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PRESS RELEASE

Personal income tax sharing among the central government, counties, cities and municipalities

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There has been a lot of discussion and writing lately about the **sharing of personal income tax revenues among the central government and the City of Zagreb.¹ The purpose of this article is not to comment on the situation in the City of Zagreb (a solution to this problem should be worked out jointly by the Ministry of Finance and the City of Zagreb), but to provide a brief and as simple as possible clarification of the statutory sharing of the personal income tax revenues.**²

The personal income tax is a shared tax, which means that the revenues from this tax are split among the municipality or city of a taxpayer's permanent or temporary residence, the county in which that municipality or city is located and the central government. There are a standard and two specific types of personal income tax sharing (Table 1)³. For the sake of simplicity, this article only deals with the standard personal income tax sharing, even though the two specific types are also shown in the Table.

The personal income tax sharing rules are defined in the:

- Act on the Financing of Units of Local and Regional Self-government (Articles 45 and 45a-45b)⁴;
- regulations governing the method of calculating the amount of equalisation grants for decentralised functions of units of local and regional self-government; and
- decisions on the minimum financial standards for each decentralised function.

The above mentioned regulations and decisions are issued for each year.

The personal income tax sharing rules have changed over time, so that, pursuant to amendments to the Act⁵ of March 1, 2012, the county receives 16%, and cities/municipalities 56.5% of the total. As the City of Zagreb performs activities falling within the competence of both a city and a county, it participates in the personal income tax revenues with 72.5% (16% + 56.5%). The cities/municipalities/counties may use the received revenues to finance any of their expenditures.

¹ For further information, see the Ministry of Finance's website.

² Surtax on personal income tax is not included in this analysis, because it completely belongs to the city or municipality of the taxpayer's permanent or temporary residence.

³ The specific personal income tax sharing rules are applied to municipalities/cities/counties in areas of special national concern (ASNC) and in hill and mountain areas (HMA) or on islands that have entered into agreements on the joint financing of investment projects that are of interest for the development of the islands. For further information on the standard tax sharing rules, see Bronić (2007) - **Newsletter No. 27.**, Zagreb: Institute of Public Finance.

⁴ Official Gazette 117/93, 33/00, 73/00, 59/01, 107/01, 117/01-correction, 150/02, 147/03, 132/06, 73/08 and 25/12. A Decision of the Constitutional Court of the Republic of Croatia, Official Gazette 26/07.

⁵ Act on Amendments to the Act on the Financing of Units of Local and Regional Self-government, Official Gazette 25/12.

Since 2001, some municipalities/cities/counties have assumed the obligation to finance one or several decentralised functions (education, social welfare, health care and/or fire fighting) from the personal income tax revenues⁶ collected. These public services were previously financed by the central government. Each year, the Government prescribes minimum financial standards, that is, the amount that each municipality/city/county should spend for the financing of each assumed decentralised function. The central government gives up a maximum of 12% of its personal income tax revenues to the municipalities/cities/counties to finance the said decentralised functions (1.3% for fire fighting and 10.7% for other decentralised functions: primary education (3.1%), high-school education (2.2%), social welfare (2.2%) and health care (3.2%). Where municipalities/cities/counties have not assumed decentralised functions, they are to be financed by the central government, in which case the additional share in the personal income tax allocated for these functions also belongs to the central government.

The remaining 15.5% of the personal income tax revenues collected in the territory of municipalities/cities is paid into the equalisation fund for the financing of decentralised functions⁷. Funds from this source are only allocated to those municipalities/cities/counties that have assumed decentralised functions but still do not have enough funds from the additional share in the personal income tax collected in their respective territories to meet the minimum financial standards for these functions.

Municipalities/cities/counties that have collected more funds from the additional share in the personal income tax earmarked for the financing of decentralised functions than prescribed by the minimum financial standards are obliged to return the surplus funds to the central budget⁸.

Table 1. Personal income tax sharing from March 1, 2012, according to the Act on Amendments to the Act on the Financing of Units of Local and Regional Self-government (in %)

| Type of tax sharing | County - basic share | Municipality or city - basic share | Public fire brigades - decentralised function * | Other decentralised functions** | Equalisation fund for decentralised functions*** | Share for joint financing of capital investment projects |
|---|----------------------|------------------------------------|---|---------------------------------|--|--|
| Standard | 16.0 | 56.5 | 1.3 | 10.7 | 15.5 | -- |
| Standard - for the C. of Zagreb | -- | 72.5 | 1.3 | 10.7 | 15.5 | -- |
| Specific - for ASNC and HMA | 10.0 | 90.0 | -- | -- | -- | -- |
| Specific - for islands (the joint financing of capital inv. projects that are of interest for the development of the islands) | 16.0 | 56.5 | 1.3 | 10.7 | -- | 15.5 |

* Goes to a municipality/city that owns and finances the regular activities of public fire brigades; otherwise it goes to the central budget.

** Goes to a municipality/city/county that finances its decentralised functions; otherwise it goes to the central budget.

*** A fund from which transfers are made to municipalities/cities/counties that are unable to finance their respective decentralised functions up to the level of the minimum standard from the additional share in the personal income tax.

Source: Act on Amendments to the Act on the Financing of Units of Local and Regional Self-government (Official Gazette 25/12).

⁶ Act on Amendments to the Act on the Financing of Units of Local and Regional Self-government, Official Gazette 59/01.

⁷ The equalisation fund is fed by all municipalities/cities, except for those located in the ASNC and HMA or on islands that have entered into agreements on the joint financing of capital investment projects that are of interest for the development of the islands.

⁸ Act on Amendments to the Act on the Financing of Units of Local and Regional Self-government, Article 45a, paragraph (3) (Official Gazette 25/12). The same was prescribed by the annual Regulations on the Method of Calculating the Amount of Equalisation Grants for Decentralised Functions of Units of Local and Regional Self-government for the period 2007-2012, and almost identical provisions can be found in the annual Regulations on the Method of Calculating the Amount of Equalisation Grants for Decentralised Functions of Units of Local and Regional Self-government for the period 2004-2007.