Problems of Financial Provision at the Latvian Municipalities in the Tax Policy Context

The research aims to raise the problems of the local municipalities in Latvia that are related to a lack of financial resources. An active use of the tax policy to ensure the municipal finances in Latvia is examined in the paper. The authors have investigated the current situation and, using the ideas and experience of the other countries, have elaborated the recommendations on how to successfully adapt the tax policy to the current Latvian conditions in order to improve the financial capacity of the local municipalities thus raising their interest to support the entrepreneurship.

**Keywords:** corporate income tax, local government budget, municipal taxes, personal income tax, property tax.

**JEL Classifications:** G22/E22/E23.

**Introduction**

Along with the consolidation of democratic principles in public administration, the municipal finances are considered as an important constituent part of the state financial system. They are used to ensure economic and social development of the national administrative territories. Therefore in the economic literature, more and more attention is being paid to this issue, and the prevailing opinion is that the success of the national macroeconomic development is stimulated by the sufficiently broad regionalization of the economic and social process, when the functions over the control of these processes are transferred to the local state government authorities.
Consequently, the role of the local finances in the implementation of the state social and economic policy strengthens and expands.

Thus, it can be affirmed that the local governments are an integral component of public administration, and the municipal finances are an important guarantee for their existence, development, and advancement of the successful functioning. An efficient use of the finances is of particular importance for the Latvian municipalities due to ever increasing demand for the quality services and the higher socioeconomic level. These factors produce the need to expand and improve the financial provision of the municipalities, as well to solve the problems related to the improvement of formation and use of the municipal financial resources. The national tax policy shall be highlighted as the most significant influencing factor.

Research object – impact of the tax policy on financial provision of the local budget.

The aim of the research is to assess an active use of the tax policy to ensure the municipal finances in Latvia.

Research objectives:
1) to assess the budget revenue structure of the Latvian municipalities from the legal and practical perspective;
2) to analyse the tax revenues of the municipal budget, indicating improvement opportunities;
3) to draw up proposals for improvement of the financial provision of the Latvian municipalities in the tax policy context.

The research methods: the monographic descriptive method, statistical methods in economics, method of logical construction are used in the research. Methodological issues are addressed on the basis of the theoretical research of the literature, research articles, and publications by Latvian and foreign authors, statistical data, as well as the legal regulations.

Assessment of the Budget Revenue Structure of Latvian Municipalities

Issues related to the municipalities in Latvia are studied by E. Vanags (2006) and I. Vilka (2006) focusing on the administrative division of the local governments, V. Vespers (2012) evaluating the development opportunities of the municipalities, E. Gross (2012), S. Bruna (2012) analysing the financial situation of Latvian municipalities and paying more attention to the financial equalization system, and S. Zelca (2008) assessing the revenues of the basic budget in the regional perspective. It shall be noted that the municipal finances are an issue extensively discussed by politicians, representatives of the regional authorities and local governments, however, it has not been investigated comprehensively enough.

In the financial practice, the main task of the municipal budget is to distribute the financial resources available at the current financial year in order to ensure the implementation of the statutory functions and duties of the municipalities in accordance with the priorities of the local governments. Since there is a situation in Latvia that the finances required to cover municipal expenditures always exceeds the resources available, the budget process involves the selection of choices and decision-making that to some extent depends on the subjective factors.

In Latvia, the financial activities, budget process, budget rights, autonomy of the local governments, and relations with
the national budget and budgets of other local governments are determined by several laws. The most important are the Law on Budget and Financial Management adopted in 1994 and the Laws on Local Governments Budgets and on Taxes and Duties adopted in 1995.

In accordance with the Law on Budget and Financial Management, municipal budgets for each financial year shall include all the revenues collected or received by the local government and loans appropriated by the municipalities for the municipal purposes. Article 42 of the Law stipulates that the municipalities have the right to budget revenues in accordance with the legislation in order to ensure an independent and secure revenue base in compliance with the requirements of macroeconomic stability, including the right to impose the local government duties in the order and to the extent prescribed by the law (Saeima, 1994).

Focusing the attention to the municipal revenues, the Law on Local Governments Budgets stipulates that the budget revenues of the cities and the territorial municipalities are comprised of:

- deductions from the state taxes and duties;
- municipal duties;
- state budget subsidies and special purpose subsidies;
- subsidies from the local government financial equalization fund;
- settlements with the municipal budgets;
- payments for services, deductions from the capital companies' profits, incomes from lease (rent) of the municipal property, property sales, and other statutory revenues (Saema, 1995a).

The authors reflect the data on the basic budget revenue structure of the Latvian municipalities in Fig. 1, demonstrating the types of income that are decisive in ensuring the financial activities of the local governments.

The largest share of municipal budget – 58.1% comprise tax revenues, therefore, it is considered as the main source of the municipal budget revenue. It can be affirmed that it has a relatively steady upward trend that, in the authors' opinion, mainly is caused by the surplus of the personal income tax revenue and a share of

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**Fig. 1. Revenue structure of the local government basic budget in 2013, %**

*Source: formed by the authors using Treasury Republic of Latvia (2013).*
the personal income tax that is to be transferred to the municipal budget in order to compensate the increase of the non-taxable minimum of incomes.

The second largest revenue item is the sums transferred to the municipalities from the state budget in the form of the state subsidies and the earmarked subsidies that, along with the payments from the state budget institutions, comprised 33.4% in 2013. The authors consider that it points out to the yet substantial dependence of the local government budgets on the state budget.

Revenue from the services rendered against payment and other incomes comprised 6.1% in 2013. In turn, the non-tax revenues consisting of revenue from the lease or sale of the state (municipal) property and from the capitalization of the tax principal was 2.2% in 2013. The municipal basic budget revenue from the foreign financial aid was 13.3 million EUR or 0.2% in 2013.

The authors consider that the revenue structure of the municipal basic budget does not demonstrate the sufficient independence of the financial resources available for the local governments, since more than a third of the total revenues yet comprises the payments received. If the state suspends transfer payments, the local government revenues would abruptly decrease, as currently the municipalities have limited possibilities to raise additional funds.

Tax Revenues in the Municipal Budgets

As provided in the National Development Plan of Latvia, in order to stop the tendency for centralization, it is necessary to increase economic activity in regions, attracting and using the resources of the surrounding areas by supporting the entrepreneurship development and promoting the mobility of the population (Saeima, 2012). Development of the regions brings up an issue of fiscal decentralization and setting the local taxes for the municipalities to be independent. G. Davulis (2009) in his research has studied this problem in Lithuania, however, it is up to date issue in Latvia as well.

In Latvia, the tax burden is relatively low, and the regional disparities become apparent as developing of one particular region, which includes the capital city Riga. The Territory Development Index, which indicates higher or lower development of territories as compared with the average of the national socio-economic development level, is positive (0.926) only in Riga region, while in other regions it is negative in 2013 (State Regional Development Agency, 2014). E. Zelgalvis and A. Joppe (2014) remark that the Territory Development Index is positive only in Riga region and constantly negative in the other four regions of Latvia starting already from 1999. The Territory Development Index for the planning regions is calculated using eight indicators, including personal income tax amount per inhabitant and per individual merchant, number of commercial enterprises per 1000 inhabitants (Cabinet of Ministers, 2014), which is related to the personal income tax revenue and activity of the performers of economic activities. The Territory Development Index is an indicator, which is considered when granting additional funding for the regions. In their study, R. M. Boboc and I. I. Alecu (2013) mention that the absorption of the EU funds should be linked to reduce dependence on the foreign loans,
growth of employment and labour productivity, diversification of economic and capital market funding. Hence, the regions should not rely only upon the EU funds, but rather should enhance the citizens’ and business activity. In its turn, increased activity of inhabitants and businesses leads them to facing with tax payments; the latter need to be improved as well.

It is clear that the fiscal policy provides financing of the public functions and the existence of the state; moreover, the existence of the state is not imaginable without taxes. C. L. Reynolds and S. M. Rohlin (2015) examine the fiscal policy not only at national level, but in the municipal aspect as well, indicating that the tax redistribution can be based on the location of the particular territory too. This question is currently present in Latvia, where the territorial development disparities exist.

Tax redistribution between the state and the local budgets are researched by L. P. Feld (2015) and M. Koethenbuerger (2011). The economists underline that the countries determine and define the municipal functions that require financial resources to be implemented, though the high-quality tax policy that would stimulate revenues is not designed along.

The authors will assess the structure of tax revenues as distributed among the central government, local government, and social security funds of the European Union (EU–28 countries). In 2012, 48.7 % of the aggregate tax revenue in the EU–28 was claimed by the central or federal government, 32.0 % accrued to the social security funds and 11.0 % – to local government. There are considerable differences in structure from one member state to another; for instance some member states are federal or they grant regions a very high degree of fiscal autonomy (Belgium, Germany, Austria, and Spain). In Latvia, 19.3 % of the total tax revenues were transferred to the municipal budget in 2012, thus presenting the eighth best result among the EU–28 countries (Eurostat, 2014). It indicates that tax revenue distribution between budgets varies in different countries.

As already noted, the main taxes constituting more than a half of the municipal budget revenue are a share of the personal income tax and the immovable property (real estate) tax. As well, the local government budget tax revenues are constituted by the deductions from the lottery and gambling tax, and the natural resources tax.

However, it shall be pointed out that all 15 taxes listed in the Law on Taxes and Duties (Saeima, 1995b) are state taxes, hence it signifies that officially no municipal taxes exist in Latvia.

In comparison, the municipal taxes exist not only in the old EU countries but also in most of the new EU member states providing the right to levy municipal own taxes; the three main categories of the local taxes are property taxes, local business taxes, and local income taxes.

As regards the property taxes, proportions of the tax revenue distribution between the state and municipal budgets and the rights provided to the local authorities to determine the taxable base, rates, and exemptions differ in the EU countries. 100 % of the property taxes are transferred to the municipal budgets in Bulgaria, Estonia, Latvia, Lithuania, Poland, and Slovenia. In Italy (95.5 %), Portugal (99.6 %), Romania (97.2 %), and Slovakia (99.4 %) over 90 % of the property tax revenues are received by the municipalities. In turn, a low percentage of deductions is in Cyprus (8.3 %), Luxembourg (7.8 %), and in Malta.
where all is transferred to the state budget (Zhang, 2013). However in these examples, it is still necessary to consider the rights provided to the municipalities to influence the taxable base, rates, and exemptions. The authors will review only those countries, where 100% of the property tax revenues are transferred to the local government budget, as it is in Latvia as well (Table 1).

As shown in Table 1, the local governments of Estonia, Lithuania, and Poland have the most rights to influence the amount of property tax. It shall be noted that none of these countries provide the rights to determine the taxable item. In Latvia, the local governments may only determine tax exemptions in accordance with the amounts stipulated by the law.

The world practice demonstrates that regarding the corporate income tax there are specific municipal rates defined or part of the total tax revenue is deducted. Specific municipal rates are defined in Germany (14–17%), Hungary (0–2%), Italy (3.5%), and Luxembourg (6–12%) (Deloitte, 2015). In Latvia, a diversion of CIT to the municipal budgets has existed twice – in 1922–1940, when the commercial and industrial tax had been divided equally between the state and local government budgets, and in 1941–1943, when the municipal budgets used to receive a share of the profit tax (Zvejnieks, 1998). As well, in Latvia since 1994, there are no corporate income tax deductions to the municipalities existing, for example, in Denmark, Finland, Poland, and Slovakia.

Many countries have determined specific municipal rates of the personal income tax, for instance, Denmark (average 25.6%), Finland (16.5–22.5%), and Sweden (29–34%). In the EU countries, the practice regarding deduction of part of the personal income tax to the local governments differs significantly. In turn, in Latvia since 2012, it constitutes 80% of the total personal income tax and; in comparison with other EU countries, it is sufficiently large share.

Yet in other countries, there is a practice to deduct to the local government budgets a part of the value added tax revenues as well, for instance, in Germany, Italy, Portugal, Spain, and the Czech Republic.

Thus, the most common tax deductions to the local governments are personal income tax, corporate income tax, value added tax, motor vehicle tax, and property transaction payments.

### Table 1

<table>
<thead>
<tr>
<th>Country</th>
<th>Local discretion</th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Tax / tax base</td>
<td>Rates</td>
<td>Exemptions</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Estonia</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Latvia</td>
<td>No</td>
<td>No</td>
<td>Yes (certain abatements)</td>
</tr>
<tr>
<td>Lithuania</td>
<td>No</td>
<td>Yes (only Immovable Property tax)</td>
<td>Yes</td>
</tr>
<tr>
<td>Poland</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Slovenia</td>
<td>No</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: formed by the authors using X. Q. Zhang (2013).
Problems of financial Provision at the Latvian municipalities in the tax policy context

In Latvia, the local governments receive transfers of two taxes – 80% of the personal income tax and 100% of the real estate tax; though the municipalities have the right to determine tax exemptions only to the real estate tax in order to foster business development on its territory. Furthermore, the local government budgets receive full amount of the lotteries and gambling tax revenues from the local lotteries, natural resources tax on the use of radioactive substances and natural resources tax on the incineration of hazardous waste, and on the use of the earth entrails pumping natural gas into the geological structures. Similarly, the local government budgets receive revenues from the lottery and gambling tax on the gambling games (25%) and from the natural resource tax payments on the extraction of the natural resources or the environmental pollution (60%).

To assess the significance of the above-mentioned tax revenues in constituting the local government budget, the authors demonstrate the growth dynamics of the municipal tax revenues in Latvia (Table 2).

Reviewing the municipal tax revenue growth dynamics (Table 2), it can be concluded that the major share of the tax revenues transferred to the total municipal budgets consists of the personal income tax that has increased by 25.06% points in the studied period and has comprised about 85% of the total amount of tax revenues transferred to the municipal budgets in 2013. In 2010, compared with the previous year, share of the personal income tax being transferred to the municipal budget was reduced by three percentage points – from 83 to 80%; although the personal income tax rate on wages increased from 23 to 26%, income tax rate on the economic activities and royalties – from 15 to 26% (the tax rate was reduced by 25% in 2011); and individual incomes from the capital are taxable by the personal income tax since 2010.

From the economic point of view, total personal income tax revenues is mainly affected by the number of employed in the economy, wages and salaries, amount of the non-taxable minimum of the personal income tax, minimum wage, as well as tax exemptions. From January 1, 2015, the minimum monthly salary is set EUR 360, which is about EUR 40 more than in 2014; in comparison it was EUR 284.57 in 2013; as well from January 1, 2014, the non-taxable minimum of the personal income tax was increased from EUR 64.03 to EUR 75 per month, and tax exemptions

<table>
<thead>
<tr>
<th>Year</th>
<th>Personal income tax</th>
<th>Immovable property tax</th>
<th>Lottery and gambling tax</th>
<th>Natural resources tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>853.15</td>
<td>103.93</td>
<td>7.07</td>
<td>3.41</td>
</tr>
<tr>
<td>2010</td>
<td>904.24</td>
<td>127.60</td>
<td>5.2</td>
<td>4.82</td>
</tr>
<tr>
<td>2011</td>
<td>924.01</td>
<td>156.79</td>
<td>5.4</td>
<td>6.72</td>
</tr>
<tr>
<td>2012</td>
<td>992.03</td>
<td>167.05</td>
<td>6.5</td>
<td>9.53</td>
</tr>
<tr>
<td>2013</td>
<td>1067.01</td>
<td>172.74</td>
<td>6.7</td>
<td>9.82</td>
</tr>
</tbody>
</table>

Source: formed by the authors using Treasury Republic of Latvia (2013).
Anita PUZULE, Erika ZUBULE

for the dependents – from EUR 113.83 to EUR 165 per month. Consequently, it can be concluded that these changes in legislation will significantly affect the local government budget revenues generating impact on the total amount of the personal income tax.

The part of the personal income tax revenue being transferred to the municipal budget is an essential part of the annual negotiations between Latvian Association of Local Authorities and the Ministry of Finances. For many years, Latvian Association of Local Authorities has been able to ensure that the redistribution of the tax is performed in favour of the local governments. In 2004, the personal income tax revenue distribution between the state budget and local budgets was respectively 28.4 % and 71.6 %; in 2005, it was 27 % and 73 %; in 2006 – 25 % and 75 %; in 2007, the share of the municipalities increased to 79 %; in 2008 it was 80 %, in 2009 – 83 %, in 2010 – 80 %, in 2011 – 82 %, but since 2012, the municipalities receive 80 % of personal income tax revenues (LALRG, 2013).

However, the authors’ opinion is that personal income tax increase in the municipal budgets differs a lot, as it is influenced by the level of economic activities both in the territory of the municipality, and in the region. As in accordance with the law “On the Personal Income Tax” the deductions of this tax are transferred to the budget of municipality, which is declared by the workers as their place of residence; consequently, a situation arises that the personal income tax payments are higher in the economically active regions as compared to the municipalities which are situated in less economically developed territories. Thus during the recent years, the problem arises that many people work outside the declared municipalities using the infrastructure services of other municipality. Therefore, to ensure that the municipalities could maintain infrastructure in good quality, some part (in average 1–2 %) of the personal incomes of the people employed in the municipal institutions and enterprises shall be transferred to the municipal budgets.

The real estate (immovable property) tax is paid on land, the buildings, and engineering structures located on the territory of the municipalities.

Evaluating a share of the real estate tax in the local government budget tax revenues in Latvia, it can be concluded that it was 10.7 % in 2009, in 2010 – 12.3 %, in 2011 – 14.4 %, in 2012 – 14.2 %, and in 2013 – 13.8 %, and it has a tendency to decrease. However, the real estate tax revenue has increased each year; within the period under review, it has increased by 66.2 % points. From 2010, residential house are taxable as well, that affected the quick rise of the tax revenue. It shall be noted that from 2008 to 2011 (inclusive), the ceiling for the increase of the real estate tax payment for the land was set (25 % from the previous year, if there is no change of land use purpose), but since 2012 the decision on whether to use the ceiling of increase or not is up to each municipality.

From 2013, the municipalities have the right to issue binding rules determining the real estate tax rate from 0.2 to 3 % of the cadastral value of the real estate, while Law on Immovable Property Tax provides that the tax rate may exceed the 1.5 % threshold only in the cases if the real estate is not managed in accordance with the legal regulations (Saeima, 1997).

If the municipality does not issue the binding rules determining specific tax rates, then in accordance with the Law On Immovable Property Tax, the following tax rates shall be applied:
• on land, buildings or parts of the buildings, excluding residential buildings and civil engineering constructions – 1.5% of the cadastral value;
• on residential houses (their parts), non-residential parts of buildings that have a functional use associated with living (garages, car parks, basements, storage areas, and utility rooms), if they are not used for economic activities – 0.2–0.6% from the cadastral value;
• additional rate of 1.5% on unprocessed agricultural land, except the land with an area less than one hectare, or the land having limitations of agricultural activity set by the legal regulations. This additional rate is applied even if the municipality has defined a special real estate tax rate on the unprocessed agricultural land in their binding regulations;
• 3% of building land cadastral values on the constructions degrading the environment, collapsed or threatening human security, if the municipalities have adopted the binding rules (Saeima, 1997).

Municipalities with their binding regulations may impose the tax exemptions envisaged by the Law on Immovable Property Tax:
• 50% tax reduction for the politically repressed persons on the land and individual residential buildings or apartment property (without land) that are in ownership or possession of these persons at least 5 years, and that is not being used for economic activities;
• on the residential houses (their parts), parts of non-residential buildings that have a functional use associated with living, other groups of buildings that have a
• tax exemption (25%, 50%, 75% or 90% of the calculated tax) to the certain groups of taxpayers determined by the municipality;
• tax exemption for the companies of the special economic zones and free ports according to the Law “On Tax Application in Free Ports and Special Economic Zones”;
• tax exemption for large families 50% on the residential house or apartment, and the land, if the family with at least three children are declared at the property. Tax exemption for large families may not exceed EUR 427 per year (Saeima, 1997).

Real estate tax, even though it is fully included in the municipal budget, is the state tax in Latvia as well. This is the only tax that is administered by the municipality itself. It should be noted that the municipalities have the right to grant exemptions on the property, which the municipalities may use to promote the business in their territory. So, this is the only tax the local governments may influence, but only by reducing the rate, without the right to increase it.

Municipality basic budget receives the payments of the taxes on goods and services – lotteries and gambling tax. Lotteries
and gambling tax revenue amount in the municipal budgets is relatively small; in 2010, it was only 0.49 % of the total local government budget tax revenues, in other years it has been 0.56 % in average. In addition, the lottery and gambling tax revenue is more typical for the large city municipalities, and there are a number of local municipalities that do not have this tax revenue at all.

Another local government budgets payments are received from the contributions of the natural resources tax, the amount of its revenue in the local government budgets is relatively small. Until 2010, the natural resource tax was transferred only to the special municipal budget, but since 2010 the municipalities, which have refused of the special budget, receive it in the basic budget; while the rest of the municipalities, as it has been before, receives it in the special budget. Analysing the amount of the natural resource tax transferred to the special municipal budget it can be concluded that its volume has increased 2.88 times in the period from 2009 to 2013, as the tax rate was increased; its share in 2013 was 0.78 % of the total municipal budget tax revenues.

From the analysis carried out it can be concluded that most of the personal income tax is transferred to the municipal budgets, the remaining part stays in the state budget. The data reflected in Table 3 demonstrates the total personal income tax distribution among the budgets, which in absolute numbers represents a steady increase of the personal income tax share in the local government budgets, and the amount of the corporate income tax revenue in the state budget.

However the authors’ opinion is that the increase of the personal income tax revenues cannot be considered exclusively as an improvement of the situation in area of the municipal financial resources, because the factors increasing municipal expenditures have to be taken into account as well, as the most significant of them – the inflation – shall be mentioned. Moreover, it shall be pointed out that, in order to maintain interest of the municipalities to develop business on its territory, it would be appropriate to link the municipal budget with a tax, which would be directly linked to the economic activity. In the authors’ view, the corporate income tax could be the one of the taxes used to distribute part of its revenues to the local government budgets, as the corporate income tax revenue is included in the calculations of the financial equalization in the municipalities.

As demonstrated in Table 3, the corporate income tax revenues tend to increase starting from 2011. The ratio between

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<th>Table 3</th>
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**Personal and corporate income tax revenues for the period of 2009–2013, million EUR**

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal income tax, total</td>
<td>1030.3</td>
<td>1125.6</td>
<td>1127.2</td>
<td>1240.2</td>
<td>1332.9</td>
</tr>
<tr>
<td>of which in the state budget</td>
<td>177.1</td>
<td>221.4</td>
<td>203.2</td>
<td>248.2</td>
<td>265.9</td>
</tr>
<tr>
<td>of which in the local government budget</td>
<td>853.2</td>
<td>904.2</td>
<td>924.0</td>
<td>992.0</td>
<td>1067.0</td>
</tr>
<tr>
<td>Corporate income tax in the state budget</td>
<td>280.6</td>
<td>159.6</td>
<td>279.0</td>
<td>346.9</td>
<td>362.5</td>
</tr>
</tbody>
</table>

Source: formed by the authors using Treasury Republic of Latvia (2013).
the share of the personal income tax to be transferred to the state budget and the corporate tax revenues remains stable starting from 2011, no drastic changes are observed. As the ratio is at the level of 0.63 to 0.73, it can be concluded that both the personal income tax revenues and the corporate income tax revenues are equally important. Altering the corporate tax redistribution ratio in favour of the municipal budgets, it is necessary to adjust the personal income tax distribution ratio in favour of the state budget.

As previously concluded by the authors, as there are countries where part of the corporate income tax is transferred to the municipal budgets, this good practice example could be applied in Latvia as well. In Latvia, this issue is studied by B. Pule and I. Leibus (2014) proposing options for the income tax redistribution between the state and local budgets. One of the risks related to the redistribution of the income tax revenues to the local budgets is that it may cause the decrease of the state budget revenues. To increase the local budget revenues, the redistribution shall not have an adverse effect on the part of the state budget revenue.

As it is recognized by M. P. Santiago (2007), there is no single model for the tax redistribution between the state and local budgets in the world. Each country shall have different redistribution, rates, exemptions, and other aspects. Each territory has to find its own best solution for the regional provision with sufficient financial resources.

The authors recommend the Ministry of Finance of Latvia to develop a methodology for reallocation of the corporate income tax revenue between the state and local budgets on the basis of the location of company’s economic activities.

Conclusions

The revenue structure of the municipal basic budget does not indicate the sufficient independence of the financial resources available for the local governments, since more than a third of the total revenues yet is comprised by the payments received. If the state suspends transfer payments, the local government revenues would abruptly decrease, as currently the municipalities have limited possibilities to raise additional funds.

In Latvia, the municipal budget received 19.3 % of the total tax revenues in 2012, thus presenting the eighth best result among the EU–28 countries (Eurostat, 2014). The main taxes constituting more than a half of the municipal budget revenues are a share of the personal income tax and the real estate tax. As well, the local government budget tax revenues are constituted by the deductions from the lottery and gambling tax, and the environment tax. However, it shall be pointed out that all of those are the state taxes, hence it signifies that legally in Latvia no municipal taxes exist.

As regards the property taxes, the tax revenue distribution proportions between the state and municipal budgets and the rights provided to the local authorities to determine the taxable base, rates, and exemptions differ in the EU countries. 100 % of the property taxes are transferred to the municipal budgets in Bulgaria, Estonia, Latvia, Lithuania, Poland, and Slovenia. The local governments in Estonia, Lithuania, and Poland have the most rights to influence the amount of property tax. It shall be noted that none of these countries provide the right to determine the taxable item. In Latvia, the local governments may only determine tax exemptions
in accordance with the amounts stipulated by the law.

Some countries have established municipal rates for the personal income tax and the corporate income tax; in other countries, a proportion deductible to the municipalities is defined, still it differs significantly. In comparison, since 2012, the share of deductions of the personal income tax to the municipal budget is 80 %, which is big enough in comparison with other EU countries. 100 % of the corporate income tax is transferred to the national budget.

The largest share of the tax revenues transferred to the total municipal budget is comprised of the personal income tax (85 % in 2013), the real estate tax (14 % in 2013), while other taxes constitute around 1 %. The personal income tax deductions are transferred to the budget of municipality, which is declared by the workers as their place of residence; consequently, a situation arises that the personal income tax payments are higher in the economically active regions as compared to the municipalities which are situated in less economically developed territories. Thus the problem is identified that many people work outside the declared municipalities using the infrastructure services of other municipality. Therefore, to ensure that the municipalities could maintain infrastructure in good quality, some part (in average 1–2 %) of the personal incomes of the people employed in the municipal institutions and enterprises shall be transferred to the municipal budgets.

From 2013, the municipalities have the rights to issue binding regulations determining the immovable property tax rate in amount of 0.2 to 3 % of the cadastral value of the real estate; however, at the same time, the Law on Immovable Property Tax determines that the tax rate may exceed the 1.5 % only in the cases, if the real estate is not managed in compliance with the procedures prescribed in the legal enactments. Likewise, the exemptions may be determined in accordance with the amounts stipulated by the legal regulations. This is the only tax administered by the municipalities; the right to influence tax rates are set forth in the national legislation. The possibility shall be considered to pass on this tax completely to the municipalities transforming it into the local tax that will provide the municipalities with possibility to regulate tax rates and to plan budget revenues.

In order to maintain interest of the municipalities to develop business on their territory, it would be appropriate to link the municipal budget with a tax, which would be directly linked to the economic activity. In the authors’ view, the corporate income tax could be the one of the taxes to be used to distribute part of its revenues to the local government budgets, as the corporate income tax revenue is included in the calculations of the financial equalization in the municipalities. The Ministry of Finance of Latvia shall develop a methodology for reallocation of the corporate income tax revenue between the state and local budgets on the basis of the location of company’s economic activities.


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Susijęs su ekonominė veikla. Autorių nuomone, įmonių pelno mokestis gali būti vienas iš tų mokesčių, kurio surenkama dalis būtų skirta į savivaldybių biudžetus, nes pelno mokesčio pajamos yra įtraukiamos į savivaldybių finansavimo išlyginimo skaičiavimus. Latvijos Finansų ministerija turėtų parengti pelno mokesčio pajamų perskirstymo tarp valstybės ir savivaldybių biudžetų metodiką, atsižvelgiant į tai, kurioje savivaldybėje įmonė vykdo savo ūkinę veiklą.