THE ROAD TO FISCAL DECENTRALISATION OF MUNICIPALITIES IN REPUBLIC OF BULGARIA

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Abstract

This publication is dedicated specifically to local taxes, given their importance for the actual achievement of local self-government in the Republic of Bulgaria. Here, financial decentralisation is understood as a way to strengthen the legal role and economic power of local government. An expression of financial decentralisation de lege lata are the tourist tax and the patent tax.

Keywords: *local taxes, competence, enforcement procedure, fiscal decentralisation.*

1. Introduction

The determination and collection of local taxes by local government bodies derives from the principle of local self-government. As a form of increasing the efficiency of state administration and solving important problems with local importance in art. 2 para. (1) of the Constitution of the Republic of Bulgaria, it is declared that the Republic of Bulgaria is a unitary state with local self-government. The financing of municipalities in practice creates, gives meaning and guarantees the manifestation of local authority. Therefore, local taxes have a key importance, through them that the autonomy of the local fiscal is formed and defended. It is no coincidence that dec. no. 9/21.09.2000 of the Constitutional Court of the Republic of Bulgaria summarises that „the legal possibility to perform certain functions would become meaningless, given that the local self-government bodies are deprived of financial resources for their implementation...”. This publication is dedicated specifically to local taxes, given their importance for the actual achievement of local self-government in the Republic of Bulgaria. Here, financial decentralisation is understood as a way to strengthen the legal role and economic power of local government. An expression of financial decentralisation *de lege lata* are the tourist tax and the patent tax.

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Local self-government, therefore, imposes the need for the municipality to have its own financial revenues. In 2007, with the Act to Amend and Supplement the Constitution of the Republic of Bulgaria (promulgated SG no. 12/2007), a significant change was made affecting the organisation of taxes in the Republic of Bulgaria. In the amended art. 84, item 3 provides that the National Assembly establishes taxes and determines the amount of state taxes. The new created para. (3) of art. 141, decrees that the municipal council determines the amount of local taxes under the conditions, according to the order and within the limits established by law. The rules introduced by art. 60, para. (1) and para. (2) of the Constitution, that citizens are obliged to pay taxes and fees established by law, according to their income and property and that tax reductions and burdens can only be established by law, remained unchanged. In all Bulgarian constitutions until the adoption of these amendments, the tax matter was regulated solely, explicitly and invariably by the legislative power.

According to the reasons for the Act to Amend and Supplement the Constitution of the Republic of Bulgaria, „the purpose of the changes is to achieve real financial decentralisation, to achieve compliance between the functions and responsibilities of the municipalities, on the one hand, and the financial possibilities for their realisation - on the other , as well as to create opportunities for municipalities to fully participate in the absorption of the structural and cohesion funds of the European Union”. With the changes made, the legislator introduced a distinction in determining the amount of republican and local taxes. The establishment of all taxes is reserved as the sole authority of the National Assembly, which determines the amount of republican taxes, and the municipal councils are assigned the competence to determine the amount of local taxes under conditions and procedures determined by law. These constitutional changes are also part of the implementation of the Decentralization Strategy 2006-2015 adopted by dec. no. 454 of the Council of Ministers dated 02.07.2010. By

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granting the municipalities the right to determine the amounts of local taxes, the process of financial decentralisation continues and local self-government is strengthened, since the greatest importance for the development of the process is the strengthening of the financial independence and autonomy of the municipalities. Local taxes are involved in the formation of revenues for the local budget, they are only one of its budgetary sources. However, the municipality cannot unilaterally and arbitrarily establish the local taxes themselves, this, as correctly noted in dec. no. 9 of the Constitutional Court of the Republic of Bulgaria, always remains within the powers of the National Assembly.

However, the normative granting of authority to the municipal council to determine the amount of local taxes (of those determined by the National Assembly for such taxes) even within the framework of the law is an important guarantee for the real achievement of local self-government, because the independent budget strengthens and maintains the independence of the local power, i.e. makes possible its separation from the central government. Thus, if it is admitted that local self-government is a form of decentralisation of state power, it must be admitted, and that the determination and collection of local taxes by local self-government bodies is an expression of decentralisation of state finances. Moreover, it must be assumed that financial decentralisation fosters and ensures the decentralisation of state power itself.

Financial decentralisation includes the way of distribution of financial responsibilities at the central and local level in the field of public revenues and expenditures. It is a specific process of transferring powers and responsibilities from the central government to the municipalities regarding the financing of local budgets.

Taxes are the main source of budget revenue. In the conditions of a market economy, taxes achieve not only fiscal goals, but also economic and social ones. Taxes affect economic activity and the income from them is an indicator of the development of the economy, as well as of the society itself. The tax reductions provided for in the legislation are a tool for achieving a fair distribution of the tax burden.

With the adoption of the Public Finance Act (promulgated SG no. 15/15.02.2013, in force from 01.01.2014), which repealed the Law on the Structure of the State Budget in force until then (SG no. 54/15.07.2011, repealed by SG no. 15/15.02.2013) and the Law on Municipal Budgets (SG, no. 33/24.03.1998, repealed by SG no. 15/15.02.2013) , the regulation of the general arrangement and structure of public finances with one common normative act became a fact. The adoption of this law is an expression of the desire to consolidate all aspects of the management and use of public resources, both at the national and local levels. Public finance is considered as a unified system for provision and financing of public goods and services, redistribution and transfer of income and accumulation of resources by budget organisations. According to art. 45 para. 1 item 1, b. "a" of the Public Finance Act, the revenue from local taxes is also included in the structure of the municipal budget, under conditions, according to the order and within the limits established by law.

As a result of the expanded powers of the Municipal Councils in 2007 for a more active tax policy at the local level, it did not lead to a significant change in the revenue structure and greater autonomy of the municipalities:

- The budgets of most Bulgarian municipalities remain strongly dependent on state transfers - more than half of municipal expenses are financed through state transfers;
- The municipal budget continues to be abstractly rather than functionally related to the economic processes (for example, investments and the labor market) taking place in the municipal territory - with the exception of the real estate market;
- The implementation of an independent fiscal policy is greatly hampered by the lack of sufficient own revenues, which limits the role of municipal councils as conduits of the democratic will of the voters and deprives them of the necessary tools for forming local policies;
- The access to the European funds of the Bulgarian municipalities both concealed and deepened the lack of own resources, and the increased obligations of the local authorities from the requirement to co-finance the projects proved the importance of the problem;
- There are examples of fiscally anemic municipalities with mounting debts, periodically frozen accounts and dysfunctional administrations unable to meet any emergencies.[1]

According to a report by the National Association of Municipalities in the Republic of Bulgaria (NSORB), municipalities in Bulgaria are mainly financed by transfers from the national budget (71%), local taxes (15%) and fees, rents, fines and non-tax revenues (14%). Transfers from the national budget finance the activities delegated

[1] *https://www.regionalprofiles.bg/var/images/IME-Fiscal-Decentralization.pdf*.

by the state, mainly public education (94% of local spending is on education) and social services (85%). Matching the delegated functions with the relevant state budget leads to a low ratio of state transfers to public works and communal services, and more than half of the municipal administration's expenses are financed by the state budget.[2]

One of the proposals made by the NSORB has a plan to set aside 20% of personal taxes and 10% of corporate tax as shared local revenues, redistributed according to their place of origin. These shared revenues will create significant new resources for municipalities: 37% own revenues or 12.1% expenditures for activities delegated by the state. Both types of shared revenue are concentrated in large urban centers.

The revenue sharing method of financing municipalities has several advantages: it is a significant source of revenue, personal income taxes (excluding corporate taxes) are a stable source and predictable revenue. Indirectly, the sharing of tax revenues binds the local economy and the municipal budget. Revenue sharing can be introduced by replacing some of the state subsidies allocated to state-delegated activities. The apportionment method should be based on the actual place of residence of the taxpayer or by using an alternative method - apportionment based on formulas. Tax distribution also offers a good opportunity for equalisation based on the per capita income redistribution mechanism. Shared taxes enhance local autonomy if they provide discretionary local sources of revenue.

In the Strategy for Decentralization 2016-2025, it is reported that financial decentralisation is currently not perceived as a means of improving the financial situation of municipalities. The main problem that led to the suspension of the reform in the field of financial decentralisation was the lack of resources for financing municipal services. In general, it can be said that functions are preemptively transferred to the municipalities with a normative act, without providing the necessary financial resources, which is contrary to art. 9 of the European Charter of Local Self-government. Bulgaria ratified the Charter with the Law on Ratification, adopted by the 37th National Assembly of the Republic of Bulgaria on 17.03.1995. With the adoption of the Law on Ratification of European Charter of Local Self-government, according to art. 5 para. (4) of the Constitution of the Republic of Bulgaria, the Charter becomes part of the domestic legislation and takes precedence over it. In this regard, it should be borne in mind that when it comes to the provision of public services that are not provided with financial resources, their quality and access to them deteriorate.

The other unresolved issues in the field of financial decentralisation:

- Activities delegated to local authorities still exceed their own activities in volume. There is no clarity in the division between delegated powers and own powers of the local government bodies, which is one of the key findings in the Second Monitoring Report of the Council of Europe;
- The processes of administrative reform and financial decentralisation should continue to be carried out in a coordinated manner. With its development, the decentralisation process has clearly reached a point where continued financial decentralisation will be critical, i.e. without the implementation of financial decentralisation measures, other decentralisation measures would not be realistically feasible. Currently, public investment decisions are concentrated in the Ministry of finance. Municipalities have the right to make independent decisions on a small percentage of the revenues and expenditures of the local budget;
- Own sources of income are limited and represent an insignificant share of municipal budgets for the majority of municipalities. This makes them unreliable partners of European funds in the co-financing of local projects. Financial decentralisation is a necessary condition for the development of a municipal credit market and for increasing the ability of municipalities to receive financing outside the central budget;
- Some imperfections in the formula for financing local authorities and difficulties in securing financial resources from the state sometimes allow bypassing the objective mechanism for financial regulation and switching to „manual management”, *i.e.*, distribution of available resources „to each a little” and thus the state continues to be the guarantor of local deficits. Municipalities must have control over their revenues in order to be able to analyse the effectiveness of one or another of their activities;
- There are a number of legal possibilities and prerequisites for increasing the revenue part of municipal budgets by using bank loans, issuing municipal bonds, creating conditions for the municipality's participation in national and international programs, attracting investors and others that are not sufficiently well known and used by local authorities;

[2] *https://www.namrb.org/uploadfiles/news/11418/Technical%20Report_fiscal%20decentralisation_FINAL%202761-6228-9416.2_BG.pdf*.

- Local authorities do not have the authority to determine tax reductions for certain taxpayers, as well as the ability to determine user fees for optional services provided by municipalities;
- The spending powers of the municipalities are limited in relation to the delegated services;
- The lack of regulation for determining the total amount of the capital subsidy, led to its formation on a residual basis, with the amount of additional subsidies for capital costs distributed among the municipalities being determined without any rules and often exceeding 50% of the actual amount of capital subsidies granted.

The path to fiscal decentralisation in Bulgaria can happen in several ways. The transfer of part of the income from the VAT to the municipalities cannot and should not be an isolated, self-serving and unconditional change in the structure of the tax system. In order to ensure the success of such a change, a number of additional steps need to be taken, including:

- Transition to effective program budgeting at the local level, which will lead to greater efficiency and transparency at the local level;
- Improving the efficiency and transparency of the finances and management of municipal enterprises and municipal property;

Territorial-administrative reform to guarantee the long-term sustainability of the territorial structure.

A real change in terms of the financial independence of the Bulgarian municipalities is possible only by restructuring the existing tax system. The imposition of new taxes (for example, on turnover) carries the risk of duplication of taxation, and the increase of existing local taxes will not solve the problem of incentives for local authorities and implies an overall growth of the tax burden on the economy.

Revenue sharing from indirect taxes such as VAT seems difficult to implement, and giving municipalities the power to determine its level or even the tax base of this tax would lead to absolute administrative chaos and create the conditions for the emergence of tax arbitrage where consumption is artificial aimed at municipalities with a lower tax burden.

Thus we arrive at the most likely and widely applied in the EU model of fiscal decentralisation in the form of direct revenue sharing or the transfer of powers in relation to already existing direct taxes - on the income of individuals (general income tax) or on profit (corporate tax).

The vast majority of policy challenges and administrative hurdles seem easily surmountable in revenue sharing or devolution of personal income taxes to local authorities:

- The resulting link between taxation and democratic representation at the local level will create incentives for local authorities to work to create jobs (mainly by attracting investment) and will link the financial situation of municipalities to the social and economic processes taking place at their territory;
- Incentives for tax arbitrage can be removed by applying the "money follows the identity card" principle, whereby revenues from personal income taxes are distributed among individual municipalities based on the individuals' permanent address;
- The relationship between taxation and democratic representation in personal income taxes is much more pronounced than in corporate taxation and creates incentives for real tax competition between municipalities;
- The vast majority of personal income tax revenues are monthly transfers from employers to the tax authorities. The timely redirection of these funds to municipal authorities will provide an additional source of liquidity and can help meet extraordinary expenses;
- The legislative effort and follow-up involved in implementing such a system are significantly lighter than existing alternatives. Taxes on the income of natural persons can be collected in the same order (by the National Revenue Agency), after which the relevant part of them can be redirected to the accounts of the municipalities.

3. Conclusions

In this regard, I consider it is correct to strengthen and further develop the tendency to increase the local fiscal by transferring part of the revenues from national taxes to the local budgets of the municipalities, the so-called financial decentralisation. Currently, legal and factual manifestations of the same are the tourist tax and the patent tax. This is undoubtedly positive, but it is not enough, as it did not achieve financial autonomy of the municipalities.

The transformation of more national taxes into local taxes is useful and fair, not least because the possible increase in the amount of the current local levies will create an excessive burden on the taxpayers, thereby deepening the collection problem and there was an overall increase in the tax burden in the country's economy.

It is important to emphasise that in the process of financial decentralisation an optimization between local and national interest should be achieved. It is harmful that the financial independence of municipalities is realised arbitrarily and entirely at the expense of the national interest. The demeaning of the national interest should not be explained as a way to understand and develop the local interest. From this point of view, for example, the direct sharing with the municipalities of a part of the income from taxes on the income of individuals appears to be adequate and balanced.

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