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# PRESS RELEASES

## Inefficiency of Revenue Collection in Local Government Units in Croatia

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**The State Audit Office's Report on Audit of Efficiency of Revenue Collection in Units of Local and Regional Self-government for 2010 and 2011 is currently in parliamentary procedure. The figure of HRK 8.6 billion in uncollected receivables suggests that local government units (LGUs) are inefficient in collecting their revenues. The cities of Bakar, Čakovec and Kutina, as well as municipalities Blato, Drnje, Đelekovec and Hlebine proved to be the most efficient in collecting revenues (receivables).**

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The State Audit Office (SAO) has conducted an efficiency audit of the collection and control of collection of LGUs' own revenues in 20 counties and the City of Zagreb. This is the first SAO report directly focused on local revenue collection, although the SAO has warned for many years of huge uncollected revenues of local budgets. The Summary Report focuses on tax revenues, despite the fact that revenues under special regulations (non-tax revenues) predominate in the revenue structure. The Report identifies 19 major failures and irregularities, and makes the same number of recommendations for their correction. The Association of Cities had prepared **recommendations**<sup>1</sup> for the improvement of revenue collection back in November 2011 and offered them in May 2012. These recommendations partly correspond with those of the SAO.

**Efficiency indicators.** The Report lacks an overview of methodology for the assessment, comparison and determination of the revenue collection efficiency. In addition to an overview of efficiency indicators, it would be useful to provide the reasons why greater emphasis in the efficiency assessment is on local tax revenues than on non-tax revenues. The Report also lacks data on the structure of receivables, their duration, the amounts written off, etc. Despite some minor defects, the Report still deserves a positive review, especially the recommendations which should be considered together with the aforementioned Report of the Association of Cities of the Republic of Croatia. The SAO should prepare a similar report on the amount and structure of liabilities of LGUs, especially as concerns (ir)regularities in the borrowing procedures followed by LGUs.

**Uncollected revenues and the status of local finance.** As at 31 December 2011, the local units' uncollected revenues stood at HRK 8.6bn. Receivables from operating revenues (HRK 5.4bn) predominated, and the rest were receivables from the sale of (non-financial) assets. Out of HRK 5.4bn, receivables from administrative fees accounted for the largest share (about 60%), followed by receivables from assets (24%), while receivables from tax revenues accounted for the smallest share (16%) of total receivables from operating revenues. Receivables from utility fees and contributions accounted for the largest share of receivables from administrative fees. The receivables of only 53 LGUs together amounted to over HRK 1 billion. Some LGUs have written off receivables, one LGU, for example

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<sup>1</sup>Association of Cities of the RC, 2011. *Preporuke za izmjene i poboljšanje normativnog okvira lokalne samouprave.*

has written off over HRK 20m in 2011. Against the backdrop of the financial crisis, LGUs should act prudently and improve the collection rates in order to obtain funds for reducing their existing budget deficits. It has been proved that 49% of 556 LGUs fail to use all sources of revenues they are entitled to use under effective regulations, while 29% of LGUs fail to take the necessary measures to collect due receivables.

The revenue collection problems result from poor cooperation in the information exchange between the Tax Administration and local government units, an inadequate definition of the tax secret, uncoordinated records and databases of assets, as well as from low transparency of the revenue collection data.

- **Poor cooperation between tax authorities and LGUs.** Most local government units have transferred the revenue collection powers to the Tax Administration, for a commission of 5% of the collected amount. Given such high commissions, it would be better for local units to collect the revenues independently. In most cases, LGUs do not have in their business books the records of individual receivables from (municipal, city and county) taxes. The Tax Administration normally submits to the LGUs monthly reports on the assessed and collected taxes, but they supply absolutely no data on taxpayers (debtors), tax rulings issued and the collection measures.
- **Tax Secret and revenue collection.** Due to the tax secrecy clause, most LGUs have no detailed information on debtors, nor can they require such data from the Tax Administration, which refuses to provide the information, invoking Article 8 of the General Tax Act according to which the tax authority is obliged to keep as a tax secret all the data provided by a taxpayer within the taxation procedure, as well as any other data related to the procedure. This institutional gap should have been overcome long ago. The Association of Cities has also warned the Tax Administration of this problem. According to Article 8, paragraph (5), item (5) of the General Tax Act, the obligation of tax secrecy is not violated if the data on a taxpayer are disclosed for the purposes of tax debt collection.
- **Inadequate coordination of the records and databases of assets.** Particularly problematic is the collection of tax and non-tax revenues related to assets, such as the second home tax (the owners do not submit data on the real estate ownership and status), or inheritance and gift tax (the Tax Administration has no obligation to notify local units of the rulings they issue). The collection rate of revenues from non-financial assets is low (for example, tax on rent and other receivables from rented premises are not collected, or are collected in inadequate amounts). Poor asset management is also reflected in a large number of vacant (unused) premises for which the maintenance costs are paid by local government units. Problems also exist in the collection of revenues from administrative fees and revenues under special regulations. For example, companies collecting utility fees do not submit to LGUs information on individual debtors, the balance of arrears or on the collection measures taken. LGUs have entrusted the collection of revenues from the sale of flats to legal entities, but they receive no information on the collection measures taken by these entities.
- **Transparency and publicity of local revenue data.** Local government units do not inform citizens on the collection efficiency of budget revenues, their allocation and use, as well as their effects on the economy development and improvement of living conditions. All data on the receivables from and collection efficiency of local revenues should be published on the websites of the associations of cities and municipalities and of the union of counties. The representative bodies of local government units should regularly discuss at their meetings the efficiency of revenue collection, and even the findings of the State Audit Office.

**Recommendations of the State Audit Office.** The SAO has issued as many as 2,404 recommendations for the improvement of revenue collection, distributed among the LGUs in individual counties. In each LGU, more than four cases of irregularity in revenue collection have been identified on average, whereas irregularities were the most frequent in the Counties of Split-Dalmatia, Osijek-Baranja and Istria. Most of the recommendations relate to the need for a substantial improvement in the records of revenues and receivables of LGUs, especially those related to assets. It is necessary to improve the collection control, provide citizens with regular information on the efficiency of and importance of efficient revenue collection, and ensure an ongoing exchange of information and better cooperation between the competent bodies of the government and local unit

administrations. Inadequate revenue collection is the consequence of inefficient asset management and a lack of individual records which are necessary for the determination of rights and duties of persons and entities subject to local taxes and contributions.

The findings of the state audit leave open some questions that are crucial for the long-term planning, development and financing of the local self-government.

- **Should revenues be decentralised?** Extensive revenue decentralisation is only possible if LGUs improve the collection of their revenues from property, especially utility fees and contributions. On the other hand, the Tax Administration must ensure timely information to LGUs on their total and major individual receivables. The poor information exchange between the LGUs and Tax Administration is a technical problem, the solution of which would increase responsibility of LGUs for revenue collection.
- **Should immovable property tax be introduced?** The introduction of immovable property tax should be postponed until the resolution of open issues between the Tax Administration and LGUs relating to ownership records, revenue collection, the identification of persons subject to taxes and contributions, and regularity of data exchange through a well-developed IT system. Given inconsistencies in the records, it is currently impossible to both introduce and effectively manage the assessment and collection of immovable property tax.

The SAO report should also be considered in light of a deteriorated financial position of LGUs, which recorded budget deficits in the last three years. Therefore, without major financial assistance from the central government, increased borrowing and improved collection of own revenues, they are hardly capable of financing their current spending in this and the next budget years.