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Financial autonomy of local self-government in Croatia

ABSTRACT: *The paper examines the notion and determinants of financial autonomy of local self-government in Croatia. The right to local and regional self-government as well as the competencies of local government units have been granted by the Constitution. Accordingly, the local government units are entitled to their own revenue, which they freely dispose of in performing their activities. However, financial autonomy is not clearly stated or defined, either at the constitutional level or at the statutory level. The primary source of local units' revenues are taxes, followed by aid, 'own source', and earmarked revenues. The special emphasis of the paper is on 'local' taxes and the role of local government units in the formal aspects of financial autonomy, i.e. designing the local taxes' notions and features. The paper also contains research on other local government units' revenues, their legislative basis and normative design, and their role in local financial autonomy. Following the setting of the normative framework, the paper goes on to investigate the substantive aspect of fiscal autonomy, i.e. the fiscal role of local government taxes and other local revenue. The conclusions of the paper sum up the findings of the research and provide recommendations with the aim of making the system more sustainable in designing and achieving the financial autonomy of local government units in Croatia.*

KEYWORDS: *financial autonomy, fiscal autonomy, local units, local taxes, Croatia*

1. Introduction

The paper deals with aspects of financial autonomy in local self-government in Croatia, with an emphasis on a narrower notion of fiscal autonomy, i.e. a focus on local taxes. In Croatia there are three levels of government: the central government and two levels of local self-government (regional, which includes counties, and

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local, which includes cities and municipalities). In this regard, the term 'financial autonomy of local self-government' encompasses all levels (local and regional) of local self-government. Following a brief constitutional provision on the right to local and regional self-government, which should involve freely disposing of their own revenue when performing their tasks, provisions with more details are contained in statutory provisions. The statutes regulating this area, namely the Local and Regional Self-government Act, as systemic act, and the accompanying Act on Financing of Local and Regional Self-Government Units, were guided by the provisions of the European Charter on Local Self-Government, especially Art. 9 thereof. Local taxes are regulated by two additional pieces of legislation.

The financial autonomy of local self-government is a logical consequence of the process of decentralisation, i.e. vertical division of government and limitation of political power, resulting in increased efficiency of public administration.¹ 'Finance follows function'.² The aim of decentralisation is making government more efficient, flexible, and responsive.³ The process of decentralisation is followed by the corresponding financial effects. Accordingly, the notion of fiscal federalism describes the division of taxation and spending powers between the central and sub-national levels of government. The process of decentralisation allows governments to consider local preferences in providing public services. Improper design of decentralisation makes intergovernmental fiscal systems more complex and less equitable.⁴

Bird and Slack⁵ suggest following the two principles in assigning revenues to local governments: first, 'own source' revenues should provide sufficient funding at least for the richest self-government units to cover all locally provided services used primarily by residents; second, local revenue should be collected from residents proportionately to benefits they receive from public services.

Fiscal or tax autonomy of sub-national levels of government represents an important part of financial autonomy. Besides local taxes, there are other important factors, such as non-tax revenue, financial equalisation, borrowing, and the participation of sub-national levels of government in decision-making processes. Normatively, tax autonomy is best defined in the European Charter on Local Self-Government, as it includes various aspects of the notion.

The OECD⁶ discusses various methods of assessment of the degree of tax autonomy of the sub-central levels of governments. First, the revenue from state and local taxes (own and shared taxes) may be expressed as a percentage of the total revenue

1 Kregar, 2011, p. 1.

2 Bird and Slack, 2014, p. 361.

3 Bird and Slack, 2014, p. 368.

4 OECD, 2022.

5 Bird and Slack, 2014, p. 364.

6 OECD, 1999, p. 10.

(which includes taxes, non-tax revenue, and grants) of lower levels of government. This method does not consider differences in the discretion over the tax base and tax rates provided to states and local authorities, hence this method is limited to the assessment of the tax autonomy of the lower layers of government. Second, it is possible to measure the share of state and local taxes in the total tax revenue of the general government. Tax revenue, in that case, belongs fully or partly to the state or local level. The greatest level of fiscal discretion is granted to sub-central governments if they are free to determine both the taxable base and tax rates, without any limits on the revenue, base, or rate enforced by the central government. The opposite case would be the central government deciding on the tax base and tax rates for the taxes collected by sub-central governments, allowing hardly any fiscal autonomy apart from administrative discretion regarding collection procedures. When observing tax-sharing options between government levels, the degree of tax autonomy of the sub-central levels of government varies. It is crucial to determine whether the consent of lower layers of government is required when deciding on the share in total proceeds from certain taxes.

Taking this context into account, the OECD⁷ states that sub-central government taxes can be divided into categories (ranked by decreasing control of the sub-central levels of government over revenue sources):

1. Sub-central government is entitled to set the tax rate and tax base
2. Sub-central government is entitled to set the tax rate only
3. Sub-central government is entitled to set the tax base only
4. Tax-sharing arrangements (sub-central government determines revenue-split; revenue-split may only be changed with consent of sub-central government; revenue-split fixed in legislation and may unilaterally be changed by central government; revenue-split determined by central government in annual budget process)
5. Central government sets the rate and base of sub-central government tax.

The sub-central level of government plays an important role in situations 1-3, as well as a part in situations under 4. In other situations, tax autonomy is limited or does not exist.

Discussions about the tax autonomy of local units and in particular local taxes can go in many directions and may involve investigating, most importantly, the competence to introduce local taxes, to set the tax rate and tax base as well as tax relief, and, finally, determine who will benefit from tax revenue – the central or local government. The paper is an investigation of what kind of taxes are appropriate to be enacted at the local level – income, property, or consumption taxes?

7 OECD, 1999, p. 11.

Besides local taxes, there are other sources of revenue for local units, such as shared taxes, fiscal equalisation funds, funding of decentralised functions, charges, fees, and contributions, which are all briefly reflected upon in the paper.

The structure of the paper is as follows. After the introductory remarks, the second part of the paper covers financial autonomy and its normative framework, the third is an analysis of the financial provisions of the European Charter of Local Self-Government, and the fourth is an examination of the financial sources of local and regional self-government. The fifth part of the paper deals with local taxes as a source of local units' funding, followed by fees and contributions as well as charges in the sixth part. The seventh part contains the case law from the Constitutional Court, followed by concluding remarks in the final chapter.

2. Financial autonomy and its normative framework

The Croatian Constitution⁸ provides for a legislative framework for sub-national administrative organization by recognising the autonomy of territorial self-government. Chapter VI of the Croatian Constitution sets out provisions on community-level, local, and regional self-government. The Constitution guarantees the right to local and regional self-government to the citizens. This right is exercised through local and/or regional representative bodies whose members are elected in free elections based on direct, equal, and general suffrage. Other forms of citizen participation in the administration of local affairs are meetings, referenda, and other forms of direct decision-making.

There are two levels of self-government in Croatia. Municipalities (Croatian: općine) and towns (Croatian: gradovi) are units of local self-government⁹, while counties (Croatian: županije) are units of regional self-government. The capital city of Zagreb has the status of a county. It is also possible to establish community-level self-government (Croatian: mjesna samouprava) in a community (Croatian: naselje)

8 The Croatian Constitution, OG 56/90, 135/97, 113/00, 28/01, 76/10 and 5/14. An English version is available at https://www.usud.hr/sites/default/files/dokumenti/The_consolidated_text_of_the_Constitution_of_the_Republic_of_Croatia_as_of_15_January_2014.pdf

9 In accordance with Art. 129A of the Constitution, units of local self-government administer affairs of a local nature, fulfilling the needs of citizens directly: organisation of localities and housing, zoning and urban planning, public utilities, child care, social welfare, primary health services, early and primary education, culture, physical education and sports, technical culture, consumer protection, protection and improvement of the environment, fire protection, and civil defence. On the other hand, regional self-government administers affairs of regional significance related to education, public health, zoning and urban planning, economic development, transportation and the transportation infrastructure, planning, and the development of the network of educational, health, social, and cultural institutions.

or a part of a community. Units of local and regional self-government are autonomous in administering the affairs in their jurisdiction and subject only to the review of constitutionality and legality by authorised state bodies.

The Local and Regional Self-Government Act¹⁰ primarily contains provisions on the organisation and competencies of local and regional self-government and represents a systemic act for this area. The Act sets out in Art. 68 that the local and regional self-government units have revenue over which they have free discretion, in line with their competencies. The revenue must be proportional to the activities performed by their bodies. The revenue sources include

- municipal, city, and county taxes, surtaxes, charges, contributions, and fees;
- revenue based on ownership;
- revenue from companies and other legal persons in a local unit;
- revenue from concession charges;
- penalties and property seized during offence procedures;
- share in shared taxes;
- aid from the central government;
- other revenue, as set out by law.

The provision of Art. 68(a) contains an obligation of publicity and transparency of information on planning, drafting, adopting, and executing local budgets. The basic financial act of local and regional self-government units is the budget. Upon the proposal of a budget by the head of a municipality, mayor, or head of a county, it must be adopted by the representative body of the local/regional self-government unit. The Act contains some further provisions regarding missing the deadlines for the adoption of a budget and the implementation of a temporary budget.

The normative framework of financing local and regional self-government units in Croatia encompasses several legal sources: the Constitution, European Charter on Local Self-Governance, Local and Regional Self-Government Act, Act on Financing Local and Regional Self-Government Units, and Budget Act.

The Constitution contains scarce provisions on the financial autonomy of local self-government. Art. 131 states that the units of local and regional self-government are entitled to their own revenue, which they must have the right to dispose of freely, in the performance of their tasks. The revenue of local and regional units of self-government has to be proportional to their powers, in accordance with the Constitution and law. In that regard, the state must provide financial assistance to weaker units of local and regional self-government.

¹⁰ Local and Regional Self-Government Act, OG 33/01, 60/01, 129/05, 109/07, 125/08, 36/09, 36/09, 150/11, 144/12, 19/13, 137/15, 123/17, 98/19, 144/20.

The three principles (the right to own revenue, principle of proportionality of revenue and responsibilities, and principle of solidarity) correspond to the principles enshrined in the European Charter of Local Self-Government (see Chapter 3). This leads to the compliance of Croatian legislation with the standards and requirements of the Charter. However, improvements are possible and necessary.¹¹

The Constitution remains silent on defining the type of revenue or 'own' resources of local government units. However, there is a separate piece of legislation dedicated to local government units' financing – The Act on Financing Local and Regional Self-Government Units.¹² This act is the central legal source for this issue. The Act was passed in 2017 and replaced the previous act of the same name.

3. European charter of local self-government

The Republic of Croatia is a party to the European Charter of Local Self-Government. The Charter was ratified and published in Croatia in 1997¹³ and it entered into force on 1 February 1998.¹⁴ Croatia ratified all paragraphs of Art. 9 of the Charter, relating to financial resources of local authorities.¹⁵

In short, the Charter provides its parties' local authorities with the right to adequate financial resources of their own, of which they may dispose freely. Their financial resources must be commensurate with their constitutional and statutory responsibilities. Local taxes and charges have been emphasised as an indispensable source of revenue. Local units should have the power to determine the tax rate. Sufficiently diversified and buoyant financial systems must enable local authorities to keep pace with the real evolution of the cost of carrying out their tasks. Financially weaker local authorities enjoy the protection of financial equalisation procedures, with the aim of correcting the effects of the unequal distribution of potential sources of financing and of the financial burden. Local authorities must be consulted on the way in which redistributed resources are allocated to them. Grants to local authorities must not be earmarked for the financing of specific projects to protect the basic freedom of local authorities to exercise policy discretion within their own jurisdiction. Local authorities must have access to the national capital market to borrow for capital investment.

11 Rogić Lugarić, 2011, p. 65.

12 The Act on Financing Local and Regional Self-Government Units, OG 127/17, 138/20.

13 Act on Confirming European Charter on Local Self-Government, OG MU 14/97.

14 Announcement on the entering of European Charter on Local Self-Government into force, OG MU 2/2007.

15 See also Dobrić, Gadžo and Bodul, 2016, p. 313.

As the implementation of the Charter provisions in Croatia goes, there are many challenges, some of which are mentioned with the aim of possible improvements. The first concern relates to paragraph 1 and the earmarked character of local units' revenues. As the purpose of local units' revenue is mostly set in advance, local units may not freely dispose of the financial resources, which limits their financial independence. The second concern is related to paragraph 2, i.e. that local units should have financial resources commensurate with their responsibilities. This is also not the reality as the local units' responsibilities surpass their financial resources. Finally, paragraph 6, which sets out the obligation to consult local units on how redistributed resources are allocated to them, has not been used in practice. Local units were never co-creators of financial policy and have not been consulted on financial issues.

4. The Act on Financing Local and Regional Self-Government Units

The Act on Financing Local and Regional Self-Government Units thoroughly lists local and regional self-government units' revenue sources. One of the most important aspects in this regard is the normative framework of tax autonomy. Rogić Lugarić¹⁶ refers to the fiscal power of local units as delegated or derivative, since local units are not independent in designing and introducing local taxes. They are only authorised to set the local taxes' tax rates, which often makes local taxes an insufficient source for financing delegated activities.

According to the Act on Financing Local and Regional Self-Government Units, the funds necessary for performing local units' tasks must be contained in their budget. The sources of local units' funding are, as set out by Art. 3(1), tax revenues, aid, as well as 'own' and earmarked revenue.¹⁷ As far as tax revenue goes, the provision related to joint taxes and local taxes covers it.

4.1. Revenue from contractual annual fees for concessions

The revenue from contractual annual fees for concessions represents shared revenue of the state, municipalities, and cities. These funds are collected for extracting mineral, geothermal, and natural spring water and for the use of water for the public water supply system. This revenue is shared between the state, the municipality,

¹⁶ Rogić Lugarić, 2021, p. 65.

¹⁷ For additional information on financing local and regional self-government units in Croatia, see Šinković, 2019.

and the city where the extraction is performed or the water is used. The share of the municipality and the city in revenues from the concession for extracting mineral, geothermal, and natural spring waters is 50% and the share of the state 50%. In case of the fee for concession for the use of water for public water supply system, the share of the municipality and the city is 30% and the share of the state is 70%.

4.2. Shares in personal income tax revenues

In accordance with Art. 5 of the Act, personal income tax is a shared tax whose revenues are shared between municipalities, cities, and counties. This is the only shared tax in the Croatian tax system. The share of a municipality or a city is 74%, the share of a county 20%, and the remaining 6% is used for decentralised functions.

Municipality, city, county, and the City of Zagreb, which take part in funding decentralised functions, distribute the part for decentralised functions by using 1.9% for primary education, 1.3% for secondary education, 0.8% for social care (0.2% for social care centres and 0.6% for nursing homes, 1.0% for health, and 1.0% for public firefighting teams. The Ministry of Finance, Tax administration is entitled to 1% of charged revenue for the administration of personal income tax.

4.3. Distribution of fiscal equalisation funds

Municipalities, cities, and counties whose capacities for tax revenue are lower than the referent value of capacity for tax revenue are entitled to receive funds of fiscal equalisation. The capacity for tax revenue is calculated by considering a five-year average of total revenue from personal income taxes and surtaxes, which would be charged had the highest statutory surtax rate been applied, per capita for a local unit. The referent value of the capacity for tax revenue is a five-year average of all the personal income tax revenue of all local units and revenue from surtaxes, which would be charged had the highest statutory surtax rate been applied, per capita for a local unit, increased by 50%.

Fiscal equalisation funds are non-earmarked and are considered current aid (Croatian: *tekuće pomoći*) from the state budget. They are calculated as the difference between the referent value of capacity of tax revenue and capacity for tax revenue of a local unit, multiplied by the number of inhabitants of that local unit.

4.4. Funding of decentralised functions

The Government may decide on the minimal amount of funds necessary for the funding of the decentralised functions of primary and secondary education, social care, healthcare, and firefighting. The funds are covered from the personal income tax revenue intended for decentralised functions. If the collected funds are lower than the amount determined by the Government, local units are entitled to aid of equalisation for decentralised functions, in the amount necessary to achieve minimum financial standard for each decentralised function.

5. Fiscal autonomy and local tax autonomy

5.1. Tax autonomy of local and regional self-government units

Bronić¹⁸ discusses the types of taxes suitable to be entrusted to lower levels of government. Property tax, vehicles tax, and various user charges and fees, as well as local corporate income tax, are easily administered by lower levels of government over local populations without causing harmful tax competition. Bronić emphasises that the attribution of taxes to local units should depend on their expenditures (e.g. local units responsible only for collection of rubbish should be granted a user charge or a low-rate general local tax; however, if they have competencies in social services, such as health or education, they should have a more abundant source of revenue with clear political accountability). Significant tax autonomy for lower levels of government would allow them to independently decide on their own tax policy, especially on tax rates. The probability is that sub-central governments would more efficiently spend and control their own expenditures if they had control over their revenue and were accountable for their actions.

Bird¹⁹ provides a list of the characteristics of a good sub-national tax. The tax base should be relatively immobile, giving local authorities space in setting tax rates without danger of losing their tax base. Tax revenue should be adequate to fund local needs, as well as relatively stable and predictable. The tax burden should not be put on non-residents. The tax base should be visible, which would contribute to accountability. Taxpayers should consider the tax fair and the tax should be relatively easy to administer.

18 Bronić, 2013, p. 627.

19 Bird, 2010, p. 3.

In Croatia, local taxes are not a constitutional category, and they have been regulated by two statutes. The first one, the Local Taxes Act,²⁰ and the other one, The Real Estate Transfer Tax Act,²¹ fall into this category because their revenue belongs to local self-government units, i.e. cities and municipalities. The local units are not authorised to introduce any other taxes apart from those enumerated by these acts. Rogić Lugarić²² explains that local self-government units (cities and municipalities) have the right to choose which local taxes to introduce (out of those set out by the statute) and prescribe the tax rates (within statutory limits). Regional self-government units (counties), however, do not enjoy any such authority – they may not choose which taxes are to be introduced, nor may they influence the tax rates.

Both the previously mentioned statutes are adopted at the national level by the Croatian Parliament. The statutes regulate most of the features of local and regional taxes; however, certain elements of taxes whose revenues belong to local self-government units may be designed by local units. Cities and municipalities may choose whether they will introduce local taxes. Also, the power of deciding on certain taxes' elements allows the local units' representative body to set out the following:

- tax rate of surtax to personal income tax;
- tax rate and competent body for assessing and collecting consumption tax;
- amount of holiday home tax, dependent on the infrastructure and other circumstances relevant for the use of the house, as well as the competent body for assessing and collecting the holiday home tax;
- for the purpose of taxes on the use of public land, define public land, the amount and conditions of paying the tax, and the competent body for assessing and collecting taxes on the use of public land.

The local units' decisions on local taxes must be delivered to the Tax Administration to be published and implemented.

The Local Taxes Act entered into force on 1 January 2017 and regulates the system of assessing and collecting the local taxes which serve as source of local units' financing. Some of the taxes included in this act were formerly regulated by The Act on Financing Local and Regional Self-Government Units. The Act introduced a new tax in the Croatian tax system – the real estate tax which was due to enter into force on 1 January 2018; however, the subsequent amendments²³ abolished this tax before its entry into force.

The administration of assessing and collecting of local taxes (apart from surtax on personal income tax and tax on slot machine games) is performed by competent

20 Local Taxes Act, OG 115/16, 101/17, 114/22.

21 Real Estate Transfer Tax Act, OG 115/16, 106/18.

22 Rogić Lugarić, 2011, p. 66.

23 The amendments on the Act on Financing Local and Regional Self-Government Units OG 101/17.

local and regional self-government units' bodies. The administration of the surtax on personal income tax and tax on slot machine games is performed by the Tax Administration. Exceptionally, local units' representative bodies may decide on delegating the assessing and collecting of local taxes to other local unit's body, under the condition that the other local unit's representative body accepts this delegation (art. 41).

In accordance with Art. 79 of the Local and Regional Self-Government Act,²⁴ the supervision over the legality of general acts passed by the representative bodies of municipalities, cities, and counties is performed by competent state bodies, which is in this case the Tax Administration, in accordance with Art. 53 of the Local Taxes Act. If determined that the local self-government units' general act is not in accordance with the Constitution or the statute or that there were some procedural faults upon its adoption, it may decide to put the general act or some of its parts aside. In that case, the Tax Administration continues the procedure before the High Administrative Court, which should evaluate its legality (Art. 82). The most frequent violations relate to timeframes for passing a decision, acting outside the competencies of a local unit's body, failing to submit the decisions to the Tax Administration, or passing multiple contradictory decisions.²⁵

5.2. Regional taxes

The taxes belonging to regional self-government units (counties)²⁶ are the inheritance and gifts tax, read motor vehicles tax, vessels tax, and tax on slot machine games, as set out by Art. 3-19 of the Local Taxes Act.

The inheritance and gifts tax is paid on money, securities, and movable property with a value higher than 6,636.14 EUR. Taxpayers are natural and legal persons who inherit or receive a gift in Croatia. The tax base is the amount of money or market value of securities and movable property, and the tax rate is set at 4%. Close relatives and state bodies are exempt from paying the tax. Tax is the revenue of a regional unit where the taxpayer resides or, alternatively, where the testator or the donor resides.

The road motor vehicles tax is paid annually by legal and natural persons who register their car. The tax is assessed by considering engine power and the age of the vehicle. Vehicles owned by state and public bodies are exempt. It is the revenue

24 The Local and Regional Self-Government Act, OG 33/01, 60/01, 129/05, 109/07, 125/08, 36/09, 36/09, 150/11, 144/12, 19/13, 137/15, 123/17, 98/19, 144/20.

25 Tax Administration (2020) Odluke jedinica lokalne samouprave kojima se propisuje plaćanje lokalnih poreza, 28 August 2020, Klasa: 410-01/17-01/700, available at: https://www.rriif.hr/odluke_jedinica_lokalne_samouprave_kojima_se_propi-3791-misljenje/ (28.11.2022)

26 For more informational on regional self-government units' taxes, see Marić & Stipičić, 2019a.

of a regional government unit in accordance with the seat or residence of the vehicle owner.

The tax on vessels is paid by natural or legal persons owning a vessel. It is paid annually, and the amount of tax due depends on the length of the vessel, whether the vessel has a cabin, and the motor power. It is the revenue of the county of registration of a vessel.

The tax on slot machine games is paid for the use of slot machines in entertainment clubs, catering facilities, public objects, and other public premises. The taxpayer is a natural or a legal person who provides for the use of slot machines. The tax is paid in the amount of 13.27 EUR per month per machine and it is the revenue of the regional government unit where the machine is located.

5.3. Local taxes

Local self-government units (municipalities and cities) are authorised to levy a surtax on income tax, consumption tax, tax on holiday houses, and tax on the use of public land.²⁷ The provisions on local taxes are contained in Art. 20-29 of the Local Taxes Act

A surtax on income tax may be imposed on personal income taxpayers. The maximum tax rate is 18%, depending on the size of a local unit, as decided by the representative body. Tax revenue belongs to the local unit of the taxpayers' residence.

The consumption tax is paid for the consumption of alcoholic beverages, natural wines, special wines, beer, and non-alcoholic beverages in catering facilities. The taxpayer is the person providing catering services. The tax base is the retail price of the beverage without VAT. Tax is paid at a rate of 3%. It is paid monthly, and the revenue belongs to the local unit where the sale occurred.

The tax on holiday houses is paid by natural and legal persons owning a holiday house. It is paid in the amount of 0.66 – 1.99 EUR/m² of the house's surface, as set out by the local unit's representative body. The tax is the revenue of the local unit where the house is set.

The tax on the use of public land is paid by natural or legal persons using the public land. The amount and the conditions are determined by the local unit. The tax is the revenue of the local unit where the public land is used.

Additionally, as set out by a separate act, the Real Estate Transfer Tax Act,²⁸ real estate transfer tax is paid on the transfer of real estate, i.e. acquiring ownership (by

²⁷ For more information on city and municipality taxes, see Marić & Stipić, 2019b.

²⁸ Real Estate Transfer Tax Act, OG 115/16, 106/18.

purchase, inheritance, exchange, gift, etc.) over a property in the Republic of Croatia. The taxpayer is the person acquiring the real estate. The tax base is the market value of real estate at the moment of transfer. The tax rate is set at 3%. The tax is not paid by the Republic of Croatia and its bodies, diplomatic and consular representatives, close family members, etc. The tax obligation occurs at the moment of signing a contract on the transfer of real estate, or a final judgement. The real estate transfer tax return is submitted by a notary public. Tax revenue belongs to the local self-government unit where the real estate is located.

5.4. Local and regional self-government units' revenue

Table 1: Share of total tax revenue compared to the total revenue of the local and regional self-government units

	Total revenue (2020, HRK mill)	Tax revenue (2020, HRK mill)	Revenue from PIT and Surtax (only PIT is shared revenue)	Revenue from property taxes (local taxes)
All local units	27.860	15.187	13.679	1.143
Local self- government units	23.043	13.276	11.962	1.137
-cities	17.751	10.745	9.784	811
-municipalities	5.292	2.531	2.178	326
Regional self- government units	4.817	1.911	1.717	5

Source: the author, using data from the Ministry of Finance, <https://mf.in.gov.hr/istaknute-teme/lokalna-samouprava/financijski-izvjestaji-ijlp-r-s/pr-ras-i-ras-funkc-za-razdoblje-2014-2020/3173?trazi=1&=&page=3>

Table 1 contains information on local units' total revenue, tax revenue, revenue from personal income tax and surtax, and revenue from property taxes. Tax revenue represents over 50% of total local units' revenue. The largest share of revenue comes from the personal income tax and surtax. Income from property taxes plays a less important role. The share of regional self-government units (counties) in total local units' revenue represents 20% or less.

Table 2: Structure of municipal revenues in 2020

Type of revenue	Amount (2020; in HRK mill.)	Share in total revenue
Total revenue	5.292	100
Tax revenue	2.531	47.8
Aid from abroad and the general budget	1.425	26.9
Income from property	367	7
Income from administrative fees	909	17.2
Income from sales of goods and services	42	0.8
Penalties	17	0.3

Source: the author, using data from the Ministry of Finance, <https://mfin.gov.hr/istaknute teme/lokalna-samouprava/financijski-izvjestaji-jlp-r-s/pr-ras-i-ras-func-za-razdoblje-2014-2020/3173?trazi=1&=&page=3>

Table 2 shows the structure of municipal revenue in 2020. Tax revenue represented almost 50%, followed by aid and income from fees. Income from property, sales of goods and services, and penalties contributed with smaller amounts.

As shown in Tables 1 and 2 above, over a half of local units' revenues are tax revenue. Local taxes play a less significant role than a share of personal income tax. Surtax on personal income tax is the most abundant of the tax revenue. It should be emphasised that local units have no impact on determining the share of personal income tax revenue allocated to them. Therefore, despite a significant share of local taxes in local units' revenues, their fiscal autonomy remains limited to determining only certain aspects of local (city and municipality) taxes.

Bronić²⁹ concludes that tax autonomy is low, as municipalities and cities only decide independently on tax rates and the tax base of tax on the use of public land. Her overall estimate is that the collected local taxes in Croatia are very low and in the 2002-2010 period, they amounted to only 0.7% of total tax revenue at the level of the general government.³⁰ Over half of that amount was revenue from surtax on personal income tax, and over 80% of tax revenue was collected in only 33 local units (out of 556 local units).³¹ The author's overall evaluation is that local taxes in Croatia are underrepresented and account for only one fifth of the local tax revenue in OECD countries. This leads to the conclusion that a part of cities and municipalities do not

29 Bronić, 2013, p. 629.

30 Bronić, 2013, p. 639.

31 Bronić, 2013, p. 641.

try enough – they often do not introduce local taxes or when they introduce them, they set out below average tax rates. The amount of collected revenue relates to the level of development of a city or a municipality, hence higher revenue is achieved by developed and tourism-oriented municipalities and cities.³²

Similar conclusions are brought by Rogić Lugarić,³³ who reflects on the fiscal capacities of local units and claims that local units have not been using sufficiently fiscal authority to increase their fiscal capacity. Many local units do not introduce all the possible taxes or they prescribe minimal tax rates. Hence, their potential fiscal capacity is larger than what is implemented. This leads to pressure towards central authorities to redistribute budget funds, leading to unnecessary political tensions. Additionally, Rogić Lugarić discusses limited disposal over local budgets' revenues insofar as non-tax revenues are earmarked, and the revenues from a shared tax are related to financing decentralised functions.³⁴

Dobrić, Gadžo, and Bodul³⁵ consider the fiscal effects of local taxes and conclude that the fiscal potential of most of them is negligible, apart from the surtax to personal income tax, which contributes the most to the local self-government units' revenues.

6. Non-tax revenue: fees, contributions, and charges as a source of local units' funding

6.1. Utility contribution and utility fee

A very important area which requires attention from the financial perspective are utility services. In Croatia, they are regulated by Utility Services Act.³⁶ As set out in Art. 2, utility services represent a system of activities, building and maintaining utility infrastructure and keeping utility order in local units. Utility services are performed in line with the principles of protecting the public interest, proportional benefits, solidarity, public services, non-profit, subsidiarity, universality and equal approach, adjustability, continuity, quality, efficiency, protection of users, environment and cultural goods, security, publicity, affordability, and protection of endangered citizens (Art. 4). In accordance with Art. 21, utility services are activities which enable building or maintaining utility infrastructure as well as utility services which provide individual users with services necessary for everyday living

32 Bronić, 2013, p. 651.

33 Rogić Lugarić, 2011, p. 66.

34 Rogić Lugarić, 2011, p. 70.

35 Dobrić, Gadžo and Bodul, 2016, p. 316.

36 Utility Services Act, OG 68/18, 110/18, 32/20.

and working in a local unit. Utility services are performed by utility companies founded by a local unit, public institution founded by a local unit, service founded by a local unit, natural or legal person based on concession agreement, or natural or legal person based on a contract on performance of utility services (Art. 33). Utility services are funded from the price of utility services, local units' budgets, and other revenues.

Another important issue is the building and maintaining of utility infrastructure (e.g. roads, parking lots, garages, green surfaces, buildings and appliances for public use, public lighting, cemeteries, and public transportation buildings (Art. 59). Those are public goods, owned by one or more local units or a person performing utility services, and they have a special legal status (Art. 61). The Act prescribes that the building and maintaining of utility infrastructure is funded from utility contribution (Croatian: komunalni doprinos), utility fee (Croatian: komunalna naknada), price of utility services, concession fee, local units' budgets, EU funds, other contracts, and fees and donations.

Art. 76-90 deal with the utility contribution, which is charged for using utility infrastructure in a local unit, as well as the benefits of a construction site when a building is built. It represents the local unit's revenue and it is earmarked only for funding construction and maintaining utility infrastructure. It is paid by the owner of the land where the building is built, in one instalment with a possibility of deferral of payment. The representative body of a local unit must decide on utility contribution zones, single unit value of utility contribution per zones, methods and timeframes for payment, and exemption of from paying utility contribution. The utility contribution is calculated by multiplying the volume of a building in construction with single unit value of utility contribution in a zone of construction.

The utility fee³⁷ (Art. 91-102 of the Act) is a monetary public payment for the maintenance of utility infrastructure. It is the revenue of a local unit, and it is earmarked, with a possibility of using the funds for building objects for education, social services, sports, and culture as well as improving the energy efficiency of public buildings. It is paid for using living area, garages, business premises, building land used for business purposes, and unbuilt building land. The fee is paid in the areas which are equipped at least with a road and public lighting, power network, and water supply. It is paid by the owner of a piece of real estate, i.e. its user. The representative body of a local unit must decide on the zones where the utility fee is paid, coefficient of a zone, purpose coefficient, time frame for payment, as well as exemptions for payment. The representative body also determines the value of a utility fee point per square meter, in accordance with estimates of the costs of maintaining utility infrastructure. The fee is calculated per square meter of a piece

³⁷ For more details on utility fees, see Žunić Kovačević & Gadžo, 2014.

of real estate by multiplying the zone coefficient, purpose coefficient, and value of the utility fee point.

In 2020, local units collected 3.18 billion HRK in utility fees and contributions. Utility contributions brought 800 million HRK, and utility fees were 2.4 billion HRK. This represents 11.4% of total local units' annual revenues,³⁸ making this an important source of local units' financing.

6.2. Charges

Charges (Croatian: pristojbe) are another source of public revenue important for local governments in Croatia. Charges which are of importance for the local budgets are administrative charges (Croatian: upravne pristojbe). In accordance with the Administrative Charges Act,³⁹ the charges are paid for the submission of documents and actions before state bodies, diplomatic and consular missions, local units' bodies, and legal persons with public authorities, in the amount determined by the tariff. Charges are paid by the person who initiates the procedure or performs an action for which charges are prescribed. Recently, the system of e-charges was introduced. In case no prescribed charge has been paid, no actions will be taken by state bodies. The revenue from duty stamps is the shared revenue of the state budget and local budget of the unit where the duty stamp was sold, in equal parts. Charges paid on the transaction account for submission of documents or actions before local or regional units' bodies are the local or regional units' revenue. Charges paid directly on the transaction account for the submission of documents or actions before legal persons with public authorities are also local units' budget revenue, determined where the approval to the legal person was issued or according to the seat of the local unit where the action was performed.

7. Case law from the Constitutional Court

Although the Constitutional Court rarely deals with tax-related cases, there are two local-taxes-related cases worth mentioning. In the first case⁴⁰, the proposal for determining compliance with Art. 18(1) of the Real Estate Transfer Tax Act⁴¹ from 1997 with the Constitution claimed that the 20% increase in the real estate transfer tax if

38 More on <https://mfin.gov.hr/istaknute-teme/lokalna-samouprava/financijski-izvjestaji-jlp-r-s/pr-ras-i-ras-funkc-za-razdoblje-2014-2020/3173?trazi=18=&page=3>

39 Administrative Charges Act, OG 115/16.

40 Arbutina, 2012, p. 1300.

41 Real Estate Transfer Tax Act, OG 69/97.

the tax return had not been filed on time was unconstitutional because the Act set out the minimum amount of increased tax obligation (no less than 1.000 HRK). The plaintiff invoked Constitutional provisions on equality, social justice, and the rule of law. The Court held that the proposal was justified and abolished the provision.⁴² The Court claimed that the 20% tax increase was in fact punitive taxation, not in line with Art. 51 of the Constitution. The Real Estate Transfer Tax implementation is related to the Personal Income Tax Act, which at the time prescribed a misdemeanour fine of 1.000-10.000 HRK for failing to file a tax return on time. This puts taxpayers with a higher tax base into a more favourable position, as low-income taxpayers end up paying the punitive tax at a rate higher than 20% because of the minimum amount of fine prescribed (1,000 HRK).

The second case relates to the Financing of Local and Regional Self-Government Units Act, which included the introduction of a tax on unused agricultural land, tax on unused entrepreneurial real estate, and tax on unbuilt construction land.⁴³ The plaintiffs contested the constitutionality of those taxes. The taxes were introduced in the Croatian tax system in 2001 and had some non-fiscal goals – they were supposed to ‘punish’ real estate owners who had not used their real estate in line with its purpose. The second purpose was fiscal, as the revenue was to be used for the funding of municipalities. The plaintiffs disputed those taxes by stating that they were opposed to principle of equality. Real estate should be taxed based on the fact of ownership over it, not on how the real estate is used, and the tax should be imposed on all owners of a certain kind of real estate, not just those who do not use the property in the way the legislator thinks it should be used. Those taxes are in fact punitive taxes because they are designed to force the owners into a certain behaviour, which is both unconstitutional and unlawful. The Court accepted the proposals and abolished provisions regulating those taxes.⁴⁴ The Court emphasised the importance of right of ownership and stated that owners may not be forced to use their property in a certain way and be punished if they do not obey. The principle of legal certainty applies, as the provisions do not instruct the owners on what kind of use would exempt them from paying taxes. The provisions are also held to be derogating from Art. 51 of the Constitution as they had not followed the ability to pay principle, nor the principles of equality and equity in the tax system, as the taxpayers were some, but not all, real estate owners.

42 The Constitutional Court decision (Odluka Ustavnog suda Republike Hrvatske broj U-I-1023/1999. od 23. veljače 2000.), OG 26/00.

43 Arbutina, 2012, p. 1301.

44 The Constitutional Court decision (Odluka Ustavnog suda Republike Hrvatske broj:U-I-1559/2001 i U-I-2355/2002 od 21. veljače 2007.), OG 26/07.

8. Conclusion

The paper contains an overview of sources of financing for local and regional self-government units in Croatia. Starting from the Constitutional level, as well as the relevant international treaty, the European Charter of Local Self-Government, the paper presents the main features of sub-central government systems. Continuing to the statutory level, the systemic Local and Regional Self-Government Act is analysed, along with accompanying Act on Financing Local and Regional Self-Government Units.

The central part of the paper deals with sources of local and regional self-government units' revenues. Local taxes play the most important role in this regard. The paper deals with the concept of financial autonomy by looking into the competences of central and local governments to introduce, design, and charge local taxes. The theoretical concept is applied in the case of Croatia, where two sub-central levels of government (local and regional) have different types of authority regarding local taxes. While the regional self-government units only apply taxes as set out by the statute, local self-government units enjoy wider authority and may determine which taxes to apply and set out tax rates or the amount of taxes.

Shared tax revenue from personal income taxes represents an important local revenue source, along with fiscal equalisation funds and decentralised functions funds. Fees, contributions, and charges are an additional local revenue source.

In the revenue structure, local taxes, particularly the surtax to personal income tax, hold the highest share of local revenue, while the other taxes mostly represent taxes of minor importance which bring lower revenues. They are followed by transfers and other earmarked/quasi-fiscal public revenue sources, which may be negatively evaluated from the transparency standpoint.

The paper examines the practice of the Constitutional Court of Croatia and discusses two cases which influenced the changes in the real estate transfer tax as well as led to abolishing taxes on unused agricultural land, taxes on unused entrepreneurial real estate, and taxes on unbuilt construction land. The court held that the statutory provisions departed from principles of equality, social justice, and the rule of law.

The recommendations for designing a more sustainable financing system primarily go towards strengthening the role of local self-government units in decision-making process on local taxes. Apart from a few notable examples, most local taxes' elements in Croatia have been set out by statutory provisions at the state level. However, a more active role of local units might make them more invested in local tax policy issues. Also, along this line is encouraging local units in more active use of local taxes, especially in cases where no taxes were introduced despite the possibility thereof. The dependence of local units on transfers from the central government

without exercising the possibility of ensuring the funds from local taxes should be frowned upon. This might even lead to occurrence of 'local tax havens' because of tax competition between the local units and a race to the bottom in attracting investments by providing a more favourable tax treatment. Finally, the current balance between earmarked and non-earmarked revenue should be significantly shifted towards non-earmarked revenue by replacing several charges with a property tax, i.e. real estate tax. This idea was already adopted in the Local Taxes Act; however, due to the political pressures and calling upon the land registry not being up to date, the real estate tax was abolished before it entered into force.

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