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What should one know about immovable property taxation in Croatia?

Immovable property tax is the most common form of property taxation. It is used much more extensively in Europe than in Croatia, and its potential introduction into the Croatia tax system depends on a number of open issues requiring a thorough analysis. Before introducing this tax, one should weigh up all its costs and benefits, including the fiscal, economic, administrative, technical, social and other aspects of its introduction.

1. Introduction

Each tax system reform usually involves a debate on property taxation, whereas the term 'property' covers a very wide range of items expected to yield some income for the government. Reference is made to immovable property, e.g. buildings and apartments, land, vacation houses and surplus housing space, but also movable property such as cash, securities, works of art and jewellery. However, as property taxation in Europe usually relates to immovable property, this study provides a detailed analysis of the tax on immovable property ownership in the EU and Croatia.

It should be noted that what we deal with here is only the tax on immovable property ownership, and not on its transfer, i.e. sale, inheritance or gift. Neither do we deal with the tax on income (from rentals) earned by the immovable property owner.

Definition of property and taxes pertaining to it

Property includes the following:

- immovable property (land and buildings);
- cash, shares and bonds, bank deposits and insurance funds;
- movables (cars, vessels, furniture etc.); and
- the so-called "invisible property" (paintings, jewellery, etc.).

Property is subject to recurrent or non-recurrent taxes imposed on the use, ownership or transfer of property, i.e. taxes on:

- the use or ownership of immovable property (land and buildings);
- net wealth, i.e. movables and immovables, net of liabilities;
- inheritance and gifts; and on
- the issue, transfer, purchase and sale of securities, cheques and immovable property.

Source: OECD (2008)

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Net wealth tax is only applied in France

Net wealth tax is very rarely applied. In the EU, it is only in place in France, where it is paid annually on net wealth owned by an individual as at 1 January. The total value of wealth is reduced by liabilities arising from it, and the tax is payable only if the net value of the wealth exceeds EUR 790,000. The tax involves a relief of 30% for primary dwelling, and exempt from taxation is business property, antiques, objects of art, some insurance policies, etc. The tax has six brackets, and in 2009, they ranged from 0.55% to a maximum of 1.6%, for the amounts over EUR 16.5 million.

Source: IBFD (2009)

2. Tax on immovable property definition

This study uses the OECD definition, according to which the tax on immovable property is levied regularly in respect of the use or ownership of immovable property, i.e. land or buildings (OECD, 2008). According to this definition, in the Croatian budgetary accounting system there also exist taxes on immovable property (land, buildings, houses etc).[1]

Tax on immovable property is imposed on the use or ownership of any form of immovable property. This tax is different from other taxes on immovable property, such as the immovable property transfer tax (on property which has been inherited, received as a gift or purchased/sold), or tax on income from immovable property, i.e. rental income tax. Tax on immovable property is levied on the use/ownership of immovable property in the territory where it is located, regardless of its owner's place of residence. Immovable property comprises built-up and non-built-up land, including buildings. The tax base can be the market, estimated or rental value of the property. The immovable property tax mainly constitutes the budget revenues of local government units.

3. Reasons for introducing immovable property tax

The introduction of the tax on immovable property, as the most significant type of assets, is largely justified by the principles of benefit and ability-to-pay. The **benefit principle** states that real property owners receive benefits from the government, for which they should pay taxes. As ownership protection constitutes one of the government's major tasks, owners should pay the government for the protection costs and care for their immovable property. These include the costs of police, judiciary and government administration. Apart from security and property protection services, the government also provides property owners with certain public services relating to health care, education or utilities, which add to the value of the immovable property and are beneficial for its owners. Thus, for example, by building a road beside a citizen's house, the government raises the value of the house and facilitates the citizen's access to his home. For these benefits the person must pay tax on house ownership. As such services are generally provided locally, the immovable property tax most frequently constitutes the revenues of local budgets rather than those of the central government budget.

On the other hand, the **ability-to-pay principle** states that immovable property owners are wealthier, so they should also pay more tax. Thus, the immovable property tax brings more equity into the tax system. More specifically, income does not represent the entire ability to pay, nor the tax capacity of an individual. The immovable property ownership increases the ability to pay above the level of an individual's income, so that two families with the same income but different immovable property are not equal in terms of wealth. Richer families are more independent, more secure in times of economic downturn, and their liquidity level is higher. However, it should be emphasized that in theory, i.e. if the ability-to-pay principle is consistently applied, immovable property tax should be based on the net value of property, i.e. net of liabilities. For example, if two persons own apartments of the same value, where one apartment is encumbered by a loan and the other is not, these two persons should not be considered equally "rich" in terms of the immovable property tax.

4. Immovable property tax characteristics

Immovable property tax has the following **economic and social characteristics**:

- Despite its generally small share in local budget revenue, this tax generally arouses strong opposition from taxpayers, as it is raised on an annual basis and thus imposes a heavy one-off burden on individuals. Immovable property tax differs from income tax which is paid monthly on salaries, or from value added tax which is mainly, "invisible" and is paid at the time of purchasing goods and services in small amounts.
- Immovable property tax revenues represent a relatively reliable **source of revenues** for local budgets. Since

[1] The Chart of Accounts is available at: http://www.mfin.hr/adminmax/docs/Racunski%20plan-%20prociscena%20verzija.xls.

immovable property can neither be 'hidden' nor taken away, it is difficult for taxpayers to avoid this tax. The tax base is stable, as opposed to income tax bases, which are more subject to economic cycles, so that the amounts of the immovable property tax can be forecast more easily.

- It has often been argued that immovable property tax **reduces saving and boosts consumption.** Specifically, if immovable property is taxed, those who are richer will save less and spend more on current consumption. Consequently, immovable property tax can adversely impact on saving and economic growth. On the other hand, there are arguments hat immovable property tax encourages property owners to invest in higher-yielding assets, e.g. shares. In such a case, immovable property tax can have a positive impact on economic growth.
- In order to efficiently implement the immovable property tax, the government needs **accurate immovable property lists**, among other things, a land register indicating the size, location and owners of immovable property. As individuals are not likely to report their immovable property accurately and promptly, the government must have a sound information basis for effective control and accurate assessment of the tax.
- **Valuation of immovable property** poses a special problem. Immovable property represents a heterogeneous category, as there are no two identical immovable property items. Its value is composed of a number of factors such as the distance from traffic routes or shopping centres, availability of cultural and recreation facilities, immovable property age, quality of construction and equipment, an apartment's position in the building, etc. On the other hand, the value of land depends on its quality and size, as well as of environment quality. The assessed value of the immovable property, used as the tax base, should as closely as possible reflect its market value. The property valuation is further complicated by inflation, so property should be revalued on an annual basis, in order to maintain its real value. All activities relating to proper immovable property valuation should be carried out annually by the tax administration.
- Immovable property taxes, as an important source of local budget revenues, stimulate **urbanisation and industrialisation**, and, consequently, influence people's decisions about their place of residence or the location of their businesses. However, these decisions also depend on local public services financed from such taxes. Thus, apart from the level of local immovable property taxes, the taxpayers' decisions on the location of their immovable property also depend on the quality of local public services.
- Immovable property taxes have been considered **more efficient than other taxes,** due to their relatively small influence on the allocation of resources in the economy. More specifically, in contrast to other taxes, these taxes do not influence the economic agents' decisions about the labour supply, investments in human capital, production, investment and innovation. It is also believed that these taxes positively correlate with economic growth.

5. Immovable property tax in the European Union

The table 1 leads to the following conclusions:

- Immovable property tax is widely implemented, and some form of this tax exists in all EU Member States, except Belgium and Malta.
- Immovable property tax is mainly assessed, and its revenues collected by local authorities. In some countries (e. g. Greece and Sweden) there are both local and national immovable property taxes.
- Taxpayers are legal and natural persons that own/use housing/business space or land.
- In all the observed countries taxable immovable property comprises buildings and land, except in Estonia, where the tax is levied on land only.
- The tax base is generally the immovable property value assessed by local tax administrations. Some countries (e.g. France, Ireland and United Kingdom) determine the tax base as the immovable property's rental value, i.e. the assessed or market value of the rental. Interestingly, even in 2009, the immovable property tax base on Cyprus was the assessed immovable property value as at 1 January 1980.
- Tax rates range between 0.1% and a maximum of 3%, and are set by local authorities.
- Housing space in which owners reside is often given a special treatment; in some countries (Greece, Ireland, Italy, Lithuania and Portugal) it is completely tax-exempt, whereas in others (Bulgaria and Slovenia) it is subject to lower tax rates.

In the graph 1, we present the shares of immovable property tax in total taxes in EU Member States and Croatia in 2006. The data relate to EU-15, including Czech Republic, Hungary, Poland and Slovakia, i.e. EU-19[2].

[2] Data for these countries have been collected and published by OECD in its publication *"Revenue Statistics"* which was used as a source of immovable property tax data. Other new EU Member States are still not included in the statistics.

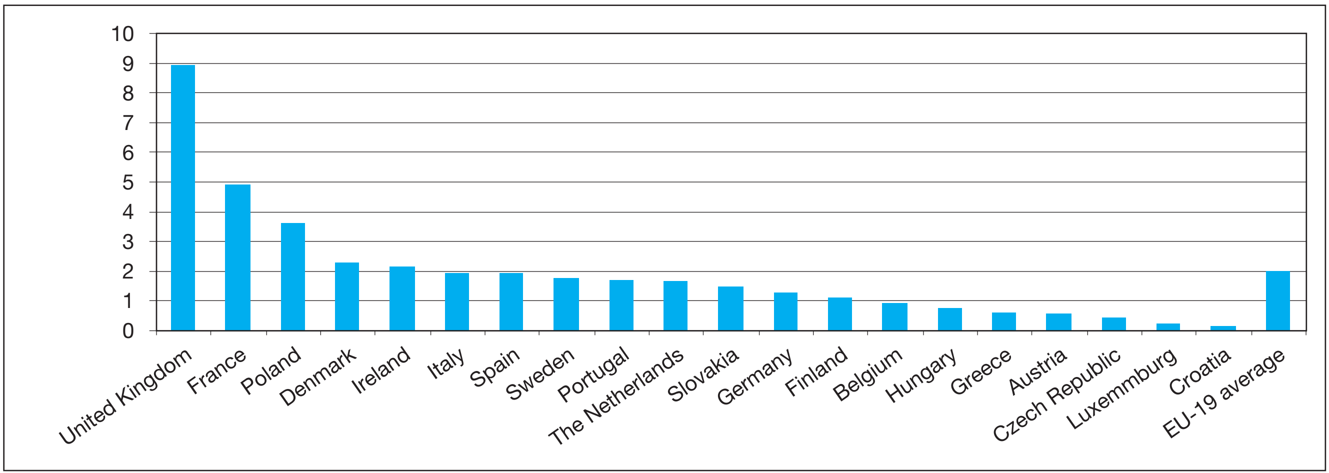
Table 1 Immovable property tax in EU-27 (natural persons, August 2009)

	Base	**Rate**	**Note**
Austria	Assessed value	0.2% to 1%	
Bulgaria	Assessed value	0.05% to 0.2%	There is a 50% tax relief on the immovable property in which the taxpayer resides.
Cyprus	Assessed value	0% to 0.4%	Tax is paid on the assessed market value as at 1 January 1980.
Czech Republic	For land – purchase price	0.25% to 0.75%	
	For buildings – ground plan area	1 to 10 CZK per square meter	
Denmark	Tax value	1.6% to 3.4%	
Estonia	Market value of land	0.1% to 2.5%	The tax is only levied on land.
Finland	Tax value	0.5% to 1%	
France	Rental value determined by local authorities	Coefficients determined by local authorities	The taxe fonciere (property tax) is paid by the owner and the taxe d'habitation (residence tax), is paid by the tenant. A tenant residing in own apartment pays both taxes.
Germany	Fiscal value	Determined by local authorities at an average of 1.9%	
Greece	Assessed value	National tax – 0.1%; Local tax – 0.025% to 0.035%	Primary dwelling is exempt from national tax.
Hungary	Market value	Maximum 3%	
Ireland	Rental value	Rates are determined annually by local authorities	The tax is not levied on housing space.
Italy	Imputed income from immovable property	0.4% to 0.7%	Primary dwelling is tax-exempt.
Latvia	Cadastral value	1%	
Lithuania	Average market value	1%	Taxpayers are legal persons only.
Luxembourg	Assessed value	0.7% to 1%	
the Netherlands	Assessed value	Rates are determined by local government units	
Poland	Ground plan area – land	0.37 to 19.81 PLN per square meter	
Portugal	Assessed value	0.2% to 1%	Primary dwelling is tax-exempt.
Romania	Accounting worth	0.25% to 1.5%	
Slovakia	Assessed value	Land – 0.25%; buildings – 1 SKK per square meter	
Slovenia	Legally determined value	0.1%-1.5%	The first 160 square meters of the apartment in which the owner dwells are tax-exempt.
Spain	Cadastral value	0.3% to 0.4%	
Sweden	Assessed value	0.5% to 1%	National tax on buildings used for commercial and trading purposes.
	Assessed value	0.4% to 0.75%	Local tax on residential buildings.
United Kingdom	Assessed value for council tax; rental value for national non-domestic rate	Rates are determined annually by local authorities	Private dwelling is subject to council tax. Companies are subject to the national non-domestic rate

Note: Belgium and Malta do not have immovable property tax. In Belgium only exists some form of tax on the rental value of property for legal persons.

Source: IBFD (2009)

Graph 1 Share of immovable property tax in total taxes and contributions, EU-15 2006 (%)



Sources: OECD (2008); Ministry of Finance, 2008

As indicated, most countries raise relatively small revenues from immovable property tax. In 2006, immovable property taxes accounted for 2% of total tax revenues on average in EU-19. Excluding Poland, France and United Kingdom, standing out markedly from other countries, immovable property tax accounts for as little as 1.3% of total taxes in these countries. Among "old" Member States, the lowest immovable property tax revenues are reported by Luxembourg (only 0.2% of total taxes), with relatively small amounts also collected by Czech Republic, Hungary and Slovakia (0.4%, 0.7% and 1.5% respectively).

Compared with EU-19, Croatia's immovable property tax revenues were small: only 0.13% of total taxes collected in 2006, which moves Croatia to the bottom of the list of observed countries.

6. Immovable property tax in Croatia

In the Croatian budgetary accounting system, **immovable property taxes** are represented as recurrent taxes on immovable property (land, buildings, houses, etc.), and they include the following:

- tax on uncultivated cultivable land;
- tax on undeveloped building land;
- tax on unused entrepreneurial real estate;
- vacation house tax; and
- tax on the use of public land.

As the first three taxes were abolished by virtue of a Constitutional Court Decision in 2007, subject to tax are only vacation houses and the use of public land. These are local taxes and as such they constitute the revenues of cities and municipalities.

Vacation house tax is paid by house owners at a rate between 5 and 15 kuna per square meter of the surface area. The amount of tax is prescribed by a decision of a municipality or city on whose territory the vacation house concerned is located and which collects the tax as its budget revenue.

Tax on the use of public land is paid by natural and legal persons using public land. The amount of tax and the definition of public land are determined by a decision of the relevant municipality or city. Despite being included in the Croatian budgetary statistics as a immov-

Table 2 Immovable property taxes in Croatia

	2003	2004	2005	2006	2007	2003-2007 Average
Total taxes and contributions (in million kuna)	81,259	85,900	91,819	100,644	110,591	94,043
Immovable property taxes (in million kuna)	102	109	115	126	121	115
Share of immovable property taxes in total taxes (%)	0.13	0.13	0.13	0.13	0.11	0.12

Source: Ministry of Finance, 2008

able property tax, this tax cannot be theoretically considered as tax on immovable property ownership.

It follows that the only immovable property ownership tax in Croatia is the **vacation house tax** which constitutes budget revenues of a city or municipality where the vacation house is located.

In the period from 2003 to 2007, immovable property taxes contributed slightly more than 100 million kuna to the average annual budget revenues of cities and municipalities, which represents 0.12% of total tax revenues (s. table 2). Croatia thus belongs to countries with low immovable property tax revenues (let us remember, in EU-19 this tax accounts for about 2% of total tax revenues).

7. What to do with immovable property tax in Croatia?

- In Croatia, immovable property taxes include vacation house tax and tax on the use of public land, of which **only the vacation house tax**, constituting the budget revenues of cities and municipalities, can be considered as immovable property ownership tax. The tax on the use of public land cannot be considered as standard immovable property ownership tax.
- Immovable property taxes **are implemented on a relatively small scale in Croatia**, and are much below the EU-19 average (0.13% vs. 2% of total taxes in 2006).
- Introducing the immovable estate tax in Croatia would require **substantial administrative effort with uncertain revenue outcome**. More specifically, this would create a need for reliable and up-to-date immovable property databases and clearly determined immovable property valuation methods. Moreover, it should be borne in mind that the immovable property of many Croatian citizens is encumbered by loan mortgages. The tax base should therefore be the net value of the immovable property, which would raise additional administrative difficulties. Home loans to households increased from 8.7% to 14.4% of GDP in the period between 2004 and 2007, reaching 52 billion kuna in May 2009 (CNB, 2009).
- One should also take into account the **tax compliance costs**, to be borne by both local tax administrations faced with new tasks and a need for new employees, and by taxpayers.
- The potential introduction of immovable property tax should be accompanied by the abolishment of some **utility fees** which are currently used for local infrastructure financing and which would become superfluous once the immovable property tax is in place. This is, of course, connected with the financial restructuring of the local public utility companies.
- The introduction of the immovable property tax is often justified by its role in the **housing policy**. According to such arguments, the tax would increase housing stock mobility, by motivating single persons living in large apartments to sell them and move to smaller ones. In Croatia, people normally live in smaller apartments. In 2006, the average surface area of an apartment for 3 household members on average was 70 square meters. However, the question is raised about the real number of single persons living in large apartments who would be forced to move out of them due to immovable property tax. Only a thorough analysis into these issues could show to what extent the immovable property tax would actually increase housing mobility.
- In addition to this, the introduction of immovable property tax cannot be considered separately, but **only within the framework of the entire tax system**. The fact that developed countries raise more tax revenues from property than Croatia is due to their completely different taxation systems. To be more specific, these countries' tax systems have traditionally relied on income, profit and property taxes, which, for example in OECD countries, accounted for as much as 42% of total taxes in 2006, and only 18% in Croatia. In contrast to this, the Croatian system is based on consumption taxes (VAT and excise taxes), accounting for 48% of total tax revenues (compared with only 30% in OECD member countries). Indeed, economic theory suggests that consumption taxation is less distorting for resource allocation and it thus provides more incentive to economic growth.
- And, finally, a tax reform, i.e. revenue side of the budget makes little sense without **substantial budget expenditure cuts**. It is only through reduced expenditures and, consequently, lower taxes that public welfare improvement and economic growth can be achieved.

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