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Local Taxes In Poland.
Base for Local Accountability?

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The paper starts from the short introduction of theoretical principles related to local taxation, which are based on the fiscal federalism theory[1]. As Rattso (2002) notes, the fiscal federalism model is based on four key assumptions: (1) local governments are responsible mostly for the delivery of public goods, (2) the base for local finance is provided by local taxes, i.e. those who pay for services also benefit from them, (3) there is considerable social (spatial) mobility, (4) in case of local services, the catchment area is close to area of administrative jurisdictions, i.e. spillovers effects are minimal. Unfortunately, althoguh these assumptions are to large extent respected in United States but not necessarily in Europe. In reality of European systems (including Poland): local governments are heavily involved in redistribution, central grants play significant role in financing local governments and people are much less mobile than in US. Nevertheless, principles of fiscal federalism remain a good normative base for evaluation of local financial systems.

The second section presents a brief description of local taxation in Poland – starting from the presentation of the legal framework and then discussing actual role of local taxes in local governments' revenues and local tax policies.

In the conclusion section I try to compare the present regulation and practice of local taxation in Poland with theoretical assumptions formulated in the introductory section. This leads to practical recommendations on the present Polish system.

1. Theoretical Issues – Why Local Taxation and What Local Taxation?

Why we think that existence of local taxes is important for local democracy and efficient functioning of local governments? Why local spending should not be financed exclusively by another sources of finance?[2]

To answer these questions let us start with a definition how the notion of local taxes is understood in this paper. First of all, local taxes are a part of own revenues of local governments. The definition of own revenues includes at least three elements:

- They are revenues allocated to local governments unconditionally, in full and for an undefined period,
- They are related to local economic base, i.e. the growth of local economy leads to the growth of local budget own revenues;
- Local government has at least some amount of discretion to decide upon these categories of revenues (for example may define – at least within some limits set by central legislation – rates of local taxes).

So a tax bringing revenue to local government budget needs to comply with these criteria to be accounted as local tax. It is important to stress that there are some tax revenues of local governments, which cannot be treated as local taxes. A typical example is provided by tax sharing systems in most of the countries. Usually, local government has no discretion upon

[1] For a full explanation of the fiscal federalizm koncept see: Musgrave (1959), Oates (1972), King (1984).
[2] For a more complete discussion of revenue assignments' principles and their application for Central and Ekstern Europe see: Swianiewicz (2003, forthcoming)

tax policy related to shared taxes. In some countries shared taxes are also distributed among individual jurisdictions in a way which is independent on local economic base (the allocation per capita is a simple example of such a method). For both of these reasons, shared revenues cannot be classified under the "local tax" label.

Local taxes are not only, but the most important category of local own revenues. It is recommended that a large proportion of local revenues comes from own sources (in particular: in form of local taxes). There are several arguments, both of political and economic nature, which supports this request:

- System in which large part of local budget comes from own sources, supports local government accountability towards local population. The shape of local budget to large extent depends on decisions on local taxes. This stimulates councilors accountability and also increases citizens interest in local government activities. In general, such a system helps in development of local democracy;
- Such a system exerts a pressure on "value for money" dimension – it presses towards rationalization of spending and looking for possible savings. It is much more difficult to argue for increase of local public spending when it is going to be covered by higher local taxes, than in case when additional expenditures will be covered by grants from the center;
- Fiscal policy can follow local preferences. In one locality citizens may expect higher supply and better quality of services, even if it costs higher taxes, while in another people may prefer lower local taxes, even if services are provided in lower quantity;
- Previous arguments suggest that the system with high share of own revenues reduces the pressure on the overall level of public spending. If most of local revenues is financed through central grants, it leads to excessive demand for local services by local citizens. Local government in turn, exerts pressure on central government in order to receive higher grants.
- Suggested structure of revenues strengthens political position of local governments within a state. It is so, because local governments are important partners who finance and provide significant functions, as opposed to situation in which they are clients receiving and demanding resources from the centre.
- The system of high own revenues increases local government interest in supporting local economic development, although as Peterson (1981) noted, local authorities are usually interested in economic growth also for another reasons.

But is should be also noted that high own revenues lead to increasing disparities between rich and poor regions. By the way, local shares in central taxes have the same disadvantage, but they do not have most of positive features of local taxes, as enumerated above. That is why in light of fiscal federalism the shared taxes system is among the least attractive sources of local revenues.

There are several candidates for local taxes and there are several criteria which help us to choose the most appropriate mix for the country. Some of these criteria are identical with requirements for good taxes in general, but some of them are specific for local governments. The most important elements of the "check-list" may be summarized in following items:

- **The allocation of tax yields is proportional to allocation of functions**. If we require that large proportion of local revenues comes from own sources (as suggested in the previous section), we need a tax system which provides such an opportunity. So, in the scale of the whole country the local tax base should enable to collect revenues close to resources sufficient to deliver the most important local functions.

- **Even geographical distribution of the tax base,** so differences between authorities with high and low local tax base are not overwhelming. For example the tax base of the tax on exploitation of natural resources would be very unevenly distributed, while tax on housing properties is much more equally available for every local government. If this condition is not followed, there will be huge differences between "rich" and "poor" jurisdictions. If local government is responsible for important services, this will imply a complex system of horizontal equalization. Obviously, there is no tax which yields are distributed in space in precisely even way, but real candidates for local taxes differ from this point of view.
- **Tax is well defined in geographical space**. Is it easy or difficult to decide which local government should collect and receive the tax? For example, in case of property tax it is very easy – every property is located in one jurisdiction. The similar, easy is a case of personal income tax, regardless we define that it is paid in a place of residence (as in most of European countries) or in place of work (as in minority of countries, such as Ukraine). But the case of corporate income tax is much more complicated. It happens that company is registered in one city, but it operates (and generates income) in several other places. Which local government should then benefit for the tax? A partial solution adopted in Poland is that tax revenues are distributed among local governments proportionally to the number of employees working in individual localities. But this solution is complicated and far from being perfect. The case of Value Added Tax is even more complicated, if not hopeless (from the point of view of the discussed criterion).
- **Visibility of the tax**. Some taxes (such as property tax or personal income tax) are more visible than others (such as VAT, excise tax). There is no doubt that visible taxes stimulate local governments accountability.
- **The elasticity of tax yields against inflation**. This is an item important for every tax, but probably especially important in case of local taxes. On the one hand low elasticity (as in case of property tax) enforces more careful financial policies of local governments (increasing of the tax rate, even in reality it only reflects inflation, is always politically difficult). On the other hand, elastic taxes provide a better financial base for delivery of local functions.
- **The tax base should be relatively immobile**. Otherwise tax payers can easily migrate between jurisdictions which may lead to excessive tax competition. Property tax or even personal income tax are better from that point of view than corporate income tax.
- Last but not least – **the system of local taxes should not be too fragmented nor too complicated**. In practice of some countries there is a large number of small local taxes, none of which brings really significant amount of resources to local budgets. The cost of tax collection in such a system is usually reltatively high. Such a system is also unneccessary complicated and non-transparent which reduces the accountability values of local taxation.

In practice, in most of European countries there is more than one local tax, although one of them is usually more important than the others. United Kingdom, with only one local tax (currently based on a property tax, although not in a typical, orthodox form) provides one of rare exceptions to this rule.

In European countries there are basically two models of local taxation:

- based on property taxes (there might be more local taxes, but property tax is the most important). United Kingdom provides probably the best example, but France, Spain or Poland also fall into this category.
- based on local income taxes. All four Nordic countries provide good example of this type of local taxation (attention: local income tax should not be mixed with a local share in an income tax which remains a central tax). One of a very few countries in Central and Eastern Europe which has decided to go in the direction of building local income tax is Croatia[3].

There are some countries in which local governments may make a choice from among of wider set of available taxes. This is a case of Hungary where local governments are entitled to introduce any or all of following taxes: land parcel tax, building tax, communal tax on private individuals, communal tax on entrepreneurs, tourism tax and local business tax (Hogye 2000).

Local government in different countries have a different discretion to decide upon rates of local taxes. The typical solution is to set a maximum (ceiling) tax rate which the local decision cannot exceed. Such a solution is present for example in Italy (where in case of the local property tax the rate may differ from 0.4 to 0.7% of the taxable values and in case of the local sur-charge to personal income tax, there is also a limitation on the extent of changes from year x to x+1, which cannot be larger than 0.2% (Fraschini 2002)). In United Kingdom the freedom to set local tax rates has been limited in the mid of 1980s and presently it is indirectly limited through caps on the overall level of local government spending (*Finance and...,* 1996). In Sweden local governemnts who set excesively high rates may be “punished” by the reduction of state grants. In Denmark local governments are basically free to set any local tax rate. Whatever is the detail solution, in practice there is often a significant variation of tax rates between individual local governments. For example in UK in 1997 the basic rate of council tax differed from less than 300 to over 900 GBP. In Denmark local tax rates vary by around 30% in municipalities and around 10% in counties (Pedersen 2002).

2. Local Taxes in Poland – A Brief Description fo the Present System

2.1. Basic Regulations

2.1.1. Brief information on the local government structure

The present local government structure is a result of two waves of decentralisation reform. The first wave took a place in 1990, when local government system was introduced on a municipal (*gmina*) level. The secodn stage of the reform was introducing two new tiers of elected sub-national governments in 1999.

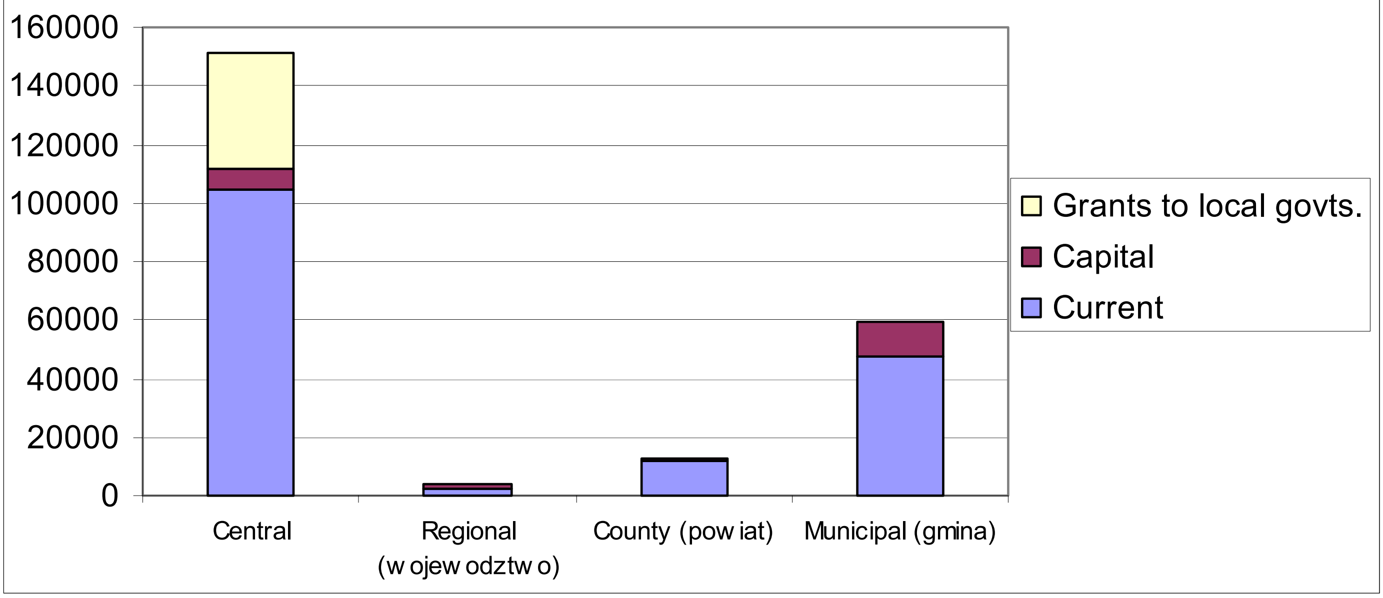
[3] There are several countries in Central Eastern Europe in which local budgets depend heavily on revenue from personal income tax. One can indicate here for example: Poland, Czech Republic, Hungary or Ukraine. But in each of these cases the system is based on a share in central tax, with no local discretion to regulate such an income.

As a result of this process currently there are three tiers of territorial governments: almost 2500 municipalities (*gmina*), 308 counties (*powiat*) (plus 66 cities of a county status) and 16 regions (*województwo*) which replaced earlier 49 smaller units. Both on a municipal and county level, self-government is the only form of public administration. On a regional level there is a dual structure – on the one hand elected self-government, and on the other – governor (*wojewoda*) nominated by the Prime Minister with his/her own administrative apparatus. However, functions of regional state and self-government administrations are clearly separated and there is no hierarchical subordination between them.

The goal of the reform was to clearly separate functions and policy areas between tiers of government and to eliminate vertical (hierarchical) dependency of the lower tier upon the higher. It has been achieved as regards to three levels of sub-national self-governments. Obviously municipal, county and regional levels co-operate, for example in economic development policies, but in terms of specific service delivery the separation is close to perfect. The situation is much more complicated as regards to relationship between central and local government level. In some cases (such as education or some of social welfare benefits) nation-wide regulations are so strict that local government's role is to a huge extent reduced to the agent of central government and implementation of central policies.

The set of reforms granted a wide range of functions to municipal governments while the list of county's functions is much shorter. The aggregate county budget is only a small fraction (about a quarter) of aggregate municipal budgets. This is illustrated by the figure 1.

Fig. 1. Budget spending by the tier of government in Poland (2000, in million złoty)



Such a division of functions is possible because of a relatively large size of municipal units in Poland[4]. Contrary to many other countries in the region (such as the Czech Republic, Hungary

[4] Similar observation in a wider European perspective was made by Page and Goldsmith (1987) who noticed that territorial organisation is very much related to the allocation of functions. Small (fragmented) local governments

or Slovakia) at the beginning of the 1990's, Poland avoided radical territorial fragmentation. As a consequence the average *gmina* has about 16,000 inhabitants and 125 square kilometres. So, the Polish municipality is quite big in the European comparative perspective (see for ex. "The Size of Municipalities...", 1995). Although it is much smaller (in terms of the population) than British or Swedish, but it is similar to Norwegian, Danish or Dutch and much larger than Czech, Slovak, Hungarian, French or Italian municipalities. Only few of Polish municipalities are smaller than 2,000 and none of them has less than 1,000 inhabitants.

Presently (2001 data) local governments spend 10.6 percent of Polish GDP or 38 percent of total government expenditures. It has been a clear increase from 7.4% of GDP and 16% of total government expenditure spent by local government in 1991. Almost 77 percent of self-government budgets are spent on a municipal level (including big cities having a county status), 18 per cent by a county level and only 5% by a regional self-government.

Polish municipal governments are responsible for the provision of the wide range of municipal services including:

- water supply and sewage treatment,
- street cleaning, refuse collection and waste disposal,
- local public transportation,
- street lighting,
- district central heating,
- maintenance and construction of local roads,
- maintenance of green areas,
- municipal housing,
- provision of education services, including kindergartens and primary schools,
- culture, including local libraries and leisure centres,
- numerous services within social welfare sector, including services for elderly, handicapped and homeless people, as well as housing benefits,
- physical planning and granting of building permissions.

County governments are responsible for:
- secondary education,
- health care (county manages only hospital and policlinics buildings. The health care reform implemented parallel with 1998 local government reform has created independent health authorities which are responsible for most of current medical operations)
- roads of county importance,
- several social services,
- labour offices (coping with unemployment problem),
- natural disasters' protection,
- consumer protection,
- land surveying,
- various inspections such as sanitary, building etc.

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are usually unable to take over responsibility for many services, which needs to be delivered by upper tiers of governments.

The role of regional self-government is direct delivery of services is very limited (although there are also some examples of such a role i.e. higher education and main roads) but they are mostly focused on strategic planning and regional development programmes.

2.1.2. Basic regulations on local taxes

The most important regulations concerning financing local governments are included in following Acts (with further amendments):

- Polish Constitution;
- 1990 Act on Municipal Government, 1998 Act on County Government, 1998 Act on Regional Government;
- 1998 Act on Public Finance;
- 1998 Act on Revenues of Territorial Self-Government;
- 1991 Act on Local Fees and Taxes;
- 1984 Act on Agriculture Tax.

Local governments in Poland are financed thorugh the mixture of local taxes, other revenues from own sources, local shares in central taxes, central general purpose and specific grants. However, municipal government is the only tier of local government who has a limited power of taxation. Presently, both county and regional governments are financed almost exclusively by central general and specific grants with a very small contribution of shares in central taxes and few very minor revenues from own sources. Therefore neiter county nor regional financial system are not in the focus of the discussion presented in this paper. One may question however, whther present system of counties' and regions' finance is complying with the Polish Constitution, which in the article 168 states that "territorial self-government units have a right to set rates of local fees and taxes, within limits decided in the Law".

There are following local taxes which are revenues of the municipal tier:

- property tax;
- tax on agriculture;
- tax on vehicles;
- forest tax;
- tax on dog owners;
- tax on civil law activities;
- tax on legacies and donations.
- tax on small businesses.

With an exception of last three taxes in the list above, local taxes are administered and collected by the municipal administration.

It should be also mentioned, that in Poland there are some local fees which have also the nature of taxes which go to local government budgets. Such a case occurs when the fee-payer receives no (direct) return from the local government. A good example is provided by the exploitation (mining) fee, 60% of which goes to the *gmina(s*) and 40% – to the National Fund for the Environment and Water Economy. Another example is the local fee paid by (some) visitors to the health-resorts or the market place fee, especially when collected from people selling goods on the streets. Maximum rates of these fees are fixed by the Parliament but local council can always reduce them, with some limitations in case of the exploitation fee. However, local fees will not be further discussed in this paper.

The general rule says, that maximum rates of local taxes are decided in the central legislation, while local governments may set their own rates which are equal or lower of the "ceiling level". Local governments can use also other instruments of their own tax policies; these instruments are presented in discussed in section 2.3.

2.1.2.1. Property tax

The property tax is paid both by physical persons and by legal entities. The list of subjects of taxation include:

- buildings or their parts;
- other architectural structures[5]
- plots of land which are not subject of agriculture or forest taxes;
- lakes, water reserviors;
- plots of agricultural land or forests, which are used for commercial activity other than agriculture or forestry;

The general rule says that the tax is paid by the owner of the property (so, for example not by the tenant of the flat).

For most of categories the tax is paid "per square meter". The only exception is made for "other architectural structures" (budowle) for which the tax depends on the value used for depreciation of these obejcts. If no depreciation is used by the tax-payer, the base of the tax is a market value of the object. But this category provides an insignificant portion of revenues from the property tax.

As it was mentioned above, the maximum rates are decided by the central legislation and annually adjusted against inflation. The ceiling rates for the most typical types of properties are illustrated in the table 1.

Table 1. The most significant maximum rates of property tax in Poland

	2001	2003
- housing properties	0.46 PLN/sq. m.	0.51 PLN/ sq. m.
- commercially used buildings	15.86 PLN/ sq. m.	17.31 PLN/ sq. m.
- commercially used plots of land	0.56 PLN/ sq. m.	0.62 PLN/ sq. m.
- "budowle" (other architectural structures)	2% of the value	

note: 1 EURO = about 4.1 PLN

[5] The Polish Law makes a distinction between buildings (*budynki*) such as residential houses, offices, factories and other agricultural structures (*budowle*). The Construction Law specifies that "*budowla*" (architectural structure) is an every object which is not a building. This distinction is very difficult to be reflected in English, but as we see later it is significant from the point of view of the property tax construction. Other agricultural structures include for examples airports, roads, bridges, antena masts, sewage treatment plants, waste disposal plants (Etel, Ruśkowski 1996).

In some cases it is not obvious which category the property belongs to. The typical example of problems is related to housing flats which are also used for commercial activity (for example, the owner of the flat is at the same time the owner of the small firm and his/her economic activity is being performed in the same apartment). The legal interpretation stipulates that the rate as for commercial use of buildings is paid only if the property is used for commercial activity exclusively. So, for example, if the living room of the apartment is used for some part of a day as an office of the SME, the tax still should be calculated as for housing property, not commercialy used building (Etel, Popławski 2001).

Article 7 of the Law on Local Taxes specifies several tax exemptions such as: properties used by local administration, by foreign embassies, properties having a status of historical monuments, schools, universities, sport field-grounds.

It is local government administration which is responsible for the property tax collection and administration. In case of individual tax payers it is an obligation of the administration to deliver the information on the amount to be paid (i.e. the home owner who has not received such an information from the town hall does not need to pay). In case of legal entities, the tax payer is obliged to calculate and pay its tax regardless whether such a notification has been delivered.

2.1.2.2. Agriculture tax

The tax on agriculture is formally not treated as one of local taxes (it is regulated in a separate Law), although it is a revenue of municipal governments and local council has a similar scope of discretion to decide the rate. In that case the rate is based on the average market price of rye, size of the farm and quality of the soil, but local council may reduce the tax rate. The tax is typically paid by the owner of the farm or by the farmer who rents the farm. The farm is defined as an area used as arable land, pond or buildings used for farming activity and if the total area is higher than 1 ha. According to the tax regulations, it does not matter whether the area is actually cultivated or not.

The taxi s paid per hectar, but the area is additionally weighted by following factors:

- quality of soil;
- economic and climate environment for farming activity. In practice this factor is reflected by the location in one of four major tax regions (Brzeszczyńska, Kazimierski 1997).

The rate from one (weighted) hectar is equal to the average market price of 250 kg of rye during first three quarters of the proceeding year.

There are several tax exemptions which are decided in the law, such as:

- farms on soils of the lowest quality (V and VI classes),
- area bought by the farmer in order to enlarge existing of to create a new farm. The tax exepmtion applies for 5 years and only to farms which are not larger than 100 ha.
- farms on which the production has been stopped, but for no longer than 3 years.

There are also some tax reductions decided by the Law. There are several categories of tax payers who are entitled for reductions, such as:

- for 15 years, the reduction related to investments in modernisation of the farm (the value of reduction – 25% of the value o fan investment);
- 60% reduction for farms belonging to soldiers who serve their compulsory military service;
- 30% or 60% reduction (depending on the quality of te soil) for farms in mountain areas. The mountain village is defined as a village in which more than 50% of agriculture area is located above 350 metres above the sea level;
- reductions which are granted in case of natural disasters.

2.1.2.3. Tax on vehicles

The tax is paid to the municipal government, on which territory the tax payer lives or on which territory the company (which is the owner of the vehicle) is registered. Until 1998 it was a significant source of local revenues, since the tax was levied on every motor vehicle. But since 1998 the tax base has bee limited. Presently, the tax is levied on onwers of: lorries with a load capacity over 2 tons, tractors, buses and trailes with a load capacity over 5 tons.

For tractors the rate of tax depends on the capacity of an engine, for lorries and trailers it depends on a load capacity and for buses it depends on number of seats. There are some tax exemptions decided in the Act on Local Fees and Taxes, for example vehicles owned by foreing Embassies in Poland are exempted from the tax.

2.1.2.4. Other local taxes

Remaining local taxes have only a very limited importance for municipal budgets and they will not be discussed in details in this paper. The forest tax is based on a very similar principles to the tax on agriculture, and the base for the tax rate is in this case a market price of the cubic meter of wood.

Tax on dog owners brings a very low revenue and it in not imposed by some local governments.

The rates of the remaining taxes which are revenues of local governments (tax on civil law activities, tax on legacies and donations, tax on small businesses) are set on a central level, municipal council cannot change them. The only discretion to decide upon local policies related to these taxes is granting individual tax exemptions or reductions.

The tax on civil law activities is levied upon civil code transactions, such as – for example – sell of motor vehicles or sell of housing properties. The tax on small businesses is a flat rate income tax levied on some small enterprises, such as taxi drivers, hair-dressesrs etc.

2.2. The Size of Revenues from Local Taxes

As it is illustrated by the table 2, revenues from own sources constitute significant, but over the last decade, a decreasing share of municipal revenues. The reasons for this diminishing role has been twofold:

- the scope of local tasks has been gradually increasing. The most important, but not the only, change was related to taking over responsibility for primary schools (the process which started in 1991 and completed in 1996). New functions were usually financed through new components of the general purpose grant, or sometimes through the increase in the local share in central taxes, but almost never by adding new sources to the list of local own revenues;
- the base of local taxes has been sometimes weakened by the central legislation. The most sailent example of such a change was a change in the tax on vehicles, as discussed in 2.1.2.3 section. The tax on private cars and motorcycles was abolished as a local tax and substituted by the increase in the excise tax on petrol. The loss of local revenues was compensated by the new component of the general purpose grant.

Table 2. Changes in the structure of municipal revenues 1992-2001

	1992	1995	1998	2000	2001
Revenues from own sources Including: - property tax - other local taxes	47,3 16,4 9,7	40,1 14,1 7,6	33,5 11,4 3,9	33,2 11,8 4,1	33,0 13,9 4,4
Shares in central taxes	22,2	23,1	24,7	16,5	15,8
General purpose grant	11,7	15,2	25,4	32,8	35,0
Specific grants	18,8	21,6	14,3	17,6	14,7
Grants from off-budget funds	-	1,0	2,1	1,3	1,6

As it is shown in the table 3, in small rural governments the local tax base is usually weaker, while in mid-size towns and cities the largest proportion of total budgets comes from own revenues.

Table 3. The structure of municipal revenues in 2001

	Cities of county status	Other cities	Mixed (Urban and rural) govts.	Rural local govts.
Revenues from own sources Including: - property tax - other local taxes	29,8 12,6 2,6	42,6 15,4 5,0	34,2 16,8 5,2	28,4 12,7 6,1
Shares in central taxes	17,2	21,9	13,3	8,9
General purpose grant	33,1	21,8	38,4	48,3
Specific grants	19,3	12,7	11,4	11,1
Grants from off-budget funds	0,6	1,0	2,7	3,3

Composition of local tax revenues is presented in the table 4. As it is shown, the property tax is the only important source of revenue. The tax on agriculture brings significant revenues, but only in rural areas. All remaining local taxes are source of insignificant shares in local budgets, usually below 1%. That is why it is a property tax which has been selected for more detail presentation in the following section.

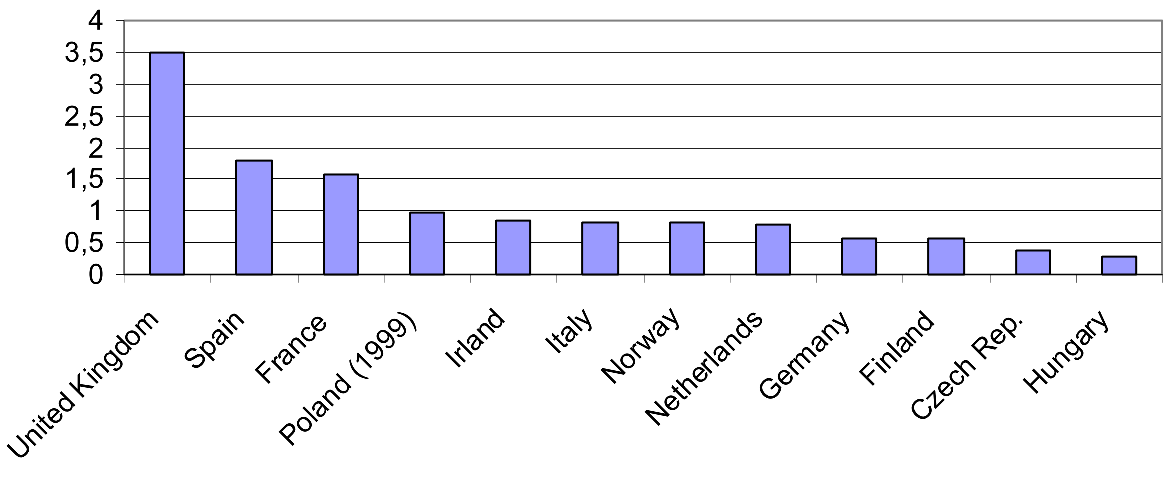
Table 4. Revenues from local taxes as % of total municipal revenues (2001)

	All municipal governments	Cities of county status	Other cities	Mixed (urban-rural) govts.	Rural local govts.
Property tax	13.95	12.59	15.35	16.82	12.74
Tax on agriculture	1.30	0.04	0.10	2.39	3.77
Tax on vehicles	0.69	0.58	0.84	0.82	0.63
Forest tax	0.18	0.00	0.01	0.35	0.51
Tax on civil law activities	1.44	1.22	2.84	1.04	0.78
Tax on dog owners	0.02	0.02	0.04	0.03	0.01
Tax on legacies and donations	0.30	0.32	0.54	0.19	0.13
Tax on small businesses	0.43	0.43	0.62	0.42	0.25

2.2.1. The revenues from the property tax

Comparing to most of other European countries, revenues from Polish property tax constitute a significant proportion of GDP (close to 1% of GDP). The variation is illustraed on the figure 2. Although the share is considerably lower than in United Kingdom (especially if we include revenues from non-domsectic rate, which is not local government tax), France or Spain but much higher than in most of other European countries. For example it is more than twice as big as in the Czech Republic and about three times bigger than in Hungary. The more precise information on the revenues from Polish property tax as against GDP is provided in the table 5.

Fig. 2. Revenues from property tax as % of GDP (1994)



source: Limitations of local taxation..., 1998.
note: in UK the revenues from non-domestic property tax has also been takes into account (the non-domestic property tax is currently not a part of local council tax in UK)

Table 5. Share of revenues from the property tax in Poland in GDP

1992	1993	1994	1995	1996	1997	1998	1999	2000
0.92	0.92	0.94	0.92	0.91	0.94	0.95	0.97	0.97

As it was mentioned in the previous secion, revenues from the property tax provide a significant part of Polish municipal budgets. In 2000 property tax brought 6.6 billion Polish złoty (approximately 1.9 billion EURO) and in 1991 even 8.5 billion Polish złoty (approximately 2.4 billion EURO). In 2001 it was 13.9% of all municipal revenues or over 40% of all revenues from own soruces. More precise information is provided in the table 6.

The importance of the property tax is the largest in mid-size cities, while much lower in rural communities, especially in those the smallest (see table 7). Relatively low significance of the property tax in budgets of the largest cities (cities of county status) is a result of the strong domination of state grants in counties (powiat) revenues (compare introductory section of this paper).

Table 6. Revenues from the property tax in Poland

	Revenues in billon PLN	As a share of total revenues	As a share of revenues from own sources
1991	0.766	15.3%	33.6%
1992	1.054	16.4%	34.6%
1993	1.428	14.8%	31.8%
1994	1.988	13.4%	33.3%
1995	2.827	14.1%	35.3%
1996	3.528	11.4%	32.8%
1997	4.427	11.2%	31.8%
1998	5.233	11.4%	33.9%
1999	5.944	11.5%	35.0%
2000	6.644	11.8%	35.5%
2001	8.505	13.9%	42.1%

Table 7. The role of property tax in budget revenues of rural and urban municipalities (2001).

		Share in total revenues	Share in revenues from own sources
Rural communities	Below 5.000 citizens	10.0%	35.9%
	Over 5.000 citizens	12.1%	43.7%
Mixed (urban-rural) communities	Below 10.000 citizens	12.6%	43.8%
	Over 10.000 citizens	17.0%	49.7%
Cities	Below 20.000 citizens	17.9%	49.8%
	20-50.000 citizens	19.4%	50.7%
	Over 50.000 citizens	20.1%	50.7%
Cities of county status		12.6%	43.6%

Which categories of properties contribute to budżet revenues in the most significant way? Unfortunately, we do not have precise information on revenues from housing properties, plots used for commercial activities and commercial buildings. But we can make some estimations from data on revenues from legal entities and physical persons (individuals). This is not a precise information, since many small firms operate as physical persons, without legal entity status. But with a risk of some simplification we may say that revenues from legal entitites represent property tax paid on commercial activity, while revenues from physical persons represent property tax paid from housing buildings and empty plot of lands allocated for housing purposes. As we see in the table 8, the dominant (although gradually decreasing) share of revenues comes from legal entities (i.e. from properties used for commercial activities).

Table 8. Revenues from property tax paid by physical persons and legal entities.

	1996	1998	2000
From individual tax-payers	16,2%	20,2%	24,0%
From legal entities	83,8%	79,8%	76,0%

Revenues from legal entities are especially important in big cities, while in small communities revenues from individual tax payers play more significant role (table 9).

Table 9. Revenues from physical persons and legal entities – variation by the size of local government (2000)

	Below 5,000	5-10,000	10-20,000	20-50,000	50-100,000	Over 100,000
From individual tax-payers	30%	34%	32%	24%	20%	16%
From legal entities	70%	66%	68%	76%	80%	84%

2.3. Local Tax Policies

In general, there are three different ways in which local governments may express their local tax policies:

- they can set local tax rates, within limits (ceiling) decided in the central legislation;
- they can grant tax exemptions to certain categories of tax payers, other than listed in tax exemptions decided in the central legislation;
- local mayor can grant individual tax releases or reductions to individual tax payers.

In practice, most of local governments levy taxes close to maximum rates, but in some cases rate reductions are quite significant. As it is illustrated by the table 10, in case of the most of local taxes, actual revenues are over 10% lower than they might be if no rate reductions of tax releases were decided by local governments.

Table 10. Consequences of local tax policies for local budget revenues – rate reductions and tax exemptions as % of potential revenues (which might be collected is maximum rates were applied)

	Results of rate reductions	Results of exemptions, releases and reductions
Propery tax	8.7%	5.1%
Tax on agriculture	14.7%	4.6%
Forest tax	-	0.8%
Tax on vehicles	7.8%	5.1%
Tax on small businesses	-	1.3%
Tax on legacies and donations	-	6.7%
Tax on dog owners	9.8%	7.8%
Tax on civil law activities	-	0.2%

What is the significance of local tax policies? The property tax is the only local tax which might be important for businesses' location decisions. It has also significant political importance, since the rate of the tax on housing properties is often a hot issue in local communities. That is why property tax policy are more carefully analysed in the following section. In some rural local governments the debate on the rate for the tax on agriculture is also of some political importance.

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2.3.1. Local tax policies on the property tax

As it is ilustrated in the table 11, since a beginning of 1990s, every year actual revenues from the property tax have been more than 10% lower than possible if not rate reductions or tax exemptions are granted by local councils and executive mayors.

Table 11. Results of reductions and exemptions from property tax as % of maximum available revenues

	1992	1993	1994	1995	1996	1997	1998	1999	2001
Overal reductions	16%	24%	29%	15%	16%	16%	16%	15%	14%
Results of rate reductions				10%	11%	10%	10%	10%	9%
Results of tax exemptions and tax releases				5%	5%	6%	6%	5%	5%

Results of reductions in tax rates are usually much more important than tax exemptions and individually granted tax releases.

There are important differences between tax policies implemented in small rural communities and in big cities. In general, tax rates are usually much lower in small municipalities. In big cities tax rates are usually very close to maximum, and the main instrument of property tax policy is related to tax exemptions and individual tax releases. These differences are illustrated in the table 12.

Table 12. Results of reductions, exemptions and releases from property tax as % of maximum available revenues – differences between small and big municipalities (2001)

	<5,000 citizens	5-10,000 citizens	10-20,000 citizens	20-50,000 citizens	Over 50,000 citizens	Cities of county status
Overal reductions	20%	21%	19%	14%	8%	8%
Results of rate reductions	15%	16%	13%	9%	4%	3%
Results of tax exemptions and tax releases	5%	5%	6%	5%	4%	5%

We know also, that in small local governments reductions in the property taxes are more often offered to individual tax-payers, while in big cities tax policy instruments are more often focused on legal entities and their commercial activity.

2.3.2. Local tax policies – typology

From the political economy point of view, one may distinguish between two types of local taxes in Poland:

- taxes which are paid by most of local voters (property tax on housing, in many rural governments agriculture tax);
- taxes levied on local businesses (property tax on buildings and plots used for business activity, tax on lorries and busses).

Taking into account such a distinction, the tax policies might be classified as on figure 3. If local taxes and businesses are high, but taxes on voters are low, such a policy may be called populist, since the main rational behind is sseking for support of voters. But sometimes the opposite is true – taxes affecting most of voters are relatively high, while taxes on businesses are kept on a low level. The argument for such a solution is an attempt to stimulate local economy, and I suggest to call this type "stimulating".

As it has been said above, lower rates of local taxes are often found in small local governments. It is interesting however to notice, that while a populist type of policies is more typical for small, rural villages, a stimulating type can be identified more often in mid-size urban governments[6]. This observation has been based on research conducted in 1995, but more recent analysis (Pszczola 2002) seem to confirm the most important conclusions.

Figure 3. Typology of local tax policies.

		Taxes related to business activities	
		low	high
Taxes affecting most of voters	low	conservative[7]	populist
	high	stimulating	fiscal

3. Local Taxes in Poland – An Evaluation

The future shape of the most important local tax – the property taxes – is a subject of a debate. There are two the most important lines of the criticism of the present property tax system in Poland. One raises, that the tax in the present form does not raise sufficient revenues, especially in big cities. The second line of criticism focuses on the fairnes of the tax – it is considered unfair that the tax depends on the type and area of property rather than on its value. Why the owner of poor, village house located in the countryside far from any urban centre should pay the same tax as the owner of similar (in size) but many times more valued house in the centre of Warsaw?

The most typical conclusion from both lines of criticism calls for the reform leading to ad valorem property tax. This has been also a typical advice brough by USAID or World Bank advisors during the last decade. The draft of new regulations of the ad valorem property tax was prepared in the Ministry of Finance and approved by the Government in 1995 (Nowecki 1996). But negative reaction of the public opinion has stopped the preparation of the reform for a long time. Most of people is afraid that the new tax would significantly increase the tax burden. As a result, in 2000 survey by the Centre for Public Opinion Research (CBOS) 31% respondents declared that in their opinion the new property tax would be less fair than the present regulation, while only 27% expressed a positive opinion on the fairness of the new

[6] For a most extensive discussion of typology of local tax policies see: Swianiewicz (1996a, 1996b).
[7] Conservative in terms of fiscal policy. The alternative label might be "liberal", but because of different meanings of this label I suggest to use the term "conservative".

tax. 29% of respondents expected that they would b negatively affected by the reform, while only 4% expected a positive change (Kasperek 2002).

Both negative reaction of the public and technical difficulties slowed- down the pace of the reform significantly, although ad valorem property tax remains an official long-term goal of the Polish government. But nobody expects to introduce it quickly, and the date of the reform remains unknown. 2006 is mentioned in some discussions, but this date is not official and far from being certain. Introduction of the new tax is a long and coslty process (it requires valuation of many thousands of individual properties).

The alternative solution might be used in thes hort- or medium-term perspective. It might be based on the variation of the maximum rates depending on the location of properties (for example different maximum rates for small rural viallges and for big cities as well as a different rate in the centre and suburbs of the city). The first step towards such a change has been done in a recent amendmend which allows local government to differentiate the actual tax rate depending on the location of property in an individual zone of the city. However, this first step is not sufficient, since maximum rates remain on the same level for the whole country. The solution close to discussed here has been applied in the Czech Republic and Slovakia. For example in Slovakia (see Kling, Niznansky, Pilat 2002) the maximum rate per square meter is dependent on the size of the settlement unit. The basic rate is multiplied by:

- 1.0 in villages below 1,000 citizens,
- 1.4 in local governments with 1-6,000 citizens,
- 1.6 in local governments with 6-10,000 citizens,
- 2.0 in local governments with 10-25,000 citizens,
- 2.5 in local governments with oper 25,000 citizens,
- 3.5 in district capitals or in spa resorts,
- 4.0 in regional capitals,
- 4.5 in Bratislava.

It should be reminded however, than both in the Czech Republic and Slovakia the overall capacity of the property tax is few times lower than in Poland. The suggested, alternative solution might combine relatively high overall fiscal capacity of the present property tax in Poland with the approach towards the variation of tax rates adopted in present Czech or Slovak regulations.

How the Polish local tax system may be assesed against criteria formulated in the first section of this paper?

- **The allocation of tax yields is not proportional to allocation of functions** – the negative assessment applies primarily to the situation of county and regional governments which do not have own tax revenues. It is much better on a municipal level- the ratio of revenues from own sources to total budget revenues is somewhat lower than is some West-European countries (such as Denmark or Sweden), but similar or even higher than in most of others (such as United Kingdom, Netherlands or Spain). The negative thing however, is the gradually diminishing role of revenues from own sources in municipal budget - - it used to be around 47% of total budget revenues in 1992, but 40% in 1995 and only 33% in 2001.

- **Uneven geographical distribution of the tax base** – there are significant differences in distribution of the local tax base. In 2001 own revenues consituted well over 40% of budgets in cities, but just over 20% in rural areas. If we take into account inequalities between regions – the variation is even larger. But probably this level of inequalities is inevitable regardless the selection of local taxes.
- **The system of local taxes is fragmented and complicated**. There are many small local fees and taxes (such as the tax on dog owners) which do not raise significant revenues but are costly in a collection and unnecessary complicate the system.
- **Tax is well defined in geographical space** – Polish local taxes do not produce major problems in this respect. Taking into account also tax-sharing, there are problems with defining the local share in corporate tax in case of companies which are registered in one municipality but operate branches in various location. A partial answer to this problem is provided by regulation which suggests allocation to municipalities proportionally to number of employees working in each of local branches, but this solution is far from being perfect.
- **Visibility of the tax** – most of Polish local taxes are visible.
- **The low elasticity of tax yields against inflation** – property tax, tax on vehicles as well as small local fees and texes are not elastic against inflation. Perhaps, the only exception is a tax on agriculture which is related to the market price of crops.
- **The tax base is relatively immobile** – this principle is definitely followed by the property tax which is by far the most important local own revenue.

Recommended changes might go in two directions:

(i) simplification of the system, and
(ii) strengthening of the local tax base (perhaps at the expense of tax sharing) first of all at the county and regional, but also on a municipal level.

The former recommendation might lead to the resignation from the tax on dog owners and perhaps some other, minor local fees and taxes.

In my opinion, the implementation of the latter recommendation might possibly go in one of two following ways:

- Transformation of present shares in central income taxes into local sur-charges to the income tax. Implementation of such a reform might follow experiences of Scandinavian countries;
- Reform of the property tax (perhaps together with an introduction of county and regional part of the tax). As it was discussed in the section 2 of this paper, it can but does not need to include the change towards the ad valorem property tax system.

But it is necessary to stress that the overall level of tax burdens for citizens and enterprises should not increase as a result of the reform. It underlies that the reform of local taxes can be never discussed in abstract of the broader change in the public finance in general. If overall burden of local taxes increases, it has to be compendated by the reduction of some central taxes. Such a change would not incur additional burden on a central level, since strenghtening of the local tax base allows to reduce state tarnsfers, which should focus on equalisation principle, rather than on a general vertical equalisation (see next section).

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