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Bronić, Mihaela

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NEWSLETTER



Institute of Public Finance, HR-10000 Zagreb, Katančićeva 5 Croatia
P.O.Box 320, Phone: (385 1) 4819 363; Fax: 4819 365; e-mail: office@ijf.hr; www.ijf.hr

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Mihaela Bronić

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At the beginning of 2007 the eleventh successive amendment to the Financing of Units of Local and Regional Self-Government Law came into force in Croatia. The modification relates to personal income tax sharing among central government, the county and municipality/city of the taxpayer. Since personal income tax (below: PIT) and surtax on PIT (below: surtax) are the most important sources of tax revenue of cities and municipalities, we are interested in how much money will go to the central government, the county, and how much to the municipality/city of the taxpayer.¹

Sharing of revenue from PIT and surtax is fairly complicated and the Law has frequently been modified so we shall try to explain the way in which the revenue is shared as simply as possible.

- Depending on the area in which the municipality/city of the taxpayer lies in Croatia, there are four ways of PIT sharing: a) the regular or standard manner, b) the manner in the city of Zagreb, c) distribution in areas of special national concern and in the hill and mounta-

in regions and d) special rules for sharing with respect to island local government units that have entered into an agreement to finance capital projects of interest for the development of the island.

- Certain public functions or tasks that are conducted at local level (for example, elementary and secondary education) can be financed by central government or local units (municipalities, cities and counties). If the local unit has assumed the obligation to fund certain decentralised functions, central government will give it an additional share of PIT in order to make sure that this local unit does have the minimum financial resources necessary for the funding of the matters taken on. So if the local unit takes on the financing of more decentralised functions, it will get more money from the revenue derived from PIT.
- Revenue from surtax belongs exclusively to the municipality/city of the taxpayer. The higher the level of surtax that the municipality/city sets, the more money from surtax they will collect.²

¹ Surtax is an extra tax levied on top of PIT. The base for the tax is PIT, and the rate of the surtax is set by the city or municipality in which the taxpayer resides.

² Up to 2001, surtax could be introduced only by cities with populations of over 40,000. The maximum rate of surtax they could introduce was 30% and 60% for the city of Zagreb. Since 2001 all local units except counties have been entitled to introduce surtax. The maximum rates of the surtax are: 10% for municipalities, 12% for cities with populations up to 30,000, and 15% for units with populations above 30,000. The maximum rate of surtax in the city of Zagreb is 30%. By January 1 2007, 251 units had introduced surtax.

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- Assessment and collection of PIT and surtax are conducted by the Tax Administration, to which the municipalities, cities and counties pay 1% of the revenue collected. An exception consists of revenue that is used for the financing of decentralised functions, for which the local units pay no fee to the Tax Administration.
- An equal distribution is applied to payments and refunds of PIT and surtax. Depending on the percentage of the totally collected PIT and surtax that after the payment of the Tax Administration fee accrued to the given level of government, the same percentage is applied to refunds of PIT and surtax. An exception is to be found in refunds in the areas of special national concern and the hill and mountain areas, which since 2004 have been paid out totally at the expense of the central government budget. That is, the central government refunds, in these areas, all PIT and surtax claimed in the annual returns.

In what follows, there are five different examples of sharing PIT and surtax in Croatia depending on the area in which the taxpayer resides.

1. The regular or standard way of personal income tax and surtax sharing

In the regular or standard manner of PIT sharing, from 100 kuna of collected PIT, 15 kuna go to the county, 52 to the city/municipality, 21 go to the equalisation fund, and 12 kuna go to the level of government that has taken on the decentralised functions. It is needful here to explain briefly the concepts decentralised functions and equalisation fund.

Decentralised functions

From 2001 on, for the 53 local units (municipalities, cities and counties) that assumed the obligation to finance the decentralised functions (of elementary and secondary education, health care and welfare) and for the 127 municipalities and cities that own and finance a public fire brigade, the central government has provided an extra/additional share in PIT. Local units that take on the financing of all the decentralised functions can increase their share in PIT by 12%. If they decide to assume the financing of just certain of the functions, then they can claim the following additional shares: 3.1% for elementary education, 2.2% for secondary education, 3.2% for health care institutions, 0.5% for welfare centres, 1.7% for homes for the elderly and disabled persons, and 1.3% for public fire brigade.

If, for example, a city assumes the financing of elementary schools and has a public fire brigade, along with the basic part of PIT that is due to it (52%) it will also obtain an additional 4.4% (3.1% and 1.3%) of the PIT collected. The extra shares in the PIT for secondary education (2.2%), for health care institutions (3.2%), for welfare centres (0.5%) and homes for the elderly and disabled persons (1.7%) will go to the county of that city if it has assumed the decentralised functions, otherwise the money will head for central government.

Equalisation fund

If local units have taken on decentralised functions and yet from the extra/additional share in the PIT still do not have enough funds to bring them to the level of the minimum financial standard, central government allocates them resources from the equalisation fund. In so doing the central government makes sure that all the local units that have taken on obligations to finance the decentralised functions do have the prescribed minimum financial resources for the funding of these functions.

Example from Table 1.

- A taxpayer has paid 100 kuna of PIT.
- The same taxpayer has paid surtax of 5 kuna, because in this municipality the surtax is set at 5%.
- The county has assumed the obligation to finance education at elementary and secondary levels, the welfare centre, and health care institutions. There is no home for the elderly and disabled persons in the county.
- The municipality does not have a public fire brigade.
- The refund of PIT the taxpayer is due because of the personal allowances claimed is 10 kuna. The refund of surtax is 50 lipa (5% of 10 kuna).

The municipality has received 5 kuna of surtax and 52 kuna of the PIT, all told, 57 kuna. Fifteen kuna have accrued to the county. Since the county has taken on the decentralised functions of secondary and elementary education, health care institutions and welfare centre, it receives 9 kuna more (3.1 + 2.2 + 0.5 + 3.2) or 24 kuna all told. The central government has taken 24 kuna. Twenty one kuna are paid in to the equalisation fund, 1.7 kuna went to the central government because the county has no retirement home, and 1.3 kuna went to it because the municipality has no public fire brigade (see Table 5, annex).

Table 1. Regular or standard way of sharing personal income tax and surtax (in kuna)

#	Central government	County	Municipality		Total
	A	B	C	D	E
	PIT and surtax	PIT	PIT	Surtax at 5%	PIT and surtax
1. PIT and surtax paid	–	–	–	–	105.00
2. Municipality, basic part	–	–	52.00	–	–
3. Surtax	–	–	–	5.00	–
4. County, basic part	–	15.00	–	–	–
5. Elementary education (dec. func.)	–	3.10	–	–	–
6. Secondary education (dec. func.)	–	2.20	–	–	–
7. Welfare centre (dec. func.)	–	0.50	–	–	–
8. Health care institutions (dec. func.)	–	3.20	–	–	–
9. Homes for elderly and disabled persons (dec. func.)	1.70	–	–	–	–
10. Public fire brigade (dec. func.)	1.30	–	–	–	–
11. Equalisation fund	21.00	–	–	–	–
12. Revenue collected before payment of the fee to the Tax Administration (sum of 1 to 11)	24.00	24.00	52.00	5.00	105.00
13. Fee to the Tax Administration	0.72	-0.15 ^a	-0.52 ^a	-0.05 ^a	0.00
14. Allocation of PIT and surtax after payment of fee to the Tax Administration and before refunds of tax are made (12 + 13)	24.72	23.85	51.48	4.95	105.00
15. Share in total PIT and surtax (%)	23.54 ^b	22.71 ^b	49.03 ^b	4.71 ^b	100.00
16. Refund of PIT and surtax (#15 * TPS ^c)	-2.47	-2.38	-5.15	-0.50	-10.50
17. Ultimate sharing of PIT and surtax revenue (14 – 16)	22.25	21.47	46.33	4.45	94.50

^a The municipality pays 1% of #2 and #3, and the county pays 1% of #4.

^b The central government's share in total PIT and surtax revenue is (14A/14E). The county's share in total PIT and surtax revenue is (14B/14E). The municipality's share of PIT in total PIT and surtax revenue is (14C/14E). The municipality's share of surtax in total PIT and surtax revenue is (14D/14E).

^c TPS (total amount of refund of PIT and surtax) = 10.5 kuna.

The county and the municipality pay the Tax Administration a fee or charge in the amount of 1% of the revenue collected (the municipality from #2 and #3 and the county from #4). Thus the municipality paid 57 lipa (52 for PIT and 5 lipa for surtax collection), and the county paid 15 lipa. The Tax Administration, or central government, gained 72 lipa in fees (57 plus 15).

Subsequently, during the year, the taxpayer had a refund of 10.5 kuna (10 kuna of PIT refund, 50 lipa surtax refund). Since after the payment of the fee to the Tax Administration 53.74% of totally paid PIT and surtax accrued to the municipality (49.03 + 4.71), 22.71% to the county and 23.54% to the central government, the same principle of sharing is applied to the refund. Of the 10.5 kuna refund of PIT and surtax, the municipality supplies 5.65 kuna (5.15 kuna of PIT and 0.5 kuna surtax), the county 2.38 kuna and the central government 2.47 kuna.

Finally, of the 105 kuna of PIT and surtax paid, and after the refund of 10.5 kuna for overpaid PIT and sur-

tax, the municipality has retained 50.78 kuna (46.33 of PIT and 4.45 kuna of surtax), the county 21.47 kuna and the central government 22.25 kuna.

2. Personal income tax and surtax sharing in the city of Zagreb

Of 100 kuna of PIT paid in within the city of Zagreb, 79 kuna (15 + 52 + 12) accrue to the city, and 21 kuna go to the equalisation fund. The city of Zagreb, that is, has a special status, according to which it is both city and county, and it obtains the 15 kuna as a county, the 52 kuna as a city and the 12 kuna that it takes for having taken on the financing of all the decentralised functions.

Example from Table 2.

- A taxpayer has paid in 100 kuna PIT and 18 kuna of surtax (the rate is 18%).
- All the decentralised functions have been assumed, and the city does have a public fire brigade.

Table 2. Sharing personal income tax and surtax in the city of Zagreb (in kuna)

#	Central government	City		Total
	A	B	C	D
	PIT and surtax	PIT	Surtax at 18%	PIT and surtax
1. PIT and surtax paid in	–	–	–	118.00
2. City, basic part	–	67.00	–	–
3. Surtax	–	–	18.00	–
4. Elementary education (dec. func.)	–	3.10	–	–
5. Elementary education (dec. func.)	–	2.20	–	–
6. Welfare (centre and retirement home) (dec. f unc.)	–	2.20	–	–
7. Health care institutions (dec. func)	–	3.20	–	–
8. Public fire brigade	–	1.30	–	–
9. Equalisation fund	21.00	–	–	–
10. Revenue collected before payment of fee to Tax Administration (sum of #1 through 9)	21.00	79.00	18.00	118.00
11. Fee to the Tax Administration	0.85	-0.67 ^a	-0.18 ^a	–
12. PIT and surtax after payment of fee to Tax Administration and before refund of PIT and surtax (10 + 11)	21.85	78.33	17.82	118.00
13. Share of total PIT and surtax revenue (in %)	18.52 ^b	66.38 ^b	15.10 ^b	100.00
14. Refund of PIT and surtax (#13 * TPS ^c)	-2.19	-7.83	-1.78	-11.80
15. Ultimate distribution of PIT and surtax revenue (12 – 14)	19.66	70.50	16.04	106.20

^a The city pays 1% of #2 and #3.

^b The share of central government in total PIT and surtax is (12A/12D). The share of the city part of the tax in total PIT and surtax is (12B/12D). The share of the city part of surtax in total PIT and surtax is (12C/12D).

^c TPS (total amount of refund of tax and surtax) = 11.8 kuna.

- Refund of PIT because of personal allowances claimed is 10 kuna. The refund of surtax comes to 1.80 kuna (18% of 10 kuna).

The city of Zagreb has received 18 kuna of surtax, 67 kuna of PIT (basic part) and 12 kuna for the decentralised functions, all told 97 kuna (67 + 12 + 18). The central government received 21 kuna to go to the equalisation fund (see Table 5 in the annex).

The city of Zagreb paid a fee to the Tax Administration of 1% of revenue collected, which comes to 0.85 kuna (0.67 + 0.18).

Since after the payment of the fee to the Tax Administration 81.48% (66.38 and 15.10) of the totally paid PIT and surtax accrued to the City of Zagreb, and 18.52% to the central government, the same principle of sharing is applied to the refund. Of the 11.80 kuna refund of PIT and surtax, the city refunds 9.61 kuna (7.83 kuna

of PIT and 1.78 kuna surtax), while the central government refunds 2.19 kuna.

Finally, of the 118 kuna of PIT and surtax actually paid in, and after the refund of 11.80 kuna of PIT and surtax, 86.54 kuna (70.50 kuna of PIT and 16.04 kuna of surtax) accrued to the city, and 19.66 kuna went to central government.

3. Personal income tax and surtax sharing in areas of special national concern and hill and mountain areas

Since these areas are of special interest to and protected by the state of Croatia, the county in these areas receives 10% of PIT collected, and the municipalities or cities receive 90%.³ Of 100 kuna of PIT collected, then, the county gets 10 kuna, and 90 kuna go to the municipality/city.⁴

³ In 1999 in Croatia two areas of special national concern were designated, and during 2002 a third was defined. There are 180 local government units in them (50 in Area 1, 61 in Area 2 and 69 in Area 3). In 2002 the hill and mountain areas were designated, including 12 cities and 33 municipalities.

⁴ There are some cities only parts of which are in the areas of special national concern (Sisak 10%, Karlovac 10%, Daruvar 25%, Slatina 10%, Virovitica 10%, Zadar 10%, Vodice 25%, Vinkovci 25%, Dubrovnik 50%). According to the new way of distributing PIT, the regular or standard manner of sharing is applied in these cities (see Table 5 in the Annex). That is, these cities are treated as if no part of them were in the areas of special national concern.

Table 3a) Sharing personal income tax and surtax in areas of special national concern, hill and mountain areas (in kuna)

#	Central government	County	Municipality		Total
	PIT and surtax	PIT	PIT	Surtax at 10%	PIT and surtax
1. PIT and surtax paid in	–	–	–	–	110.00
2. Municipality, basic part	–	–	90.00	–	–
3. Surtax	–	–	–	10.00	–
4. County, basic part	–	10.00	–	–	–
5. Sharing PIT and surtax before payment of fee to the Tax Administration (sum of 1 to 4)	0.00	10.00	90.00	10.00	–
6. Fee to the Tax Administration	1.10	-0.10 ^a	-0.90 ^a	-0.10 ^a	–
7. Sharing PIT and surtax after payment of fee to the Tax Administration and before refunds of tax are made (5 + 6)	1.10	9.90	89.10	9.90	110.00
8. Refund of PIT and surtax ^b	-11.00	–	–	–	-11.00
9. Final distribution of revenue from PIT and surtax (7 – 8)	-9.90	9.90	89.10	9.90	99.00

^a The municipality pays 1% of #2 and #3 and the county pays 1% of #4.

^b All PIT and surtax refunds are made by the central government.

From the revenue received, the municipality/city and county are bound to finance their own and decentralised functions. But how is a county to finance also its decentralised functions from just 10% of the PIT? The answer provided is that the county will actually finance its decentralised functions from the extra share in PIT that it receives for the decentralised functions from the municipalities and cities that are not in the areas of special national concern and hill and mountain areas, but since this is most commonly still not enough to cover the minimum standards, as a rule central government steps in with resources from the equalisation fund.

Nevertheless, counties from the municipalities and cities that are in the areas of special national concern and hill and mountain areas do not receive the basic county share of 15%, but only 10% of PIT. The regular or standard distribution says that the county receives its basic part of PIT revenue at the rate of 15%. Hence the question arises as to why counties from the cities/municipalities in areas of special national concern and hill and mountain areas receive a lower basic share in the PIT, of 10%, when the counties from cities/municipalities in all the other areas receive a basic share of 15%.

Example from Table 3a.

- One hundred kuna of PIT are paid in. Surtax is 10 kuna (10% of 100 kuna).

- The county has assumed responsibilities for education at primary and secondary levels and for the welfare centre.
- The refund of PIT is 10 kuna, and the refund of surtax is 1 kuna (10% of 10 kuna).

The municipality has obtained 10 kuna from surtax and 90 kuna from PIT, that is, all told 100 kuna. The county has obtained 10 kuna for its requirements. Primary and secondary education and the welfare centre are financed from the extra share of PIT that it receives for financing decentralised functions from the municipalities and cities that are in its area but not part of the areas of special national concern and hill and mountain areas, and if this is not sufficient to cover minimal financial standards, the central government will help the county with resources from the equalisation fund. Of the 110 kuna paid in within this municipality, the central government receives nothing (see Table 5 in the annex).

The county and the municipality pay the Tax Administration a fee of 1% of PIT collected. The municipality pays 1 kuna (90 lipa for PIT and 10 lipa for surtax) while the county pays 10 lipa. Thus the Tax Administration or the central government receives 1.10 kuna of fees.

Subsequently, 11 kuna are refunded to the taxpayer (10 kuna for PIT and 1 kuna for surtax). The entire amount of the refund is provided by central government.

Of the 110 kuna of PIT and surtax paid in a municipality, and after the refund of 11 kuna, 99 kuna (89.1 kuna

Table 3b) Sharing personal income tax and surtax revenue in the areas of special national concern and the hill and mountain areas (in kuna)

#	Central government	County	City	Total
	PIT and surtax	PIT	PIT	PIT and surtax
1. PIT and surtax paid	–	–	–	112.00
2. City, basic part	–	–	85.60	–
3. Surtax	–	–	–	12.00
4. Elementary education (dec. func.)	–	–	3.10 ^a	–
5. Public fire brigade (dec. func.)	–	–	1.30 ^a	–
6. County, basic part	–	10.00	–	–
7. Sharing PIT and surtax revenue before payment of fee to the Tax Administration (sum of #1 to 4)	0.00	10.00	90.00	12.00
8. Fee to the Tax Administration	1.12	-0.10 ^b	-0.90 ^b	-0.12 ^b
9. Sharing PIT and surtax after payment of fee to the Tax Administration but before the refund of taxation (7 + 8)	1.12	9.90	89.10	11.88
10. Refund of PIT and surtax ^c	-11.20	–	–	–
11. Final distribution of PIT and surtax (9 – 10)	-10.08	9.90	89.10	11.88

^a The funds must be spent on the decentralised functions for which they have been allocated.

^b County and municipality pay 1% of #7.

^c The entire refund is made by central government.

of PIT and 9.9 kuna of surtax) accrue to the municipality, 9.9 kuna to the county, while the central government ends up with a deficit of 9.9 kuna (the 1.1 kuna of the fee to the Tax Administration from which are subtracted the 11 kuna refund according to the annual return).

In order to show that the existing manner of sharing does not incentivise the cities and municipalities in the areas of special national concern and hill and mountain areas to take upon themselves the responsibility for decentralised functions, but instead induces them to levy as much surtax as they can, we shall give the example of a city in an area of special national concern that has taken on responsibility for public fire brigade and elementary education.

Example from Table 3b.

- A taxpayer has paid 100 kuna of PIT and 12 kuna of surtax (the surtax can be a maximum of 12% since the city has a population of below 30,000).
- The city has assumed responsibility for the public fire brigade and elementary education.
- The county has assumed responsibility for financing secondary education, the welfare centre, and homes for the elderly and disabled persons as well as healthcare institutions.

- Refund of PIT is 10 kuna, refund of surtax 1.2 kuna (12% of 10 kuna).

It obviously does not pay a city or municipality in areas of special national concern and hill and mountain areas to take on the financing of decentralised functions. The city or municipality can spend the basic share of the PIT that they receive any way they want. Since in our case here however the city has taken on the funding of elementary education and firefighting, the basic share of the PIT that it is due is reduced by 3.1% (for elementary education) and 1.3% (for the public fire brigade). And so the city is left with the basic part of the PIT revenue, 85.6%, which it can spend as it sees fit, and yet it has to pay 3.1% on elementary education and 1.3% on public fire brigade.

The county has received 10 kuna for its needs. Since the city finances elementary education, resources for the financing of secondary education, the welfare centre, the retiree homes and the healthcare institutions (county hospitals for example) are paid for out of the extra share of PIT that it receives for performance of decentralised functions from local units that are not in the areas of special national concern and hill and mountain areas. But since these are most often not enough to meet the minimum financial standards, central gover-

ment as a rule has to step in with funds from the equalisation fund.

Because the central government provides all the refunds of PIT and surtax in the areas of special national concern and hill and mountain areas, a municipality/city has the incentive to set surtax as high as it can. It will receive more revenue from the surtax, and the taxpayers in the regions, most of whom have the right to a refund of almost the whole amount of PIT or surtax they pay will have a larger refund of surtax (which comes out of the central government).

4. Personal income tax and surtax sharing in municipalities and cities on the islands

In order to help the cities and municipalities on the islands that enter into an agreement with each other to finance capital projects that are of interest for the development of the island(s), the government exempts them

from the obligation to pay part of their PIT into the equalisation fund (21%). This amount then becomes the revenue of these municipalities and cities for the financing of capital projects. Of the 100 kuna of PIT collected, 15 go to the county, 73 kuna (the 52 kuna basic share and the 21 kuna capital project part) to the city/municipality, while 12 kuna are left for the decentralised functions of the level of government that has assumed them.

Example from Table 4.

- A taxpayer has paid 100 kuna of PIT.
- There is no surtax in the municipality.
- The county has taken over elementary and secondary education, welfare and health care institutions.
- The municipality is involved in the joint financing of a capital project of interest for island development, and it has a public fire brigade.
- PIT refund is 10 kuna.

Table 4. Sharing personal income tax and surtax in island municipalities that jointly finance capital projects of interest for island development (in kuna)

#	Central government	County	Municipality	Total	
	A	B	C	D	
	PIT and surtax	PIT	PIT	Surtax (0%)	
				E	
				PIT and surtax	
1. Total PIT and surtax paid	–	–	–	–	100.00
2. Surtax	–	–	–	0.00	–
3. Municipality – basic part	–	–	52.00	–	–
4. County – basic part	–	15.00	–	–	–
5. Elementary education (dec. func.)	–	3.10	–	–	–
6. Secondary education (dec. func.)	–	2.20	–	–	–
7. Welfare (centre and retirees' home) (dec. func.)	–	2.20	–	–	–
8. Health care institutions (dec. func.)	–	3.20	–	–	–
9. For capital investment projects	–	–	21.00	–	–
10. For public fire brigade (dec. func.)	–	–	1.30	–	–
11. Sharing PIT and surtax before payment of fee to Tax Administration (sum of #1 to 10)	0.00	25.70	74.30	0.00	100.00
12. Fee to Tax Administration	0.67	-0.15 ^a	-0.52 ^a	0.00	0.00
13. Sharing PIT and surtax after payment of Tax Administration fee and before refund	0.67	25.55	73.78	0.00	100.00
14. Share in total tax and surtax (in %)	0.67 ^b	25.55 ^b	73.78 ^b		100.00
15. Refund of PIT and surtax (#14 * TPS)	-0.06	-2.56	-7.38		-10.00
16. Final distribution of PIT and surtax (13 – 15)	0.61	22.99	66.40	0.00	90.00

^a County pays 1% of #4 and municipality 1% of #3.

^b Central government share of total PIT and surtax is (13A/13E). Share of county in total PIT and surtax is (13B/13E). Share of municipality in total PIT and surtax is (13C/13E).

^c TPS (total amount of refund of PIT and surtax) = 10 kn.

The municipality has received the basic 52 kuna of PIT revenue, 21 kuna for capital investment projects and 1.30 kuna for public fire brigade, thus all told 74.3 kuna. The county has obtained its basic 15 kuna. Since the county has taken on the decentralised functions of elementary and central education, welfare and health care institutions, it receives another 10.7 kuna, thus all told 25.7 kuna (15 + 10.7). Central government has received nothing from the PIT collected on the island.

The county and the municipality pay fees to the Tax Administration of 1% of the PIT collected but not inclusive of the PIT for the decentralised functions. Thus the municipality paid 52 lipa and the county paid 15 lipa. The central government, i.e., the Tax Administration, took in 67 lipa worth of fees.

Subsequently during the year the taxpayer pursuant to the annual tax return has a 10 kuna refund. After the payment of the fee to the Tax Administration, 73.78% of the PIT accrued to the municipality, 25.55% to the county and 0.67% to the central government. These percentages were also applied to the PIT refund, and so of the 10 kuna refund, the municipality gave 7.38 kuna, the county 2.56 kuna and the central government 6 lipa.

Finally, of the 100 kuna of PIT that was paid, and after the 10 kuna refund, the municipality kept 66.40 kuna, the county 22.99 kuna and the central government 61 lipa.

Conclusion and recommendations

It has been explained how the revenue from PIT and surtax is shared in Croatia. PIT sharing is complicated and depends on: (1) the area in which the city/municipality of the taxpayer is located, (2) the decentralised functions that a city/municipality or county has or has not taken on, (3) the amount of surtax levied by the municipality/city, (4) the amount of the fee paid by the city/municipality and the county to the Tax Administration and (5) on who pays the refund pursuant to the annual tax return, and how. The Finance Ministry does not publish statistics concerning the sharing of PIT and surtax among the different levels of government. Since the PIT is the biggest tax revenue of the local budgets in Croatia, members of the public should certainly know how it is divided. Hence it would be desirable for the Finance Ministry to publish figures about the real sharing of PIT made among the different levels of government and better explain the manner of the division. Thus it is necessary to announce how much PIT and surtax has been collected in every city and municipality, and where which part of this revenue went to. Without such information, it is impossible to make any meaningful analysis of the sharing of PIT and surtax revenue.

Over the longer term, it might be worth considering simplifying PIT sharing. Perhaps one or two kinds of simpler PIT sharing could be used in all areas. The areas of special national concern, hill and mountain areas

Annex 1

Table 5. Personal income tax sharing in Croatia in percentages (from January 1, 2007)

Way in which tax is shared	County basic – share	City or municipality – basic share	Public fire brigade – dec. func. ^a	Other dec. functions ^b	Equalisation fund ^c	Share for joint financing of capital investment projects
Regular or standard way of sharing	15.0	52.0	1.3	10.7	21.0	–
Zagreb	–	67.0	1.3	10.7	21.0	–
Areas of special national concern, hill and mountain	10.0	90.0	–	–	–	–
Islands, joint financing of capital investment projects	15.0	52.0	1.3	10.7	–	21.0

^a Goes to a city or municipality that owns and finances the regular work of public fire brigade, otherwise accrues to central government.

^b Goes to a city or municipality or county that finances decentralised functions, otherwise it goes to central government.

^c Resources from the central government level from which transfers are sent to those local units that cannot finance their own decentralised functions up to the level of the minimum financial standard from the additional share in PIT.

and the islands that have made agreements to finance capital projects could be additionally helped in a different way, through grant allocation for example.

The Law that governs this area is difficult to understand. Since 1993, when it was passed, it has been changed eleven times, and there is no revised or consolidated version. The part of the Law that refers to the PIT sharing has been modified six times from 2001 to 2007. Such frequent alterations to the Law and the manner of distributing the revenue can only confuse the public and result in mistaken interpretations. The Finance Ministry should publish revised versi-

ons and endeavour to amend them as infrequently as possible.

The issue inevitably arises as to why the counties from cities/municipalities in the areas of special national concern and hill and mountain areas receive a smaller basic share of PIT (10%), when counties from cities/municipalities in all other areas receive 15% of PIT.

This paper has shown that the existing way of sharing PIT does not incentivise cities and municipalities in the areas of special national concern and hill and mountain areas to take on the decentralised functions, rather to introduce the maximum permitted rates of surtax.

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