Smith Commission states that neither the Scottish or UK budgets should be worse off at the point of devolution. In light of that principle, the Scottish and UK governments agreed that there will be some requirement for a compensatory amount to be subsequently added to the Scottish budget as a consequence of forestalling of transactions arising from the UK Autumn Statement 2014 changes to the UK Stamp Duty regime. The changes made in that UK fiscal event provided an incentive for certain transactions in Scotland to be brought forward into financial year 2014-15 to reduce tax burdens, thus impacting positively on 2014-15 SDLT receipts and negatively on 2015-16 LBTT receipts.

The Deputy First Minister wrote to the Committee on 22 January confirming the new bands and rates and the revised forecast for residential LBTT receipts. He also stated that as “this is the first year of LBTT and there are significant differences in the tax charge between LBTT and the UK tax which it replaces, I also intend to make an adjustment to this forecast to reflect potential revenue losses to Scotland as a result of forestalling effects.”

http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_the_Convener_dated_22_January_2015.pdf
advised the Committee that the SFC “has begun its work to scrutinise the approach which we are taking to estimate the value of these forestalling effects, and I will provide a further update to the Committee when that work has concluded.”

The SFC wrote to the Scottish Government on 21 January with its assessment of the revised forecasts. They stated that they were content that the revised forecasts were based on a consistent application of the forecasting methodology which they had previously viewed as reasonable. They added that:

“The calculation of the forestalling effect is both desirable and relatively straightforward in itself. However, it depends upon identifying the elasticity of the transactions with respect to anticipated changes in the tax schedules, which is less straightforward.

We have engaged with your officials, reviewed early and later versions of their analysis, and asked them to provide further and sufficient evidence on the value of this elasticity in order to enable the SFC to form a view of the reasonableness of that calculation.

Our understanding is that they continue to refine this work. We appreciate that it is complex and requires judgement. We will review any further evidence they can provide in support of the assumptions underpinning their forestalling calculation as and when it becomes available.”

In its response to the Committee’s report on Draft Budget 2015-16 the SFC stated that it had “responded in brief to the forecasters’ initial work on forestalling” and “requested that further evidence be provided in relation to the assumptions underpinning the calculation.” They advised that when “the next iteration is ready, we will review it and make a further judgement.” None of this work has been made public and the SFC has not reported on its work on forestalling.

The Committee wrote to the SFC on 27 August 2015 inviting the SFC to provide a commentary on the first 6 months of outturn figures for the devolved taxes relative to the Scottish Government forecasts including the impact of forestalling. The Committee also expressed concern about the lack of transparency in relation to the work which the SFC has been carrying out with the Scottish Government on forestalling. The Deputy First Minister told the Committee on 2 September that work on forestalling is still under way and we “will obviously have much clearer data from the end of the previous financial
year and the start of this financial year.” Discussions are also taking place around forestalling as part of the fiscal framework negotiations.

The SFC wrote to the Committee on 19 November 2015 with its commentary on the outturn figures for the devolved taxes. This was described as a “concise summary of the work we have done” – it is not clear whether this work is to be published. Given the points summarised below, it might be helpful for the Committee to receive more information on the workings behind some of the numbers in the letter. Generally speaking, it is not possible to replicate the figures shown in the SFC letter.

For example:

- The SFC refers to a forecast in January 2015 for forestalling of £12m to £37m. The SFC has not provided any commentary on how these figures were arrived at. It is unclear where these figures come from or how they were produced and they do not appear to have been previously published.

- Likewise it is ambiguous how the £215.5m (min forestalling) and £247.4m (max forestalling) figures are arrived at. Following the methodology in the commentary, the six-month outturn, £96.2m plus the minimum forestalling of £12m gives a “corrected” outturn of £108.2m. This is then taken to be 53% of the annual projected revenue giving a forecast for the year of £204.2m rather than the £215.5m from the SFC. Similarly for maximum forestalling the forecast outturn is £251.3m rather than £247.4m. The SFC calculation appears to involve some factor not mentioned in the letter.

- The paper also refers to preliminary analysis of an actual shortfall in revenues of £30m over the period of April to September 2015. Again, it is not clear how this figure has been arrived at and the SFC has provided no commentary.

The Committee will be aware that one of the key OECD principles for independent fiscal institutions is transparency:

“Given that promoting transparency in public finances is a key goal of IFIs, they have a special duty to act as transparently as possible. Full transparency in their work and operations provides the greatest protection of IFI independence and allows them to build credibility with the public.”

The Committee may wish to consider whether the provision of “a concise summary of our work” is consistent with this principle.

**OBR forestalling estimate**

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6 Finance Committee, 2 September 2015, OR Col. 30
The OBR’s July Devolved Taxes forecasts estimates the impact of forestalling at £20m. It states:

“Our forecast takes into account the bringing forward of some higher-priced transactions in order to avoid the higher rates in 2015-16 and some delayed transactions at the lower end. These behavioural responses reduce the LBTT forecast by £20 million in 2015-16 with the effect concentrated in the earlier months of the year.

Outturn data

Revenue Scotland publish monthly aggregated figures for LBTT in the third week of the month. SLfT figures are also published on the Revenue Scotland website on an aggregated basis quarterly in arrears, in the second month of the following quarter. The latest available LBTT outturn figures are presented in tables 3 and 4.

As can be seen by tables 3 and 4, compliance with LBTT in both the residential and commercial sector is high. For example, in the residential sector in the first 6-months of operation £96.2m has been collected from £96.4m due (99.8%).

Forecasts are based on an accruals basis (how much money would be expected to be raised from a given number of transactions), while receipts are recorded on a cash basis (actual receipts in a given time period). As taxpayers are allowed 30 days to complete a return, expected receipts might differ from actual receipts at a given point in time. The difference will only arise where payments for transactions in a given month end up taking place in a later month. Eleanor Emberson, in evidence to Finance Committee on 18 November, referred to this issue, but did not indicate the size of any difference. However, it is likely that this will not be a significant issue as most residential LBTT tax returns are completed on the day of purchase as part of the transaction.

**Table 3: LBTT Residential outturn figures**

<table>
<thead>
<tr>
<th>Month</th>
<th>Residential Returns Received</th>
<th>Total Residential Tax Liabilities</th>
<th>Total Residential Tax Received By Month To Date</th>
<th>Average Revenue per transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-2015</td>
<td>6,880</td>
<td>£7,000,000</td>
<td>£7,000,000</td>
<td>£1,017</td>
</tr>
<tr>
<td>May-2015</td>
<td>7,810</td>
<td>£11,400,000</td>
<td>£11,400,000</td>
<td>£1,460</td>
</tr>
<tr>
<td>Jun-2015</td>
<td>10,030</td>
<td>£18,500,000</td>
<td>£18,500,000</td>
<td>£1,844</td>
</tr>
<tr>
<td>Jul-2015</td>
<td>9,940</td>
<td>£19,400,000</td>
<td>£19,400,000</td>
<td>£1,952</td>
</tr>
<tr>
<td>Aug-2015</td>
<td>9,540</td>
<td>£21,400,000</td>
<td>£21,400,000</td>
<td>£2,243</td>
</tr>
<tr>
<td>Sep-2015</td>
<td>9,040</td>
<td>£18,700,000</td>
<td>£18,500,000</td>
<td>£2,046</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>53,240</strong></td>
<td><strong>£96,400,000</strong></td>
<td><strong>£96,200,000</strong></td>
<td><strong>£1,807</strong></td>
</tr>
</tbody>
</table>

All figures are provisional
Key points to note from the LBTT residential outturn figures are as follows:

- In the 6-months to September 2015, 41% of the forecast residential revenues for the year have been collected.
- The 6-months for which outturn data has been collected are the spring and summer months, typically the strongest months for house sales.
- Revenue Scotland states on its website that “Residential property transactions follow a fairly regular seasonal pattern, whereby there is a higher number of sales in the spring and summer and relatively few in the winter, particularly January and February. Consequently we expect notifications and revenue from LBTT to follow a similar pattern.”
- Adding the OBR’s £20m estimated impact of forestalling to the collected revenue figure, would take the 6-month collected receipt figure up to 49% of forecast revenues.
- Deducting the OBR’s £20m estimated impact of forestalling from the Scottish Government’s forecast revenues, would take the 6-month collected receipt figure to 45% of forecast revenues.
- With tax on transactions above £330,000 increasing in April 2015 compared to the previous UK Stamp Duty system, there appears to have been significant forestalling effects in the opening two months of the financial year.
- Rettie and Co (2015) state that the number of higher value properties coming to the market early in the year increased dramatically, then retreated after 1 April. In April, the average revenue per transaction was £1,017. The average revenue per transaction increased in May 2015 to £1,460 and continued rising in each month until August.
- After a slow first two months (April and May), transaction numbers and revenues have increased, averaging £19,450,000 per month in the June to September period. Were that average monthly figure to be replicated across a 12 month period, forecasts would be close to predicted at £233m.
- However, as mentioned above, property sales tend to be highest in spring, summer and autumn (with October typically being a strong month) before the market cools in the run up to Christmas.
- Average revenues per transaction peaked in August at £2,243.
Table 4: LBTT non-residential outturn figures

<table>
<thead>
<tr>
<th></th>
<th>Non-Residential Returns Received¹</th>
<th>Total Non-Residential Tax Liabilities²</th>
<th>Total Non-Residential Tax Received By Month To Date³</th>
<th>Average revenue per transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-2015</td>
<td>610</td>
<td>£10,900,000</td>
<td>£10,900,000</td>
<td>£17,869</td>
</tr>
<tr>
<td>May-2015</td>
<td>810</td>
<td>£12,600,000</td>
<td>£12,600,000</td>
<td>£15,556</td>
</tr>
<tr>
<td>Jun-2015</td>
<td>950</td>
<td>£13,800,000</td>
<td>£13,800,000</td>
<td>£14,526</td>
</tr>
<tr>
<td>Jul-2015</td>
<td>970</td>
<td>£18,100,000</td>
<td>£18,100,000</td>
<td>£18,660</td>
</tr>
<tr>
<td>Aug-2015</td>
<td>900</td>
<td>£15,500,000</td>
<td>£15,500,000</td>
<td>£17,222</td>
</tr>
<tr>
<td>Sep-2015</td>
<td>970</td>
<td>£15,800,000</td>
<td>£15,700,000</td>
<td>£16,186</td>
</tr>
<tr>
<td>Total</td>
<td>5210</td>
<td>£86,700,000</td>
<td>£86,600,000</td>
<td>£16,622</td>
</tr>
</tbody>
</table>

All figures are provisional.
1: All valid non-residential returns received during the stated month.
2: Total self-reported tax due on non-residential returns received during the stated month.
3: Total payments received by date of data extraction relating to returns received during the stated month.

Key points to note from the LBTT non-residential data is as follows:

- In the 6-months to September 2015, 59% of forecast revenues for the year have been collected.
- The Scottish Property Federation (2015) state that behavioural responses have been much less of an issue in the commercial sector compared with the residential sector “due to a closer alignment to the previous tax regime as well as a rising market”.
- As such prospects for meeting the LBTT non-residential forecast revenues in 2015-16 look much higher.
- Average revenue per transaction has been fairly consistent, averaging £16,622, peaking at £18,660 per transaction in July.

Scottish Landfill tax outturn data

At the time of writing only the first quarter of SLfT receipts had been published, covering the period April to June 2015. A total of £37.4m had been received to date from 34 returns. This amounts to 32% of forecast annual revenues (£117m) after one quarter of the financial year, suggesting that the Scottish Government’s revenue forecasts are likely to be reached.

Sources

Rettie and Co. (2015) *LBTT Briefing.* Available at: [http://www.rettie.co.uk/blog/lbtt-briefing/](http://www.rettie.co.uk/blog/lbtt-briefing/)


Ross Burnside  
Financial Scrutiny Unit (SPICe)  
November 2015

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The Scottish Parliament, Edinburgh, EH99 1SP [www.scottish.parliament.uk](http://www.scottish.parliament.uk)
Finance Committee

30th Meeting 2015 (Session 4), Wednesday 25 November 2015

SFC Bill

1. The Scottish Government introduced its Bill to give the Scottish Fiscal Commission (SFC) a basis in statute on 28 September 2015. Copies of the Bill and its accompanying documents have previously been circulated to the Committee. The Committee’s call for evidence is available on line.

2. The Committee is due to hear from the SFC at its meeting on 25 November and its views on the Bill are attached as Annexe A. This paper provides a summary of the role of the non-statutory Commission as well as a summary of some of the main issues which have arisen in this inquiry and the Committee’s previous work in relation to the establishment of an independent fiscal institution in Scotland.

Role of the Non-Statutory Commission

3. The Commission has been operating on a non-statutory basis since June 2014. It is required to report on its assessment of the reasonableness of the Scottish Government’s forecasts of tax receipts from the devolved taxes and of the economic determinants underpinning the forecasts of non-domestic rate income.

4. The Bill team stated that the Scottish Government “has sole responsibility for producing the forecasts; the role of the Commission is to challenge and scrutinise them.”

Under the present process, “Scottish Government economists prepare forecasts and forecasting methodology papers, which are presented to the Commission for discussion.” These papers “are subject to robust scrutiny and review by Commission members.”

This scrutiny is carried out prior to the publication of the draft budget. The Bill team stated that, importantly, this allows Ministers, “if they so choose, to revise their forecasts in line with the Commission’s findings.”

The Bill team also indicated that Scottish Government officials “work very closely with the Commission.”

5. The Policy Memorandum (PM) states that the non-statutory Commission scrutinises and challenges the forecasts and “reports the outcome of that scrutiny to the Parliament and to the public.” The Commission is, therefore, able to “exert significant influence over the forecasts.”

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1 Finance Committee, 28 October 2015, OR Col. 5
2 Finance Committee, 28 October 2015, OR Col. 5
3 Finance Committee, 28 October 2015, OR Col. 5
4 Finance Committee, 28 October 2015, OR Col. 6
5 Finance Committee, 28 October 2015, OR Col. 7
6 http://www.scottish.parliament.uk/S4_Bills/Scottish%20Fiscal%20Commission%20Bill/SPBill78PMS042015.pdf paragraph 15
7 http://www.scottish.parliament.uk/S4_Bills/Scottish%20Fiscal%20Commission%20Bill/SPBill78PMS042015.pdf paragraph 16
6. The non-statutory Commission states on its website that it:

“scrutinises the Scottish Government’s work in developing models and methodologies to produce its forecasts. Its interaction with the Scottish Government informs the Commission’s understanding of the reasonableness or otherwise of their forecasts and its scrutiny improves the methods used by the Scottish Government and thereby the eventual forecasts.”

7. It published its first report alongside Draft Budget 2015-16 in October 2014 and this is attached as Annexe B. The report describes the approach of the non-statutory Commission as “one of enquiry and challenge followed by response, followed by further enquiry and suggested improvements.” This included regular meetings and correspondence with Scottish Government economists and forecasters.

8. The report provides a detailed assessment of the Scottish Government’s forecasting methods for both of the devolved taxes and the economic determinants of income from non-domestic rates. In particular, there is an emphasis on a lack of sufficient data. The report also states that the non-statutory Commission “intends to discuss with the Scottish Government forecasters possible ways to enhance the forecasting methods employed in future forecasting rounds, especially as improved data becomes available.”

9. The Scottish Government also published a paper alongside Draft Budget 2015-16 on its forecasting methodology for the devolved taxes. This paper provides details of the Scottish Government’s modelling approach and the assumptions which underpin the forecasts. For example, in relation to Land and Buildings Transaction Tax (LBTT) the Scottish Government provides details of its projections for the growth in house prices and the growth in the number of transactions. These are compared with the OBR projections. The paper states that the Scottish Government will keep its forecasting methodologies under review including in light of recommendations made by the SFC.

10. Read together the Scottish Government’s methodology paper and the report of the non-statutory Commission provide clarity in relation to the methodologies which underpin the forecasts. The SFC also provide recommendations as to how the methodology may be improved in the future. However, there is little detail in either report in relation to how the process of enquiry and challenge influenced the methods used by the Scottish Government in producing its 2015-16 forecasts. In particular, it is not clear what was discussed as part of this scrutiny process and whether the Scottish Government made any modifications to its forecasting methods for the devolved taxes based on suggestions from the SFC. There is no reference within the Scottish Government’s methodology paper to any input from the SFC in developing its forecast methods for 2015-16.

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8 http://www.fiscal.scot/media/media_364407_en.pdf
9 http://www.fiscal.scot/media/media_364407_en.pdf
10 http://www.fiscal.scot/media/media_364407_en.pdf
11. It is also not clear from both reports how the process has worked in relation to assessing the reasonableness of the forecasts. As noted above, the Bill team explained that Scottish Government economists prepare forecasts and forecasting methodology papers and these are presented to the Commission for discussion. However, it is not clear from either report how this process worked. For example, to what extent were provisional forecasts provided and revised subsequent to the publication of the final forecasts.

12. The Deputy First Minister did announce one change to the official forecast as a consequence of the recommendations in the non-statutory Commission’s report. During his statement on Draft Budget 2015-16 he announced that the SFC “has considered our NDRI forecasts and has expressed the view that the buoyancy assumptions ‘seem optimistic’. As a result I have revised down the NDRI forecast in the draft budget for 2015-16.” This suggests that the forecast was changed following receipt of the non-statutory Commission’s report. The figures for the original forecast were not provided so it is not possible to identify how much it changed.

13. It is also not clear why this recommendation led to a change in the official forecasts while other SFC recommendations did not. For example, the SFC recommended the need to account for behavioural responses in producing the forecasts for residential LBTT. The report does not mention whether this issue was raised with the Scottish Government as part of the process of enquiry and challenge and what, if any, response was provided. There is no mention of this issue in the Scottish Government’s methodology paper.

14. Ian Lienert questions whether it is desirable for the Commission to exert significant influence over the Scottish Government’s forecasts. He argues that this is “undesirable, as it could change the SFC from being an “independent assessor” of the SG’s forecasts to being an “advisor” to the Scottish Government.” He suggests that the Commission “should step back from being closely involved” in the preparation of the official forecasts.

15. Rather, it should “develop its own fiscal forecasts independently” of the Scottish Government. It may also be preferable for the Commission to assess the official forecasts “only once they are submitted to the Scottish Parliament.” His view is the same day reporting requirement in the Bill could undermine the Commission’s independence. The Bill should be amended to allow the assessment report to be laid before the Parliament as soon as practicable after the publication of the draft budget.

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16. He also questions the requirement within the Bill for the Commission to send a copy of its report to Scottish Ministers prior to being laid before the Parliament which could undermine its independence. The OECD’s view is that this “requirement may be perceived as favouring the government.” Ian Lienert recommends that section 4(3) should be removed from the Bill. However, the Bill Team pointed out that the Scottish Government would only be looking to check the factual accuracy of the report and that the “only changes we would envisage would be to clarify understanding of the forecasting processes and methodologies that the Scottish Government had put in place.”

17. Robert Chote was also asked whether it was appropriate for the Commission to have significant influence over the forecasts at the same time as providing an assessment of reasonableness. His view is that the whole point of independent scrutiny is to exert influence. The question arises as to how that influence is exerted and whether it is done in “private conversation with the commission in the run-up to publishing the draft budget?” The experience of the OBR is that “if there is this sort of debate beforehand, it might be harder to satisfy everybody and demonstrate that the commission is being independent.” At the same time though there would clearly be “more opportunity for the Commission to influence the numbers if it has that prior discussion rather than waiting for the draft budget to come out.”

18. The International Monetary Fund (IMF) noted that there is clearly a trade-off between exerting influence and providing independent assessment. In their written submission they state that “early intervention would give the SFC more influence which on the forecasts in the short run, but would involve some degree of ownership, which would reduce its independence over the medium term.” While there is nothing wrong in having discussions throughout the year this “should not become a formal scrutiny.” On this basis the IMF argue that the assessment should be carried out after the Scottish Government forecasts are published. Otherwise, the forecasts could be changed which “would essentially mean that the SFC could influence the forecasts.”

19. In contrast, Dr Armstrong and Dr Lisenkova argue that the SFC should have sufficient time to evaluate the forecasts prior to publication. They suggest that to do so after publication “would place intolerable political pressure on the SFC and more likely to lead to suspicion rather than trust which is essential.” Scrutiny of the forecasting methods should be a collaborative and iterative process in which

17 Finance Committee, 28 October 2015, OR Col. 9
18 Finance Committee, 4 November 2015, OR Col. 7
19 Finance Committee, 4 November 2015, OR Col. 7
20 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/IMF_SFC.pdf
21 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/IMF_SFC.pdf
22 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Dr_Lisenkova_and_Dr_Armstrong.pdf
the SFC “should continuously communicate with the Scottish Government and civil servants to make its opinion as to methodology and assumptions known.”

20. During the Committee’s fact-finding visit to Dublin, Members heard that the secretariat of the Irish Fiscal Advisory Council (IFAC) has significant levels of ongoing interaction with Irish Government officials. The Council was clear that in its meetings with officials it does not give an opinion on levels of figures or attempt to influence the direction of travel of the government. Once the date of the Budget has been announced only discussions around the clarification of technical issues can take place.

21. The SFC proposes in its submission that it would have no contact with the Scottish Government during the period when it is developing its forecasts. Interaction with the Scottish Government would only take place during the year when the forecasters are developing their models and once the forecasts have been produced. The SFC proposes to publish minutes of its meetings with the Scottish Government.

Forecasting

22. The Committee recommended in its report on Proposals for a Scottish Fiscal Commission that its remit should include the option to develop its own forecasting method and analytical capacity in order to provide a benchmark set of projections. The Scottish Government stated in its response that it “does not expect that the SFC would need to develop its own forecasting methods or to have its own analytical capacity in order to provide a benchmark set of projections.”

23. The Committee subsequently recommended in its report on Scotland’s Fiscal Framework that the Commission should be able to carry out its own forecasts and that the draft SFC Bill should be amended accordingly. The Scottish Government responded that it was not persuaded that the SFC “should prepare the official forecasts for the devolved taxes” but it, of course, “remains open to the Commission to prepare alternative forecasts or assumptions to support its scrutiny of the government’s forecasts.”

24. The Bill team explained that “we have not shut down in any way the commission’s ability to produce its own alternative forecasts” and that it “will be empowered both through legislative powers and the resources that will be

http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Dr_Lisenkova_and_Dr_Armstrong.pdf
http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/72938.aspx
http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/fir15-12w.pdf
http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/SFF_Response_to_Stage_1_report.pdf
allocated to them as set out in the financial memorandum.”

However, when asked whether resources had been allocated to allow the SFC to carry out its own forecasts, the Bill team responded that “we have not specifically addressed the alternative forecast issue in our interactions with the commission on the financial memorandum.”

25. The Bill team was subsequently asked whether there may need to be a significant increase in the commission’s budget if it were to do substantial forecasting. The Bill team responded that “without being able to specify exactly what the commission might want to do, it is difficult to give a precise figure.”

Paragraph 6 of the FM states that these estimates have been prepared in consultation with the non-statutory Commission and are “intended to provide a collective understanding” of its likely resourcing requirements. It is not clear why the issue of alternative forecasts was not specifically addressed in developing a “collective understanding” of resource requirements.

26. Ian Lienert suggests that “it would be helpful for the SFC to build up in-house macroeconomic and fiscal forecasting expertise” and that the “SFC’s forecasts would be for the purpose of benchmarking” the Scottish Government’s forecasts. He points out that unlike other independent fiscal institutions the SFC will not have the option of comparing the official forecasts with those of another forecaster. It should be for the SFC to decide whether or not to publish the benchmark forecasts.

27. Robert Chote highlights the experience of the IFAC which “suggests that, with time, the commission will pretty much end up having to do a forecast of its own in order to be able to critique the forecast that it looks at from the Government.”

His view is that the Commission should have the resources to do that if they wish.

28. During the Committee’s fact-finding visit to Dublin, Members heard that the IFAC soon realised that in order to endorse the official macro-economic forecasts, it would need to produce its own forecasts as a benchmark. The IFAC’s approach to endorsement focuses on whether the macroeconomic forecasts are within a range of appropriate forecasts. This “endorseable range” is informed by benchmark projections prepared by the council’s secretariat. It involves a full-scale forecasting exercise and the development of a range of forecasting tools.

29. The benchmark projections are based around a “suite of models” approach. The models used include some based on the equations used by the Department of Finance and some developed by the council’s Secretariat. The preparation of the benchmark projections also involves discussion and input from other forecasters including the Irish central bank, the Economic and Social Research Institute, the European Commission and the IMF.

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28 Finance Committee, 28 October 2015, OR Col. 4
29 Finance Committee 28 October 2015, OR Col. 22
30 Finance Committee, 28 October 2015, OR Col. 19
31 Finance Committee, 4 November, Official Report Col. 3-4
30. The IFAC’s examination of the official forecasts includes comparing them to the benchmark projections and the endorseable range as well as assessing the consistency of the overall set of projections. The council states that while its benchmark projections may differ from the official forecasts they could still be endorseable:

“either because (i) the differences are sufficiently small to be within the endorseable range, or (ii) if the Department of Finance provides convincing reasons for forecasts further from the benchmark projections.”

31. In order “to provide an independent analysis of, and to effectively challenge the Department of Finance forecasts, the benchmark projections are completed before the Council engages in in-depth endorsement meetings with the Department of Finance.” These projections are not shared with the Department of Finance who advised that sharing forecasts in advance could lead to errors in forecasts not being picked up. It also ensures that the Department of Finance doesn’t inadvertently tailor its own forecasts to ensure they receive endorsement from the IFAC. However, the benchmark forecasts are published in the council’s fiscal assessment report.

32. The RSE are “firmly of the view that the SFC should be able to originate its own independent forecasts of the future fiscal revenues” and, indeed, “to fulfil its functions the SFC will need to be able to produce independent forecasts.” The Scottish Property Federation suggest that if the SFC “is only able to verify Scottish Ministers’ assessments then it may be difficult to convince the wider world that it is truly an independent body.” Dr Cuthbert highlights the need or an independent risk assessment of the Scottish Government’s forecasts but this does not necessarily require the SFC to carry out its own forecasts.

33. Professor McGregor and Professor Swales point out that international practice suggests that if fiscal bodies “do not provide their own forecasts they typically have access to sufficiently detailed independent forecasts.” The SFC should, therefore, produce its own forecasts for comparative purposes but it “would seem sensible perhaps to aim gradually to build internal forecasting/analytical capability.” Professor MacDonald prefers a similar evolutionary approach. The SFC should initially use the Scottish Government’s forecasting model rather than seeking to develop its own model but as its role evolves it should take on the responsibility for producing the official forecasts.

34. The Canadian parliamentary budget officer states that if the SFC produces its own forecasts, this will allow the parliament to challenge the assumptions underlying the Scottish Government forecasts. His view is that even if the SFC “is not mandated to provide independent forecasts, it needs to have the capacity and resources to produce its own alternative forecasts.”

35. Dr Armstrong and Dr Lisenkova argue that the SFC should prepare their own independent forecasts on the basis that producing a forecast “greatly adds to discipline.” However, if the remit of the SFC is limited to assessing the official forecasts...

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forecasts then Dr Armstrong and Dr Lisenkova do not think that the SFC should produce a “competing forecast.” They suggest that its role would be unclear and would create tensions with the Scottish Government “which would have a negative effect on the ability of the SFC to effectively carry out its duties. Moreover, we doubt that this would add to the credibility of the SFC.”

36. Neither the Chartered Institute for Taxation (CIFT) or ICAS believe that there is a need for the SFC to produce its own forecasts. ICAS suggest that this would be a duplication of work while the CIFT suggest the SFC could explore whether there are other alternative forecasts which it could use in its work.

37. The SFC states in its submission that “it should develop its own forecasting methods and analytical tools and its capacity over time” but it does not propose to produce the official forecasts.

38. The Committee has also previously recommended that the Scottish Government should be required to produce five year forecasts. The Scottish Government responded that it would consider this recommendation further but that currently the forecast horizon for the tax revenue forecasts is aligned with the Spending Review period. The SFC stated in their response that “the forecasters currently model the devolved taxes within a two year time frame” and that adopting “a longer timeframe might require a change to the forecasting method.”

39. The Committee has also previously recommended that the SFC should be required to provide a commentary on the Scottish Government’s tax revenue forecasts twice a year. The Scottish Government responded that it would be willing to discuss this further with the Committee.

Financial Memorandum (FM)

40. The FM estimates recurring costs of £850,000 per annum from 2017-18. This reflects the statutory functions of the Commission provided for in the Bill and does not include “the additional costs associated with any future expansion of the Commission’s functions.” Rather, the Commission’s remit as set out in the Bill “is designed to reflect and be proportionate to the fiscal powers that are devolved to the Scottish Parliament under the Scotland Act 2012.”

36 http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_Covnener_dated_3_February_2015(1).pdf
40 Finance Committee, 28 October 2015, OR Col. 2-3
41. The PM states that the Parliament’s tax-raising powers will remain modest even following the implementation of the Smith Commission proposals. The remit has, therefore, "been designed to be proportionate to the current fiscal powers of the Scottish Parliament, but to provide a basis for expanding the Commission’s functions as these powers expand."[^41]

42. Ian Lienert suggests that the estimates within the FM "are generous relative to comparable small IFS elsewhere." Table 1 below provides a comparison with the Swedish and Irish models although it should be noted that they have much wider mandates than the relatively limited remit initially proposed for the SFC.

<table>
<thead>
<tr>
<th></th>
<th>Number of Members</th>
<th>Number of Staff</th>
<th>Staffing Costs</th>
<th>Member costs</th>
<th>Annual Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFAC (2014)</td>
<td>5</td>
<td>5</td>
<td>360,000 euros</td>
<td>97,000 euros incl. expenses</td>
<td>605,000 euros</td>
</tr>
<tr>
<td>SFPC</td>
<td>6</td>
<td>5</td>
<td>500,000 euros</td>
<td>100,000 euros</td>
<td>1 million euros</td>
</tr>
<tr>
<td>SFC (2017-18)</td>
<td>3</td>
<td>6</td>
<td>£345,000</td>
<td>£112,000</td>
<td>£850,000</td>
</tr>
</tbody>
</table>

**IFAC**

43. The figures provided above for the IFAC are taken from its annual report for 2014. The budget for the Council is capped at 800,000 euros linked to inflation. The actual spend in 2013 was 480,941 euros and 604,756 euros in 2014. The Council initially had 3 staff. Since the endorsement function was added to its remit the Council has hired an additional economist and two research assistants bringing the secretariat to six. One staff member works specifically on short and medium term macroeconomic forecasting. Given the small size of the secretariat, all staff (except the administrator) contributes to the production of IFAC’s macroeconomic forecasts as part of the process of carrying out the Council’s endorsement function.

44. Council members are either paid a fee or compensation is paid to Council members’ full time-employers for the time spent on IFAC work. Fees are comparable with other non-commercial state-sponsored bodies. The 2014 annual accounts show expenditure of 65,317 euros for Council fees and expenses and that 31,720 euros was paid to other public bodies. The main time commitment for Members is to participate in a full meeting of the Council once per month. An ex Council Member has advised the Committee that in addition to these monthly meetings there is around two days a month needed to read and provide comments on draft papers prepared by the secretariat. There is also two

parliamentary appearances per year and two meetings with Irish Government officials in relation to the endorsement function.

SFPC

45. The annual budget for the SFPC is slightly less than 10 million kronor which is around 1 million euros. The Council has 5 staff which includes a head of agency, two senior economists, one junior economist and an administrator. The Council does not do any forecasting. The main forecasting institution is the National Institute of Economic Research which has approximately 60 employees. The Council relies on their forecasts and at times it commissions specified analyses from the NIER.

46. Staff costs are around 60% of the total budget but this includes remuneration for Members who are paid a fixed monthly amount. The Chairman receives 180,000 kronor per year which is around 19,000 euros. The vice chairman receives 127,000 kronor per year which is around 14,000 euros and regular members receive 110,000 kronor which is around 12,000 euros. The cost for the council is higher since this includes employer fees. As with the IFAC the main time commitment for Members is to participate in a full day meeting once per month.

47. From the above we can see that the estimated costs for Members of the SFC are much higher than for the Irish and Swedish Councils despite having fewer Members and a much smaller remit. The estimate of 1.5 days per week for SFC Members would appear to be greater than the time commitment for Swedish and Irish Council Members. It’s not clear why this is the case given the relative size of its remit compared to the Swedish and Irish models.

48. Ian Lienert suggests that it is questionable whether more than 3 Members of the SFC would be needed even with an increased remit. However, he suggests that as the SFC becomes more established then consideration could be given to “recruiting two non-executive members who would provide oversight” of the three executive members.

Staffing

49. The FM states that estimated staff costs are based on “a team of 6 full time equivalent staff providing governance, strategic, operational and technical support to members in discharging the Commission’s functions.”[^1] This is the total staffing resource which the Commission is likely to require in carrying out its functions as set out in the Bill. It does not include the likely staffing resource to support an expansion of the Commission’s role following the enactment of the Scotland Bill 2015.

50. Given the SFC’s relatively limited mandate, Ian Lienert questions why 6 full time staff are required. He points out that while the proposed staffing levels are broadly similar to Ireland and Sweden these councils have considerably wider

mandates. At the same time he also recognises that given the lack of other forecasting bodies in Scotland there will be a need for the SFC to develop a strong in-house forecasting expertise. He suggest that a “pragmatic way forward may be to recruit, say 3 staff in addition to the existing secretary, and see whether there is a need for further staff.”\footnote{Robert Chote on the other hand states that:}

“The resources that are needed to do the job properly may be rather larger than some people who have not engaged in the process think, so I suspect that the Scottish Government has made quite a good judgement on that rather than an excessively generous one.”\footnote{Finance Committee, 4 November 2015, OR Col. 5}

51. It is not clear though whether the proposed staffing resource is based on the Commission carrying out its own forecasts or whether more staff would be required if this were the case. The IFAC secretariat has doubled in size from 3 to six since it began its own forecasting operation following the introduction of the endorsement function. Ian Lienert suggests that it will take time to “build up a strong forecasting capacity within the SFC” but nonetheless such capacity is urgently needed.\footnote{http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/SFC_IFIs_Lienert_Research_Oct_2015.pdf page 34} The SFC should begin to recruit as soon as possible staff with strong analytical skills and prior forecasting experience.

52. The SFC state in their submission that the resources provided within the FM are suitable for the work which they are currently required to do but as the remit of the SFC expands, the “resources available to it will need to grow prudenty to support the additional work.”

**Additional Functions**

53. While as noted above the Bill is intended to reflect the existing legislative competence of the Scottish Parliament, the Scottish Government expects the functions of the SFC to “develop substantially to take account of the new fiscal powers to be devolved under the Scotland Bill currently proceeding through parliament and any further future devolution.”\footnote{http://www.scottish.parliament.uk/S4_Bills/Scottish%20Fiscal%20Commission%20Bill/SPBill78PMS042015.pdf}

54. The Committee previously recommended that the draft SFC Bill should be amended to widen the functions of the commission to include assessing the performance of the government against its fiscal rules and an assessment of the long-term sustainability of the public finances.\footnote{http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/90923.aspx} The Scottish Government responded that it recognised that this may be desirable and that it was included as potential future function of the SFC in its consultation on the draft Bill.
However, the “Scottish Parliament does not yet have competence to legislate for additional functions for the Commission to reflect the further fiscal powers recommended for devolution by Smith.”

55. There was a broad agreement among witnesses that the Bill should be amended to widen the functions of the SFC to include responsibility for assessing the sustainability of the public finances including adherence to fiscal rules and that the Bill. For example, the IMF’s view is that “it is common practice for fiscal councils to have responsibilities that go beyond the assessment of forecasts and, definitely, assessing the adherence of fiscal rules is often part of those responsibilities.” It would be preferable that the Bill is amended “to ensure that the SFC has a clear remit to do so.” The Canadian parliamentary budget officer states that we “are of the opinion that a charter for budget responsibility framed around the Organisation for Economic Co-operation and Development’s (OECD) best practices for budget transparency would be useful and that the SFC could ensure the Government’s adherence to the charter.”

56. Ian Lienert recommends that the Committee should urge the Scottish Government to publish a medium-term fiscal strategy including a medium-term budget framework alongside the annual draft budget. The Scottish Government should also be encouraged to publish a “comprehensive analysis of medium-term fiscal risks, including those from PFIs.” The SFC could then “assess their realism and comment on key components, including the basis of the adjustments which, along with borrowing, determine the total resources available for spending in Scotland.”

57. He also notes that in other countries such as Ireland the legislation establishing the independent fiscal institution also established the wider fiscal framework including fiscal rules. He points out that it would be possible to amend the Bill to include a few generally worded phrases relating to the wider fiscal framework. However, he highlights the need to resolve institutional weaknesses in inter-governmental relations across the UK prior to extending the mandate of the SFC.

58. The SFC states in its submission that it “believes it should have responsibility for assessing the Scottish Government’s forecasts on the sustainability of Scotland’s public finances, such as adherence to fiscal rules as an example, and it would welcome the Bill being amended now to anticipate this additional responsibility when it arises.”

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http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/SFF_Response_to_Stage_1_report.pdf

http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/IMF_SFC.pdf

http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Parliamentary_Budget_Officer_Canada_SFC.pdf


59. As these functions are not currently in the Bill, the FM does not address the level of resources which would be required.

**Conclusion**

60. The Committee is invited to consider the above in taking evidence from the SFC on the Bill at Stage 1.

Clerk to the Committee

November 2015
19th November 2015

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

Dear Convener,

Thank you for asking the Scottish Fiscal Commission (SFC) to respond to questions the Finance Committee has raised in relation to the Scottish Fiscal Commission Bill which is currently under scrutiny.

Forecasting tax revenues

In a rational world, there should be one official forecast of tax revenues and there should be an independent assessment of that forecast. The assessment may be informed by activities such as independent forecasting, drawing on research, modeling and analyses; such exercises should be done as required, and do not need to be done for every instrument and in every round. These activities should lead to a check on the official forecast. They should not become the basis in themselves for informing the Draft Budget.

The SFC, as the ‘assessor’, believes it should develop the latter type of forecasts alongside research, modeling and analysis. The object of the SFC doing so would be to provide a comparator to the forecasts released by the Scottish Government, which would help in the overall assessment of the reasonableness of the official forecasts.

The SFC will need appropriate capacity and resources to do this work, and indeed has already begun the process of building such capacity this year with the engagement of two research assistants. But it would note that building up technical and targeted modeling capacity takes time; it’s not a matter of hiring people off the street.

In order to operate independently, the SFC would itself determine when and about what to carry out such forecasting, research, modeling and analysis.

Regarding sensitivity analyses, there are limited variables in current Scottish Government forecasts which could be subjected to such analysis; there may be more over time. But, even now, there may be instances, for example, when the SFC would want to consider or propose a wider range of economic determinants for a given tax, or it might comment that the official forecast is reasonable but particularly sensitive to specified factors.
In sum, the SFC agrees that it should develop its own forecasting methods and analytical tools and its capacity over time, to assist in its judgment of the reasonableness of the official forecasts. But it does not propose to produce the official forecasts which inform the Draft Budget.

**Role of the SFC prior to the publication of the SG forecasts**

The SFC identifies two types of interaction with the Scottish Government forecasters. There are pros and cons as to when these interactions should take place.

There is a time when contact with the forecasters is helpful in equipping the SFC with a full understanding of the approaches they are taking. And there is interaction once the official forecasts are complete, at which time the SFC will have questions for the Scottish Government in order to understand better what underpins the forecasts, so that it can carry out its assessment of their reasonableness.

However, if there is direct engagement while the forecasters are developing and refining their forecasts, there could be the imputation of undue influence over the very forecasts on which the SFC has to pass judgment.

On the other hand, if there is no contact, there is the possibility of a Budget debate taking place using unreasonable numbers, and that is surely to no one’s benefit. If there is no contact between the SFC and the forecasters until the Draft Budget is published, and the forecasts turn out to be lacking, surely there will be loud voices asking where was the SFC? And why did they not do something to ensure a sounder set of forecasts?

The SFC views its role as one of serving the public good. With that aim in mind, it would propose a possible solution to this conundrum. The SFC could have direct engagement with the forecasters in the early part of the year when the forecasters are developing or refining their models. The SFC would draw on any challenges it had issued in relation to the forecasts developed for the previous Draft Budget, and on its own conceptual approach to given taxes. The SFC’s role would be to challenge and influence the efficacy of Scottish Government processes and approaches, for example in light of out-turn numbers or if an approach has had to be developed for a new tax.

The SFC would then have no contact while the Scottish Government developed its forecasts and until the point when the Draft Budget itself is submitted for publication. At that point, the SFC would engage directly with the Scottish Government again to investigate the processes and approaches they chose in the end to take. And, at that stage, without having had any interaction while the forecasts were developed, the SFC would make its assessment of the reasonableness of those forecasts.

In order to ensure transparency at every stage, the SFC would publish Minutes of its meetings with the Scottish Government, both those early in the cycle to look at Scottish Government methods and approaches, and those emanating from the scrutiny meetings after the forecasts are made public.
It would facilitate our work if the SFC could see the forecasts as soon as the Draft Budget goes to print, which is some days before it becomes public. Also, the SFC has found value in submitting its Report to Scottish Government purely to check for factual errors, and would propose doing so very shortly before its Report is published, and after the forecasts have been finalised.

**Additional functions**

The SFC believes it should have responsibility for assessing the Scottish Government’s forecasts on the sustainability of Scotland’s public finances, such as adherence to fiscal rules as an example, and it would welcome the Bill being amended now to anticipate this additional responsibility when it arises.

In order to play a role in relation to the block grant adjustment, the SFC would clearly need to understand how the adjustment is calculated and applied. However, the SFC understands that the mechanisms for adjusting the block grant are currently under discussion. For that reason, we won’t at this time offer a view about potential engagement in this area. Whatever the ultimate decision, however, the SFC should play no role in negotiations between the Scottish Government and the UK Government.

Whether Parliament proposes that the Scottish Government develop a charter for budget responsibility, or the adoption of fiscal rules, our response is the same. The SFC should play a role in adherence to these requirements.

**Right of access to information**

The SFC believes that the right of access to the information it requires is essential; it would have no objection if this wording were made more robust.

MOUs are the normal way of working across public sector areas; if the SFC’s right to establish relevant MOUs would be better safeguarded with more explicit wording on the face of the Bill, then the SFC would support doing so.

Principles of transparency and cooperation should underpin all the working arrangements between the SFC and the Scottish Government and other relevant public bodies. To date, the SFC has found these counterparties to be fully cooperative.

Over time and in order to do its job properly, the SFC’s goal would be to have a deeper relationship with the OBR and HMRC. The Scottish Government would need to negotiate with the UK Government in the first instance to establish formally those relationships.

**Appointment of members and staff**

The SFC believes the proposed appointment and removal procedures are adequate for ensuring the independence of Commission Members. The Public Appointments process is rigorous and rigorously executed.
The term of office should be stated in the Bill and the SFC believes, on the whole, that a single non-renewable term as currently pertains is effective, and that individual terms should be staggered.

The SFC must be able to determine its own staffing arrangements, within the constraints of public sector T’s and C’s.

**Resources**

The overall costs set out in the Financial Memorandum appear to be suitable for the work currently required of the SFC. As the remit of the SFC expands, it will need to commit more time for instance to research, assessment of adherence to fiscal rules and to carry out other activities. The resources available to it will need to grow prudently to support the additional work.

We hope these comments are useful and look forward to meeting with the Committee in due course.

Sincerely yours,

Lady Susan Rice   Professor Campbell Leith   Prof Andrew Hughes Hallett
Report

by

Scottish Fiscal Commission

9th October 2014

www.scottishfiscalcommission.org
Overview

Under powers in the Scotland Act 2012, the Scottish Government will begin to receive tax revenues from two newly devolved taxes to fund a proportion of public spending in Scotland starting in 2015/16. The Land and Buildings Transaction Tax and the Scottish Landfill Tax will differ in some respects from the equivalent taxes today.

The Scottish Fiscal Commission was created in June 2014 by the Scottish Parliament. It was established with a simple remit, to review Government forecasts of receipts from these devolved taxes, and to scrutinise the economic determinants underpinning forecasted receipts from non-domestic rates. The Commission is not charged with doing its own economic forecasts or original analysis.

In providing ‘impartial and expert public scrutiny’ of the Scottish Government’s tax forecasts, its aim is to give both the Scottish Parliament and the public assurance about the reasonableness and integrity of the forecasts.

The Commission anticipates being put on a statutory basis in the future but has meanwhile set out to operate to the extent possible according to best public sector practices.

The nominations of Commissioners by the Cabinet Secretary for Finance, Employment and Sustainable Growth were scrutinised by the Finance Committee, debated in and ultimately approved by the Scottish Parliament. Three Commissioners were appointed on staggered, non-renewable contracts in July and began formal meetings in early August.

The Commission operates independently of the Scottish Government. It does not draw on Scottish Government officials for its own work or analysis, but can commission research independently as needed. The Commission is also in the process of establishing access to new data sources, and alternative forecasts where they are available for comparison. To help ensure its independence from Government, the Commission will be hosted by Glasgow University.

An initial budget of £20,000 was set aside for expenses. To date, these have related to travel or incidentals and have not yet been claimed against the budget. The University of Glasgow will generously provide in-kind support including an office, administrative assistance, access to its library and archives, and it will host the Commission’s website.
Work Programme

The Commissioners have held a series of internal meetings and regularly met and corresponded with Scottish Government economists and forecasters. Their first step was to understand the models being used by the officials to predict potential tax revenues. They then moved to examine the Government’s quality of data and information, as well as the working assumptions being applied.

The Commission’s approach can best be described as one of enquiry and challenge, followed by response, followed by further enquiry and suggested improvements. It examined many issues, ranging from formal mathematical modelling, to the role of judgement in methods of forecasting, to the composition of landfill waste.

Meetings were also held with several agencies with whom a long-term relationship will be important, for example with SEPA and soon with the Registers of Scotland, all of which have a role in the provision of data. In addition, the Commission had more extensive contact with the OBR, whose UK forecasts are sometimes used as an element feeding into the Scottish Government’s forecasts.

Contact was also made with HMRC, the OECD team which enables an international network of fiscal commissions, with the UK network of parliamentary budget offices, with Fiscal Commissions in Sweden and Ireland, as well as with the Scottish Parliament’s Financial Scrutiny Unit.

Where meetings have already taken place, the Commission has found everyone contacted willing to share expertise, views, and their assumptions and analysis when asked.

Assessment of the Forecasts

Overall, the Scottish Fiscal Commission is able to endorse as reasonable the forecasts made by the Scottish Government in respect of the items defined in our remit. We expect these forecasts to be refined over time with experience and practice. However, the Commission also intends to discuss with Scottish Government forecasters possible ways to enhance the forecasting methods employed in future forecasting rounds, especially as improved data become available.

In the Commission’s view, the biggest contribution to improving the accuracy and reliability of these forecasts will be to improve the availability of data relevant to the Scottish economy in general, and these three revenue streams in particular, whether newly collected data, data held by the Scottish government and its various agencies, or data held by the UK government and not yet available to outside agencies.

We recommend, especially if revenue-raising powers expand, that Parliament and the Government take early steps to enhance accessibility to and quality of historic data.

Over time, as well, the Commission would expect the forecasts to reflect economic drivers such as external financial conditions, and behavioural responses, for instance in reaction to changes in tax rates.

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1 See Appendix for outline of the Commission’s activities
Conclusion

This is a ‘first’ for all of us, for the Scottish Government to forecast what revenues it might take from the new taxes, for the Scottish Fiscal Commission to become familiar with the Government’s models and make a judgement on its forecasts, for both sides to assess the quality of data which is available and to determine what needs to improve or be enhanced in the coming years.

The Commission is grateful for the co-operation of the Scottish Government officials; it would welcome feedback from any reader to this report. What follows is an assessment of their forecasting methods as applied to both of the devolved taxes and of the economic determinants of income from non-domestic rates. The Commission found these forecasts, within the constraints of the available data, to be reasonable.
Assessment of Forecasting Methods

The forecasting methods applied to each devolved tax and the income from non-domestic rates are considered in turn, each followed by recommendations.

1) Land and Buildings Transactions Tax (LBTT)

*The residential model*

The forecasting of the tax revenue from LBTT is divided into *residential* and *non-residential* components. The former begins by using historical data on property transactions to describe the probability that any observed property transaction will occur at a particular price. The forecaster then uses a simple statistical model to forecast average house prices. This average is then used to adjust the parameters of the distribution for the period of the forecast in question.

Finally a linear extrapolation from the current level of transactions to an assumed long-run trend or average is used to forecast the volume of transactions. This forecasted volume of transactions can be combined with the forecasted (repositioned) distribution of property transactions in different price categories to generate forecasts for the volume of transactions in each price category. The relevant tax schedule can then be applied to calculate forecast tax revenues per price category and in total.

However, given that the reliable application of standard statistical forecasting techniques depends on having a significant quantity of relevant historical data, the Commission would recommend that the Scottish Government prioritises obtaining such data from existing sources. This is likely to be a more effective way of quickly improving the quality of data available to forecasters than waiting to accumulate meaningful quantities of data from new data sources over time.

That suggestion notwithstanding, this approach is reasonable at this stage in the economic cycle\(^2\), although the simplicity of the extrapolations of both price and transaction volumes makes it difficult to undertake formal assessment of the uncertainty inherent in the forecast, or to undertake any sensitivity analysis beyond mechanically varying either the level of prices or volume of transactions to give a range but not likelihood of forecast errors.

*Recommendations*

a) The fit of the price distribution reveals that: i) 4% of revenue is lost at the tax band thresholds under the existing tax system – this should largely be removed under the new tax; ii) there is an underprediction of the volume of high end property transactions. But since such transactions currently only account for 1-2% of revenues raised, this second element is likely to be small relative to possible specification and data errors elsewhere in the model; and iii) the relatively high tax rates applicable to the upper band of the new LBTT may also induce an additional behavioural response which has not been factored into the forecast\(^3\). The current forecasting methodology does not account for these revenue losses. The forecast

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\(^2\) The simple linear extrapolation of transactions between their current and long-run average value is, however, likely to misforecast this variable as we enter a recession or the expansionary phase of the economic cycle.

\(^3\) The Commissioners will review the evidence presented to the Finance Committee on this issue.
revenues therefore may be expected to overestimate the actual outcomes to some extent. That said, it may be worth investigating another type of distribution with a similar shape for the distribution of prices across price bands to see if a better fit can be obtained.

b) The forecasts of average house prices and the volume of transactions are both areas where, ideally, the forecasts would be based on a reliable statistical model which took account of the economic determinants of these variables. These determinants would include, for example, the evolution of the economic cycle, the level of household indebtedness, the level of interest rates, the regulation of mortgages or other, similar, factors. However, successfully developing such models is notoriously difficult and they are unlikely to be successful in this instance given the available data.

Accordingly, in the short to medium term, as more data become available, we would like to see development, and exploration, of a range of simple statistical models of the path of the house price and transactions data, either individually or jointly. A simple statistical model is currently employed in forecasting average house prices, but extending this to the forecast of residential housing transactions is likely to be particularly important as this variable is volatile and the current approach is unlikely to be robust at all stages of the business cycle.

Little can be done about these issues in the short term. But, in the longer term, there are a number of ways in which the forecasting techniques could be adapted to take account of insufficient or imperfect data on the Scottish economy.

One possibility is to use Bayesian econometric techniques for forecasting in data-poor environments by combining different models to produce a forecast – for example, using the limited Scottish data to update a forecast based on UK data. This would essentially be a formalisation of some of the subjective adjustments currently being made in the forecasting process. Of course, the success of such an approach ultimately depends on the extent to which the information which is being fed in is representative of the missing data.

Another possibility is to take a base model, together with a series of ready reckoner adjustments based on past outliers and knowledge of the market, to get projections back on track. This approach is perhaps best suited for taking into account the effects of external factors for which no explicit Scottish data exist.

The non-residential model

Scottish Government forecasters revealed that the non-residential element of the forecast is hampered today by data availability. It therefore largely relies on the Office for Budget Responsibility (OBR) forecasts for commercial property prices and transactions for the UK as a whole, albeit with a smoothing adjustment in the way OBR’s growth rates are projected forward. In the absence of directly relevant data, this approach is reasonable. However, since it is not possible to assess the applicability of this approach to Scotland for lack of Scottish data, this part of the forecast is liable to significant uncertainty which is not possible to quantify. Further work is therefore needed to assess the extent to which relying on prorated OBR forecasts from UK-wide data is an acceptable strategy.

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4 Preliminary HMRC data suggest that the tax revenues under the Stamp Duty Land Tax regime have been significantly higher than forecast for the non-residential sector. The most likely reason for this is that a greater volume of transactions has taken place at the upper end of the distribution of property prices than was implicitly assumed in the forecast. As these data are preliminary, the Scottish Government has chosen not to update its forecast. However, to the extent that such a pattern is maintained, the current forecast is likely to be more conservative than previously thought.
Recommendations
Because there is currently a lack of data to forecast this component of the Scottish economy directly, the primary recommendation is to develop new data sources as a high priority. Ideally, the forecasters should have a substantial time series of Scottish data carved out from existing sources. However, as this is currently a challenge, creating a new Scotland-specific data set may be the only reliable strategy. That is neither a short-term nor cheap undertaking.

The Scottish Government takes comfort from the fact that, in recent years, the changes in transactions appear to be similar in both Scotland and the UK. However, this does not always translate into the same similarity in observed changes in tax revenues, possibly because the transactions are taking place at different points in the price distribution. This suggests that further work on developing a model for Scottish non-residential revenues is therefore required.

The Commission believes that a new model, with some explanation of the economic drivers of the revenue variations, and better data, are needed in the longer term.

2) Scottish Landfill Tax (SLfT)

The Scottish Landfill Tax forecasts start from the assumption that the Scottish Government will achieve its targets for the reduction in landfill waste by 2025, in a linear extrapolation from the current level of waste being sent to landfill to the target value of 5% of total waste to landfill. At present there are insufficient data to speculate as to whether there will be slippage in the future, in part because landfill operators report on a UK-wide basis. This problem may resolve when Revenue Scotland starts to collect the tax instead of HMRC.

Thus, the current methodology is the most optimistic of forecasts for reducing landfill waste, and the most conservative in terms of forecasting tax revenues. However, it is not out of line with declines in the volume of waste sent to landfill in recent years. The Commission will continue to monitor landfill volumes to assess whether this projected path is a reasonable one and whether or not this downward trajectory will be sustained.

Data limitations then require assumptions to be made about the composition of waste being sent to landfill – namely that the ‘mixed waste’ reported by SEPA is all taxed at standard rates, and that the proportion of ‘active waste’, also taxed at the standard rate, relative to total waste is constant over time. This has to be done because detailed SEPA data are categorised differently from the definitions used in the application of the Scottish Landfill Tax. It should also be noted that SEPA data are reported with a two year lag, giving an asymmetry between the information on which the forecasts are based, compared to information on which the taxes are assessed.

Finally, a lack of Scotland-specific data means that the discrepancy between landfill waste reported by the environmental agencies and HMRC at the UK level (16% lower using HMRC data for 2011/12) have been applied to the Scottish Government’s forecasts for taxable waste volumes.
**Recommendations**

a) The fact that different types of waste need to be separated out implies that the different tax rates on each are thought to make a difference. In that case, the behavioural responses to changing tax rates need to be investigated. We should be able to learn from that and improve the forecasts.

b) That said, the Scottish Government’s forecasts reflect data collected from site visits while the OBR forecasts are based on HMRC’s revenue data. We will monitor in the future to see which is the more accurate and robust approach.

c) As data emerge, we need to assess whether or not the assumed downward trajectory of landfill volumes is on a reasonable path to achieving the 2025 target.

Overall, given the current data availability, this approach to forecasting revenues from the SLfT is not unreasonable, although the Commission would hope to see a close monitoring of the validity of the assumptions underpinning the forecast as Scotland-specific data on landfill waste and tax receipts become available.

3) **Non-Domestic Rates Income**

The change in income from non-domestic rates depends upon three factors – the change in the rateable value of properties (excluding revaluation appeals) or ‘buoyancy’, the change in the poundage – a tax rate applied to the rateable value adjusted in line with inflation to maintain the revenue’s real value, less the value of any reliefs granted. These three components are forecasted separately.

i) **Buoyancy**: the rateable value component of the model, calculated as the forecasted increase in the tax base not including any annual changes in the value per square foot of floor space (i.e. at constant prices).

The forecast of buoyancy begins from a base year (last known values) and applies forecast changes for three years using a data average growth rate of 1.25% derived from data for 2006-14. Unfortunately, this is an insufficient time-span of data to undertake any formal statistical modelling or an assessment of its reliability. Second, only the first of the forecast years is used for the budget while figures for the other two years only indicate what may happen in subsequent budgets.

The underlying average growth in buoyancy is then adjusted upwards or downwards based on an assessment of a number of macroeconomic and microeconomic leading indicators, some of which are noted below. For the current forecast, the Scottish Government forecasters believe that such indicators are generally positive and have adopted a forecast buoyancy growth rate of 1.55%. It is not known if this increase in trend will be a one-off or permanent increase, but the implication of the model is that it should be temporary and reflect movements in economic leading indicators.

This increase in the forecast growth rate seems to be on the optimistic side, implying an increase in buoyancy as large as anything observed in the available data, rather than an historical average. Note that this change in trend growth would make little difference to the change in buoyancy for a particular year, but a larger difference to the level of buoyancy over time from which the revenue forecasts for that particular year are calculated, in other words, the impact of buoyancy is cumulative. At this point there are no other allowances for the economic factors that provide incentives to change the floor space in use, although there
is work underway to identify what those factors might be and how they have affected the buoyancy figures.

ii) **Poundage**: (% per £ of rateable value) is essentially a decision made by Government, and therefore acts like a tax rate set by Government. One issue is that, while it will be known in advance, it could nevertheless change.

In recent years, poundage has been set to rise with inflation. The inflation forecasts are taken from the OBR’s forecasts for September RPI inflation, with a cap of 2% imposed for the 2014-15 adjustment. If a similar cap were to be applied in the future, then given the OBR’s forecasts that RPI inflation will lie significantly above this threshold in the forecast horizon, the Scottish Government calculates that there would be a reduction in the forecast income in the order of £2.6m for every 0.1% of inflation cap. No cap has been factored into the forecasts, although it is anticipated that Barnett consequentials will be triggered should a cap be applied as happened in 2014-15.

iii) **Reliefs**: these are subject to a legal process and lie beyond the forecaster’s reach. It would be best to follow current practice and take the data from local Councils, including data from backdated reliefs. It is also possible that reliefs may become an instrument of policy in the future (eg granting relief to SMEs). If that happens, or if it becomes an item for discussion, then the proposed reliefs can be entered directly like any other policy variable.

**Recommendations**

a) At present, the forecasters project the trend in buoyancy for the next three years in order to make their NDR revenue forecasts. This could be improved by projecting the trend adjusted by economic and local factors, such as forecasted changes in GDP, investment trends, data on planning applications, specific projects that are known to be coming on stream, business confidence indicators, among others. To do that requires econometric studies of what economic factors matter, how much they matter and, most important, how the lags between the changes in those factors and buoyancy play out. The Commission understands that the forecasters have begun a programme of research to address those questions.

b) Similarly, it would be important to allow for financial influences on NDRI revenues – most probably in delaying or accelerating the finishing time of different projects and hence the timing of changes in NDRI revenues. Anecdotal evidence from the work done so far suggests that the timing and lags between changes in the determining variables and revenue levels are the most important items for improving the buoyancy projections. The Commission would like to see this part of the forecasting process extended and/or made more systematic.

c) The Commission recognises that, with limited data sets, a more comprehensive econometric exercise in extending the methodology is unlikely to provide reliable results. Nevertheless, some understanding of the economic influences would be helpful for formally justifying adjustments to the buoyancy trend. They otherwise appear arbitrary and open to question. In that context, the increase in trend buoyancy appears to be largely a subjective assessment of projected movements in buoyancy.

d) The Commission recommends that work continues on improving understanding of the economic determinants underlying the NDRI forecasts as a matter of priority. And revaluation is an important factor to consider. Net NDRI revenues are five to six times larger than the LBT and SLfT taxes combined. It would therefore pay to make them as reliable as possible, as quickly as possible.
4) Improving the Forecasting Process

Since it has not been necessary to collect data to forecast these taxes in the past, it is inevitable that data have been limited in this first round of forecasts. Plans are therefore in train to gather Scottish data in the future, for instance waste data by SEPA and revenues by Revenue Scotland. However, since a robust forecast should ideally draw on time series data of at least 30 years in length, it would also be useful to carve out existing data from existing sources such as HMRC.

Such an approach could also usefully be complemented by employing statistical techniques designed to facilitate forecasting in data poor environments. However, there are also a number of other cases where there are no Scotland-specific data available at all. In those cases it would be important to examine possible forecast errors implied by, and the value of, using pro-rated UK data in their place.

Thus, the forecasting of almost all elements of the devolved taxes and non-domestic rates income is hampered by data availability in this, their first year. Assumptions which appear to be reasonable have therefore had to be made to build a forecast from available data, but a formal statistical analysis of the results cannot yet be undertaken. As a consequence, the forecasts will have unquantifiable uncertainties attached to them.

The Commission intends to engage with the Scottish Government forecasters to monitor the validity of the assumptions that have been and will be made as new Scottish data become available, and to improve forecasting methods in light of that information.

Lady Susan Rice CBE FRSE
Commission Chairman

Professor Andrew Hughes Hallett FRSE
Commissioner

Professor Campbell Leith FRSE
Commissioner
## Appendix

### Scottish Fiscal Commission Activities

<table>
<thead>
<tr>
<th>Week</th>
<th>Activities</th>
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<tbody>
<tr>
<td>May 12th</td>
<td>Initial conversations with John Swinney about SFC</td>
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<tr>
<td>May 19th</td>
<td>- Conversation with SG for background to the scrutiny process</td>
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<td></td>
<td>- Applications submitted to Finance Committee</td>
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<tr>
<td>May 26th</td>
<td>- Finance Committee: CL and SR scrutinised</td>
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<tr>
<td>June 9th</td>
<td>- Finance Committee: AHH scrutinised</td>
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<td></td>
<td>- Mr Swinney’s evidence to Finance Committee on nominations to SFC</td>
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<tr>
<td>June 16th</td>
<td>- Finance Committee report published about appointments to the SFC</td>
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<tr>
<td></td>
<td>- Meeting of SFC (as nominees)</td>
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<tr>
<td>June 23rd</td>
<td>- Parliamentary debate and confirmation of the SFC appointments</td>
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<td></td>
<td>- SFC Commissioners announced</td>
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<td></td>
<td>- Conversation with SG on way ahead</td>
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<td></td>
<td>- Correspondence with SEPA regarding meeting</td>
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<td></td>
<td>- Correspondence regarding work arrangements</td>
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<tr>
<td>June 30th</td>
<td>- Correspondence with Robert Chote of the OBR regarding a first meeting</td>
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<td></td>
<td>- Correspondence with Glasgow University regarding hosting the SFC</td>
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<td></td>
<td>- Second meeting of the SFC with Scottish Government representative</td>
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<tr>
<td>July 7th</td>
<td>- Correspondence with SG regarding arrangements and contracts</td>
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<td></td>
<td>- Correspondence with Glasgow University about arrangements</td>
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<tr>
<td>July 14th</td>
<td>- Review Terms and Conditions of appointment</td>
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<tr>
<td>July 21/28th</td>
<td>Holidays</td>
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<td></td>
<td>- Review of OBR Reports and OECD guidance</td>
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<tr>
<td>August 4th</td>
<td>- Meeting with Robert Chote, chairman of the OBR</td>
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<td></td>
<td>- Correspondence with SG on Terms of Engagement</td>
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<td></td>
<td>- Update of work over the summer</td>
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<tr>
<td>August 11th</td>
<td>- Initial papers on economic models received from SG</td>
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<td></td>
<td>- First meeting with Scottish Government economists and forecasters and</td>
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<td>follow-up correspondence</td>
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<td></td>
<td>- Comment in Parliament about female representation on the SFC</td>
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<td></td>
<td>- First meeting at Glasgow University and follow-up on arrangements for an</td>
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<td></td>
<td>office and support</td>
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<td></td>
<td>- Correspondence with SG on SFC engagement plans with agencies such as the</td>
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<td></td>
<td>OECD, SEPA, and specific contacts</td>
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<td></td>
<td>- Review note of Scottish Tax Consultation forum (May ’14)</td>
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<td>Week August 18th</td>
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<tr>
<td>- Invitation from Finance Committee to speak to them on 29/10</td>
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<tr>
<td>- Ongoing correspondence with Glasgow University on arrangements</td>
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<tr>
<td>- New papers received from Scottish Government in response to SFC queries</td>
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<tr>
<td>- Correspondence with SEPA regarding a meeting</td>
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<tr>
<td>- Correspondence with the OECD to introduce SFC</td>
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<tr>
<td>- Correspondence with the Scottish Parliament’s Business Scrutiny Unit to introduce SFC</td>
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<tr>
<td>- Correspondence with Scottish Government Chief Economist about external sources of models of the Scottish economy</td>
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<thead>
<tr>
<th>Week August 25th</th>
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<tr>
<td>- Meeting with Simon Wakefield of the Parliamentary Budget Scrutiny Unit</td>
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<tr>
<td>- Further correspondence with Budget Scrutiny unit</td>
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<tr>
<td>- Correspondence with Scottish Government, receipt of NDRI papers and responses to other questions</td>
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<tr>
<td>- Correspondence with Registers of Scotland to introduce SFC</td>
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<td>- Correspondence with Lisa von Trapp of the OECD to introduce SFC</td>
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<tr>
<th>Week September 1st</th>
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<tbody>
<tr>
<td>- Ongoing analysis and challenge back to SG</td>
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<tr>
<td>- Further discussions on research assistant and PA to provide support in Glasgow University</td>
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<tr>
<td>- Correspondence with Registrars of Scotland to introduce SFC</td>
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<tr>
<td>- Ongoing consideration of all information to hand and receipt of models of Scottish economy</td>
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<td>- Further correspondence with OECD</td>
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<tr>
<th>Week September 8th</th>
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<tbody>
<tr>
<td>- Meeting at SEPA</td>
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<tr>
<th>Week September 15th</th>
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<tbody>
<tr>
<td>- Meeting of SFC</td>
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<tr>
<td>- Preparation for and meeting with Scottish Government officials</td>
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<tr>
<td>- Extensive discussion and early drafting of Report by the SFC</td>
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<tr>
<td>- Correspondence with SEPA requesting information</td>
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<tr>
<td>- Meeting with Peter Aitchison and press team, and others, at Glasgow University about website, communications, office arrangements</td>
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<tr>
<th>Week September 22nd</th>
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<tr>
<td>- Meeting of SFC in Glasgow</td>
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<tr>
<td>- Correspondence with HMRC to introduce SFC</td>
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<tr>
<td>- Further progress within Glasgow University</td>
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<tr>
<td>- Ongoing exchange with Scottish Government</td>
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<tr>
<td>- Meeting with SG officials</td>
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<tr>
<td>- Meeting with Irish Fiscal Commission for background discussion</td>
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<tr>
<td>- Receipt of report from Swedish Fiscal Commission again for review and comparison</td>
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<tr>
<th>Week September 29th</th>
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<tr>
<td>- Several meetings of the SFC</td>
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<tr>
<td>- Meeting with the Cabinet Secretary for Finance, Employment and Sustainable Growth to present draft Report and discuss logistics for release of the final version</td>
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<tr>
<td>- Receipt of a draft Framework for the SFC to consider regarding its working arrangements and responsibilities</td>
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<tr>
<td>- Regular correspondence with SG to clarify information</td>
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</table>
- Correspondence with the OBR requesting information
- Letter to HMRC to introduce SFC and requesting information
- Letter to Revenue Scotland to request meeting
- Correspondence with UK network of budget scrutiny offices about joining their next meeting
- Extensive work on Report
- Draft Report sent to SG for fact check

**Week October 6th**
- Continued fine-tuning of Report and further fact checks
- Report finalised
- Press Release finalised and arrangements made to publish the Report on the SFC website, hosted by Glasgow University, issuing press release a couple of days beforehand.

HMRC  Her Majesty’s Revenue & Customs  
NDRI  Non-Domestic Rates Income  
OBR  Office of Budget Responsibility  
OECD  Organisation of Economic Cooperation and Development  
SEPA  Scottish Environmental Protection Agency  
SFC  Scottish Fiscal Commission  
SG  Scottish Government