



The Fiscal Decentralization Initiative
for Central and Eastern Europe

Property Taxation: Evolving From a Shared Legislative Heritage

The Means of Property Taxation in Croatia

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Property Taxation: Evolving From a Shared Legislative Heritage

The Means of Property Taxation in Croatia

Ante Pavić

Introduction

Many different approaches to property taxation exist among European countries. The European Union does not have any requirements or conditionalities with respect to an ad valorem property tax. The European Charter on Local Self Government only states that local governments should be provided the fiscal tools with which to carry out their responsibilities.

Virtually all European Union countries have some form of property taxation, the only exceptions being Malta and Norway. All of the countries which administer a property tax, base the tax on the value of the property. However, each country may define “property” differently. Some countries may tax the land only, others only tax the buildings. However, most European countries include both land and buildings in their definition of real estate. Many combinations of property taxation may be found depending on how property is defined for each type of real estate.

In over half of the EU countries, the owner of the real estate is specified as the taxpayer. However, in countries where land registries are outdated, oftentimes the owner or occupier is the one who pays the tax. The issue of regular maintenance, updating and verification of land registries and property values is a problem for many European governments. Few countries have provisions for updating valuations and most governments have postponed revaluations for a number of years. This leads to inaccurate capital value estimates, undermining the basis of the tax, not to mention taxpayer confidence that the tax is being administered fairly.

In terms of exemptions and reliefs, it is difficult to find a common approach amongst EU countries but they tend to be limited and targeted towards specific taxpayers such as religious, cultural and historical institutions.

Property taxation in Croatia, as well as in most eastern European countries, is the result of unique set of historical, political, and institutional facts and changes that shaped and influenced ways of government financing in this part of the world. As a result of that Croatia doesn't

have a real ad valorem property tax, but instead a range of property related taxes and fees. That said, at the outset of this paper it is worthwhile to note, that the majority of property related taxes in Croatia belong to local government units, mainly municipalities and towns.

The goal of this work is to explain relevant issues concerning all taxes and fees that are directly or indirectly related to property taxation.

On the next page we will list all these taxes and show to which level of government revenues from them belong. They are as follows:

- The Tax Shared Between the State and Local Units
 - Property Transfer Tax
- The County Tax
 - Gift and Inheritance Tax
- Municipality/Town Taxes
 - Tax on vacation houses
 - Tax on idle agricultural land (imposed in 2001)
 - Tax on vacant business properties (imposed in 2001)
 - Tax on undeveloped building land (imposed in 2001)
 - Company and title tax
 - Tax on public areas use
- Municipality/Town non-tax revenues
 - Communal fee
 - Communal charges (contributions)

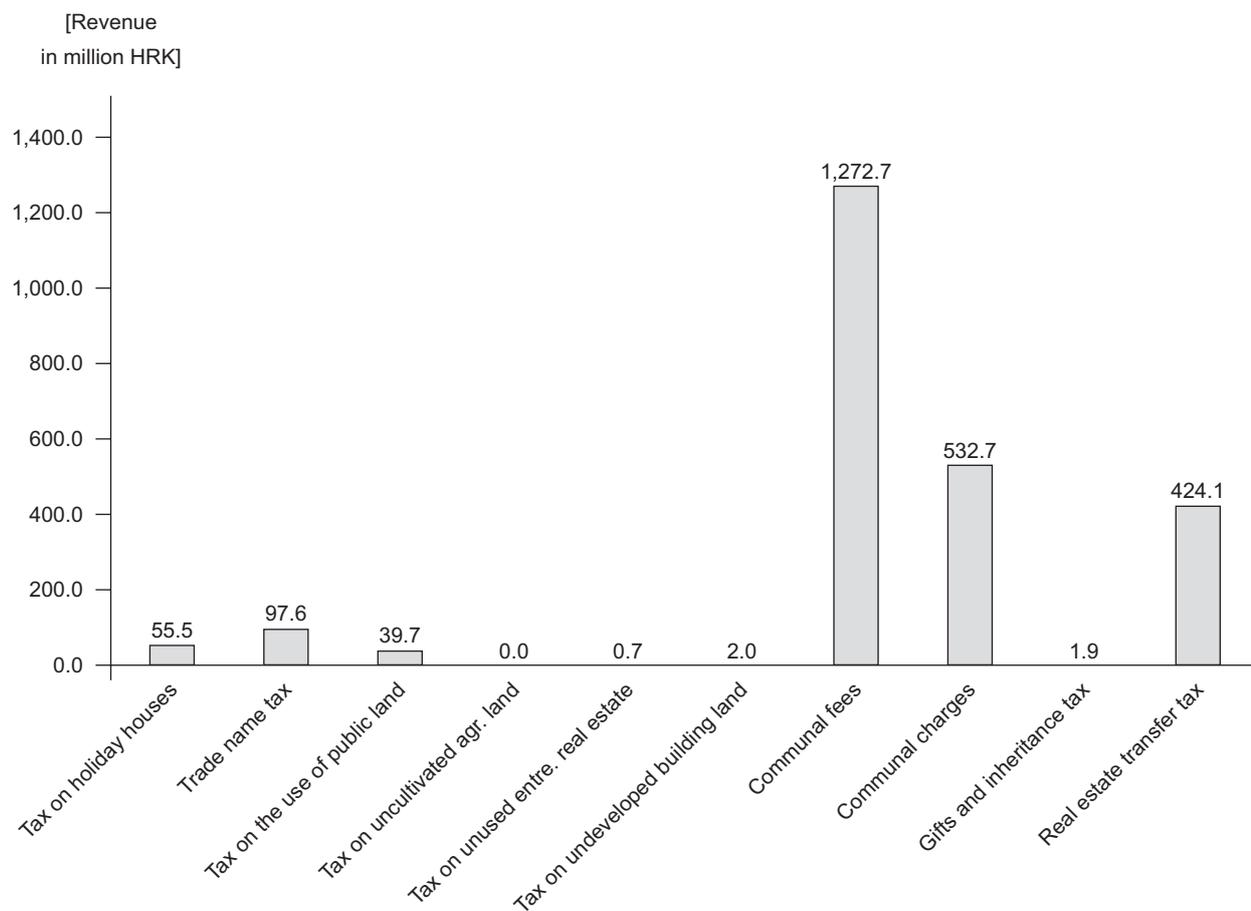
In Croatia, the different property taxes, the real estate transfer tax, and the communal fee and charge system each has a base and range of rates set by the central government. Local government is responsible for confirming the base, for setting tax rates within the legal ranges, and deciding on local exemptions. The revenue from all property taxes and the communal fee and charge is allocated to local budgets, except for the property transfer tax where 60% of income from the property transfer tax is allocated to local budgets.

Table 1. Property related taxes in Croatia

Taxes	01.01.–31.12.2003 (million HRK)	(%)	01.01.–29.02.2004. (million HRK)	(%)
Tax on vacation houses	55,467	2,29	2,340	0,73
Company and title tax	97,617	4,02	5,800	1,81
Tax on public area use	39,683	1,64	2,430	0,76
Tax on idle agricultural land	0,015	0,00	0,001	0,00
Tax on vacant business properties	0,708	0,03	0,075	0,02
Tax on undeveloped building land	2,013	0,08	0,210	0,07
Communal fees	1272,736	52,44	166,430	51,89
Communal charges	532,700	21,95	76,167	23,75
Gifts and inheritance tax	1,900	0,08	0,285	0,09
Real estate transfer tax	424,100	17,47	67,000	20,89
Total property taxes	2426,939	100,00	320,738	100,00

Source: Institute for Public Finance, Croatia, 2004.

Chart 1. Importance of various property related taxes in Croatia



Source: Institute for Public Finance, Croatia, 2004.

Table 2. Tax revenue sharing between different levels of government

Type of taxes	Central Government	County	Municipality/ Town	Decentralized functions	Fire Brigades	Equalization Fund
Income Tax	24.6	10	34	9.4	1	21
Income Tax (Zagreb)	21.6		47	9.4	1	21
Profit Tax	70.0	10	20			
Property Transfer Tax	40.0		60			

1. Tax Shared Between the State and Local Units

The main source of local units' revenues are the taxes shared between the central government and local units. Table 2. shows the shared taxes in 2003.

The local units' expenditures are mostly financed from the shared taxes, particularly by the income tax and surtax. This is confirmed by the high income tax and surtax portions of the total taxes: 63% in the counties, 66% in municipalities, 69% in towns and almost 74% in the City of Zagreb. In addition to this, the portion of income tax and surtax increases in all local units. Other tax forms have a different role. The profit tax in the counties occupies the second place and is about 23% of the tax revenues in the counties and 16% in the City of Zagreb. The property transfer tax occupies the second place in municipalities, with 22%, and in towns with 16%.

1.1 Property Transfer Tax

Subject of Taxation

The subject of taxation of the property transfer tax is, as the name of the tax already implies, the property transfer, meaning any acquiring of an ownership right over the properties in the Republic of Croatia. The law also defines what is meant by "properties" and specifies the existence of two groups of properties:

- Lands
- Buildings

Lands can be additionally classified into: building lands (developed and undeveloped) and agricultural lands (used and idle).

Buildings can have the following forms: residence buildings and their parts, business and other buildings, as well as their parts, and other buildings (including garages, roads, etc.).

Property acquisition includes the following: purchase and sale, swapping, donation, inheritance, bringing the properties into a company or out of it; acquisition of properties in a bankruptcy or liquidity procedure, and; acquisition of properties on the basis of court decisions or state administrative decisions, and other not mentioned ways of acquiring property from other persons.

Tax Rate

The tax rate for the property transfer tax is 5 %.

In addition to the property transfer tax, the value added tax can also be paid on a property transfer. The property transfer tax is paid when the seller is a citizen, legal or physical person not included in the value added tax system (banks, insurance companies, doctors, dentists, religious institutions, etc.). The value added tax is paid when the seller is the value added taxpayer, mainly in the case of newly built properties.

The value added tax rate is 22 %

The Taxpayer

The taxpayer of this tax is the acquirer of the property, who can be a buyer, inheritor or donee. The property transfer taxpayer for swapped properties is each participant in the swapping, for the value of the property acquired. When a co-owner's share in a property is acquired, the property transfer taxpayer is each acquirer of the property, proportional to their acquired share.

Foreign and domestic persons are considered equally liable as property transfer taxpayers, whether physical or legal persons, except if regulated otherwise by an international agreement. It is necessary to point out that foreign physical and legal persons may purchase a property in the Republic of Croatia only if regulated by an agreement between the Republic of Croatia and the country in which the foreign buyers usually reside (pursuant to the reciprocity principle), or if they obtain approval from the Foreign Ministry and the Ministry of Justice, Administration and Local Self-Government.

The tax obligation arises:

- At the moment of the entering into the contract, or the conclusion of some other legal action on the basis of which the property is acquired.
- Legal validation by a court or state administrative body decision in which a property is acquired.
- At the moment of the alimony recipient's death when the property ownership right is transferred on the basis of life-long support.
- By entering into agreement of life-long support when the property ownership right is transferred prior to the support (alimony) recipient's death.

The taxpayer is obliged to submit the statement on the property transfer to the local Tax Administration Office in the area where the property is located within 30 days and along with the statement, submit the sale contract or some other document as evidence of the transaction. On the basis of this document, the tax administration establishes the property's market value, which the owner or taxpayer may appeal. In this latter case, the tax administration reviews the appeal and sends it to the Commission to assess the property's market value.

The Tax Base

The tax basis is the market value of the property at the moment of its acquisition, i.e. the price of the property that was achieved or that can be achieved. The market value is established on the basis of the acquisition document, the sale contract by rule, inheritance deed or court sentence.

In addition to the fee, the property transfer tax base is the total amount of the fee paid for obtaining ownership of the property. The total amount means all that the acquirer of the property, or the person acting on his behalf, paid or gave by ceding the right, by ceding of other property, or by the assuming of debts for the purpose of acquiring the property.

Exemptions

In this tax there is a wide range of tax exceptions. We will mention only the most frequent and most significant ones. The first group is general exemptions, under which the tax shall not be paid by:

- The Republic of Croatia and local self-government and government units, state administration bodies, public institutions, legacies and foundations, Red Cross and other humanitarian organizations.

- Foreign diplomatic and consular agencies, under the reciprocity condition, and international organizations for which the property transfer tax exemption was agreed upon by international treaty.
- Persons acquiring the property by means of a return of confiscated property and land consolidation.
- Displaced persons and refugees acquiring property by swapping their properties located abroad.
- Citizens buying a residential building or apartment (including the land) on which they had occupancy rights, or with consent of the occupancy right holder, pursuant to the regulations on the sale of apartments with the occupancy right. The same applies to protected tenants buying a residential building or apartment in which they live on the basis of a lease agreement
- Persons acquiring properties in accordance with regulations on transferring social ownership into another ownership form.
- Persons acquiring properties on the basis of an agreement to provide life-long support, which persons are the first-line inheritors from the donor of the property.
- Persons acquiring certain particular parts of the property by the termination of co-ownership, or in the division of the shared property ownership up to the level of their co-ownership value, or of the shared ownership before the termination.

In addition to these general exemptions, there are also some other exemptions. We will only mention them here, rather than describe them in detail:

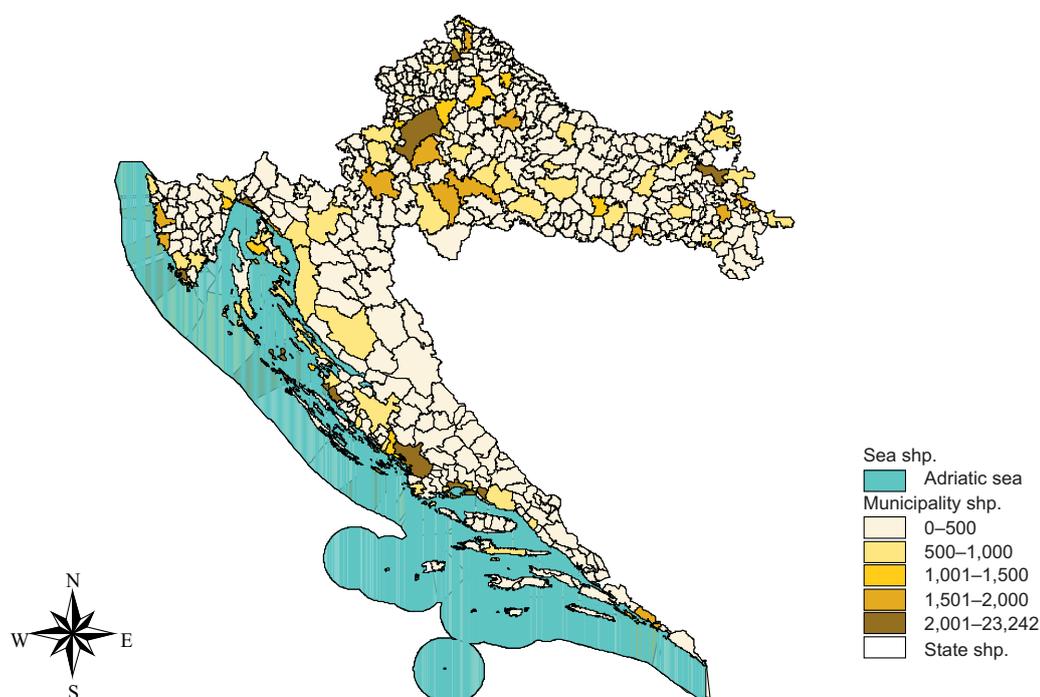
- Tax exemptions while bringing properties into corporate ownership.
- Tax exemptions in the inheritance, donation or other acquisition of properties without any compensation.
- Reliefs of the property transfer taxation in areas of special state concern.
- Tax exemptions pursuant to provisions of the law on socially encouraged house-building.

Table 3. Revenue from Property Transfer Tax

	1995	1996	1997
Property Transfer Tax in HRK			
City	44.353.565	42.060.554	51.709.749
Municipality	16.735.409	17.050.449	12.349.112
Total	61.088.974	59.111.003	64.058.861
Total tax revenues of local budgets			
City	2.381.444.331	2.851.748.594	3.254.176.241
Municipality	413.623.294	498.458.789	351.271.963
Total	2.795.067.625	3.350.207.383	3.605.448.204
Share of property transfer tax revenues in total local tax revenues			
City	1,86	1,47	1,59
Municipality	4,05	3,42	3,52
Total	2,19	1,76	1,78
Share of property transfer tax revenues in total tax revenues of state budget			
Total tax revenues of state budget	26.505.353.000	28.530.426.000	31.338.173.000
Property transfer tax in state budget	141.756.000	171.776.000	242.702.000
Share of PTT in state budget	0,53	0,60	0,77
Property transfer tax in local budgets	206.207.696	250.968.799	354.852.761
Share of PTT in local budgets	0,78	0,88	1,13

Source: Ministry of Finance, CRO (1999).

Chart 2. Number of property Transfers per municipalities in 2001



Source: Ministry of Finance, Tax department, 2001.

The real estate transfer tax is one example of a shared tax, of which revenue generated by collection of it is distributed between central and local government units (municipalities and cities). It is distributed so that the central government keeps 40 % of collected revenues and the rest, 60 %, is distributed to local governments.

It is worth noting that the amount of revenue from this tax that LGU receives varies by their size, mainly because of the sheer number of transactions undertaken on their territory, so ultimately urban areas will generate much more revenue from this tax. This can be seen by revenue generated by cities and municipalities in the previous table. The map below shows the number of transactions in different parts of the country.

Chart 2. clearly shows that the majority of property transfers are located in major cities, with only capital Zagreb, Osijek, Split, Zadar, Pula and a few other towns having more than 2000 property transfers in year 2001. The map also shows the slightly higher number of property transfers near the coast than the country average.

2. The County Tax

2.1 Gift and Inheritance Tax

Subject of Taxation

The gift and inheritance tax is paid on the cash, cash receivables and security papers and on movables, if their individual market value exceeds 50,000.00 kuna on the date of the assessment. The gift and inheritance tax is not paid if the value added tax is paid on the inherited or donated movables.

The Taxpayer

The gift and inheritance taxpayers are physical and legal persons who have inherited or received as a gift, or acquired on some other basis without compensation, the property in the Croatian territory on which property the gift and inheritance tax is paid. If the inheritor gives up the inheritance or cedes it to some other person in the probate proceedings, the person to which the inheritance fell to or was ceded to pays the gifts and inheritance tax.

The Tax Base

The gift and inheritance tax base is the amount of cash, and the market value of financial and other assets on the date of the assessment of the tax obligation, after the deduction of debts and costs related to the property on

which the tax is paid. The gift and inheritance tax rate is assessed by the competent tax body.

The obligation to pay the gift and inheritance tax rate arises in the moment of the legal validity of the decision on inheritance or the decision of the state body or court, or in the moment of the receiving of the gift. A gift is received in the moment of signing the agreement on donation, and if the agreement on donation was not made in writing, in the moment of receiving the gift.

If the decision on inheritance or the decision of the state administration body or court or the agreement on donation were not reported, or if they were not reported timely, the tax base is assessed pursuant to the market value of the inherited or donated property on the date of the stating or discovering the tax obligation.

The gift and inheritance taxpayers must deliver to the responsible tax body, according to the taxpayer's permanent residence or usual residence or seat, the decision on the inheritance, or the decision of the state administration body, court or the agreement on the donation within the period of 30 days from the date of the legal validity of the decision on inheritance or the decision of the state administration body or court, or from the date of the entering into the agreement on donation.

The gift and inheritance tax is paid within the time limit of 15 days from the date of the delivery of the decision on the establishing of the tax.

The gift and inheritance tax is the revenue of the county according to the permanent or usual residence or seat of the inheritor or donee.

Tax Rate

The gift and inheritance tax is paid by the rate of 5%.

Exemptions

The gift and inheritance tax is not paid by:

- 1) Spouse, first-line blood relatives, and adopted persons and adopters of the deceased or the donor,
- 2) Brothers and sisters, their descendants and the testator's or donor's sons-in-law and daughters-in-law if they lived in the common household with the testator in the moment of his death, or with the donor in the moment of the receiving of the gift. In the spirit of this Law, the common household is the joint earning of income and assets and the management of income and assets inherited or donated.
- 3) Legal and physical persons to whom the Republic of Croatia or the local self-government and govern-

Table 4. Revenue from Gift and Inheritance Tax

Gift and Inheritance Tax in HRK			
City	0	0	38.888.181
Municipality	0	0	42.539
County	15.855.829	20.375.320	16.214.531
Total	15.855.829	20.375.320	55.145.251
Total tax revenues of local budgets			
City	2.381.444.331	2.851.748.594	3.254.176.241
Municipality	413.623.294	498.458.789	351.271.963
County	284.623.120	350.983.947	388.904.660
Total	3.079.690.745	3.701.191.330	3.994.352.864
Gift and Inheritance Tax revenue share in total local tax revenues			
City	0,00	0,00	1,20
Municipality	0,00	0,00	0,01
County	5,57	5,81	4,17
Total	0,51	0,55	1,38
Gift and Inheritance Tax revenue share in total tax revenues of state budget			
Total tax revenues	26.505.353.000	28.530.426.000	31.338.173.000
Gift and Inheritance Tax	15.855.829	20.375.320	55.145.251
Share (%)	0,06	0,07	0,18

Source: Ministry of Finance, CRO (1999).

ment unit donates, i.e. gives properties without any compensation for the indemnification, or some other reasons related to the Homeland War,

- 4) The Republic of Croatia and local and regional self-government units, state administration bodies and bodies of local and regional self-government, public institutions, religious communities, legacies and foundations, Red Cross and other humanitarian associations established on the basis of special regulations,
- 5) Physical and legal persons, when receiving gifts (donations) for purposes established by special regulations.

3. Municipal/Town Taxes

3.1 The Tax on Vacation Houses

The Taxpayer

Taxpayers are legal and physical persons that are the owners of vacation houses. A vacation house is any building or part of buildings, or apartment used periodically or seasonally.

Vacation houses are not economic buildings for keeping agricultural machines, tools or other equipment.

Subject of Taxation

The tax base is the square meter (m²) of the vacation house's useful living area.

Tax Rate

The tax base applied pursuant to the law is determined by an interval from 5 to 15 HRK per square meter, and the local units may set the rate within this interval and stipulate it by their decision, depending on the location, age, condition of the infrastructure, and other circumstances essential for the vacation house use.

Exemptions

The tax on vacation houses is not paid for: houses that cannot be used due to devastation by war and natural disasters (floods, fire, earth-quake), age, or the run-down state; the tax on vacation houses is not paid while refugees and displaced persons are accommodated in them; on the retreats owned by local and regional self-government units serving for the accommodation of children

up to the age of 15. The municipality or town decision may lay down other exemptions for the tax on vacation houses due to economic or social reasons.

Forms and Deadlines for Payment

The taxpayer must deliver to the responsible tax body the data on vacation houses, related to the location of objects and the living area by March 31 in the year in which the tax is assessed.

The tax on vacation houses is paid within 15 days from the date of the delivery of the tax assessment.

The tax on vacation houses belongs to the municipality or town in the area in which the vacation house is located.

3.2 The Tax on Idle Agricultural Land

The Taxpayer

These taxpayers are the owners or lease-holders of agricultural land not cultivated for more than one year. Idle agricultural land is land that by its size, class and culture can be cultivated and used for agricultural production, but is not used by the owners or lease-holders of such land.

Subject of Taxation

The tax base, i.e. the subject of taxation, is the area of the idle arable agricultural land expressed in hectares.

Tax Rate

The tax on idle agricultural land is paid by one hectare of the idle arable agricultural land in the following amount:

- On arable land up to 500.00 HRK annually
- On vegetable patches up to 800.00 HRK annually
- On orchards up to 1,000.00 HRK annually
- On olive woods up to 1,000.00 HRK annually
- On vineyards up to 1,000.00 HRK annually
- On meadows up to 250.00 HRK annually

The municipality or town decides the level of the tax on idle agriculture land depending on the location, size, class and culture, and other circumstances essential to the use of the idle arable land.

Exemptions

The tax on idle arable land is not paid on land temporarily entrusted to a municipality or town for the management. The municipality or town may, by their decision, make exemptions for this tax depending on the location (mountain area), size, class and culture of the land, and also for a taxpayer's inability to work caused by age or illness.

Forms and Deadlines for Payment

The taxpayers of the idle arable land tax must deliver to the responsible tax body data on the location, size, class and culture of the land being cultivated, by March 31 of the year for which the tax is assessed.

The tax is the revenue of the municipality or town in the area in which the idle arable land is located.

3.3 Tax on Vacant Business Properties

The Taxpayer

The taxpayer is any legal or physical person that owns the vacant business properties (industrial and other commercial spaces), and these are properties in which activities were not performed for the period of one year.

The Tax Base

The base for the tax on vacant business properties is the living area of the property expressed in square meters.

Tax Rate

The tax rate is from 5 to 15 HRK per square meter of the living business property. The level of the tax within the limits mentioned above is by the municipal or town decision.

Exemptions

The tax is not paid for properties entrusted for temporary management to the municipality or town or for properties with an attribute of cultural heritage under the Law on Cultural Heritage Protection and Preservation. The municipality or town may lay down exemptions from the payment of the tax on vacant business properties for Acts of God, natural disasters, or if there is some other obstacle to their utilization.

Forms and Deadlines for Payment

The taxpayers of the vacant business properties tax must deliver data on the vacant business properties to the

responsible body by March 31 for the year for which the tax is assessed.

The tax on vacant business properties must be paid within 15 days of the delivery of the tax assessment.

The tax is revenue of the municipality or town in the area on which the vacant business property is located.

3.4 Tax on Undeveloped Business Land

The Taxpayer

Taxpayers are legal and physical persons that are the owners of the undeveloped building land.

Undeveloped building land is the land located within the boundaries of a building area of a settlement where buildings for residential, business and other use may be built in accordance with a physical plan. The undeveloped building land is also land with a temporary building whose construction does not require building permit, as well as the land on which the remaining parts of the previous building can be still found.

Subject of Taxation

The subject of taxation is the square meter of the undeveloped building land.

Tax Rate

The level of the tax is determined by between 1 HRK to 5 HRK per square meter of the undeveloped building land, and the precise level of the tax is decided by the municipality or town, depending on the location, size and other circumstances.

Forms and Deadlines for Payment

The undeveloped building land taxpayers must deliver to the responsible tax body the data on the location and size of the undeveloped building land by March 31 of the year for which the tax is assessed.

The tax on undeveloped building land must be paid within 15 days from the date of the tax assessment.

The revenue belongs to the municipality or town in the area on which the undeveloped building land is located.

3.5 The Company and Title Tax

The Taxpayer

The company and title taxpayers are legal and physical persons that are profit or income taxpayers that are registered to perform activities.

The legal and physical persons that are profit and income taxpayers and that are registered to perform activities, and that have business units within their organization (shops, branch factories, workshops, sales outlets), are the company taxpayers for every operating unit.

Company taxpayers not performing any activity are not bound to pay the company tax.

The Tax Base

Tax base is the trade name.

Tax Rate

The company or title tax is paid in an annual amount stipulated by the municipality or town and may not exceed 2,000 HRK per each company or title. The calculation and manner of payment are regulated by the municipality or town decision.

The company or title tax is the revenue of the municipality or town in the area of which the seat, or permanent residence or usual residence of the taxpayer is located. If the company or title taxpayer has within his organization operating units, the company tax for the operating unit is the revenue of the municipality or town in the area of which the said operating unit is located.

Exemptions

The company taxpayers not performing any activity are not bound to pay the company tax.

3.6 The Tax on Public Areas Use

The Taxpayer

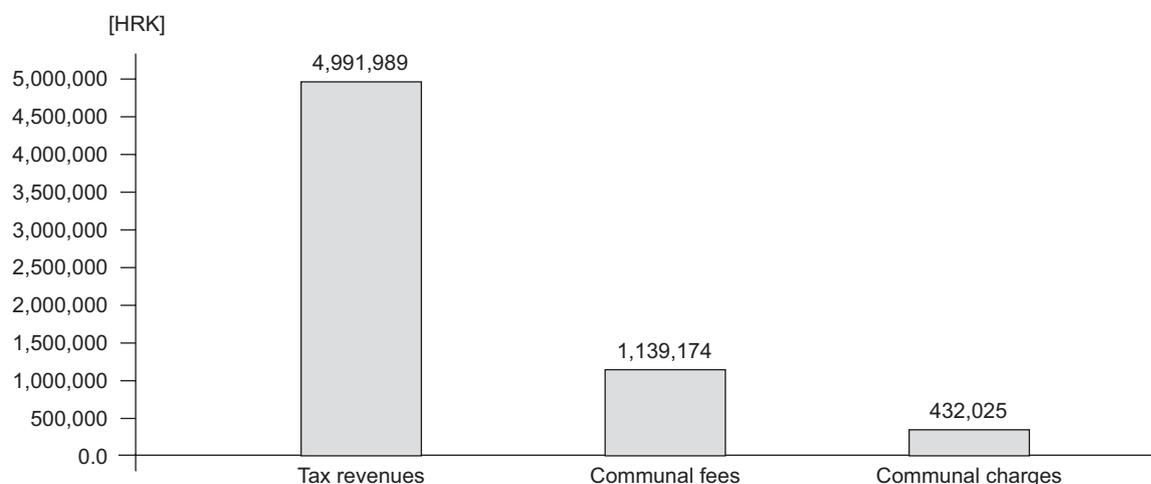
The Tax on Public Areas Use is paid by legal and physical persons using public areas, and they pay tax in the amount, manner and under the requirements laid down by the municipality or town.

By their decision, the municipality or town decides what is a public area.

4. Municipal/Town Non-Tax Revenues

The significance of communal revenues in the structure of local budgets varies from one local unit to other. Thus, the Kostrena municipality has the greatest revenue per capita all of Croatia, 8,831 HRK (3900 residents according to last census). 81,32 % of this is non-tax revenues, and concretely: 71 % of the total revenues are the communal fees (by the data from 2001, Ministry of Finance). This is mainly because of the industry situated on its territory.

Chart 3. Local government revenues in 2001



Source: Ministry of Finance, CRO (2001).

4.1 Communal Fees

Communal requirements of the residents of each community represent the following:

- drainage of precipitation
- cleaning of public surfaces
- maintenance of public surfaces
- maintenance of unclassified roads
- public lighting
- maintenance of cemeteries

The communal requirements of the residents in some place are usually financed from two sources: 1) revenues generated from the price of the service itself, 2) other public financing instruments of which the most important is communal fees and communal charges. The communal activities (utility services) are performed by companies, public institutions or factory branches founded by the local units, i.e. by legal and physical persons on the basis of granted concessions.

The sources of revenues from which *the performing of utility services* is financed are distinguished by law from the sources used for *financing their development*.

The funds required for financing utility services (communal activities) are ensured from:

- Communal Service Price
- Communal Fee
- Local Unit Budget

The price can include an amount for financing construction and improvement of communal infrastructure, but then this amount must be shown separately. The level and the method of establishing the communal fee depends on the location and type of property that the communal fee is established for.

Communal Fee Calculation

The communal fee per square meter is established by multiplying the point value, zone coefficient and use coefficient.

The point value is the basis for the calculation of the communal fee level and is set as kuna per square meter.

Zone coefficients are set by each municipality with a restriction stated in the law that the coefficient in zone 1, which is always the most valuable zone, must be 1.

The use coefficient for residential properties must be 1, and for business it varies: for production activities the law sets a range from 1 to 5, and for services from 5 to 10. It is worth noting that each town or municipality has its own systematization of business activities, so in smaller municipalities you will find few, and in bigger towns more, so we can say it is size related.

Communal fee = Rate (kunas/m²) x Zone coefficient x Use coefficient x Area (m²)

The representative body of the local unit establishes the point and coefficients values, provided that the zone coefficient in the first zone may be 1% at the most. In the majority of Croatian towns, the zones are determined

Table 5. Municipalities and cities that have communal fee and communal charges

	Communal fee	Communa charge	No. of cities or municipalities	Amount of communal fee in 2000	Amount of communal charges in 2000	Own revenues in 2000	Communal fee as % of own revenues	Communal fee as % of own revenues	Population in 2001	% of total population	Communal fee per resident	Communal fee per resident
Municipalities	No	No	50	0	0	24,583,231	0.0	0.0	78,353	1.8	0	0
Municipalities	No	Yes	25	0	1,859,785	17,436,105	0.0	10.7	70,013	1.6	0	27
Municipalities	Yes	No	156	33,641,514	0	163,125,323	20.6	0.0	458,275	10.5	73	0
Municipalities	Yes	Yes	207	137,265,663	46,281,229	564,914,364	24.3	8.2	741,511	16.9	185	62
Subtotal			438	170,907,177	48,141,014	770,059,023	22.2	6.3	1,348,152	30.8	127	36
Cities	No	No	2	0	0	2,545,688	0.0	0.0	28,222	0.6	0	0
Cities	Yes	No	25	24,216,290	0	76,317,932	31.7	0.0	198,951	4.5	122	0
Cities	Yes	Yes	96	815,660,123	288,743,726	3,106,153,999	26.3	9.3	2,799,927	64.0	291	103
Subtotal			123	839,876,413	288,743,726	3,185,017,619	26.4	9.1	3,027,100	69.2	277	95
Total			561	1,010,783,590	336,884,740	3,955,076,642	25.6	8.5	4,375,252	100.0	231	77

Source: Ministry of Finance, 2001.

as rings spreading from the center of the town (center = first zone); the exceptions are the towns at the sea coast, where the most attractive zone is close to the sea.

The Taxpayer

The communal fee payers are owners of the residential space, business space, garage space, building land (used for business activities) and undeveloped building land.

Exemptions

A number of exemptions also exist, and local governments have a fair degree of freedom in exempting additional properties from the communal fee. The list of exemptions includes:

- Properties used by the Croatian Army for operative needs of defense (barracks, training field, etc.).
- Properties used for preschool, primary school, secondary school and university education; museums founded by the Republic of Croatia, and the Archives.
- Properties used by health protection and social welfare institutions, owned by the state and a county.
- Properties used by the firefighting services.

- Properties for religious communities performing religious and educational activity.
- Building lands on which there are memorials, memorial areas and mass graves.
- Properties for which it is ascertained by a decision about the municipal compensation that they are of importance for the unit of local self-government and their maintenance is financed from the budget; provided that those real estate structures are not given into lease, sublease, rent, sub-rent or other temporary use by their users.

Under the current area based system in Croatia, the owner of less valuable property would pay the same tax as the owner of a more desirable and valuable property that is the same size in the same land zone. For example, under the current system, the tax due on an old, run-down, seventy square meter flat located in the center of Zagreb would be the same as the tax due on a newly renovated seventy square meter flat located on Jelacic Trg (the most attractive location). It seems inequitable that the tax due on a highly valuable property would be the same as the tax due on a very low value property, even if they are the same size and in a similar location.

The main drawbacks of the current system have to do with the lack of a basis in market value for the communal fee, and the lack of horizontal and vertical equity among taxpayers. First, the communal fee calculation as prescribed in the Law on Municipal Economy is governed by fixed regulations and coefficients for calculation which provide no recognition for market activity and is not transparent to taxpayers.

This leads to the second point that contrary to the practice in countries with a market based property tax, there is a great disparity in the taxation of individuals and legal entities, as well as for rich and poor taxpayers. In our test communities, businesses are taxed at effective tax rates that are six to ten times higher than residential rates. As an area based tax, the communal fee is static, depending on new construction or an increase in coefficients to raise more revenue. However, businesses typically constitute just 5% of the tax base yet shoulder approximately 70% of the tax burden. This places a drag on the business climate in general. This inequity may also be found within property classes. As stated previously, take for example a luxury apartment of 100 square meters in the center of the city with a sale price of 1 million HRK. This apartment would pay the exact same communal fee as an apartment of the same size in the same location but of one-third the value, in an old socialist apartment block, and in much worse condition.

Another significant aspect of the current system is that the communal fee plays an important role in local government budgets, and a large percentage of the assessed communal fee is being collected as was evident in the test communities. However, the collection rate (estimated at roughly 70%) is lower than other taxes, partly for reasons of psychology and partly because of a different set of penalties, which are not so severe, as penalties for tax evasion are.

Each of the 521 local governments in Croatia which administers a communal fee, has an established system for assessing the amount of fee due from an individual property owner, issuing bills and collecting the taxes. Compliance rates vary, but they appear to be over 50%.

Property Records

Local governments are responsible for maintaining the municipality's property records to administer the communal fee. If the municipal administration lacks the capacity to build its own information system to administer the communal fee, it will select a private IT firm

to house the data and develop and maintain a software program for the calculation and tracking of communal fee collections. However, there is no standardization in terms of data maintenance and control.

Database management is contracted out to professional IT firms, using modern hardware and software (Oracle) which is adequate for the development of a fiscal cadastre and should serve the local governments' IT needs for a number of years. The human resource qualifications are also excellent. The local officials we met with are well educated and trained in the necessary IT methodologies and technologies.

The major deficiency lies with the actual data entered into the communal fee databases. At all of the test sites, tax officials were quick to say that the information contained in their databases is out of date and unreliable. Very limited data on building characteristics is available in the capital transactions database.

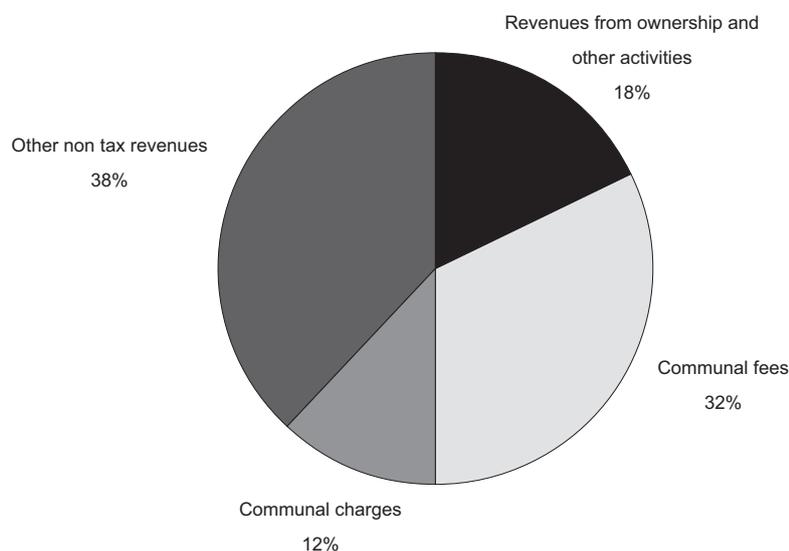
However, the fact that local governments are solely responsible for administering the communal fee also means that they do not have any assistance in updating their property records from other state ministries which might collect information relevant to the administration of the communal fee. Local governments' communal fee databases are incomplete and not updated on a regular basis, resulting in bills based on erroneous information. For example, the Ministry of Justice maintains the official registry for property rights. Since they do not share the information contained in their registry with municipalities, local governments are often unaware when property changes hands and communal fee bills continue to be addressed to the previous owner. Or a property owner may make improvements on his home by building an addition, but the new property size is never recorded in the communal fee database.

4.2 Communal Charges

The communal charges are paid by the owner of the building parcel on which the building is being constructed, and this is done by cubic meter (m^3) of the building which is being constructed, excluding swimming pools and similar open constructions. The communal charges for these are paid by square meter of their blue print area.

The communal charge is set for m^3 for different zones in the city/municipality, and it is the highest for the first zone and cannot be higher than 10 percent of average costs of constructing one m^3 of the building; that information is published by the minister in charge of communal economy.

Chart 4. Structure of local non tax revenues in 2001.



Source: Ministry of Finance, 2001.

The communal charge is used to finance construction of:

- 1) Public areas,
- 2) Unclassified roads,
- 3) Cemeteries,
- 4) Public lighting.

The main difference between communal fees and communal charges are:

- 1) Communal charge revenue is used for financing new infrastructure, and the communal fee for maintaining the infrastructure listed above.
- 2) The communal charge is paid only once, and the communal fee on a monthly basis in the majority of municipalities.

5. Possibilities for Reform

5.1 Objectives

Croatia is exploring decentralization for local governments and reforming the methods of municipal financing. The general principles of this reform are to improve the targeting of intergovernmental transfers and encour-

age the development of fair and efficient to administer municipal sources of own income, ultimately to reduce reliance on transfers from the central budget. One of the main sources of local government revenues in the future should be an ad valorem property tax.

Conversion of the communal fee to a market based property tax will achieve multiple objectives:

- Improve the fairness of tax burden allocation among taxpayers – horizontal and vertical equity would be greatly improved.
- Further decentralization by giving local governments an easy to administer, stable, own source revenue stream
- Tax bases on which Croatian public services depend for their finance will become more diversified.
- Provide a consistent measure of municipal credit-worthiness.
- Improve land use efficiency by sending signals to the market where land is scarce and serve as an incentive for people to recycle properties and relocate activities according to “highest and best” use.
- Improve the position of local governments in Croatia when it comes to EU accession which requires large investments in public infrastructure and funding for

pre-accession and structural funds, both of which necessitate increasing the financial capacity of local governments.

Evidence developed in some studies demonstrates that modern methods of mass valuation can be put in place in Croatia soon, as the sales data and the skilled appraisal knowledge is already available.

Future changes to property tax in Croatia could go in two different directions:

- 1) Recalibration of existing communal fee coefficients
- 2) Full ad valorem property tax implementation

5.2 Market Calibration of Coefficients

By recalibrating existing coefficients we can replicate a basic, elementary ad valorem property tax at any rate with zone, use, and area coefficients which are calibrated to the market value of real estate. One still follows the same formula to calculate the communal fee, only the coefficients now more accurately reflect the average value of the property in each zone and use category. In this way, the communal fee can simulate an ad valorem tax.

The current coefficients are largely a political decision determined by the city council based on the total amount of revenue they would like to raise. They then make a decision as to the percentage of the total each class of property shall comprise, placing the greatest burden on business properties because of widely held perceptions of relative wealth.

Test Community Market Calibration Analysis

The test community presently uses the following set of coefficients in determining communal fee bills as prescribed by an ordinance passed by the city council.

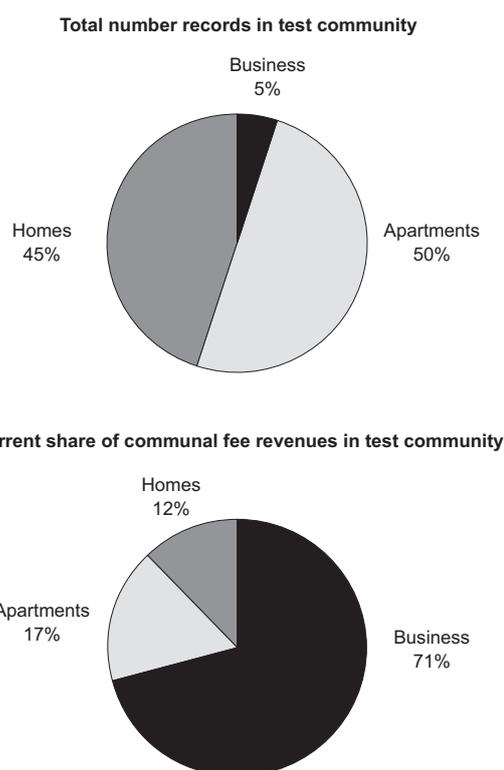
Current Coefficients for Communal Fee Calculation in Test Community

Zone	Zone Coefficient
1	1
2	0.95
3	0.8
4	0.65
5	0.55
6	0.45
7	0.35
8	0.3
9	0.2

Use	Use Coefficient
Residential	1
Business	1–10
Rate	Coefficient
Point value	0,39

Businesses are assigned a use coefficient by their type of activity and the perception of their ability to pay. The result is that several disparate businesses are lumped together under the same coefficient. For example, there is no discernable connection between an international organization and the electric power industry, yet their communal fee bills are calculated according to the same coefficient. This exemplifies the inherent inequity of a system based on a set of normative coefficients with no basis on the value of the real estate.

Chart 5. Breakdown of Property Classes and Yields in Test Community



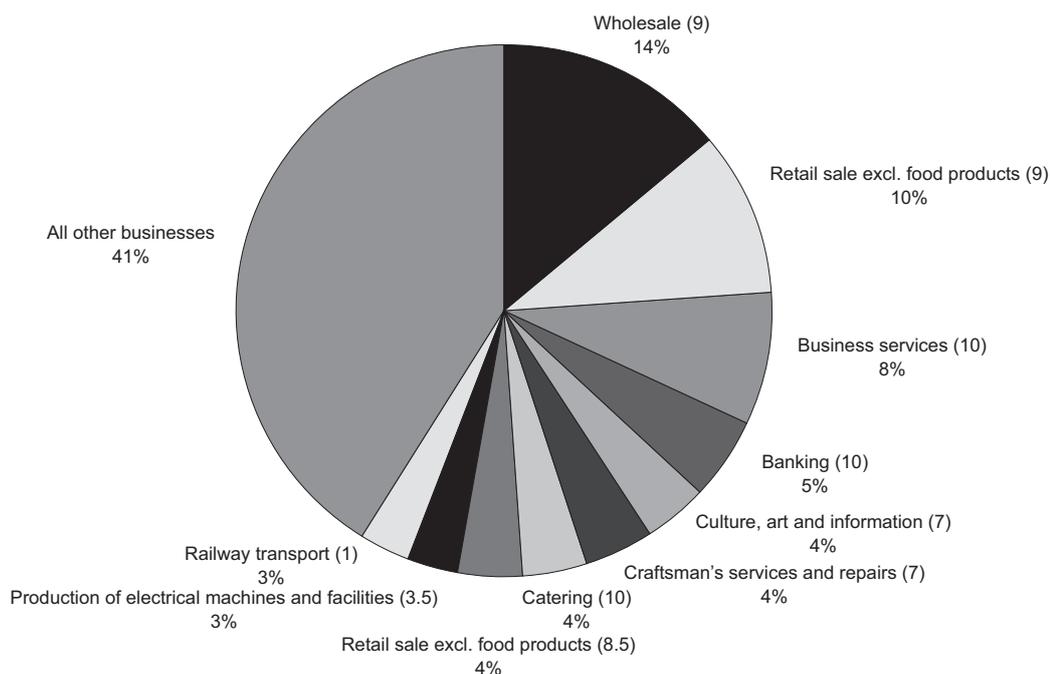
It was found that while businesses represent 5% of the taxable properties in the test community, they shoulder 70% of the tax burden (tax burden is in this case the amount of communal fee they pay).

Table 5. Example of business coefficients for test community

“Other” Businesses	Use Coefficient
Catering, Foreign Trade, Tourist Mediation, Banking, Insurance, Transport Svcs, Parking Svcs & Public Garages, Business Svcs, Air Transport, Telecommunications	10
Trans-shipment Services / Road Traffic	9.5
Wholesale Trade, Agricultural Services, Retail Sale excluding food products	9.0
Water Resources Mgt; Rail, Pipeline, Maritime, & City Transport; Postal Svcs; Food Retail; Industrial Waste Processing; Personal and Household Services	8.5
Surveying, Public Utility and Housing Services	8.0
Craftsman Services, all other activities not specified	7.0

Businesses Engaged in Production/Industrial Activities	Use Coefficient
Diplomatic body or International Organization, Electric Power Industry, Coal Industry, Oil Refinery, Iron & Steel Industry, Non-Ferrous Metals Industry, Shipbuilding, Chemical Industry, Leather & Fur Industry, Rubber Processing	5.0
Building Material Production, Building Construction, Forestry, Building Construction, Stone, Gravel & Sand Industry	4.5
Metal-Working Industry, Engineering Industry, Transportation Production, Tobacco Industry, Beverage Industry, Paper Processing	4.0
Production of Wood Products, Production of Electrical Machines, Production of Cattle Feed, Installation of Civil Engineering	3.5
Food Products Industry, Textiles, Leather Shoe Production, Luxury Goods, Agricultural Industry, Graphical Activity, Fishing Industry	3.0
Railway corridors established by physical plan if they are maintained by Croatian railways, the land and surfaces for sports activities, locksmith’s trade, chimney sweeping, production of laces, production of upper parts of shoes and the repair of shoes, production and repair of musical instruments, production and repair of orthopaedic aids, production of hats, chemical cleaning shops, ceramic works, stove maker’s trade, wheel-wright’s trade, smith’s trade, tailor’s trade for the production of folk dresses, mending of laundry and textiles, pedicure’s services, wood sawyers for heating, pleating, repair of socks, repair of umbrellas, repair of shatters, laundering and ironing, molting of buttons, carpentry (production and repairing of works of art and other repairs), upholstery’s trade, decorating, clockmaker’s trade, wig-maker	1.0

Chart 6. Current revenue yield from top 10 businesses (with Use coefficient)



The broad range (3.54HRK/sq.m.) in business tax burden on a per square meter basis underscores the inequity and lack of uniformity in the current system. Businesses with a coefficient of one pay on average the lowest amount of communal fee, between 0.26HRK and 0.39HRK per square meter. These businesses include “personal services to households,” railroads, and craftsman’s services, among others. The more heavily taxed businesses are those with coefficients between eight and ten and can expect to receive a bill which averages from 3.04HRK up to 3.80HRK per square meter. Such businesses include tourist mediation firms, banking, insurance, catering and air transportation. In a market calibrated system, there is a single use coefficient for all businesses which means that the range is limited to less than one kuna per square meter.

Currently, half of the communal fee revenue derived from businesses comes from seven industries: wholesale (14%), retail sale excluding food products (10%), business services (8%), banking (5%), culture/art & information (4%), craftsman’s services (4%), and catering (4%). These businesses comprise 58% of the total business properties recorded in the cities communal fee database but only 26% of the total business space in Zagreb. Businesses such as railroads (15% of total business area) occupy a greater percentage of the total business space and in prime locations in the center of the city but shoulder a much lower tax burden.

Chart 7. shows current average sales prices in the zones 1 through 6, data for zones 7, 8 and 9 which cover suburban areas of the city are unavailable. This is presumably because there are not many real-estate transactions in those areas. This will improve over time as the real estate market evolves.

Zone coefficients could be calibrated using non-linear regression according to the estimated market value of properties in each zone. The coefficients which would then be developed would follow the same line as that of the average sale prices across zones. What is clearly evident is that the price of real estate does not drop as consistently or as steeply as the current zone coefficients. As one would expect, the highest valued properties may be found in the center (zone one) with values dropping as one moves away from the center. Property values flatten out after zone three with a slight bump in values in zones four and five, most likely due to new constructions.

As described previously, the effective tax rates for each property class and the overall equalized tax rate were determined by first adding up the transaction prices of all the records in both the apartments and business samples to get the total capital value for all properties.

This is the overall tax base. The current communal fee assessed for all properties was then added up to get the current total revenue. We then divided the total current communal fee revenue by the total ad valorem value and found an equalized (revenue neutral) tax rate of 0.12%. This is the rate at which the value of each property would be taxed to achieve complete uniformity of tax burden across property classes while maintaining the current level of municipal revenue. The same exercise was done for each property class to obtain the effective tax rates and it was found that the current communal fee effective tax rates for residential properties is 0.058% and for businesses is 0.414% – approximately seven times higher for businesses than residential properties.

To simulate the effects of a property tax system, the effective tax rate on businesses was set at three times the residential rate to narrow the differential tax rates to a more reasonable ratio. Using the formula outlined in the previous section, the revenue neutral effective tax rates were determined to be 0.089% for residential properties and 0.269% for businesses. These effective tax rates were then multiplied by the predicted sale price of each property to produce the ad valorem tax, that is, what the market based tax would be to maintain the current level of total communal fee revenue. This reveals a picture of what an ad valorem property tax that generates the same amount of revenue should look like. The objective is to then use regression modeling to determine coefficients that would duplicate this result. The market calibrated coefficients that were determined through this process do achieve this goal.

Market-Calibrated Coefficients for Communal Fee Calculation in Test Community

Zone	Zone Coefficient
1	1
2	0.9102607
3	0.8153290
4	0.8598685
5	0.8538123
6	0.7924057
7	No Sales Data
8	No Sales Data
9	No Sales Data
Use	Use Coefficient
Residential	1
Business	2.437774257
Rate	Coefficient
Point value	0.5735845

Chart 7. Average sale prices

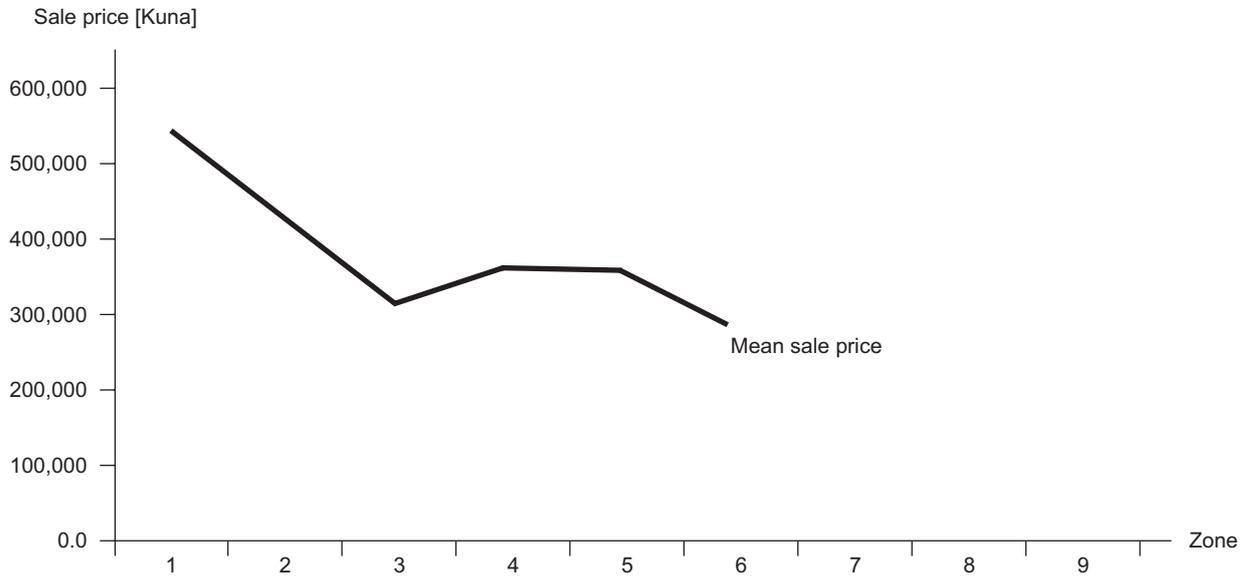
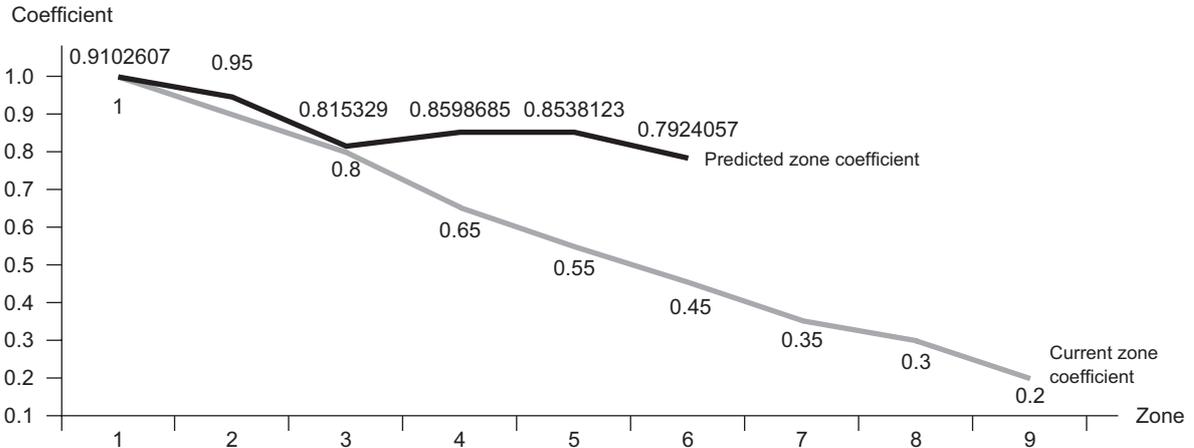


Chart 8. Zone coefficients in tested community



At the end it is worth noting that this method of communal fee coefficient recalibration does not involve any major legal changes or new law implementation. It would only require certain amendments to the current law on communal economy, the part which deals with communal fees. Coefficient ranges would need to be addressed, to make them compatible with recalibrated coefficients.

One other thing favors this interim step towards a full property tax, and that is the level of real estate

market development. Currently, the real estate market in Croatia is rapidly developing, but it still did not reach a level that would be suitable and that would complement property tax implementation.

5.3 Legal Reform and Institutional Framework

The fact that the communal fee is wholly administered by local governments is important. It means that there can be an efficient migration to a property tax system once the implementing legislation is enacted. We believe that

once the framework legislation is enacted, procedural manuals are developed, and training is provided, local governments will be able to move quickly to transform their communal fee departments into property tax departments.

Croatia is well positioned to quickly implement a property tax should the government and local authorities choose to do so. The current communal fee is a locally based tax with local governments solely responsible for surveying the properties subject to the fee, storing the data, assessing and distributing the bills, and collecting the revenue. There are no complex, entangling lines of control between various state agencies with which to contend. Because of this, the technical and human capacity to administer an ad valorem property tax already exists at the local level. The responsibility vested in local governments, without interference from an overbearing central authority, will facilitate the development of property tax departments. What they will need is guidance from the Ministry of Finance on the specific actions local governments need to take to manage the changeover to a property tax.

At the central government level, a new law is needed for the taxation of real estate (land and improvements) based on market value (or providing for the market calibration of coefficients). This law should establish common administrative procedures, set the tax base, determine assessment ratios for various types of properties, and provide general guidance on rates for all communities throughout the country. At the same time, a unit should be established with oversight authority for property taxation. This unit will be tasked with certifying communities which are ready to collect property taxes and ensuring compliance with relevant legislation and regulations. Under the recalibration approach, this unit would provide local governments with a new schedule of communal fee coefficients.

Other areas that need to be addressed include:

- Making the property tax a general purpose tax and allowing local governments to spend the revenue as they see fit.
- Establishing more realistic tax rates than the effective tax rates currently in place under the communal fee system, and constraining the ratio between business and residential tax rates so that businesses are not taxed more than 2 to 4 times residential properties. This is discussed more fully in the tax impact study.

- Establishing a common tax base for the entire country and limiting exemptions.
- Standardizing the classification of property across the country and establishing common administrative procedures.
- Establishing a reasonable system for non-judicial appeal of taxpayer grievances.

5.4 Fiscal Cadastar

Of primary importance at the outset of the implementation of a property tax is the recording of the municipality's property inventory. This will be the responsibility of each individual municipality. The discovery of all properties in a municipality is a critical first step and will require some prototyping to establish the best methods of taking the property inventory and determine how long it will take.

An efficient first step in ensuring all properties are recorded is to maximize the use of information from other resources, such as capital transactions database and from other city departments such as the utility companies. Once this is done, all these data sets can be merged, and records with no matches showing communal fee payment could then be targeted for follow-up. The challenge lies in getting all of these organizations to work together, and procedures will have to be developed by the government for the sharing of information.

Finally, it will be necessary to conduct a field survey of some properties to verify the basic information and property characteristics recorded for new properties being entered into the database.

At the outset, one of the major tasks for local governments will be the development of a fiscal cadastre to store all of the property information necessary to administer the property tax. Since the fiscal cadastre can be housed at the local or central government level, there needs to be a protocol and system established for data exchange between the bodies that will benefit from such a system. The State Geodetic Administration, with assistance from the World Bank, is in the process of developing an integrated legal/fiscal cadastre which will store information on ownership and property rights as well as the characteristics of the property. They are also developing a scheme for unique Parcel Identification Numbers (PIN) and surveying parcels' geographic x-y coordinates. Local governments will need to organize their fiscal cadastres by each property's PIN rather than by owner as is the current practice, and they will need to

know each parcel's x-y coordinates to develop the most accurate valuation models possible.

In turn, the State Geodetic Administration will need to be able to look up and store other property characteristics which are stored in the local cadastres. Individual PIN's and x-y coordinates will not be fully developed for several years, but local fiscal cadastres should be developed in the meantime with an eye toward including this information in the future.

The process of change begins with the building of a fiscal cadastre for the management of property information. This is a time consuming effort which calls for the unification of one database with several types of information, including identification of the taxpayer, property description along with its characteristics such as the size and location. Information on property characteristics, most of which are now in written form with the Ministry of Finance Tax Department, will need to be entered into the database. A uniform system of Property Identification Numbers (PIN) for taxable property which combines land and building records will need to be created (this task falls to the State Geodetic Administration with assistance from the World Bank).

While much work is needed to create the databases and enter the necessary data, the job is made easier by the fact that local governments currently own their communal fee databases. The communal fee databases are a useful starting point in developing a fiscal cadastre because they already contain such basic information as the property address, owner, zone location, area and property class. What local governments will be required to do is collect additional information on property characteristics such as the total number of rooms, bedrooms and bathrooms; type of building material and construction, current state of repair; etc. Other agencies, most notably the Ministry of Finance Tax Department, but

also the utility companies, and banks for property under mortgage, have computerized data that would be useful for both cadastre development and establishment and management of a property tax system. Procedures should be developed for the sharing of this information.

Information on these characteristics should also be collected by the Ministry of Finance as part of its responsibilities for administering the capital transactions tax. The Ministry of Finance is currently working to computerize characteristics data collected by government assessors who verify property sale prices to ensure compliance with the 5% capital transactions tax. Once in computer format, this data may be transferred to local governments to aid them in the establishment of their fiscal cadastres to be stored at the local level. For local governments currently collecting communal fees, taxpayers could be asked to self-declare their property characteristics on the back of their communal fee bill at the time of payment, or municipalities could mail separate questionnaires to households.

The goal is to minimize the amount of surveying that needs to be done, hopefully to the point where surveyors only need to visit a small number of properties to verify the information reported and collect data on those that remain undeclared. However, as local governments move to implement a property tax, the burden of collection of property characteristics should be borne entirely by the community. Donor assistance should be limited to guidance and training with the adoption of forms, procedures, software, and other materials and methods related to populating and using the fiscal cadastre.

The biggest task facing municipalities, the development of a fiscal cadastre is also the most important. The entire property tax system is completely dependent upon the quality of the data stored in the fiscal cadastre.

