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NEWSLETTER



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What Are the Compliance Costs of Taxation in Croatia for Individuals?¹

From June 2001 to June 2002, tax compliance costs of almost 57 million kuna, or about 0.03% of GDP were incurred by individual Croatian citizens.

The beginning of the year is the time when many of us who are fortunate enough to have a job and have thus acquired the privilege of paying income tax, collect numerous documents from various institutions (retirement and healthcare institutions, insurance companies, dentists and doctors) in order to be able to claim a refund of the tax paid in the previous year. Apart from hoping that the government (i.e., the Tax Administration) is going to refund to us a certain amount of excess tax, most of us do not know or are not aware that the mere collection of all these documents (required for the refund of tax) creates certain costs.

They constitute a part of the costs above and beyond the actual amount of tax paid that citizens have to bear in order to fulfill the requirements imposed by law and revenue services.

These costs consist of time spent, fees paid, possible payment of tax advisers, the work of unpaid assistants and so on (see Table 1).

Sometimes these costs are lower, but sometimes they are greater than the amount of excess tax refunded.

Therefore, each one of us has to do the math (alone or with the help of friends who are skilled in such matters, or perhaps with tax advisers) and decide whether getting involved in the procedure of claiming an income tax refund is worthwhile.

The Institute of Public Finance made a study using the face-to-face interview method to assess the amount and structure of costs of tax compliance borne by all taxpayers liable to (pay) income tax.

In the research, which covered 300 (randomly selected) subjects (selected by random sampling), we arrived at following conclusions.

The total gross social costs of individual (non-corporate) taxpayers in Croatia are relatively low as compared with other countries, and amount to

¹ This newsletter is based on an article by Blažić, H., 2004. "The Costs of Submitting Income Tax Return", *Financijska teorija i praksa* 3/04, Institut za javne financije. Available from the URL: <http://www.ijf.hr/publikacije/indexpub.html>. The author would like to thank Helena Blažić for the right to use this article.

The Institute of Public Finance deals with economic research and analysis related to various forms of public finances such as the budget, taxation and customs duties. Its orientation is thus to the various economic, legal and institutional topics that are important for the sound long-term economic development of the Republic of Croatia. So that the public should be able to have a better insight into certain issues, the Institute of Public Finance is launching its Newsletter, in which it will from time to time publish informed and independent analysis of economic questions. The views expressed in the articles published in the Newsletter will reflect the opinions of the authors, which do not necessarily coincide with those of the Institute as institution. Full text of Newsletter is also available on Institute's Web site: <http://www.ijf.hr/newsletter>.

about 56.9 million kuna, which comes to approximately 0.03% of GDP, 0.8% of the total revenue from income tax, and about 0.9% of the revenue of income tax collected from individuals.

This means that for 100 kuna of tax collected by the Tax Administration, citizens have to bear an additional cost of about one kuna (80 lipa).

A large part of these costs consists of time spent by individuals.

Net costs are higher thanks to cash flow costs, because most taxpayers have to submit a return in order to gain a refund.

This means that the costs have to be increased by the amount of lost interest because, even if individuals can claim the right to a tax refund, the government enjoys the use of their money for some time before returning that surplus (tax that has been overpaid by citizens).

Net costs amount to between 0.05 and 0.07% of GDP, or between 1.3 and 1.8% of the revenue from income tax collected from individual taxpayers. The reasons for income tax compliance costs' being so low is that final tax is collected by withholding and the fact that the period for compliance is short. The average taxpayer takes less than 2 hours a year to perform this duty (1.7 hours, to be exact).

The study showed that the costs of taxing individuals are regressive. This increase in the regressiveness of the compliance costs is mostly related to the increase in the costs of an hour's work and in the overall growth of income.

The structure of the total compliance costs of the income tax of individuals, not including lost interest, is shown in Table 1.

Table 1. Structure of total compliance costs of the taxation of individuals (income tax)

Kind of cost	Structure (%)
Time spent by the person submitting the return	55.93
Paid fees	9.61
Monetary costs apart from paid fees	14.95
Unpaid assistance by officials in the revenue service	0.47
Unpaid assistance by other persons	19.04
Total	100.00

The own time spent constitute the largest part of the costs (56%), followed by unpaid assistance by others (19%) and monetary costs (15%). Taxpayers quite often make use of unpaid help. Here it is important whether the taxpayers fill in their returns themselves or whether they use someone else's assistance, and if they do, what kind of assistance. Unlike the practice in developed countries, taxpayers in Croatia rarely turn to paid expert help (tax advisers, accountants) – only 10% of them do so. However, one can assume that this situation is beginning to change – in 2001, authorized tax advisers have begun their work, whereas before they did not exist. Still, there are not many of them today. Outsourced accountancy provides certain services, but they mainly concentrate on larger business operators, and only rarely on private citizens. Another group of citizens (19%) mostly relies on unpaid help of members of their family, other relatives, friends, and most of all friends and partners at work.

It is interesting that only a third of taxpayers filled in their tax returns themselves. The average time that a taxpayer spent on all activities related to their own tax return, irrespective of whether the taxpayer filled it in himself amounted to 1 hour and 42 minutes. Taxpayers in Slovenia, the only other transition country in which such research has been carried out, took almost the same amount of time (on average, 1.72 hours). But taxpayers who themselves filled in their tax returns spent a little more on average, i.e., 2.15 hours.

Even individuals who engaged other persons to help them fill in their tax returns spent (relatively) quite a lot of time (on average 1.44 hours). The time of other persons whose help was used in filling in the returns consists of the time of persons who are not members of the Tax Administration and the time spent by officials in the revenue service itself. As for the time of unpaid persons, its average came to 0.85 hours, which is much less than the time spent by taxpayers who filled in their returns themselves (2.15 hours). This is directly related to the greater expertise and skill of the persons who helped in filling in the return. This amount is also lower than the average time spent by the taxpayers who used unpaid assistance (help). The difference is explained by other activities that the taxpayer has had to undertake to submit a return.

The number of hours put in by officials of the Tax Administration helping citizens to fill in their

² Klun, M., 2002. "Tax Compliance Costs in Slovenia", *Financijska teorija i praksa* 26 (4), p. 775-792.

returns is of course much lower (0.4 hours). The reason is the greater expertise of officials in the Tax Administration and the fact that the citizens had to fill in most of their forms before bringing it into the office of the Tax Administration. Unpaid assistance of officials in the Tax Administration is in fact part of the administrative costs of taxation, the costs of the Tax Administration. Since it has been shifted to the revenue authorities, it is not part of individual tax compliance costs. In reality, this part is even greater because many persons submitting returns send them in by post, and only some of them are correctly completed. The situation could be improved by more acceptable prices of tax advisers' services. Thus, people without experience in the completion of tax returns and those who do not know anyone willing to help them free of charge, could directly approach a tax adviser, which would result in this cost-shifting being avoided.

It is to be expected that the greatest slice of the pie in the structure of time spent falls due to the actual taxpayer. If we add the time of unpaid assistants, the total time costs make up about three quarters of all the costs of income tax return submissions.

At the end, we provide (some) general and particular recommendations by which the procedure for submitting income tax returns for individuals who are liable to pay income tax might to some extent simplify and improve.

General recommendations:

- The taxation system has to be stable and without constant modifications.
- The tax regulations have to be clear and precise, in order to avoid different interpretations of their application.
- It is necessary for the taxpayer and the tax officials to work together.

Particular recommendations:

- Reduce and simplify the number of forms necessary.
- In order to allow the benefits of the introduction of new relief to outweigh the increased cost of tax compliance and, in general, to be used to the full, it would be a good idea to think about introducing techniques (procedures), which would prevent them being lost in the event of insufficiently large income (tax loss, refunding tax credits, i.e., negative taxes and so on). That is, income tax relief (applied in the tax return in 2001 for the first time) have partially (somewhat) complicated the procedure for submitting the tax return, and most of them cannot be used to the full by taxpayers with low incomes³, anyway.

³ For more about relief in the income tax system, see Newsletter no. 18 "The New Income Tax Law: Impact on the Distribution of the Tax Burden" <http://www.ijf.hr/publikacije/indexpub.html>.

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