Local taxation in European countries

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Abstract
The aim of the paper is to examine similarities and differences of local tax systems in Europe. We have studied both the European and the national regulations. Local tax systems show the characteristics of four main governmental models: the Anglo-Saxon model, and three of the continental models: the German, the French and the Scandinavian. In order to analyse these systems we have chosen four countries from the representatives of public administration models. We have compared how the local taxation works in England, Germany, Spain and Sweden. The paper shows the structures of local government in these countries and the role of tax revenues highlighting characteristic features and the problems as well.

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1 Introduction

Central governments in different countries delegate a part of the public services to lower tiers of government. In order to ensure the public services, local tax revenues are one of the most important financial sources for local governments. To cover their operational costs, local governments can levy local taxes and they can have a share of tax revenues of the central governments.

In multilevel government systems local governance depends on the central legislature. The conformation of local budgeting system is defined by the flexibility and steadiness of the confines settled by the central government. Local tax revenues support the autonomy of local governments, because they make the local budgets less sensitive to the volatility of the budgets of higher tiers of government. The vertical public finance balance between the governmental sectors is assured by local taxes by sharing tax among the different levels of government (Vigvári, 2011), since it is necessary to delegate the right of levying taxes to lower tiers of government.

2 Local tax legislation in Europe

In the European Union, the formulation of fiscal policy and tax policies fall primarily within the competence of member states. The tax harmonisation of the European Union is most extended in case of indirect taxation and value-added tax has a standardized regulation in the first place. In accordance with direct taxes, there is no single regulation therefore European Union relies mainly on the practice and the case-law of the Court of Justice of the European Union (CJEU). Not obligatory, but generally followed rules are the official statements of the European Commission, the Code of Conduct for Business Taxation, or the OECD reports on harmful tax practices (Erdős, 2008).The European Commission (2015) has set the objective of the verification of the Code of Conduct of Business Taxation in 2015 to improve its effectiveness.

OECD regulates the taxation policies of its member states with international agreements and rules. Its efforts and intentions are different from the tax harmonisation activity of the European Union, since OECD does not have to face the challenges of budgeting in the member states of the European Union (Czakó, 2011). The agreements and commitments of the OECD give guidance and support for the European Union in its own tax harmonisation activities. The report Harmful Tax Competition, published by the OECD in 1998, claims that tax competition is considered harmful if it distorts financial and investment processes.

The European Union ensures the rights and the autonomy of local and regional authorities in member states in the European Charter of Local Self-Government. According to Article 6 of the Charta, local governments can determine their own internal administration structure, adapting to the local needs and for the sake of operational efficiency.

3 The types of local governments

Through variant levels of development of public administration and public finance in European countries, different forms of local government systems evolved. Three types of welfare states came into existence: Liberal, Corporatist-Statist and Social Democratic (Esping-Andersen, 1990). The difference comes from the degree of redistribution: while in Liberal systems the redistribution is lower (for example in the United States and Canada), and in Corporatist-Statist systems it is middling (for instance in France, or Germany), the highest level of redistribution takes place in Social Democratic states (as Scandinavian countries).

Another classification of European tax systems distinguishes the Anglo-Saxon and the Continental models (Kara – Kökényesi, 2007). In Anglo-Saxon tax systems local governance is very much divided and there are a small number of local public services. Beyond the local level, intermediary and regional governments are functioning with wider range of responsibilities. Within the Continental model, some sub-types can be distinguished.

In the Scandinavian model the large-sized local governments have broader responsibilities and competence. Smaller municipalities were merged into large local authorities in order to strengthen the efficiency and to avoid problems arising from the various sizes of municipalities. Local authorities with high population provide all basic public services while the county is responsible for intermediate services, especially health and medical care, education, culture and public transport.

French government model has a local public administration system built up from small-sized local governments, which have comprehensive responsibilities, they provide a wide range of public services. In the French model there are regional levels in the government system as well, county councils perform basic public duties and regional governments provide intermediate services. Besides, association system also improves the public administration system. Among other countries, Spain, Italy and Portugal follows the French model.

The third type of the Continental model comprises the so-called mixed government systems, which are functioning mostly in transitional Central European countries. For example, the Hungarian local government system combines the French type of government structure and the public service sharing system of Scandinavian countries.

In the German public administration system, which is represented by Germany and Austria, states (Land, Bundesland) enjoy a high degree of autonomy, and there is a lack of uniform, standardized local government regulation. Besides the states, municipalities and districts (Kreise) are the administrative divisions of these countries (Szamel et al., 2011).

4 Methods of local tax assessment

Legislators can apply two different indirect regulation methods in case of local tax assessment: open list of taxes and closed list of allowable taxes (Bosch – Durán, 2008).

The open list method allows local authorities almost total freedom in introducing and levying taxes. They can levy almost any kind of taxes, when on the one hand there is no conflict with constitutional legislation and on the other hand in order to avoid double taxation, these taxes do not cover tax objects that are already taxed by upper level of government. Rarely is the open list method used in the world, since it makes the tax system of a country very complex and confusing and less predictable. In Hungary, open list tax, "municipal tax" was introduced on 1 January 2015. Pursuant to Article 1/A of Act on Local Taxes local governments can levy municipal tax on any tax object, which are out of the effect of any statutory impositions.

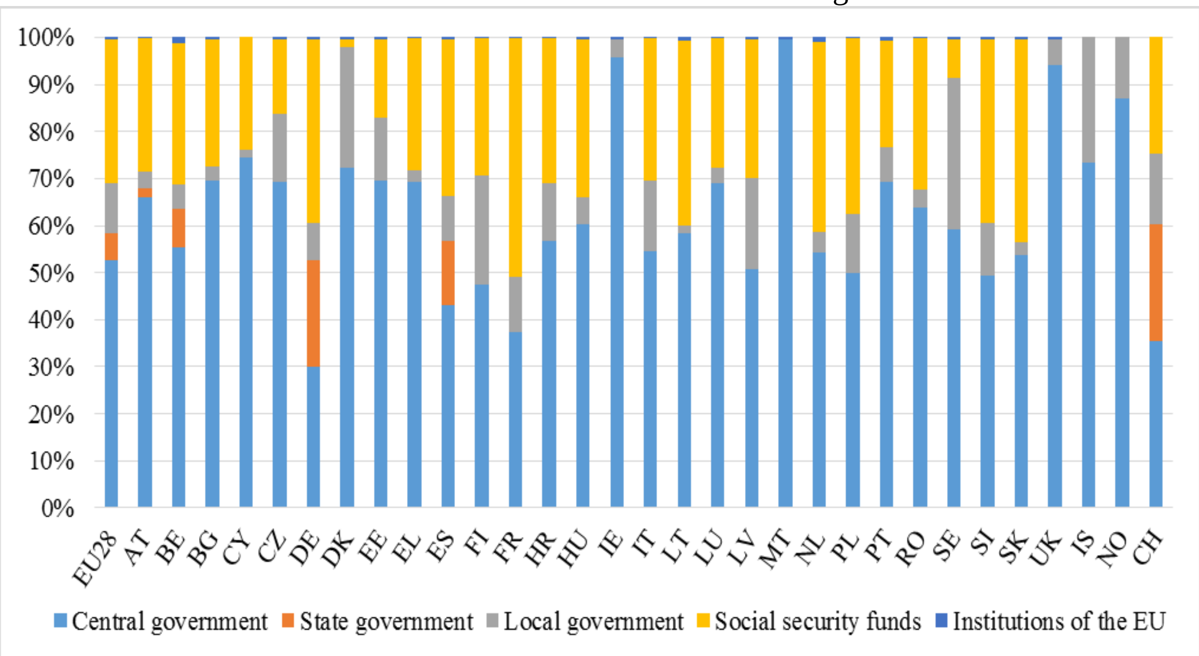
In the closed list method of local tax assessment, the types of local taxes are determined in legislation. Local governments are allowed to choose from these taxes for introduction. Their autonomy includes the choice about tax bases, tax rates, exemptions and allowances as well (Kecső, 2013). An overwhelming majority of national legal systems use the closed list method, including countries we analysed in detail.

5 Particularities of European local taxes

Despite the diverse European practice in local taxation, some basic similarities can still be detected. The degree of fiscal decentralization is various in Europe, but central governments receive the significant part of tax revenues (Figure 1). In countries, where at regional level the government plays an important role in public administration (for example in Germany), tax revenues are more dividend between the segments of government.

Figure 1

Distribution of local tax revenues between the different levels of government in 2013



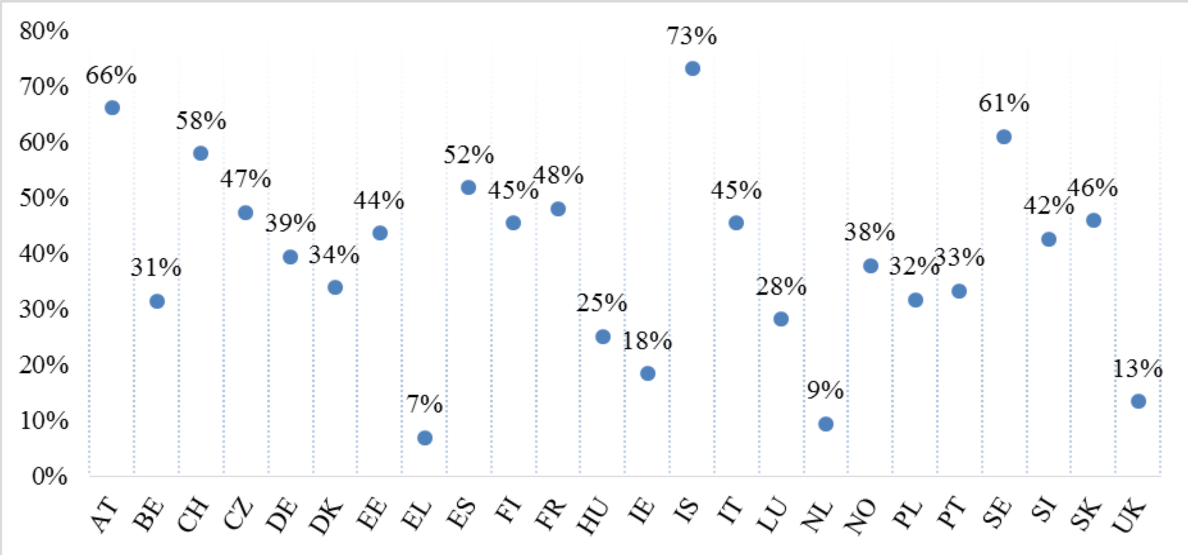
Source: Eurostat (2015)

However, with regard to the revenue structure of local authorities, major differences appear in the countries, in view of the fact how much tax revenue local governments gain.

Figure 2 shows the proportion of tax revenues at the local level of governments in total local revenues (tax revenues include shared taxes received from central governments as well).

Figure 2

Proportion of taxes in local government revenues in European countries in 2013



Source: OECD Database (2015a)

Local governments in Greece, the Netherlands, the United Kingdom and Ireland receive the less proportion of tax revenues. In contrast, the highest proportion of tax revenues belong to local authorities in Iceland, Austria and Sweden. It can be concluded with respect to Figure 2 that while local governments of the latter countries have stronger autonomy to determine the income side of their budget, Greek, Dutch, English and Irish local authorities are extremely grant dependent, because a significant amount of their revenues are from transfers and grants received from central governments.

In some of the European countries, taxes levied on immobile tax bases are dominant, which are mostly taxes on wealth, including property taxes. Despite the fact that taxation of wealth is being pushed into the background these days, they form an important part of tax revenues in local tax systems of many countries, such as in the United Kingdom, France, Spain, or Poland. In some local tax systems, like in the United Kingdom, only natural person is assessable, while local authorities for example in Norway levy these taxes exclusively on the business community. In case of property taxation, several countries keep cadastral registers, where properties are evaluated by national authorities. In some cases, the process is based on older valuations, such as the English or German local property taxation practice. In contrast, in the Netherlands property values are reviewed every year. Local tax legislation makes a difference, by using different tax rates, between rural and urban properties in some countries (for example in Spain and Portugal).

Besides local wealth taxation, mobile tax bases, including personal income taxes and business income taxes, are prevalent in several European local tax systems. In Scandinavian countries (like Sweden, Norway, or Denmark), and furthermore, among others in Slovakia, Latvia, and Estonia tax revenues from taxes with mobile tax base are the largest part of tax revenues at local governments. In most of the European countries, tax revenues from personal and business income taxes are shared between the different levels of government, so that local authorities set a tax rate as a surtax on the tax base used by upper levels of government.

Apart from aforesaid local taxes, we can find some widespread local taxes in Europe as well, for example motor vehicle taxes, dog tax, tourist taxes, but there are also smaller local taxes, such as waste collection tax (e.g. in Italy and France), entertainment tax (e.g. in Germany and Switzerland), tax on the use of public area (e.g. in Slovakia, Croatia), household tax (in Switzerland), and residence tax (in France).

Differences appear between local taxation systems in accordance with the degree of autonomy of local governments as well. Central governments assign some rights to local authorities in case of decision making. These rights refer to every aspect of local taxation, including decisions about introducing the taxes, which taxes are obligatory, whether they have choice about tax bases, rates, exemptions and allowances, or whether they can expend the revenues freely.

6 A comparison of the local taxation systems in the analyzed countries

After the analysis of the local governments in four countries from each public administration models, the differences and similarities became visible.

6.1 Differences between the government structures

The number of local and regional governments can be a tool to describe the differences between the structures of the four governmental models (Table 1).

Table 1
The structure of government in the four analyzed countries

	Inhabitants (thousands)	Number of authorities			
		Municipal level		Intermediary level	Regional or state level
			Average number of municipalities per 100 000 inhabitants		
England	54 317	324	0.6	27	3
Germany	80 913	11116	13.7	402	16
Spain	46 464	8117	17.7	50	17
Sweden	9 698	290	3.0	-	21

Source: OECD (2015) and English Department for Communities and Local Government (2015)

The structure of sub-national governments in England follows the Anglo-Saxon model. The structure of the governmental sector and the division of duties related to public services between the levels of government are confirmed by the few municipal governments and the number of intermediary and regional governments. In contrast to the Anglo-Saxon model, Germanic countries have a considerable amount of municipal governments, furthermore, the number of districts (Landkreise) is also significant which are at an intermediate level of administration between the states and the municipal governments, is also significant. The Spanish public administration system bears the characteristics of the French government model, where the governmental sector consists of small municipalities and the major part of public services is delegated to local governments.

There are 18 local governments for 100 thousands of inhabitants in Spain, which confirms the high amount of local governments as well. Conversely, in Sweden, that represents the Scandinavian model, local governments have a large population in European comparison and there are only 3 local governments for 100 thousands of inhabitants.

6.2 A comparison of the revenue structure of local governments

First of all, it needs to be clarified that the analysis uses data from OECD. Therefore, the database about the structure of local government revenues in the United Kingdom constitutes the basis of the research, but the results of the analysis have not become distorted, because the data reflects the peculiarities of the Anglo-Saxon government model properly. Furthermore, data about the tax revenues of the different tiers of government contains not only the autonomous local tax revenues, but also the shared taxes.

In the four analysed countries tax revenues are allocated in different proportions between the levels of public administration. Despite the fact, that local governments in the United Kingdom spend a quarter of public expenditures, they receive less than 10 per cent of the total revenue of the central government (Table 2). In point of the content of local revenues, tax revenues constitute a small proportion of the local governmental revenues. Swedish local governments realise the most tax revenues, more than 60 per cent of their local revenue sources come from taxes.

Table 2

Comparing data of the local government revenue structure in 2014

	United Kingdom	Germany	Spain	Sweden
Local government expenditures in percentage of total government expenditures	24.58%	16.70%	10.91%	47.83%
Local government revenues in percentage of total government revenues	9.01%	10.97%	10.95%	34.09%
Local government debt in percentage of GDP	9.28%	5.21%	5.26%	11.60%
Tax revenues in percentage of local government revenues	13.34%	39.41%	51.67%	60.89%

Source: OECD Statistics (2015b)

Besides gaining a high proportion of tax revenues from the Swedish government, local authorities have to spend nearly half of the public expenditures, because of the numerous public services they are entrusted with. According to the high amount of expenditures, it needs to be mentioned that in European comparison local government debt in Sweden is hardly negligible. From the analysed countries we can speak about a higher level of indebtedness of local governments in case of the United Kingdom.

Tax revenues play a significant role in local revenues in Germany and Spain, as well. In Germany 40 per cent of local government revenues come from taxes, while Spanish local tax revenues take half of the total local revenues. The local share in total government tax revenues is nearly equal in these two countries.

In order to compare the extent of revenues, Table 3 shows the per capita local tax revenues converted to euro in each of the countries.

Table 3

Local tax revenue per capita in 2013

	United Kingdom	Germany	Spain	Sweden
Local tax revenue *(billion euro)*	32 303	84 963	34 533	69 332
Inhabitants *(billion)*	62.57	80.65	46.59	9.61
Local tax revenue per capita *(euro)*	516.26	1 053.53	741.16	7 215.37

Source: OECD database (2015b) and average annual exchange rates of Central Bank of Hungary in 2013

Out of the four analysed countries, Swedish local governments realise the most amount of tax revenue in per capita terms. It is of no surprise, because of the high proportion of taxes in local revenues. In addition, Sweden has relatively small population, e.g. in 2014 the population density was only 23.9 inhabitants per square kilometre (Statistic Sweden, 2015a). In contrast with the Swedish system, English local governments have the least share in tax revenues, they get altogether 516 euro per capita tax revenue. This number is 741 euro per capita in Spain and 1053 euro per capita in Germany.

6.3 Local taxes in use

Local authorities levy only property tax, namely council tax, on individuals in England. The object of the tax is the dwelling and the tax base is the value of the property set out in the list of Valuation Office Agency (VOA), which contains council tax bands based on market prices in 1991. Tax rates are set by local governments with the use of statutory council tax bands laid down in Act on Local Government Finance (1992). Tax rates have no legal limits, local governments have to set their band D (the average value, which is the base value for the calculation of the other bands) so that local tax revenues cover expenditures that are above external revenues. However, the increase of tax rates should not be irresponsible, because through the introduction of Act on Localism (2011), the control over the tax rate increases fell within the competence of residents. In case of extremely high tax rate increase, which is 2 per cent in 2015, referendum is held about the acceptance or refusal of the increase (Sanford, 2015).

In accordance with German local tax revenues, the most important source of law is the Basic Law (Grundgesetz), which ensures that local governments are entitled to get revenues from property tax (Grundsteuer) and trade tax (Gewerbesteuer), as well as local excise and luxury taxes (Örtliche Verbrauch- und Aufwandsteuern). Provinces and the state also have a share in trade tax revenues, furthermore, shared taxes (income tax (Einkommensteuer) and value-added tax (Umsatzsteuer)) play a significant role in local tax revenues. All business operations in Germany are liable to pay trade tax irrespective of their legal form. Under the terms of the Act of Trade Tax (Gewerbesteuergesetz) the subject of the tax is the trading activity and the tax base is the business income. The assessment of tax rates is special in the German tax system, because the legislation sets a 3.5 per cent tax rate (Steuermesszahl) and local authorities multiply this with their own rate (Hebesatz), with at least 200 per cent. The minimum trade tax rate is consequently 7 per cent. There is no upper limit of the local tax rate set by the federal government, only states can regulate it. Trade tax is the most dominant local tax, because approximately 80 per cent of revenues from the three main local taxes come from trade tax. The tax base of property tax is the estimated value of the estate, the rules of valuation are declared in the Act on Valuation (Bewertungsgesetz). Similarly to trade tax rates, the tax rate of property tax consists also of a federal and a local rate. Concerning local excise and luxury taxes, states have the legislative power.

Spanish local governments are allowed to levy five types of local taxes. Among them there are three obligatory taxes: tax on economic activities (IAE), real estate tax (IBI) and tax on vehicles (IVTM), furthermore, there are two optional local taxes: tax on building works (ICIO) and tax on the increase of value of urban land (IIVTNU). With the use of closed tax assessment method, local authorities can make decisions only about tax rates within the limits and conditions of the Act on Local Taxes. The base of real estate tax is calculated according to the property register of Cadastre Office operated by Spanish Ministry of Finance. This central authority estimates first of all the values of properties, than they increase the values in every year with a certain rate. Real estate tax accounts for almost 70 per cent of local tax revenues. Each of the two other obligatory local taxes represents circa 10 per cent of the tax revenues at local governments. In case of tax on business activities the tax base is the annual turnover. In accordance with vehicle tax, various tax rates are determined for different motor vehicle types. The base of tax on the increase of value of urban land is the margin between the values at acquisition and sales, so that the tax is independent from market prices. Furthermore, the base of tax on building works is the actual cost of building work, which requires planning or licence.

Local tax revenues are exclusively from income tax at Swedish local governments. Act on Income Tax (Inkomstskattelag 1999:1229) provides regulation for local income tax. Sweden use also the closed tax assessment method, since local governments are not allowed to levy other taxes, and in case of local income tax they can only choose their tax rate, which is levied on the central tax base as a surtax. The local tax rate varied between 29.19 and 34.70 per cent (Statistic Sweden, 2015b) depending on the residence of tax payers. The tax is levied on the monthly incomes of tax payers. More than 65 per cent of local revenues are from tax revenues, which accounted in 2014 for approximately 602 billion SEK. From this, 35 per cent is realized at local level and 65 per cent at county governments.

6.4 Problems

English local taxation system applies only one local tax, which is operating with the use of closed tax assessment method. The increase of local tax revenues can be achieved only by increasing the tax base, namely the size of band D. Immobile tax base ensures stable financial sources for local governments, eliminates risks from property value fluctuations, and makes tax revenues more calculable, furthermore, tax policies can be established orientated to local conditions. However, there can be large differences between tax rates at certain local governments, because tax rates depend on the expenditure side of local budgets. An important imperfection of local taxation system is that the valuation of properties is not refreshed, which does not encourage proper taxation which fits to financial status and solvency. It is also a problem that the scope of council tax includes only individuals, so local governments are not able to influence local economy, because they have no power to encourage local economic performance and they have no effect on location choices.

The most significant problem in German local taxation system is that in case of local property tax, properties are registered by taking property market prices in 1964 into account. The process needs to be refreshed urgently. Tax revenues from trade tax can follow economic fluctuations, and they show notable differences between certain municipalities. Shared taxes are stable local revenues sources, however, local governments have no effect on the amount of these revenues. Local excise and luxury taxes make the local tax system more diversified, but the assessment and administration of these taxes are relatively expensive and requires a lot of additional work.

Spanish local governments have a high degree of autonomy, still the base value of real estate tax is set by a central authority, which has no interest in applying proper, effective and reliable property values. The effort of local governments to change this procedure is understandable, because through their local knowledge they could establish more accurate values.

In Sweden local tax revenues can be easily proposed. Through local government financial equalisation, which means the balancing of incomes and costs, not even one part of the country is deprived of the national welfare, because it ensures that all local governments, irrespective of their tax base, have equal basic conditions for providing public services for their residents. Nonetheless, local governments are uninterested in increasing tax rates, since in this equalization system the surplus gets rearranged to other disadvantaged local authorities. Moreover, tax payers also reluctantly finance expenditures of other local governments from their own taxes.

7 Conclusions

Local taxes show wide variations in Europe. In addition to the tendency of economy and politics, historical and cultural development also have an effect on the formation of local tax systems. Local taxation systems can hardly be unified because of the dissimilarities of public administration systems and the sovereignty of countries.

The main conclusion of our examination is that both local taxes and government transfers have important roles to form and maintain the balance of vertical public finance. Not only local but regional governments are entitled to impose tax but their competences are limited, in general.

Due to immobile tax base, the revenues from property tax are constant sources for local governments. In reference to property taxation, property valuation procedure is a serious problem because it based on property values on decades before. It means that property tax is independent of incomes and inflation. The system requires refreshing or the methods need to be changed but it would be more expensive to be introduced and valorised annually. Revenues from property tax can be large enough if the tax burden is not only on individuals but on companies as well.

Instead or besides property tax, a lot of European countries apply several local taxes on mobile tax base. As a consequence, the local tax system is diversified in these countries, since tax revenues stem from several financial sources. Especially, taxes on business activities are an important segment of local tax revenues. In contrast to this fact the Scandinavian model presents an effective local tax system on incomes.

Finally, we have come to the conclusion that an ‘ideal’ local tax system requires a dominant type of tax extending it to a wide range of taxpayers to keep the principle of universality and equality but it requires some other taxes as well. In general, the local tax system can be more flexible and planning tax revenues is easier if local governments are allowed to choose the type of taxes and even their rates.

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