



OPTIMIZATION POSSIBILITIES IN BULGARIAN LOCAL TAXATION

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ABSTRACT

The main goal of this article is to review and analyze the potential of local taxes in terms of increasing revenue to municipalities in Bulgaria. The analysis of local taxation covers a period of 4 years (2018-2021) and it is focused on two directions: to evaluate the collection level of local taxes and to indicate the degree of importance of local taxes compared to the revenues in the municipal budget. In order to guarantee proper information processing, the following methods are used: analysis and synthesis; grouping, systematization, classification, and structural analysis. Results and conclusions are providing information about the local taxes status and the need for change in the local policies in certain municipalities depending on their size and collection levels. The results will have a local impact on the evaluation of missed opportunities to the local budget's revenue capacity and the possibilities to increase their results.

Key words: local taxes, municipalities, local finances

INTRODUCTION

The independence of local self-government is an important part of the identity of the municipalities and the possibilities for their development. To achieve this independence, there is a need to optimize the powers at the municipal level. On the one hand, municipalities must have the necessary power to redistribute their monetary resources freely, but on the other hand, the necessary control must be applied.

Achieving the necessary balance comes with a proper transfer of responsibilities from the central to the local authorities and, with their financial coverage. Thus, each municipality could satisfy local needs and not allow large differences in the provision of basic services.

All this is possible on the condition that, together with the transferred responsibilities, the central government gives as well the

opportunity to generate funds in the local budgets. If we review a municipal budget, we can easily see that the local taxes in the municipalities' own revenues are of key importance - the greater their share is, the more self-sufficient and independent that municipality could be. In municipalities of different sizes, the share of own revenues in the total revenues is different, and it varies from about 10% to 60-70% in larger municipalities (1). It is of great importance in municipalities with larger own revenues to increase collection and revenue potential. Currently, there is a system that allows local taxation collection to reach in the range of 50% to 90%, and there is a need to create an appropriate environment to increase this share. The problem, on the one hand, lies in the decisions taken at the municipal level to determine the rate of local taxes and whether all municipalities will benefit from applying the maximum allowable values compared to what is allowed in the legislation. Municipalities have important powers to set their own rates, and a large number of them have lost benefits due to approved lower tax rates than the maximum possible.

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Taxes have been known since ancient times under a different form and name. In the past they were a free and sporadic donation in favor of the community chief. This act of donation expressed gratitude, obedience, respect, etc., and even the main purpose was not income, but an addition to wealth (2). In ancient Mesopotamia there was a term "miksi" which literally means "to take a share" (e.g. of the harvest). (3) As Ricardo says, taxes are the part of the produce of the land and labor of a country placed at the disposal of the government; and always ultimately paid either out of the capital or revenue of the country (4). Nowadays, taxes are the subject of many discussions and disputes, part of the media space and a current topic with a wide scope.

For the purpose of this study, it is necessary to provide detailed information about: what we are meant by local taxes, how they differ from other taxes, who owes them etc.?

At the local level, municipalities have budgets and tax revenues, which will subsequently serve to provide the necessary services to the population of a given territory. Despite the desire of the local authorities to deal with and take care of all the needs of the population, this is not within their power, as there are needs of the population that are the responsibility of the state (defense, health care, education, etc.). By distinguishing the responsibilities and obligations of local communities, institutional relationships can be precisely defined. For larger and generally mandatory needs, municipalities rely on the central government, and typically local services remain their concern, secured with self-generated revenues, covering the exact needs of the population on the territory of their municipality. Revenues in municipal budgets are essential for their development and independence, and local taxes represent a significant share of own revenues. The municipality is the main administrative-territorial unit in which local self-government takes place. According to European Charter of Local Self-Government, this means that the majority of the costs of municipal services are financed with own revenues. (5)

The tax system has one peculiarity, and that is that it cannot possibly be completely fair. Tax revenues are redistributed from richer to poorer and thus have a social effect and influence the behavior of citizens and all entities operating in the given territory. However, there is much to be done to increase the empathy of all citizens

for the common good. Research by Pablo Balan et al. (6) shows that if local taxes are collected by local agents, collection is 36% higher than if the central government sends its representatives for this activity. He finds out that local agents have more information about taxpayers and can use it to increase collection, such as information on when a household has income (monthly salary). Locals contribute with greater confidence and thus can increase the "tax morale" of taxpayers. Last but not least, the possibility of the local tax agents to better explain to the taxpayers the consequences of a possible overdue obligation and thus to convince them that sooner or later it has to be paid.

Of course, not all taxes can be local, and not all tax revenues can be associated with the central budget. Local taxes must cover costs for the local community and bring development to a given community and a specific territory (municipality). This is relevant from a territorial point of view, i.e. revenues collected on the territory of a given municipality to be used to provide the relevant necessary services on the territory of the same municipality.

METHODS

The analysis of local taxes covers a period of 4 years (2018-2021) and is focused in two areas:

- an indicator of effective collection of local taxes
- an indicator of the importance of the local tax, i.e. the total revenue from local taxes

Local tax collection rate:

It aims to track the collection of some local taxes as a nominal value over a period of 4 years and then to compare in percentage the collection of taxes against the potential for maximum collection.

For this purpose, it is possible to use the following formula:

$$T_C = \frac{C_{TC}}{P_{TC}} \times 100\%$$

Where:

T_C – tax collection rate

C_{TC} – actual tax collection

P_{TC} – potential maximum collection

Also, the correlation analysis aims to confirm whether there is a relationship between the size of the municipality and the collection share.

RESULTS

For the purpose of the analysis, the municipalities in Bulgaria are divided into

groups according to their population. In this way, it will be possible to track whether the collection in smaller municipalities is higher or

lower, as well as whether the size of the municipality affects the collection rate of local taxes and fees

Table 1. *Municipalities divided to groups according population*

Number of municipalities by year and population									
Groups		2018	Average population in 1 municipality	2019	Average population in 1 municipality	2020	Average population in 1 municipality	2021	Average population in 1 municipality
1	Under 10 000	132	5 695	133	5 657	132	5 684	133	5 593
2	10 000 - 49 999	109	21 099	108	20 980	109	20 969	108	20 719
3	50 000 - 99 999	15	70 474	15	69 872	15	69 289	15	68 343
4	above 100 000	8	195 410	8	194 541	8	191 608	8	190 606
5	Sofia municipality (capital)	1	1 328 120	1	1 328 790	1	1 308 412	1	1 307 439
Total		265	26 415	265	26 232	265	26 100	265	25 807

Source: Author visualization according to NSI data (7)

From the information provided in **Table 1**, it can be seen that the average population is gradually decreasing in Bulgarian municipalities regardless of size. A higher degree of reduction is observed in larger municipalities with 0.3%, while in small municipalities this percentage is 0.2%.

Local taxes with the largest share of total local revenue are property tax and vehicle tax. Table 2 presents the data on the collection of these taxes for the period of 4 years (2018-2021) in the municipalities in Bulgaria, and they are grouped according to the population (**Table 1**).

Table 2. *Property tax collectability by municipalities groups, %*

Property tax collectability					
Groups		2018	2019	2020	2021
1	under 10 000	69,92	72,65	71,27	74,59
2	10 000 - 49 999	73,79	76,52	75,8	78,81
3	50 000 - 99 999	74,69	78,28	77,02	81,06
4	above 100 000	78,71	80,28	79,54	84,5
5	Sofia municipality	71,19	72,88	76,26	78,22
Total		72,05	74,78	73,73	76,99

Source: Ministry of Finance, <https://www.minfin.bg/bg/19> (8)

The property tax collectability for the period 2018-2021 shows a positive trend regardless of the size of the municipality. There is a slight drop in collections in 2020, which is a logical behavior of taxpayers given the uncertainty and global processes related to the COVID-19 pandemic. Despite this difficult period, immediately in 2021 an increase in collections and even higher values compared to the beginning of the considered period are observed.

The lowest property tax collection is observed in the smallest municipalities of up to 10,000

people, where the maximum collection is in 2021 – 74.59%. On the other hand, in large municipalities with a population of over 100,000 people, for 2021, a higher collection rate is observed compared to small municipalities by 10%, reaching 84.5%. If we look at all municipalities and the average collection, there is a general increase in the collection of this tax by about 4% over the period of 4 years.

The collectability of vehicle tax is more constant and unchanging than that of property tax. Here, the collection rate is around 70% for

the smaller municipalities and over 75% for the larger Bulgarian municipalities. The same trend is observed in 2020 for a drop in collection and

then in 2021 there is an increase compared to the beginning of the considered period.

Table 3. Vehicle tax collectability by municipalities groups, %

Collectability of vehicle tax					
Groups		2018	2019	2020	2021
1	under 10 000	70,10	70,27	69,32	71,04
2	10 000 - 49 999	71,93	71,86	70,51	72,64
3	50 000 - 99 999	67,69	69,37	68,82	70,52
4	above 100 000	71,10	71,61	70,46	75,00
5	Sofia municipality	75,79	76,3	74,68	76,68
Total		70,77	70,93	69,83	71,81

Source: Ministry of Finance, <https://www.minfin.bg/bg/19> (8)

Grouping the municipalities according to their population, the lowest collection rate is observed in the medium-sized ones (50 to 100 thousand people), with 67.69% at the beginning of the collection period and reaching only

70.52% at the end. In the larger municipalities and in the metropolitan municipality, the percentage of those who have paid tax on vehicles is the highest – 76.68%.

Table 4. Average level of collection of the two taxes (property and vehicle),

Average level of collection of the two taxes					
Groups		2018	2019	2020	2021
1	under 10 000	70,01	71,46	70,29	72,82
2	10 000 - 49 999	72,86	74,19	73,15	75,73
3	50 000 - 99 999	71,19	73,82	72,92	75,79
4	above 100 000	74,91	75,94	75,00	79,75
5	Sofia municipality	73,49	74,59	75,47	77,45
Total		71,41%	72,85	71,78	74,40

Source: Ministry of Finance, <https://www.minfin.bg/bg/19> (8)

The average values of the collection of the two considered taxes shows a positive trend at the beginning of the study period in 2018 and 2019 with an average increase of 1.44%. In the second half of the period, a decrease was observed in 2020 with similar collection values to those from the beginning of the period. On the other hand, the increase over the last year was about 3%, and thus the collection of both taxes in Bulgarian municipalities has increased.

CONCLUSION

We have to pose the question whether about 75% collection of the two most significant local taxes is sufficient for the autonomy of the municipalities and the satisfactory provision of local services that the population needs? The answer is that more than ¼ of the possible revenues are not collected and we can consider this as missed benefit from the municipalities to

generate more income to the local budgets and use it for better services. Also another point of view will reveal that not all municipalities are voting for high tax rate even though it is allowed in the law, which states that the property tax rate is determined by municipal council regulation within the limits of 0.1 and 4.5 per thousand on the property tax assessment (9). Still we can see that in different municipalities there are tax rates a lot lower than the maximum allowed by the law.

There is possibility to outline few conclusions according the data received as results:

- Municipalities are given opportunity to decide by themselves the tax rate and we monitor that not all of them are accepting the higher limit of the taxes;
- On top of the missed opportunities to increase their tax rates, municipalities are

having about 20-25% lost profits from tax collection for the two most important and biggest income taxes (property and vehicles)
 - In the smallest municipalities we monitor the lowest average collection values for these taxes and for Bulgarian municipalities it is not valid that the closer connections in small villages are affecting people`s internal sense of duty.

For further analysis and study it can be outlined the option to correlate the size of the municipality and also the average salary with the tax collection. It might appear that the tax collection ratio is in strong correlation to the financial welfare and not so much with the personal relations among people in small municipalities.

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