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REFORM OF TAXATION SYSTEM (2)

Center for Liberal-Democratic Studies

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Introduction

This Study is a continuation of the research of the revenue side of the Serbian fiscal system which was undertaken last year and the product of which was the study, *Tax System Reform* published by CLDS (2003). That Study addressed the principal issues of tax reform, such as changes in the profit tax, excise tax, contributions for social insurance, property tax, a part of personal income tax, funding of local communities, and tax debts. The proposals of reforms mentioned in the Study were well received both in the Ministry of Finance and by experts. The result was that the proposals of amendments and supplements to these laws, as prepared by CLDS, were forwarded by the Government of the Republic of Serbia at the time, to the Parliament for its approval.

The Study includes assessments and proposals for the reform of parts of tax laws that as yet have not been changed or have only been partly reformed (property tax, personal income tax, and agricultural tax), but also of the charges for the use of natural and public resources and local utility fees which constitute widely neglected and almost unknown areas of the public revenue system. A more thorough analysis revealed some very serious inadequacies in the above – mentioned forms of revenues, as well as the need for radical reforms. These two areas are fraught with bad solutions and represent the unfair, inconsistent, unstimulating, and non-transparent part of the public revenues system.

The Study highlighted the proposals for further reforms, which is only natural since it was made in the light of the requirements of the Ministry of Finance and Economy.

Authors of individual headings are: Heading I – Boris Begović; Heading II – Dejan Popović; Heading III – Boško Mijatović; Heading IV – Milica Bisić, Gordana Ilić-Popov, and Boško Mijatović; and Heading V – Milica Bisić.

We would like to express our gratitude to the Permanent Conference of Cities and Municipalities for their kind cooperation in conducting the survey on the revenues of local government units.

We would also like to thank the participants in the conference on taxation reform held on 12th September 2004 under the auspices of the CLDS for their helpful suggestions that have improved this study.

June 28th 2004

Boško Mijatović

I Property Tax Reform

INTRODUCTION

The concept of Property Tax Reform is defined in the previous study (*Reform of Taxation System,* CLDS, 2003) and relies on the following elements:

- Reform of the method for periodic property tax base determination, where a property value assessment for determining absolute rights transfer tax liability is used as a best approximation of the property value, which constitutes the tax base.
- Introduction of a single tax rate for periodic property tax, regardless of the property value or level of tax base.
- Introduction of decentralized decision-making with regard to tax rate level, by allowing local authorities to choose the level of the tax rate applied within their jurisdiction, while leaving definition of the range within which the tax rate may vary to the Law. Local authorities should independently determine the effective tax rate as well, which implies that they should be mandated to allow tax credits, within the range defined by Law.
- Revenues from charged and collected periodic property tax are autonomous revenues of local authorities, which is the case in the present Law as well.
- Examining the possibility of abolishing the fee for using construction land and incorporating it in the periodic property tax.

These elements of property tax reform call for the following steps to be taken in course of the reform implementation:

- Implementation of the new model for tax base evaluation, based on assessed property market value for determining absolute rights transfer tax liability.
- Defining the revenue neutral tax rate and analyzing the impact of its application to the new tax base.
- Defining the revenue neutral tax rate for the integrated fee for use of construction land.
- Defining a range within which local authorities may determine periodic property tax rates.
- Identifying the possibility to decrease the absolute rights transfer tax rate.

THE NEW MODEL OF TAX BASE EVALUATION

Basic Features of the Model

The new tax base evaluation model rests on the inference that real estate value is far better assessed (closer to the market value) for purposes of absolute rights transfer tax determination (dynamic tax), than in case of periodic property tax determination (static tax). In other words, analysis has shown that real estate values assessed for the purpose of dynamic tax are very close to the actual market values of the real estate, thus pointing to the dynamic tax base as the best approximation of the actual market real estate value. This inference represents a fundamental assumption of the developed model which uses information on the real estate values, assessed for purposes of dynamic tax, as a base for determining assessment of the market value of all real estate, including those that have not been traded, but are subject to property tax.

The model of tax base evaluation for property tax purposes was derived from application of the NCSS statistical software, which specified and assessed a non-linear regression model, all that based on information on value (assessed dynamic tax base) of 809 real estate items traded (sold) in 2003.

The parameters resulting from the model are applied to a sample of 40,394 real estate items in a statistical data base (periodic property tax collection data base), including those real estate items which have not been traded, but which are subject to periodic property tax. This value assessment method was used for every real estate item in the sample. In order to get effective revenue neutral tax rates (meaning those tax rates whose application to the new tax base specified by this model would result in the same level of tax revenues as is the case presently), the existing tax burden for every particular real estate item in the sample was divided by the appropriate assessed market value. In addition, real estate items in the sample were classified depending on their purpose and municipality, in order to calculate average revenue neutral tax rates for all these categories. In this way it is possible to compare the present tax burden with that which would come after implementation of the real estate value assessment method, or the method for determining the base for property tax. Furthermore, this procedure enables further widening of the analysis to allow examination of the effects of possible inclusion of the fee for use of construction land into property tax.

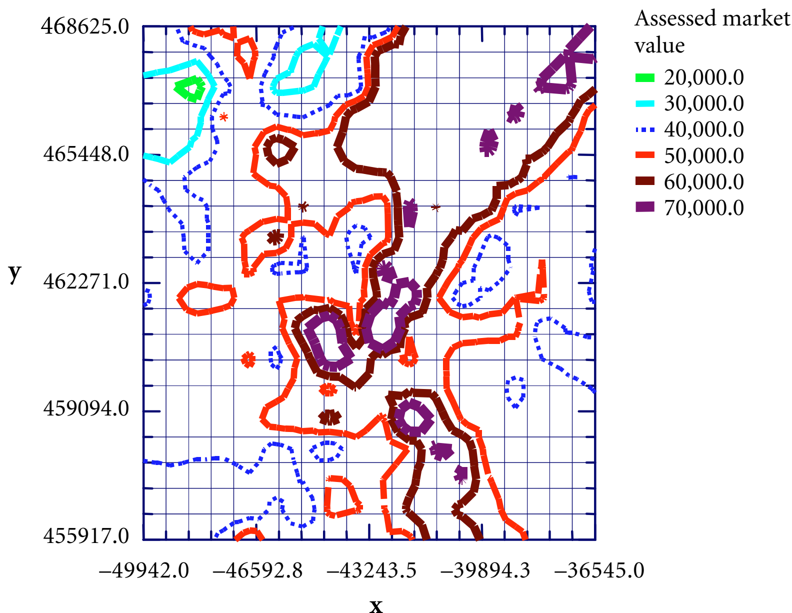
The Results of the Model

The statistical (stochastic) model used for the analysis utilized data on the value of 809 real estate items traded in 2003, in Belgrade, Niš and Novi Sad. Initial analysis was based on about 1,700 items of real estate, but this number was reduced to 809, due to an insufficient

quality of data. All identified real estate items in the case of property sales tax were juxtaposed to all real estate items in the case of property tax on these addresses. In that way, 809 real estate items in dynamics were successfully matched up with around 40,000 real estate items in the property tax base, which resulted in significant enlargement of the sample used for the analysis.

Utilizing the actual geographical coordinates of the real estate item (position in real space), the new model was defined to attach value (based on dynamics) per square meter to the actual geographical location of the real estate. This means that the model emphasized the location of the real estate as the basic variable influencing its value per unit of usable surface area. Based on the data on price and geographical location, the NCSS software drew isovalue lines (the lines showing equal value of real estate items). Based on these lines the so-called high value real estate location centers were determined for the cities of Belgrade, Niš and Novi Sad, as well as the distance of every item of real estate from these high value location centers.[1] Thus calculated, the distance became a new independent variable, used in the model for explaining changes in the value of a real estate item. The map of isovalue lines for the city of Belgrade is presented in the following image:

Image 1
Isovalue lines



1 High value center is the spot in real space around which there is no spot with a higher value of real estate per unit of usable area.

Besides the distance from a high value center, the stochastic model used another independent variable – an indicator of a zone determined in the course of the property tax assessment by the Tax Administration. These zones are identical to the zones used in defining the fee for using construction land. This variable is very significant, since it incorporates the experience and knowledge of people working on real estate value assessment in the Tax Administration. The following independent variables (all that were available) have been used as well:

- m^2 (usable surface);
- Zone, determined by the Tax Administration;
- Location of the particular real estate (coordinates: X and Y);
- The year of reconstruction;
- Purpose (apartment, business premises, house).

The following stochastic model has been assessed:

Assessed market value = distance from the high value center^(B1) * zone^(B2) *purpose^(B3) * adapted value^(B4) * the year of reconstruction^(B5) * ((B6) * size/area)

Adapted value is a variable derived from the usable surface variable, introduced for econometric purposes, in order to solve certain econometric problems which arose in the course of parameter assessment in the model.

Econometric assessment of the model resulted in the following parameter assessment:

Assessed market value = distance from the high value center^(0.479) * zone^(0.586) *purpose^(0.847) * adapted value^(-1.054) * the year of reconstruction^(-0.134) * ((61449.32) *size/area)

All these parameter assessments are statistically significantly different from zero ($p < 0.05$).

The coefficient of determination amounts to 0.94, which may be considered exceptionally good, although experience shows that this indicator is less reliable in case of non-linear regression models than in the case of linear ones.

The next important measure for assessing adequacy of this model is the price differential. It represents the measure of tendency in the model to systematically overestimate real estate items with a lower price and underestimate real estate items with a higher price. In this case it amounts to 1.015 (when price differential equals 1, it shows that there is no bias, neither overestimation nor underestimation), which is acceptable in conformity with international experience and standards.

Thus derived parameters were applied to all 40,000 real estate items in our sample in property tax and compared with real estate value currently used for determination of the property tax base in conformity

with existing by-laws. The following table shows basic descriptive statistics of the value of the tax base resulting from the model (assessed market value) in comparison with the presently applied property tax base and categorized in three different types of real estate.

Table 1.

Purpose	**Assessed market value (din/m²)**		**Assessed value for taxation (din/m²)**	
	Mean	**Median**	**Mean**	**Median**
Apartment	58,382	58,789	15,714	14,734
House	29,876	30,265	10,468	9,747
Business premises	69,227	65,342	37,674	40,156
Total	57,907		17,021	

Assessed market value for apartments is on average 3.7 times higher than the one used by the Tax Administration as a property tax base. Considering that data was available for only 14 houses in our sample, statistics for this category of purpose tend to be unreliable, nevertheless assessed market value is 2.9 times higher than the tax base which is presently used. Finally, in case of business premises, the difference is lower, considering that the market value for this type of real estate is approximately 1.8 times higher than the value used by the Tax Administration as a property tax base. This stark difference between apartments and business premises may be explained by the fact that in case of business premises, the value presently used as a tax base is a bookkeeping value of real estate, which is less underestimated than current assessed value of residential real estate for taxation.

Given that our sample encompasses data collected only in three cities in Serbia, specifically the three largest cities, the question arises whether this sample is representative, or whether the resulting parameter assessments are biased. Considering the size of the sample, there is no problem, however the problem arises in view of the fact that only the three largest cities are taken into account. Therefore, we should answer the question whether it can be assumed that the relation between market real estate value at the moment of trade (dynamic tax base) and property tax base changes with the size of the city? There is one argument in favor of the assumption that modification of the size of the city influences the change in the mentioned relation. Namely, current procedure for determining the value of the property tax base is based, among other things, on statistical data on building costs (very often without costs of primary and secondary land servicing), taken as an approximation of the real estate value. Taking into account that the value of land is higher in larger cities, there can be expected that in

smaller cities the difference between market value of real estate (which encompasses also the value of the land) and construction cost of a building (which does not encompass the value of the land), as a property tax base, is smaller.

With the data available at this moment, it is not feasible to empirically verify the presented statement, nor to assess the degree of sampling bias in relation to the population. However, it can be suspected from the above presented reasons that the revenue neutral tax rate is underestimated, which means that the actual value of revenue neutral tax rate is higher than the one derived from the model. The most significant consequence of possible bias in case of revenue neutral tax rate assessment is the one relating to the problem of defining future tax rates and their range.

Modification of the tax base value assessment method – analysis of the effects

As was mentioned before, effective revenue neutral tax rates for all real estate in the sample are calculated by dividing the amount of the tax by the assessed market value. The total average revenue neutral tax rate of the periodic property tax for our sample is 0.12%, which means that application of this rate to the tax base defined on the basis of the market value of the real estate results in tax revenue which is equal to that presently realized.

The assessed revenue neutral tax burden after tax reform is calculated by multiplying every individual assessed market price of the real estate item by 1.12%. The tables that follow show average revenue neutral tax rates, as well as the forecasted effects of the tax reform in different municipalities and for different types of purpose. The same tendencies which have been mentioned earlier may be seen here too: in some municipalities and for some types of purpose, there will be a significant change in the tax burden.

As can be seen from the table 2, the highest rise in tax may be expected in municipalities which have been previously identified as underestimating the value of real estate the most, for example Stari Grad, Zemun and Novi Sad. In any case, it can be noticed that there is a relatively significant deviation (in the range 0.09% – 0.14%) in the effective revenue neutral rate of property tax between certain municipalities. However, in comparison to some other neighboring countries, the situation is not that heterogeneous (for example, in Croatia effective revenue neutral rates are up to 10 times higher in some in comparison to other municipalities). Nevertheless, it should be born in mind that our sample contains the largest municipalities in Serbia, so it can be assumed that the heterogeneity is higher than can be seen from this sample.

The table shows that there is a significant difference in the revenue neutral rate of the property tax depending on the purpose of the

Table 2.

Municipality	Number of properties	Revenue Neutral Tax Rate	Tax per Real Estate Item (din)	The New Tax per Real Estate Item (din)	Change in Percentage points	Change in Absolute Terms (din)
Čukarica	5,041	0.0014	3,577	3,473	–2.9%	–105
Novi Beograd	9,714	0.0012	4,275	4,555	6.6%	280
Savski venac	2,309	0.0011	3,768	4,248	12.7%	480
Stari grad	2,733	0.0009	3,452	5,247	52.0%	1,795
Vračar	2,293	0.0014	4,298	4,402	2.4%	104
Zemun	3,070	0.0011	3,264	3,782	15.9%	518
Zvezdara	2,526	0.0013	3,063	3,150	2.8%	87
Niš	4,861	0.0014	2,457	2,388	–2.8%	–70
Novi Sad	5,702	0.0008	2,639	4,364	65.4%	1725

Table 3.

Purpose	Number of properties	Revenue Neutral Tax Rate	Present Tax (din)	The New Tax (din)	Change in Percentage Points	Change in Absolute Terms (din)
Apartment	35,704	0.0011	3,458	3,959	14.5%	500
House	1,737	0.0015	3,099	2,739	–11.6%	–360
Business premises	808	0.0022	4,252	2,649	–37.7%	–1,603

building or real estate. Average rate which is paid on business premises is two times higher than the one applicable in calculation of the tax on apartments. As mentioned before, unification of the rate for residential and business premises would lead to a relatively significant rise in tax on residential buildings and to a significant decline in the tax burden for legal entities.

Integration of fee for use of the construction land into property tax – analysis of the effects

In order to examine integration of the fee for use of construction land into property tax, in the course if the analysis of the tax reform effects, it was necessary to estimate the determined fee for each municipality and for real estate items covered by the sample. Considering the fact that it was not feasible to obtain data on the fee for each individual

item of real estate, the percentage of the total charged fee pertaining to our sample has been determined, based on the ratio between total tax in our sample and total charged property tax.

Table 4.

Municipality	Total Property Tax in the Sample	Total Property tax in the Population	Sample/Whole Municipality
Čukarica	18,160,433	114,468,594	16%
Novi Beograd	41,938,931	207,986,841	20%
Savski venac	8,729,627	61,314,992	14%
Stari grad	9,440,127	117,539,761	8%
Vračar	9,874,785	83,313,450	12%
Zemun	10,057,109	83,592,442	12%
Zvezdara	7,770,609	74,507,782	10%
Niš	11,995,808	170,930,668	7%
Novi Sad	15,100,408	239,766,194	6%

Thus derived ratio was applied to the total charged fee in order to calculate total charged fee in our sample. The results are shown in the following table.

Table 5.

Municipality	Total Fee	Ratio for the Sample	Estimated Fee for the Sample	The Number of Real Estate Items in the Sample	Average Fee per Real Estate
Čukarica	118,249,661	16%	18,760,299	5,039	3,723
Novi Beograd	327,208,043	20%	65,978,961	9,714	6,792
Savski venac	198,541,843	14%	28,267,089	2,309	12,242
Stari grad	227,357,239	8%	18,260,045	2,733	6,681
Vračar	93,134,086	12%	11,038,783	2,293	4,814
Zemun	110,853,280	12%	13,336,893	3,070	4,344
Zvezdara	86,453,465	10%	9,016,455	2,526	3,569
Niš	89,201,290	7%	6,260,091	4,861	1,288
Novi Sad	692,236,304	6%	43,596,849	5,702	7,646

The last column shows the average rise of the periodic property tax in absolute terms with the addition of the fee. In almost every

municipality the charged average fee is higher than property tax. For that reason, the effects of the change in estimates of real estate prices will have far less impact than the effects of adding the fee, and this addition will only intensify the tendency of shifting from business premises towards apartments.

The next step is the analysis of the revenue neutral tax rate in case of integrating the fee into property taxes. By dividing the charged fee for our sample with the total value of property in the sample, we determine the effective fee rates for the use of the construction land:

214,515,465 / 128,157,477,486 = 0.0017

If we add 0.17% to the revenue neutral tax rate of 1.12%, the new, integral revenue neutral tax rate would amount to 0.29%. In other words, if the fee is abolished, a tax rate of 0.29% applied to the new tax base will result in the same amount of revenues as currently realized from tax and fees.

The effects of application of thus defined revenue neutral tax rate and comparison with the present situation are shown in the following table.

Table 6.

Municipality	Number	Revenue Neutral Tax Rate	Property Tax	New Property Tax (Including Fee)	Change Expressed in Percentage	Change Expressed in Absolute Terms
Čukarica	5,039	0.0029	3,577	8,392	135%	4,815
Novi Beograd	9,714	0.0029	4,275	11,009	158%	6,734
Savski venac	22,309	0.0029	3,768	10,266	172%	6,497
Stari grad	2,733	0.0029	3,4521	2,679	267%	9,227
Vračar	2,293	0.0029	4,2981	0,637	148%	6,340
Zemun	3,070	0.0029	3,264	9,139	180%	5,875
Zvezdara	2,523	0.0029	3,063	7,613	149%	4,550
Niš	4,861	0.0029	2,457	5,770	135%	3,313
Novi Sad	5,683	0.0029	2,639	10,547	300%	7,908
Total	38,225	0.0029	3,422	9,562	182%	6,140

The application effects of this tax rate to the real estate with different purposes (different categories of real estate) are shown in the following table.

Table 7.

Purpose	Effective Tax Rate	Average Property Tax, Present Situation (din)	New Average Property Tax With Fee (din)	Change Expressed in Percentage Points	Change Expressed in Absolute Terms (din)
Apartment	0.0029	3,458	9,812	184%	6,354
House	0.0029	3,100	6,790	119%	3,690
Business premises	0.0029	4,252	6,566	54%	2,314

Determining the range of the tax rate

The key problem arising in the course of calculating the range of the tax rate which has to be applied to the new tax base for determining periodical property tax is the nature of the fee for use of construction land. The problem lies in the dual character of that fee. On one hand, the fee has the character of a property tax, considering that its amount is proportional to the real estate value (this assertion is based on complicated and unreliable approximations), and that revenues collected on these grounds are used for financing supply of local public goods. On the other hand, however, the fee has the character of a rent which is charged, or should be charged, to users of construction land in state (previously social) ownership, while the effective title holders of the land are the local authorities.

The dual character of this fee leads to the conclusion that it should not be fully integrated into the periodic property tax and that this may be done only partially. Furthermore, it is hardly feasible to objectively divide the fee into the part which should be integrated into the tax and the part which should be collected independently, therefore it results from arbitrary estimation. Moreover, in order to maintain the compatibility of tax and fee, the fee should be charged and collected *ad valorem*, as a percentage of the real estate value, or in the same way periodical property tax is charged and collected.

It is very important to notice that the new fee for use of the construction land, defined in the above way, has the exclusive character of a rent ("cleansed" from all tax elements), so that it can be charged exclusively in cases of the state owned land. In case of privately owned land, it is either the case that its user pays rent to the private owner on a basis of a contract, or its owner benefits from the rent on the basis of land ownership.

Having all that in mind, it is necessary to define two types of rates: 1) a property tax rate which would enable the inclusion of tax related elements of the current fee for use of construction land into property tax

and 2) a fee rate for use of construction land which would serve exclusively as a rent for the use of state owned land.

The next relevant question is whether defining a tax rate range should include, besides maximum, also a minimum rate of tax and fee. An argument against determining a minimum tax or fee rate is the fact that all revenues represent, or should represent, original public revenues of local authorities, and they have a powerful incentive to increase their public revenues by increasing those rates. Therefore, there is no need to define minimum tax or fee rates.

Solving the mentioned conceptual dilemmas should facilitate defining the tax rate range. Also, the following facts should be born in mind:

- One of the goals of tax reform is raising fiscal revenues from periodic property tax.
- The revenue neutral tax rate without integrated fee for use of construction land amounts to 0.12%.
- The revenue neutral tax rate with fully integrated fee for use of construction land amounts to 0.29%.

Bearing all this in mind, the following range of tax and fee rates is suggested:

- The periodic property tax rate should not be higher than 0.5% of the real estate value.
- The fee rate for use of construction land should not be higher than 0.1% of the real estate value.

The fee for use of the construction land may be collected only in case of land in state (previously social) ownership, and the maximum tax burden for taxpayers residing on state owned land amounts to 0.6%, while the maximum burden of those occupying land in private ownership amounts to 0.5%.

Considering that tax credit influences the effective tax rate, besides defining tax rate determination, it is necessary to define the method for tax credit determination. There are two possible solutions to this problem. One is maintenance of the current solution, which stipulates direct definition of tax credits and their use by the Law. The other solution is to leave the issue of defining tax credits to the local authorities, since they are already granted the right to determine tax rates. In that case municipal by-laws would define criteria and the procedure for determining tax credit. The Law should only prescribe a ceiling for the tax credit amount which should be limited to 50%

Property tax and absolute rights transfer tax

Considering that absolute rights transfer tax rate is relatively high (5%), and that periodic property tax reform could significantly increase tax revenues, there is a window of opportunity to reduce absolute rights transfer tax rate. The calculation in the following table is conducted based on the tax collection structure in 2002:

Table 8.

In Thousands of Dinars	Revenue	Structure in %	Tax Rate	Tax Base	Number of Taxpayers
Property Taxes:	**12,519,335**	**100.0**			
Property Tax	3,757,052	30.0	0.12%	3,130,876,666	2,467,591
Inheritance and Gift Tax	219,572	1.8			36,120
Absolute Rights Transfer Tax	4,996,736	39.9	5%	99,934,720	249,262
Holding and Utilizing Goods Tax	3,545,975	28.3			574,257

Property tax base is calculated utilizing an estimated revenue neutral rate of 0.12%, and absolute rights transfer tax by using tax rate prescribed by Law, amounting to 5%.

The following table presents combinations of periodic property tax rate and property sales tax (absolute rights transfer tax) rate, which would result in collecting the same amount of combined tax revenues.

Table 9.

Property Tax Rate (%)	Real Estate Sales Tax Rate (%)	Tax Base (Property Tax) in Thousands of din.	Tax Base (Transfer/ Sales Tax) in Thousands of din.	Collected Property Tax in Thousands of din.	Collected Sales Tax in Thousands of din.	Total Collected in Thousands of din.
0.10%	5.63%	3,130,876,666	99,934,720	3,130,877	5,622,911	8,753,788
0.12%	5.00%	3,130,876,666	99,934,720	3,757,052	4,996,736	8,753,788
0.15%	4.06%	3,130,876,666	99,934,720	4,696,315	4,057,473	8,753,788
0.20%	2.49%	3,130,876,666	99,934,720	6,261,753	2,492,035	8,753,788
0.25%	0.93%	3,130,876,666	99,934,720	7,827,192	926,596	8,753,788
0.28%	0.00%	3,130,876,666	99,934,720	8,753,788	0	8,753,788
0.30%	–0.64%	3,130,876,666	99,934,720	9,392,630	–638,842	8,753,788

As can be seen from the table, if the goal is maintenance of the current level of combined tax revenues and property tax rate amounts to 0.28%, real estate sales tax need not be applied at all.

Plan of activities pertaining to implementation of the pilot projects

Taking into consideration the conceptual advantages of the suggested changes, amendments to the Law on Property Taxes may commence

immediately, notwithstanding the term for completion of computerized real estate value estimation model. Even if this model is not ready by the beginning of 2005, all new tax solutions may be applied to the old tax base, without causing a massive plunge of fiscal revenues.

Sequencing is however needed in case of amendments to the Law on Planning and Construction, since the collection method for the construction land fee should be transformed only after full implementation of the new real estate value estimation model. Maintaining the old method of collecting construction land fee would provide for the continuity of public revenues in case the new real estate value estimation model is not ready in time, that is if it does not keep up with the amendments to the Property Tax Law.

The first step in establishing a computerized mechanism of mass evaluation of the market real estate value is application of the model developed in this study, in the four cities in Serbia. That shall allow the creation of the necessary information base for defining optimal tax rate. In addition this will facilitate solving issues arising in the current model, predominantly pertaining to sample bias and bias of revenue neutral tax rate, in the course of the actual model implementation. Therefore, it is suggested that a smaller number of cities should be chosen to apply the computerized model of mass evaluation of market real estate value during 2004, in cooperation with the Ministry of Finance and the Tax Administration.

II Tax on Revenue from Self-employment

THE CONCEPT OF TAX ON REVENUE FROM SELF-EMPLOYMENT

The need to identify revenue as revenue from self-employment arises in the scheduler as well as in the global system of individual income tax. In schedular systems, distinguishing between revenue from employment, revenue from self-employment and revenue from investments, and thus identifying certain amount as revenue from one of these categories, means determining the tax regime for that particular amount. The global system is most often based on schedular infrastructure: it is either the case where tax law stipulates categories of revenues included in income (in which case, revenue from self-employment is one of these categories), or – as in totally "globalized" income tax systems like the American system, which does not stipulate categories of revenues included in income – special rules, primarily accounting ones, are applied to revenue identified as a revenue from self-employment.

In order to identify revenue as revenue from self-employment, it is necessary to define the concept of self-employment first. From a comparative perspective, the most frequently used term is "business". "Business" can be defined as self-employment in commercial or industrial activity aimed at attaining profit. In some countries, there is a difference between revenue from commercial trade activities (in French *bénéfices industriels et commerciaux*) and revenue from professional activity (in French *bénéfices des professions non commerciales*). This differentiation is derived from the Continental law system where a difference was made between the merchants and the members of free professions: merchants did business for profit, while the motive for members of free professions to supply their services was not profit but rather a "fee" (honoraria)[2]. Although it is still present in some areas of law (for example rules of ethics and professional associations), this kind of differentiation is trivial, because nowadays it is very difficult to imagine that a consultant, tax advisor or an attorney are not driven by the motive to maximize their profit. In the Common Law systems defini-

2 See: Lee Burns – Richard Krever, *Individual Income Tax* (in: *Tax Law Design and Drafting*, Vol. II, ed. by Victor Thuronyi, IMF, Washington, D.C. 1998), p. 525 and 525f.

tion of business revenue, as a rule, encompasses revenue from professional activity[3], and the same treatment is applied in the tax laws of some Continental law countries[4]. Therefore, if historic and other than tax related reasons for differentiation of the revenues from business and the revenues from professional activity are disregarded, there is no convincing tax policy rationale for justifying that differentiation. For tax administration purposes, application of integrated rules regulating both activities is a much simpler solution, and, in case of some specificities (for example, accounting treatment of work in progress), instead of introducing completely separate taxing regime, only separate accounting standards can be applied[5].

The Serbian Law on Individual Income Tax[6] (in further text: LIIT) defines revenue from self-employment as a "revenue stemming from a business, provision of professional and other intellectual services, as well as from other activities, unless tax is payable on such revenues on some other grounds pursuant to the present law"[7]. By stressing that revenue results from business activity, the legislator had in mind the income derived from a *registered* business activity, as defined in the Law on Entrepreneurs. However, the Law prescribes an exception: "revenue stemming from self-employment shall also be understood to mean revenue earned by using land, permanently or seasonally, for non-agricultural purposes (sand, gravel and stone extraction, production of lime, bricks, roofing-tiles, charcoal etc.), producing vine/fruit and other nursery stock and grafts, incubator-based production of poultry and pursuing other similar activities, regardless whether they are registered with the competent authorities as activities constituting self-employment "[8]. Since the activities in question are in the area between agriculture and forestry, almost none of the taxpayers–farmers are registered for conducting this kind of activity; they are rather subject to payment of tax on cadastral income from agriculture and forestry (if they are registered in the cadastral books as owners or holders of the right to use and enjoy the land */usus fructus/*), or on other business activities for which registration is mandatory. If the concept of taxing cadastral income from agriculture and forestry is abandoned, the permanent or seasonal utilization of land for purposes of extracting sand, gravel and stones, producing of lime, bricks, roofing-tiles, charcoal etc., as well as production of vine/fruit and other nursery stock and grafts, incubator-based production of poultry and the like, would

3 Compare for example § 18, sched. D, cases I and II of the British Income and Corporation Taxes Act-a (1988); § 995-1. Australian Income Tax Assessment Act-a (1997) a § 248 (1) Canadian Income Tax Act-a (1985).

4 Compare for example: § 40. Spanish Ley del impuesto sobre la renta de las personas físicas (1991) and § 6/2 Dutch Wet op de Inkomstenbelasting (1964).

5 See: Lee Burns – Richard Krever, op. cit., p. 525-526.

6 "Official Gazette of the RS", No. 24/2001 and 80/2002.

7 See: Article 31, paragraph 1, Law on Individual Income Tax (LIIT).

8 See: Article 31, paragraph 2, LIIT.

have to be classified among revenues from agriculture and forestry; or, alternatively, mandatory registration of these revenues would have to be established, so that only *registered* activities remain under the scope of revenues from self-employment.

Concluding this discussion about the concept of "revenue from self-employment", we could ask ourselves whether this very designation is theoretically and linguistically appropriate for this type of revenue. A literal translation of the term "self-employment" is not to be found in other languages, except in Croatian. Intending to depart from the legacy of "socialism and workers management", in the years of SFRY dissolution and formation of independent states (with their own tax systems), the Croatian legislators, similarly to their Serbian counterparts, decided to replace the term "personal income from self-reliant conducting of (business and professional) activity" – used in all republics of the former SFRY, by the term "revenue from self-employment". Slovenia has, however, chosen a more appropriate term – *dohodek iz dejavnosti,* which corresponds best to the English *business income*[9] in the comparative law perspective.

Emphasizing the 'self-reliant' aspect would be worthwhile only when referring to the services which can be "self-reliant" (such as legal, medical, auditing services etc.), as opposed to "non self-reliant" services (from an employment relationship). To reiterate – since it is not required for taxation purposes to differentiate between "self-reliant" (professional) services and "business" (industrial and commercial) activities, which *per definitionem* cannot be "non self-reliant", I believe that the term "revenues from business activities" is more appropriate for the revenues discussed in this paper, for that is probably the translation that most corresponds to the English expression.

RELATIONSHIP BETWEEN FINANCIAL REPORTING AND TAXING

From a comparative perspective, there are two approaches for determining taxable revenue from business activity (self-employment) for a given tax period: the first is based on a profit and loss account, and the second on a balance sheet.

Although prevailing in the common law systems, the approach based on profit and loss account is now accepted by some transition countries, including Serbia. According to this approach, taxable income would be equal to the difference between recognized revenues effected within a given tax period and allowable expenditure incurred by the taxpayer within a given tax period. In practice, this means that

9 Let us reiterate that in French there is still a difference between bénéfices industriels et commerciaux and bénéfices des professions non commerciales, predominantly motivated by reasons of tradition. Since tax treatment of both types of revenues are basically the same, it is reasonable to term them as "business revenues".

the first step involves development of profit and loss account for financial reporting purposes, and the second step involves adjustment of tax account by introducing corrections of revenues and expenditures to reflect the difference between taxing rules and financial (commercial) accounting rules.

The approach based on a balance sheet prevails in European Continental systems; according to this principle, taxable revenue is calculated by comparing the value of net assets in the taxpayers balance sheet at the end of the year that is increased by dividends distributed throughout the year, with the value of net assets in the taxpayers balance sheets at the end of preceding year. A positive difference represents taxable revenue from self-employment, while a negative difference represents a loss.

Since the balance sheet based approach also requires adjustments of individual accounting items in order to show differences between taxing rules and financial (commercial) accounting rules, both approaches could eventually lead to the same amount of taxable revenue from self-employment. Therefore, I believe that there is no need for Serbian Tax Law to change its course towards accepting the balance sheet approach to taxing revenues from self-employment; taxing based on profits and loss account has been used for fourteen years now and no serious problems in this context have been identified. This is even more true in view of the fact that, even in the countries that use the balance sheet approach for determining the tax base, smaller taxpayers do not have an obligation to produce balance sheets but may rather opt for the approach based on profits and loss account. Since these taxpayers in Serbia are allowed to keep single entry books[10], it is possible that general acceptance of the balance sheet approach would call for envisaging special treatment for these taxpayers, which would then make taxing system of revenues from self-employment much less transparent.

It may be easier to understand the relationship between determining the revenue from self-employment for financial reporting purposes and for taxation purposes, if we consider the purpose for choosing one or the other. The purpose of financial reporting is to provide reliable analysis of profitability of the accounting unit (company or a shop), to the owner/owners and management/supervisor, as well as creditors and potential external investors. On the other hand, the purpose of tax accounting is to determine the economic net gain of a taxpayer in the given tax period. This perspective also facilitates understanding the purpose of the differentiation, commonly encountered in financial reporting, between regular and extraordinary revenues (often capital gains): financial report receivers should keep in mind

10 Single-entry bookkeeping includes revenues and expenditures, fixed assets, tools and inventories with calculative write-offs, as well as other data, required by Law. See: Article 44 of the LIIT.

that extraordinary expenditures will not occur regularly in the following years. In the countries with a balance sheet based approach to tax base determination, tax related accounting does not have the need to replicate this differentiation, except in cases where capital gains are granted special treatment (as, for example, in Belgium, France and Greece). In countries where the tax base is determined based on a profit and loss account, the mentioned accounting differentiation may also serve a need for expressing capital gains for taxing purposes.

The rules of financial and tax related accounting also differ with respect to the treatment of revenues associated with some future obligation or revenues followed by delivery of goods and services in subsequent years. This differentiation is relevant regardless of the approach according to which the tax base is determined. For financial reporting purposes, the revenues that are followed by some future obligation are commonly presented in the annual report. However, in order to emphasize that this amount is not disposable for distribution and is intended for settlement of future obligations, it is expressed as a reserve in the annual report. The rules of tax related accounting do not normally permit any delay in recognizing revenues, but rather stipulate that they are to be included in the tax base immediately after they are realized by the taxpayer, while the associated obligation is recognized only after it is fulfilled. In case of the revenues that are followed by delivery of goods and services in some future period, financial reporting prescribes that they should not be entered as revenues in the current year, but expressed in the "account of advance revenues", entered on the liabilities side (with simultaneous increase of cash on the asset side). When goods and services are actually delivered/supplied, the liability decreases and that amount is transferred from the "account of advance revenues" into the profits and loss account. Although the same tax treatment and accounting rules may apply to advance revenues, in some instances it is necessary to include them in the income of the current year.

FISCAL SIGNIFICANCE OF THE TAX

Tax on revenue from self-employment does not have a very significant place in the structure of tax revenues and social contributions in Serbia. See table 1:

Tax on income from self-employment has maintained its share in total revenues from taxes and social contributions in 2002, as in the year 2000, while the significant decrease in 2003 can be explained by the decline of the tax rate from 20% to 14%, and widening of the scope of tax reliefs (predominantly investment tax credit, which is for small taxpayers increased by one third /from 30% to 40%/). If only *tax* revenues are examined, they declined in 2002 in comparison to their amount in 2000. This was a result of a considerable increase in the

Table 1. Fiscal Significance of the Tax on Revenue From Self-Employment

Year	Collected (Thousands of Dinars)	Share in Total Revenues:		
		Taxes and Social Contributions	Taxes	Individual Income Tax
2000	601,262	0.55%	0.96%	4.40%
2002	2,150,639	0.55%	0.77%	4.04%
2003	1,809,855	0.39%	0.56%	2.91%

Source: Payment and Accounts Office (PAO), B2 report for the year 2000 (re-classified in accordance with the GFS classification by Dejan Popović and Diana Dragutinović); PAO, T report for the year 2002; Directorate for Public Payments, T report for the year 2003.

share of taxes in total revenues from taxes and social contributions, especially the share of excise taxes and sales tax, due to a significant reduction in contributions.

However, if we analyze the share of tax on income from self-employment in individual income taxes, it is obvious that it decreased constantly – moderately in the period from 2000 to 2002 (due to the increased role of tax on salaries/wages) and exceedingly in 2003 (due to mentioned reduction of the tax rate and widening of the scope of tax reliefs).

LUMP-SUM TAXING

Out of 71,025[11] taxpayers that are liable to tax on revenue from self-employment, 60% pay taxes on revenue determined on a lump-sum basis. Since lump-sum taxing is believed to inadequately cover economic capacity of certain categories of taxpayers, it is often suggested that it should be allowed less frequently, or even completely abolished. However, I would not recommend that such conclusions be made too hastily.

The share of collected taxes from lump-sum revenues in the total sum of collected taxes on revenues from self-employment decreased from 44.5% (in 2002) to 42.1% in 2003. Under the assumption of unaltered number of taxpayers, this might mean either that: (1) average lump-sum revenue per taxpayer has decreased, or that (2) there was real appreciation of the tax base of those taxpayers who pay taxes on real income, or (3) that there was some combination of these two possibilities. The latter of the two typical examples of inconsistent implementation of legal norms concerning lump-sum taxing, which will be elaborated on in the following paragraphs, reveals reasons for a

11 Data for 2002.

decrease of average lump-sum revenue per taxpayer in some areas. Yet, it is hard to believe that there was a real tax base appreciation for the taxpayers paying taxes on real income in 2003, since in that same period the tax reliefs widened in scope (primarily investment tax credit) and the result was that the amount of taxes collected was reduced by 12.32% (in comparison with 2002). Therefore, I believe that the decline of the fiscal significance of lump-sum taxing in 2003 should be attributed to inadequate evaluation of the lump-sum revenues rather than to real appreciation of the tax base of the taxpayers who pay taxes on real income.

Let us examine the way in which the Tax Law regulates conditions for lump-sum taxing. Article 40, paragraph 1 of the Law on Individual Income Tax (LIIT) stipulates that if unable to keep books (other than those to effected sales) because of the circumstances in which he conducts his business activities, or where keeping such books would be an impediment to his conduct of business, a sole proprietor may apply to be allowed to pay lump-sum taxes. In the Article 40, paragraph 2 of the LIIT it is prescribed that the right to lump-sum taxation may not be granted to the sole proprietor:

- Who is a founder of a partnership;
- Who is engaged in wholesale and retail trading, with the exception of motor vehicle maintenance and repair, hotel and restaurant keeping, financial mediation and activities associated with real estate;
- Who received a part of investments from other persons;
- Whose total turnover in the year preceding the one for which tax is determined, or whose planned turnover at the start of the business exceeds 2,000,000 Dinars.

In the interpretation of the norm in Article 40 of the Law on Individual Income Tax, the tax Administration has shown two characteristic types of inconsistencies – both explicable only in the light of fear of the consequences which might result from strong opposition from the interested categories of taxpayers.

First, the Tax Administration sometimes takes no notice of the conditions stipulated in Article 40, paragraph 1 of the LIIT, but only of the proscriptions in paragraph 2 of that Article. It is only in this context that one can understand why lawyers are allowed to pay lump-sum taxes when it seems paradoxical that this category of taxpayers is rendered "unable to keep books" or that their "keeping…would impede the conduct of their business". The danger of exceeding the limit of 2,000 000 Dinars of total annual turnover (166,667 Dinars monthly, or 8,510 Dinars per working day) and thus loosing the opportunity to apply for lump-sum taxing is evaded by receiving cash for a part of services supplied in order to hide part of the turnover from being displayed in the bank account, in spite of the explicit stipulation in the Article 51, paragraph 1 of the LIIT.

The second type of inconsistent treatment is apparent from the determination of the lump-sum tax base for taxi drivers, since its amount is lower than it would be the case had it been determined pursuant to the criteria and elements for lump-sum taxing, regulated by the Decree based on Article 41, of the LIIT. It also happens that, when wishing to exercise a right for which they are eligible only if their total income is above some minimum amount, the taxi drivers are required to show a certificate verifying the amount of their revenue determined on a lump-sum basis. For these purposes they are issued such a certificate exceeding the amount in their tax bills – probably the amount which would be determined, if the criteria and elements for lump-sum taxing, stipulated in the Decree, were actually implemented.

However, if these unwarranted concessions to certain "problematic" categories of taxpayers were avoided, the lump-sum taxing could also serve to cover income of the smallest taxpayers of revenue from self-employment, with minimal administrative costs and compliance costs. Introduction of fiscal cash registers will further simplify implementation of the regulations on determining lump-sum tax base, since they provide the data based on which one could verify the truthfulness of the data presented in the books on the sales effected[12] by the lump-sum taxpayers.

In light of announced introduction of Value Added Tax (VAT in the further text), it is necessary to further examine the relationship between lump-sum taxing on revenue from self-employment and treatment of the "small taxpayer"[13] in VAT. In case of tax on revenue from self-employment, the limit of 2,000,000 Dinars of total annual turnover is only a necessary, but not a sufficient condition for lump-sum treatment to be allowed, since there are other conditions in the Article 40 of the LIIT to be fulfilled. In case of the VAT, annual limit of 2,000,000 Dinars is the only condition: every person (legal entity or sole proprietor) whose annual turnover does not exceed that limit is a "small taxpayer", without any additional conditionality, and persons whose total annual turnover is between 1,000,000 and 2,000,000 Dinars have an opportunity to opt for the status of a "regular" VAT taxpayer. I believe that amendments to the LIIT should prescribe that any sole proprietor, even though his annual turnover does not exceed 2,000,000 Dinars (but is higher than 1,000,000 Dinars), who opts for the status of the "regular" VAT[14] taxpayer, should loose the right to lump-sum taxing. Still unresolved issue is how to deal with a sole

12 It is the only business book that sole proprietors – taxpayers of the lump-sum tax must keep pursuant to the Article 43, paragraph 4 of the LIIT.

13 "Small taxpayer" does not have the right to express VAT in bills, nor the right on the deduction from previous tax, and is not under obligation to keep books prescribed by the Law.

14 Such a solution is already offered by CLDS in its version of the *Draft Law on Amendments of the LIIT*, from September 2003.

proprietor whose annual turnover does not exceed 1,000,000 Dinars – and thus in respect of VAT automatically falls within "small taxpayers" category – but does not meet other requirements for lump-sum taxing stipulated by Article 40 of the LIIT. Such a sole proprietor would pay taxes on income from self-employment based on effected revenue, and would keep business books as stipulated by Law on Accounting and LIIT.

DEFINING TAX BASE

Appropriating business related funds for private purposes

If tax on revenue from self-employment is paid on effected revenue, and the tax base is determined by applying the profit and loss account approach, there is an unresolved issue of revenue at the taxpayer's disposal. Unlike a natural person – a single owner of a company, who receives a dividend from the profit left after taxing (in further text: *net profit*), and pays individual income tax on 50% of this dividend (in the form of withholding tax on income from capital), the sole proprietor who receives net profit does not pay such taxes. However, since the obligation to pay tax on revenues from self-employment for that tax year is paid only after the end of that year[15], the question arises whether a sole proprietor may use the funds available in the business account for purposes other than those related to his business. Such funds are stored in the bank account, opened against a Tax Identification Number (TIN), of the sole proprietor, and not based on the Unique Citizens' Identification Number (UCIN) of a natural person.

It is advisable to consult comparative legal solutions when establishing the principles for tax treatment of business funds withdrawals. In this context, the most elaborate rules were developed in German Law. Namely, it differentiates between:

- merchants
  - associations of capital, associations of persons and sole proprietors entered in the commercial registry (*Vollkaufleute* in German) shall keep business books on a double-entry basis, as prescribed by the Merchants Law (*Handelsgesetzbuch* in German);

15 A taxpayer is under obligation to a file tax declaration as well as tax account, with calculated tax obligation for that tax year, until March 15th of the following year, and to pay the difference between calculated amount and the sum of monthly tax advances paid throughout the year. Following that, Tax Administration issues decision on determination of tax on revenues from self-employment, and a taxpayer shall pay any potential difference between determined amount and the amount presented in his tax account within 15 days from the receipt of the first-instance tax decision. See Article 93, paragraph 1 and Article 114 of the LIIT.

– smaller sole proprietors (*Minderkaufleute* in German) shall keep books on double-entry basis and file a tax account, as prescribed by the Law on Public Revenues (*Abgabenordnung*), since their turnover, business capital and profit exceeds the prescribed amount;

- other small taxpayers who realize revenues from business activity (in further text: *other small sole proprietors*) and do not have an obligation to keep business books on a double-entry basis (although they can opt to do so) – since their turnover, business capital and profit does not exceed the prescribed limit – are under the obligation to determine taxable revenue from self-employment through the books of revenues and expenses (single entry bookkeeping).

From the perspective of revenues from self-employment, as elaborated above, both categories of individual merchants and other small sole proprietors are significant, while from the perspective of examining relations between personal property and business related funds, only individual merchants are relevant, since other small sole proprietors keep only books on single entry basis.

Individual merchants differentiate between business assets and liabilities (business property) and personal assets and liabilities (personal property). Differentiation between essential business property, essential personal property and optional business property is relevant for taxation purposes.

The assets whose utilization is essentially limited to business purposes are designated as "essential business property" (factory facilities, production equipment, office supplies, stocks, business claims etc.). Even though denotation of an asset as "essential business property" does not necessarily mean that it is registered in the business books, essential business property must be recorded in business books. Transactions related to assets included in the essential business property are considered to be business transactions, and the expenditures incurred are considered to be business expenditures. Appropriating essential business property for personal utilization (*Entnahme* in German) is allowed, regardless whether in the form of cash, goods, services of employees or any other property element. It is also allowed to invest funds into essential business property (*Einlagen* in German).

The term "essential personal property" designates resources which are not commonly utilized for business purposes (apartment which is merchant's place of residence, jewelry, artistic objects etc.). Essential personal property may not be invested in business. Although a merchant may include his essential personal property into a balance sheet, these resources must be eliminated from the tax account, since they are not taken into account when taxable revenue from self-employment is being determined. Liabilities can have a personal nature too (for example the medical bills of the merchant, costs of car repair, if the car is exclusively in personal use etc.). Paying personal expenditures from

business assets constitutes an act of appropriating business property, not a business expenditure.

The term “optional business property” designates the resources of an individual merchant whose nature is such that they cannot be included either in “essential business property” or in “essential personal property”, but that, depending on the decision, may be appropriated in any of these two categories. This term includes: cash, non-bank securities, cars not designed strictly for business purposes etc. Allocation of these funds to business property may be conducted directly (by including securities in the business portfolio, for example) or indirectly (through establishing a pledge on securities from personal property for the purpose of securing business debt, for example). Although, in principle, classification of such resources as business property depends on its actual use, the fact that it is entered into business books is sufficient evidence that it is actually allocated in the said way.

Having in mind above mentioned differentiation between business property and personal property, appropriating business property for personal use (as well as deficit, waste, refuse, defect and breakage above the prescribed limit[16]) may be classified as *business revenue*, and investment into business property – as *business expenditure* (except investment in “long term property” /for example fixed assets/, for which depreciation has to be calculated). In other words, the taxpayer – sole proprietor would be required to increase his business revenues in the tax account for any appropriations from business property (for paying personal expenditures from business resources, for example), or to increase his business expenditures for any investments in the business property. Appropriations or investments which are not in the form of cash are evaluated in conformity with the comparable market value, in accordance with the *going concern principle*.

Here it must be pointed out that appropriation from business property of a company for personal use of a sole proprietor is treated as profit distribution, which means that this amount shall be taxed as a dividend and is not recognized in the course of profit determination.

Compensation of travel expenses

Article 18 of the LIIT stipulates that wage/salary tax is not payable on employees earnings based on:

- meal allowance on business trips in the country, against presented bills, not exceeding 600 Dinars per day;

16 Similarly to the case of sales tax, upper recognized amount for deficit might be a maximum quantity that can be attributed to vis major, and for waste, refuse, defect and breakage – quantity determined by the Decree of the Government of the Republic of Serbia. See: Article 2, paragraph 2, items 4 and 5 of the Law on Sales Tax, “Official Gazette of the RS”, No. 22/2001, 73/2001, 80/2002, 71/2003.

- daily allowances for business trips abroad – up to the amount prescribed by the competent state authority;
- accommodation allowance on business trips, against presented bills, and up to the daily rate for "A" and "B" category hotels;
- public transport allowance on business trips, against presented bills of transportation provider, and when the use of personal car is allowed – up to 30% of the price per liter of gas, not exceeding 1,500 Dinars monthly.

Considering that these tax reliefs are placed in the first chapter of part two of the LIIT ("Wage/Salary Tax"), they are applicable only to employees, and not to sole proprietors, which constitutes a serious discrimination against the latter. I believe that the Law should explicitly prescribe that a taxpayer-sole proprietor (who pays taxes on realized revenue from self-employment) has a right to tax relief on the above listed grounds. It is also suggested that maximum amounts in Dinars should be raised (600 Dinars per day for meals and 1,500 Dinars per month for using personal car on business trips), since that amount was set in April 2001, when the LIIT was enacted. The reevaluation rate for raising maximum amounts should not be lower than 50%, which approximates a cumulative rise in the consumer price index in the period 2001 to 2003.

Contributions for mandatory social insurance

According to the regulation in effect at the moment of completion of this paper, the base for calculating contributions for mandatory pension and disability insurance and insurance from unemployment of sole proprietors – "the persons insured on the basis of self-employment" consists of the taxable profit determined on the basis of tax account, in conformity of the LIIT, if that base is neither:

- lower than average monthly salary per employee in the Republic in the preceding semester; nor
- higher than the five times average monthly salary per employee in the Republic determined according to the latest published data of the Statistical Bureau.

However, for health insurance purposes, the base may not be lower than the average monthly salary per employee, realized in the current year in the Republic, nor higher than four times the amount of average monthly salary per employee, realized in the current year in the Republic.

Pending determination of the taxable profit based on the annual tax account, a sole proprietor pays a monthly advance of contributions for mandatory pension and disability insurance and insurance from unemployment for the current year, on the base equal to the base for the monthly tax advance, and this base may not be lower than the average monthly salary per employee in the preceding semester in the Republic nor higher than the five times the amount of the average

monthly salary per employee in the Republic determined according to the latest published data of the Statistical Bureau. However, the base for health insurance may not be lower than the average monthly salary per employee, for December of the preceding year in the Republic, and monthly adjusted for the salary growth rate[17].

There is no viable reason to have multiple bases for certain types of social insurance for the same category of insured persons. On these grounds, the Draft Law on Contributions for Social Insurance (June, 2004) stipulates that the base for pension and disability insurance, insurance from unemployment and health insurance should be unique:

(a) on the annual level – taxable profit, or revenue determined on a lump-sum basis and subject to tax on revenue from self-employment;

(b) pending final determination of the taxable profit for the current year – the base for monthly advance of the tax on revenue from self-employment.

In addition, contribution base may not be:

- lower than 40% of the average monthly salary per employee in the Republic in the preceding quarter; nor
- higher than the five times amount of the average monthly (annual) salary per employee in the Republic according to (the latest) published data of the Statistical Bureau.

Nevertheless, it should be borne in mind that the Law does not precisely define the *tax* base on revenues from self-employment in its provisions that refer to advance payment of contributions. Namely, the tax base consists of the taxable profit as determined in the annual tax account; for the purpose of its calculation, it is necessary to deduct the amount of contributions that were *finally* paid in the year for which the

17 Sole proprietor who pays taxes on revenues from self-employment, determined on a lump-sum basis, also pays mandatory pension and disability insurance and insurance from unemployment on revenue determined on a lump-sum basis (with above elaborated lower and upper limit), but Organization for Mandatory Social Insurance is authorized to prescribe minimum base for certain categories of lump-sum taxpayers. Hence, the Decision of the Republic Fund for Pension and Disability Insurance (Decision on determining minimum insurance base for certain categories of self-employed ensured persons, "Official Gazette of the RS", No. 42/2003, 50/2003) and the Decision of the National Employment Service prescribe that minimum insurance base for paying contributions for specified category of insured persons – lump-sum taxpayers – amounts to 65% of the average (monthly) salary per employee, in the previous quarter, in the Republic, if their revenue determined on a lump-sum basis is lower then insurance base calculated according to the above method. This applies to the lump-sum taxpayers classified in the first group by the Decree on Detailed Conditions, Criteria and Elements for Lump-Sum Taxing of Taxpayers Subject to Tax on Revenue From Self-Employment "Official Gazette of the RS", No. 65/2001, 45/2002, 91/2002, 23/2003. It includes: porters, shoe shiners, knife sharpeners, duvet makers, glove makers, cart-wright, brush makers, umbrella menders, old traits, clergymen etc.. On the other hand, the base for calculation of contributions for health insurance, may not be lower that the average salary per employee in December of the preceding year in the Republic, and monthly adjusted for the salary growth rate.

tax base is being calculated. However, *de lege lata* as well as *de lege ferenda*, that amount is determined as a percentage of taxable profit – a figure that is not identified at the moment of final determination of contributions. Therefore, I believe that the legal norm should be made more precise so that referring to the *final* amount of the taxable profit for the given year can be avoided: it would be acceptable to hold on to the base for monthly advances of the tax on revenues from self-employment, and then, in the first month *after* final determination of the *tax* base, to calculate the contributions taking into account the difference, if any, between the sum of advances and the final tax obligation on revenues from self-employment. That amount would be recognized as a deduction from the tax base on revenues from self-employment in the *following* year.

Some authors argue that, for purposes of taxes and contributions of sole proprietors, "calculative salary" should be established and recognized as a cost in the determination of taxable profit, the profit that would be subject to tax on income from self-employment[18]. The theory (that is tax jurisprudence) contends that revenues of a sole proprietor (as well as any member of the association of persons or an owner of any other non-incorporated firm who works in his own firm) may be defined as a yield on capital and work, entrepreneurship and risk taking[19]. However, the opinion prevails that, from a tax policy point of view, these revenues should be taken *all together,* so that a component of these revenues that would relate to compensation based on work (salary) should not have the status of a deduction in the process of determining taxable profit. This solution is applied in all countries-members of the OECD[20]. Croatia has a specific approach, where natural person-sole proprietor may opt between "standard" taxing by individual income tax (from self-employment) and taxing by enterprise profit tax (applicable to legal entities). In the "standard" regime, there is no deviation from the above elaborated approach, while in case of profit taxing the, "entrepreneurs salary" is recognized for sole proprietors. This "entrepreneurs salary" is included in the expenditure which can be deducted in the course of determination of the profit tax, and for profit taxing purposes, it is treated as revenue from "non self-reliant work" (i.e. as a salary). Considering that in the Serbian tax system (as well as in tax systems in almost all other European countries) there is no opportunity offered to natural person-sole proprietor to opt for taxing by enterprise profit tax, I believe that legal solutions should not be further complicated by prescribing "calculative salary" for the sole proprietor.

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18 See: Milan Kovačević, Tax Account (in: *Special graduate studies for staff of the Republic Administration of Public Revenues*, book II, Božidar Raičević, Law School and Economic Institute, Belgrade 1994), page 195.

19 *Taxation and Small Business*, OECD, Paris 1994, page 45.

20 For more see: ibid., p. 46.

Other deductions

LIIT (as well as the Enterprise Profit Tax Law) does not contain a norm which would prescribe that expenditure, directly related to untaxed revenue, may not be deducted. In this fashion, for example, revenues from interest on the basis of public debt are exempted from the tax base, and the taxpayer – sole proprietor (legal entity as well) presently has the right to deduct the cost of interest, that can be proportionally allocated to revenues from interest on a public loan, from the tax base. In this way the taxpayer is given the opportunity to take advantage of double exemption: he will take a loan to buy state bonds; then he will deduct the interest paid on that loan as cost; and then the revenues from the interest on the state bonds will be exempted from taxation. For this reason, I believe that LIIT should explicitly prescribe that expenditure directly related to untaxed revenue may not be deducted from the tax base for purposes of taxing revenues from self-employment.

III Tax on Income from Agriculture

INTRODUCTION

Taxing the income of individual farmers can be quite challenging. The most important problems with using standard income tax to tax private farming activity and private farmers (a hard-to-tax group) arises from the following facts:

- They are typically not familiar with complex tax regulations,
- They do not keep books, i.e. do not keep accounting records,
- They are great in numbers but their income is low; the tax administration therefore does not usually show much interest to undertake extensive and costly control when so small an amount of tax is in question,
- They often take cash for their goods; consequently, their accounting records, if they were compelled to keep them, would be inaccurate,
- Considering that they mostly operate in cash, the withholding tax is not a realistic option,
- They easily make tax debts, etc.

All the above elements are present in Serbia. They complicate any idea and effort to tax the private farmers with a tax on real income. That is why efforts are made in Serbia to cover the income of private farmers by cadastral income tax since the latter is computed relatively simply and does not depend on real current income of the agricultural household.

However, the taxation of farmers with cadastral income tax has many downsides and later in the text a proposal will be made for the reform of the taxation system for the farmers based on a concept of partial taxation of real income.

The first section of the paper offers an overview and analysis of the existing system for taxation of farmers in Serbia, the second section summarizes comparative approaches, and the third entails a reform proposal.

CADASTRAL INCOME TAX

Cadastral income tax is a tax that is used in Serbia for the taxation of the agricultural activity of private farmers. While for the taxation of

other economic sectors – even for taxation of agricultural activity when it is performed by companies, cooperatives, or similar – standard taxes are used, such as income tax, profit tax, etc., the private farmers are taxed through cadastral income tax since it is believed that technical issues make it impossible to accurately determine what their real income, or profit is.

Basic Concepts

Private farmers' income from agricultural activity is taxed in accordance with the Law on Personal Income Tax.

The income that is subject to taxation is either cadastral income or real income from agricultural activity, as chosen by the taxpayer.

The cadastral income is calculated income; it is computed for each and every land unit in the Real Estate Cadastre, regardless whether the land is used and regardless of the manner in which it is used for agricultural activity.

If a taxpayer opts to be taxed based on real income, his income is determined by the rules applied in taxation of self-employment activities.

A taxpayer is either the owner, holder of right to use, holder of right to enjoy, or rentee of the land.

The tax base is either cadastral income or real income.

The tax rate is 14%.

Exempted from tax is the land on which any hydro energy facilities or similar facilities are located, or cultural monuments, religious shrines, land newly brought into cultivation, and newly-raised orchards and vineyards for the period of five years, land under residential buildings (up to 500 m^2), the land owned by a taxpayer who is over 65 (men), or 60 (women) if receiving no income other than that from agriculture, land which is ceded free of charge by taxpayers to the refugees who have no other source of income.

Tax reduction may apply if, due to natural disasters or plant diseases and pests, or similar, the crop yields have decreased by more than 25% of average crop yields in previous three years, proportionate to the decrease in yields.

Cadastral Income Computation

The main provisions for computation of cadastral income have been defined by the Law on Determination of Cadastral Income,[21] and the methodology has been described in detail in the Instructions on Methodology for Determination of Cadastral Income.[22]

As a rule, cadastral income covers both crop and livestock production. However, while crop production is computed according to a

21 *Official Gazette of RS*, No. 49/92
22 *Official Gazette of SRS*, No. 30/77

defined methodology, livestock production is implicitly included in income, as the Instruction reads, through 'the prices of agricultural products intended for animal feed'.

Income from crop production has been defined as a difference between:

- Monetary value of average crop yields per hectare, according to the existing structure of crops and plantations and the usual manner of land treatment, where monetary value is the product of in this way computed yields and average prices of agricultural products; and
- Average material costs of production, defined as average expenses required for realization of average yield, where depreciation of agricultural buildings, equipment, orchards and vineyards is, but the value of human labor is not, included.

Based on this methodology, cadastral income is determined for each cadastral district in Serbia separately.

All land is classified in the following categories: arable fields, gardens, orchards, vineyards, meadows, grasslands, forests, and reed beds-wetlands. Each of these categories is divided into eight classes according to quality of soil.

Accordingly, and based on physical properties, cadastral income is computed for each parcel of agricultural land in Serbia.

Table 1. Cadastral Schedule, din/ha, 1994-2004 (summarized overview)

	Bogatić	**Sjenica**
Arable field Class 1	245.97	73.29
Arable field Class 2	203.92	57.82
Arable field Class 8	26.17	9.19
Garden Class 1	910.92	0.00
Garden Class 3	434.33	0.00
Orchard Class 1	132.72	46.74
Orchard Class 6	0.00	8.93
Vineyard Class 1	200.11	0.00
Vineyard Class 4	64.89	0.00
Meadow Class 1	64.244	0.82
Meadow Class 8	10.85	0.00
Grassland Class 1	38.55	15.54
Grassland Class 8	9.47	0.00
Forest Class 1	120.79	76.81
Forest Class 8	16.16	0.00
Reed beds-wetland Class 1	5.48	0.00

The schedule of cadastral income per districts and soil types and classes is drafted by the Parliament of Serbia. This was last done in 1994. The table below shows an excerpt from the Schedule for two cadastral districts: Bogatić from the lowland, fertile Mačva district; and Sjenica from the mountainous Raška district.

The level of cadastral income has not changed since 1994 when the Schedule was last amended.

Basic Figures

Let us examine revenues from agriculture and forestry, namely from the tax on cadastral income, considering that almost all taxpayers pay their taxes based on their cadastral income rather than on their real income.

Table 2. Cadastral Income Tax

	2002	2003
Amount Billed, 000 din.	77,631	
Amount Collected, 000 din.	72,561	71,487
Number of Taxpayers, 000	1,445	1,440
Revenue per Taxpayer, din.	49.9	49.6
Percent of Total Tax Revenue	0.03%	0.03%

Source: Tax Administration and Ministry of Finance Treasury

The revenue is negligible and amounts to about 72 million dinars in 2002 and 2003 in the whole of Serbia, which means that a taxpayer (household) pays only 50 dinars of taxes for the entire year. It should be noted at this point that this tax is not supposed to cover only the profit a taxpayer makes but his overall income as well. It is obvious that private farmers are basically exempted from income tax liability.

Since the inflow to the state budget of average 50 dinars per taxpayer would not suffice even for covering the Tax Administration postal costs, this would make the tax detrimental to state revenues were it not for the additional four duties that are billed based on the cadastral income. Only one of these duties is noteworthy: the drainage fee which is revalued over time through increase of the rate that is in computation applied to cadastral income.

The tax on income from agriculture and forestry constitutes only 0.03% of total tax revenue and is a negligible funding source for public purposes. In light of its share in total tax revenue, this tax should be abolished. It only makes the task of state authorities more complicated and, since it contributes very little to state revenues, it may be deemed ineffective. Abolishment is not the only option, however: this tax could be reformed so as to bring much more revenue to local communities,

for it is the local communities to whom are the revenue from this tax allocated.

Such meager effects of tax collection, and of private farming taxation in general, may only in part be attributed to weaknesses of cadastral income. In a larger part it may be attributed to tax policy that, mostly for demagogic reasons, favors farmers.

Assessment of the Cadastral Income Based Taxation

The system for taxation of private farmers based on their cadastral income, as is in effect now in Serbia, has both good and bad sides.

The good sides are lesser in number. Firstly, this tax is extremely low and this encourages agricultural development and causes the prices of agricultural products to be lower than they would be if all economic activities were taxed in an even way. Any economic activity that is not taxed is given an advantage in terms of the prospects for development and the same applies to agricultural activity. However, the question is whether any economic activity should be left untaxed because, if one economic activity does not yield tax revenue, some or all other economic activities will suffer a heavier fiscal burden in order to provide necessary resources for public consumption. In other words, when it is necessary to ensure a given tax revenue, as it usually is, then non-payment of taxes by one economic activity (or any other taxpayer) inevitably leads to the need that the minus be offset by somebody else. And then the question is whether it is better to favor, by tax instruments, one economic activity at the expense of other economic activities, even if it is agricultural activity, or to tax all economic activities equally – through a neutral tax system – and let the market dictate how resources will be allocated.

Secondly, and when it is not as low as it now is in Serbia, cadastral income tax is an efficient tax in terms of welfare economics. Namely, considering that this tax is not paid on real income, it does not affect the behavior of farmers and causes no distortions since it does not levy tax on additional income. In other words, the amount of tax for farmers is predefined and is not conditional on production or income; it is therefore an incentive to the increase of business activity because it does not tax it at all.

Thirdly, cadastral income tax is an old tax; taxpayers are used to it and this is an important asset for any good tax.

On the other hand, cadastral income tax for farmers, such as it is in Serbia, entails serious faults. Some of them are the result of the approaches currently taken in Serbia, and some of them from the very concept of taxing cadastral income.

Firstly, taxation of cadastral income infringes the principle of equality which is a fundamental principle of any good tax system. Because it does not tax real economic power, i.e. real income, but rather potential income, this tax equally collects from unequal persons and collects

unequally from equal persons and thus infringes the principles of both the vertical and the horizontal equality of the tax system.

This weakness pertains to all forms of cadastral income taxation, and it is particularly manifested in Serbia since the tax liability here is exceptionally low. Two types of high agricultural activity related incomes are not liable to taxation. The first arises from intensive production in private households, particularly related to livestock and poultry rising, but also in crop production (raspberries, etc). Quite high earnings may be gained from a small and low taxed estate here. The second results from enlargement of agricultural households and their conversion into efficient agricultural producers. Namely, the rumor has it that the process of bigger, modern farm formation has already commenced in Serbia – you sometimes hear it mentioned that several hundreds, even thousands of hectares are rented – and this, together with modern agricultural technology, allows high production, and high profit, both in total and per unit of surface. It is unreasonable to tax such households/firms with a (low) cadastral income tax. The general notion of private farmers – that we are dealing here with households which are typical and which hardly make ends meet – is more often than not wrong: many of them are of good standing and some of them are quite wealthy.

Secondly, taxation of cadastral income discourages technological progress of private farming and, therefore, constitutes a barrier to advancement of both agriculture and agricultural households. Namely, the cause for this negative effect is the manner in which investments and other costs of agricultural production are treated: even though, in nominal terms, average costs are taken into account in computation of cadastral income, they, and this is what is of critical importance, do not appear as a deducted item when taxation is effected. In other words, the fact that the methodology of cadastral income computation refers to operating expenses has no influence whatsoever on taxation in practice and a farmer pays a fixed amount of tax regardless of real investments made in production and material costs of such production. Moreover, when investments and material costs are not deducted from tax liability, the incentives for investments diminish and primitive ways of production are encouraged. On the other hand, modern taxation of real income always envisages tax deduction for investments and material costs of production and is always a greater incentive to improvements in agriculture.

Thirdly, cadastral income tax has not been changed since 1994, and even then the computation was not methodologically correct. As it was, an earlier computation was simply revalued and translated into new dinars following the Avramovic monetary reform. Consequently, due to wide-spread obsolescence, many shortcomings of taxing the farmers' income by cadastral income tax were exposed:

- The tax has not been revalued for ten years and this means that inflation has greatly reduced the real tax burden which even in

1994 was hardly cumbersome; in the period between 1994 (average for the entire year) and January 2004 the prices, measured by retail price index, have increased 34 times, which means that the real tax burden has been reduced to only 3% of what it was in 1994;
- Agricultural technology has advanced in the meantime (better quality seed, agricultural machinery, fertilizers, improved plant protection, etc.), which has raised the productivity level;
- introduction of new plant species (champignons, kiwi, etc) and changes in the demand for some old species (raspberries, etc) has altered the structure of crop production, which should have some impact on cadastral income;
- relative prices of plant products have changed, which should be taken into account when computing the cadastral income;
- livestock and poultry raising, as intensive forms of agricultural production, were, in terms of methodology, taken into account in an utterly inappropriate manner; to put it more precisely, they are completely left out from the computation of cadastral income and, consequently, from the taxation of income form private farming,
- the records of owners and utilized land areas are outdated, due to the fact that they do not track the real changes of the situation in rural areas (deceased taxpayers, disused land plots, etc).

The tax on cadastral income from agriculture is not a good tax, both in general perspective and in the way it is implemented in Serbia. That fact *per se* is not a sufficient reason to abandon it and replace it by some other tax, however, since the alternatives may prove to be even more inadequate. For instance, the obvious alternative – tax on real income – may, due to technical reasons, prove to be unfeasible or feasible only to an extent, which leave us in the situation of choosing a lesser evil.

HOW AGRICULTURE IS TAXED IN OTHER COUNTRIES

Introduction

Taxation of agricultural activity, as is true for taxation of all economic activities, has changed throughout history. From our perspective today, the taxation was most unjust at the time when agriculture was the primary source of income and tax (poll tax and related forms). As the share of agriculture in domestic product diminished, namely as the taxation system developed, the taxation of this economic activity improved. A big step forward was the taxation based on cadastral income as a measure of potential income, and, in more recent times, many developed countries have extended the modern taxation of real income to agriculture.

Many developing countries[23] still use miscellaneous and numerous methods for approximation of real income, and that not only in agriculture but in other economic activities as well (particularly in case of small enterprises). The goal is to avoid complex taxation techniques, and in particular sophisticated accounting and complex tax forms, by introducing simpler forms of tax on perceptible bases which are, to the greatest extent possible, correlated with income or profit. Some examples of variables are: unemployment numbers, overall turnover, value of land or property, cadastral income.

The selection of tax structure in a country doubtless depends on a large number of different factors. One of them is the tax philosophy of the state (tradition, demagogy level, lobbying, political profile, etc), the second is capability of tax administration to administer more complex tax forms in a proper manner, and the third is the competence level of the average taxpayer to, despite his best wishes, abide by the provisions of tax legislation (educational level, complexity of procedures, costs).

Taxation of real income of taxpayers from agriculture is predominant in developed countries, in developing countries some of the methods of presumed/estimated income prevail, and both methods are present in transition countries.

An overview of contemporary taxation of income (and profit) in the agriculture in a number of countries is given below, as an illustration of modern trends in taxation.

USA

In the United States the income from agriculture does not constitute a separate type of income that would be taxed in a separate manner. It is determined and taxed the same as any other income of comparable size, except for some regulatory details. And taxable income is a sum of all incomes, regardless of the source or type of economic activity, reduced by necessary costs.

The total income of a taxpayer includes income from salary, interest, dividends, capital gains, rents, net revenue from business activity, pension, and other sources. Net revenue from business activity is a difference between the total income and deductions of allowed costs, including a half of the tax on the self-employed, contributions for pension insurance and health insurance of the self-employed, and also the medical costs, interest on mortgage loans for houses and some tax duties. Also, there are tax deductions for each member of the household. Similarly to other business activities, what is taken into account is the status of livestock and plant products in the beginning and at the end of the year, and the stock of semi-finished products. Also, there are dif-

23 For example, S. Wallace – *Imputed and Presumptive Taxes: International Experience and Lessons for Russia*, WP 02-03, Andrew Young School of Policy Studies, Georgia State University, March 2002

ferent types of depreciation, including accelerated depreciation. According to the alternative system which is based on a simplified cash accounting, the stock is not determined.

As regards the deductible items, many approaches are common, such as for salaries, energy, spare parts, fertilizers, etc. The specific approaches are those that relate to investments in improvement and protection of land, irrigation systems, agricultural vehicles, some state subsidies, and similar.

Consumption of agricultural products by the member of a household is not taxed. However, the related costs are not included in the deductible items in computation of taxable revenue.

If they are considered to be a one-person capital company, American farmers may opt for the corporate profit tax instead of the income tax,

American legislation imposes the obligation to keep accounts, but it does not prescribe the manner in which this must be done. Therefore, cash accounting, being simpler, prevails among farmers.

Great Britain

The customary legal form of the agricultural farm in Britain is the partnership, and that usually between spouses. Other forms are also common, such as collective farmsteads, contractual farmsteads, closed end companies or trusts.

All farmers in Britain are required to keep full accounting records.

The revenue of a household from agriculture is addressed in the section that governs taxation of profit from trade. This means that no difference is made between this and other commercial, i.e. profit-oriented activities.

In the computation of the tax base, almost all usual deductions are made for business input costs, salaries, energy, etc. whose purpose is enlargement of revenue. The exception is the way of treating the depreciation of equipment, buildings and other permanent improvements. Namely, the depreciation of these goods is not taken into account in tax statements. Rather, capital relief intended for fixed investments is deducted from the taxable income. In the year in which the item is procured, the tax liability is reduced by a generous 40% of the value of such an item, and then the item is included in a unique pool of equipment. Like this, a complex procedure of accounting and depreciation according to different methods and rates of individual items is evaded.[24] The value of collection is written off at the annual rate of 25%.

Considering that Britain has a very advanced rental system with a third of all farms under rental, taxation of the income from rent is also of relevance. The tax base is the amount of rent reduced by normal costs of repair and maintenance of the farmstead and for administrative costs.

24 Similar concept of equipment pooling in our Law on Profit Tax was proposed in the study *Reform of Taxation System*, CLDS, 2003, pp. 108-109

Annual tax rates on total income are progressive and are in the range of between 10 and 40 percent.

The system with the tax payers self reporting their income is in force. The system of joint taxation of partners has recently been abandoned and now they (even when they are spouses) submit separate tax returns.

France

French farmers normally pay income tax following the same rules as other members of the self-employed (self-employment activities). However, there are some rules that make the taxation of income rather different.

The income from agriculture may be determined in four different ways for taxation purposes:

1. through ordinary, standard accounting, the same as in other business activities, where usual deductions of income are applied, such as for operating expenses, etc;
2. through simplified accounting, which is an option for the farms whose annual income is less than 224 thousand euros;
3. through simplified computation of income (forfait), which is an option for the farms whose annual income is less than 76 thousand euros; according to this well known system, the tax administration estimates the farmers' income based on collective estimation for individual groups of taxpayers, differentiated according to the type, location, and size of estate; in the next phase the taxpayer may question the estimate made by tax authority and has obligation to supply documentary evidence, meaning to keep accounting records, and
4. through the transitional scheme.

About 500 thousand farms apply the forfait system of simplified computation of income, and about 250 thousand farms apply the accounting system (half of them full, half of them simplified). However, only a quarter of production originates from the estates which apply the forfait method.

There are two incentive schemes: in the first, for young people starting business in agriculture the income is deducted by 50% in the first five years; and in the second, the income is deducted by 20% to those who keep accounting records.

In France, the income from agriculture is included in the base for the annual tax on total income and the rates are anywhere between 0 and 53%.

Germany

Annual tax on personal income is applied in Germany as well. It comprises seven categories of income. The tax rate is progressive and varies between 17 and 47% (2004).

One of seven categories of income is the income from agriculture and forestry. It may be determined in any of the following four ways:

1. through assessment of real income of the farm, based on full accounting records; the income is defined as a difference between the assets at the end of the year and at the beginning of the year, increased by withdrawals and decreased by the contributions to assets; the farms that are over a certain size are under obligation to determine their income in this way, and such farms constitute 30% total number of farmsteads in Germany,
2. through simplified computation of income, based on simplified bookkeeping; this method is prescribed for the farms whose size does not exceed the limit for the method under 3, and such farms constitute 15% all farms in Germany,
3. according to the value of land (item valuation), that is the potential quality of land; this computation normally results in computation of income that is lower than it would be were either of the first two methods applied; it covers about a half of all farms,
4. according to the estimation of tax administration; if a taxpayer fails to compute the income according to one of the above three methods, the tax administration shall do it.

For the agricultural households with lower incomes, there is a general deduction of tax liability. Moreover, until 2001 there was an additional deduction for those whose income is computed according to the value of land.

Poland

In Poland, the tax on income from agriculture is paid by natural and legal persons, and the organizations which are not legal persons if they are owners or users of agricultural land.

Agricultural tax is paid according to a specific cadastral income. The land is classified based on the type, class and location, according to data from the Land Cadastre.

Agricultural farms pay the tax based on the following formula: number of hectares x conversion factor x value of 250 kg of rye. The conversion factor includes differentiation according to the type and class of land and location (districts). The value of rye plays the role of the monetary converter and, what is more important, of the tax rate, and it is computed based on the market price of rye in the previous year. This system ensured automatic adjustment to inflation to the extent in which inflation affects the price of rye, but not adjustment to the fluctuations of real income from agriculture. Namely, the price of rye may rise significantly due to a fall in production, for example, and this would lead to the increase of tax liability even though the income may not have changed or may even have decreased.

For land that does not belong to agricultural farms, tax is paid according to the following formula: number of hectares x value of 500

kg of rye. The type and quality of land are not appreciated; each unit is taxed by an equal amount.

Taxpayers submit reports and the tax is paid four times a year.

Croatia

Croatian farmers are taxed by the self-employment tax, the same as craftsmen and free lancers.

The tax base is the difference between business income and business related expenditures. Business income are the goods (money, assets, tangible rights, services, etc) computed based on the market value, and business expenses are all outflows that arise in connection with realization of income, such as for the goods, material, energy, gross salaries for staff, depreciation of durable property, etc. Depreciation may be one-off or accelerated, which is an incentive to investment.

Moreover, there are some deductions, such as personal deductions, for dependant members of household, and taxable income does not include different kinds of income (from interest, insurance, social benefits, inheritance, etc).

Taxpayers keep books, namely: 1) book of revenues and expenditures, which shows the records of all daily and total receipts and expenses in a tax period, 2) records of all claims and liabilities, i.e. records of all issued and received bills which have not been realized, 3) book of turnover, in which records are kept of daily turnover in cash and cheques, and 4) inventory of durable property, for depreciation computation purposes.

Income from agriculture is included in the annual personal income tax. Tax rates are progressive and amount to 15, 25, 35, and 45%. The taxpayer from agriculture pays, according to an administrative decision, the monthly advance of tax liability. Local communities may introduce a surtax on income tax.

The taxpayer may opt for payment of profit tax in preference to income tax, and any decision they make remains in force for at least three years.

There is also the possibility of lump sum taxation of farmers, if they are not liable to VAT payment. In that case, they do not keep books, and they pay the tax based on the administrative decision of the tax administration, in monthly installments.

Slovenia

In Slovenia, natural persons' income from agriculture is taxed through cadastral income.

The tax liability of farmers is deducted by investments in adaptation of the space intended for tourism, building and reconstruction of the facilities and procurement of equipment and mechanization for 25% of the value per a year, for the duration of four years.

The tax rates are: 0% if the base amounts to 30% of annual amount of average salary in Slovenia, and 8% if the base exceeds that amount. Non-residents pay the tax at the rate of 17%.

The annual tax on total personal income is paid in Slovenia. The set of incomes includes the (cadastral) income from agriculture, deducted by the amount of contributions for social insurance that are paid on cadastral income. The annual rate of the tax on total income is progressive and its range is between 17 and 50 percent.

PROPOSAL OF A NEW SYSTEM FOR TAXING AGRICULTURE INCOME

Introduction

In the context of tax policy, the first question that arises is whether it would be worthwhile to raise the extremely low taxation level of private farmers taxation, in acknowledgement of the following:

1) that farmers are used to being taxed at an extremely low level; therefore, a more severe taxation policy towards them could cause political difficulties to the Government;
2) that considerable problems and taxation costs are present (a great number of taxpayers, relatively low and total and average income per a taxpayer, limited capacity of tax administration, etc); and
3) that it might be useful to encourage the development of agriculture through low taxation of peasant farmers.

If only the above arguments are taken into account, total abolishment of private farmers taxation in Serbia might be suggested.

On the other hand, there are some arguments in favor of more intensive taxation of agriculture:

1) the equality principle, because everybody should pay taxes according to their capacity and benefits they have from public consumption, the minimal taxation that we now have in Serbia is definitely unjust; what is more, abolishment of taxation for one group of population/business operators is clearly counter – constitutional (Constitution of Serbia, Articles 52 and 69);
2) administrative difficulties in processing the taxes on agriculture may be resolved by choosing a suitable taxation method and through strengthening the capacity of the tax administration, rather than by abolishment of tax,
3) maximization of efficiency typically involves neutral taxation, i.e. equal treatment of all sectors of the economy; arguments for abolishment of taxation encourage (agricultural) production, as is true for any other economic sector, while the world of open market economy offers no persuasive reasons for favoring one sector (agricultural) above other sectors, and

4) further economic differentiation is yet to take place in the Serbian agricultural sector, through the enlargement of estates and market competition; it is therefore necessary to think beforehand how to tax rich farmers and entrepreneurs, in view of the fact that it would be absurd if they remain untaxed or are taxed by the today's negligible tax.

Favoring the taxation of private farming, as we can see, are the arguments of both ethical and economic nature, and weaknesses of an administrative nature cannot be grounds for abolishment of the tax on income from agriculture. Furthermore, the ongoing efforts on improvement of the operation of the Tax Administration, and technological progress, i.e. computerization and control advantages that come with the value added tax (which will be elaborated on further in the text), offer solid grounds for a more ambitious approach to taxation of income from agriculture, just as of all other taxpayers and all other taxation bases for that matter.

Short Term Changes

It is impossible in the short term to prepare and implement a radical reform of the taxation of income from agriculture. However, it is possible to revalue the value of cadastral income and as a result raise the tax burden from the negligible level it is at presently.

This for the reason that, as was already mentioned, the cadastral income was last revalued in 1994, after the hyperinflation and has not changed, i.e. been revalued since then, regardless of inflation. Since the tax has remained nominally the same, it's valued in real terns has declined greatly. The retail price index (average for 1994 – January 2004) increased 34 times in the meantime, which means that cadastral income was, in real terms, reduced in 2004 to 3% of what it was in 1994.

To revalue, but to what extent? One candidate for the revaluation factor is the aforementioned retail prices index for the period 1994-2004. If it was used, the tax liability for the average household based on cadastral income in 2004 would be around 1,700 dinars. Such an amount is less than the monthly income tax employees with an average salary paid in the beginning of 2004 (about 2500 dinars). This means that an agricultural household, with average of 2 – 3 persons working, would pay less income tax than one average employee for a month. Even if we allow for the advantage in productivity of an employee in other business sectors over an agricultural worker, this difference in taxation would be too large.

A larger revaluation could be based on factors 100 or 300. This would result in the average annual liability of a household reaching 5 thousand, or 15 thousand dinars.

Methodologically a more acceptable approach for determination of cadastral income would be based on a completely new way of cadastral income computation. As was mentioned above, the present calculation

is very outdated and a new one could be made – with new prices, new cultures, new costs, etc – by virtue of the Law on Cadastral Income Determination.

LONGER TERM REFORM

Introduction

In the longer term, it is possible to implement full reform of the taxation of agriculture in Serbia. On one hand, a certain amount of time is necessary to prepare a completely new taxation system which would aim to be relatively simple, to facilitate implementation and allow for crucial parameters of the new system to be evaluated in the meantime. Namely, the proposal of the reform that follows below is based on the concept of *incomplete* computation of the real income the individuals earn from agriculture (see below why it is incomplete), and this model requires assessment of some parameters which must be assessed outside the model (based on a survey conducted among farmers, for example). On the other hand, the introduction of value added tax (presumably from 1 January 2005) shall offer a completely new and valuable possibility of monitoring income from agriculture; that is the reason why the herewith proposed taxation system should not be introduced before value added tax becomes effective (see further in the text).

As was mentioned already, the farmers constitute a taxpayer group that is very hard to tax by standard income tax since they are typically unfamiliar with complex tax regulations, they usually do not keep accounts, they are large in number, their income is mostly low, they often sell their goods for cash – their accounting records, if they were compelled to keep them, would therefore be impossible to validate; also, since they do business in cash, a withholding tax is not realistic, they incur debts easily, etc.

It is obvious that it will be a long time before small farmers can be incorporated into a modern and complex taxation system for private income and self-employment activities (without lump sum taxation; to an extent the cadastral income is reduced to lump sum taxation). That is why it is necessary to create a specific and simplified system of income determination and taxation.

A major role should be given to the principle of reasonableness, i.e. selection of such tax form which is possible to implement and administrate, without any illusions. It would be irrational to devise a tax that would be theoretically ideal – the tax on real income, for example – which the Tax Administration of Serbia would not be able to implement in the next 10 years.

New Taxation Concept

The tax would be paid in two ways:
1. based on the assessed income, and
2. in lump sum.

An agricultural producer would pay the tax in one of the above two ways, depending on the level of income earned by the household during the year: the households whose income exceeds a certain amount would pay the tax based on the assessed income, and those whose income is lower would pay the tax based on the lump sum.

Ad 1. The tax base would be the assessed income of the agricultural household. The assessed income would constitute the difference between actual revenues and prescribed standard costs. The actual revenue would be constituted of the sum of individual revenues of the household realized during the year. Prescribed standard costs would be prescribed by law, as a percentage (60%, for example) of the amount of total revenue.

Determination of total revenue of a household would entail the obligation of each taxpayer to keep accounting records of their income. However, this would be simplified accounting – records would be made of income only – and according to the cash accounting: such and such amount of dinars was received, paid by such and such buyer, date of payment, the document (the bill). Cash accounting of income is so simple that even individual farmers can keep it, and many of them already do.

In introducing a taxation system for taxing the individual agricultural household based on actual income, the first question that arises is that of tax evasion since many of them do business in cash and such earnings are practically out of the reach of the Tax Administration. True, the income of farmers made through sale of goods at the green market is rather illusive. Similarly, the trade between farmers and merchants, either individual or companies from the formal sector, is almost always made in cash now – this is therefore yet another area in which the Tax Administration has no simple and efficient control system at its disposal. The only way possible is by inspecting the documents in the companies from formal sector that are pertinent to individual farmers, but this could be accomplished only with massive extra effort and at high cost, which would not be rational.

However, the pending introduction of the value added tax will greatly facilitate the tax control of trade in agricultural products between private farmers and companies that belong to the formal sector. This for the reasons that the farmers will be included in the VAT system in one of two ways, and the Tax Administration will consequently have access to data about their trade with the companies of the formal sector. The first way shall apply to the farmers whose turnover exceeds the amount prescribed by the law (over 2 million dinars a year), who, just like all other businesses, will be taxpayers and will pay VAT according

to general rules. The result will be that the Tax Administration shall keep track of their turnover.

The other way will apply to the farmers whose trade volume is below the prescribed amount for which a simplified system will be used: they are not VAT payers and they shall realize the compensation for the amount of VAT they have paid for production inputs through standard compensation of 5% of the value of each sale of goods, as approved to them by the buyer (see Article 34 of the Law on VAT). This would allow the Tax Administration to have a better view of the transactions between the private farmers and the formal sector. In order to realize the right to a deduction from previously paid tax, which is also pertinent to VAT compensation paid to the farmers, the VAT payer must keep appropriate records and issue bills with the prescribed content. Also, the existing draft of a future tax declaration for VAT has a separate column for VAT compensation. This means that the Tax Administration shall, as a matter of course, have access to the data on aggregate monthly income of the farmers, based on the VAT payers who are buyers of agricultural products.

The expansion of cashless trade among private farms would contribute considerably to better transparency and more precise determination of the individual tax base. The first step in that direction the state could make through cashless payments for agricultural products purchased for commodity reserves, as made to the bank account of the farmer. The second step would be cashless payment of subsidies, premia and other similar allowances to farmers. The third step could be a legal obligation to do business in a cashless manner completely, even though the question still remains whether such legal obligation should be introduced. The first two steps would already considerably expand the cashless way of payments between the farmers and their inclusion in standard ways of doing business.

Expenditures of a private farm, as mentioned already, would be approximated through the prescribed standard costs provided by the law, as a percent of total income. Any effort to establish what are the real costs using the standard methods would probably be doomed to failure since their computation in modern tax systems is too complicated for many farmers (this having in mind the calculation of depreciation, stock, salaries, etc. which entails the far more complex standard accounting).

The most serious questions raised with regard to this entire concept of agricultural income taxation are concerned with prescribed standard costs.

The first question addresses the level of average costs of private farming versus revenue. What is the percentage? The fact is that no major surveys have recently been conducted with regard to the structure of revenues and expenditures of farmers' households in Serbia which could answer this question. Statistics of domestic product computation, as is done in the Statistical Office of the Republic, assumes that total intermediate consumption (that is without depreciation), constitutes

50% of the value of production of private farmers in the agricultural sector.[25] In other words, the state statistical office operates with the share of costs of 50% in the value of private farming production.

The second question is the following: whether to use only a unique percentage of regulated expenditures for the entire agricultural production, or to classify the prescribed standard costs according to various dimensions (different sectors of agricultural production, different types of farms, different regions). In principle, there is no doubt that it is better to make the classification according to the production sectors because the related real costs are probably different – however, the question is whether it is possible to

1) make differentiation correctly? Namely, the fact that many different products are produced in one and the same farmstead (livestock, grain, fruit, vegetables, poultry, dairy, etc) and that many inputs that are used in different segments of agricultural production, makes it practically impossible to compute the costs for each of them separately; in other words, a survey conducted among farmers, for example, would not be able to give a true answer to the question about the costs of each of these productions, considering that the farmers themselves do not know what part of the costs can be attributed to what kind of production;
2) assess whether the farmers apply differentiation of prescribed standard costs in conformity with the law? If we bear in mind that they usually practice several kinds of agricultural activities on their land, the answer to this question would probably be negative since the differentiation of the percent of prescribed standard costs allowed ample opportunity for artificial reduction of tax burden through presentation of production with a bigger percent of prescribed standard costs instead with the real percentage.

The fact that the differentiation of the percent of prescribed standard costs is not a good or realistic option surely does not necessarily mean that the option with one and the same percent is a good option. Let's take a look at how it is:

1. average percentage of costs in relation to the income is possible to determine empirically, by conducting a survey about the revenues and expenditures of farmsteads, for example,
2. such an average percentage of costs may be assumed to be a percentage of prescribed standard costs prescribed by the law,
3. in this way the determined percentage of prescribed standard costs will be appropriate for a majority of private farmsteads for they, due to considerable diversification of production, reflect the total agricultural production as per the ratio between the costs and revenues – namely, the difference between the costs and rev-

25 This procedure is not a result of a written methodology; it was based on the experience that it was decided to do computation in this way.

enues here cannot be exceeded by the large margin of that in agriculture as a whole,

4. the proposed taxation system may to a large extent discriminate only against highly specialized farms, those that produce a product in which the share of production costs is much greater than in the average of the agriculture in whole,
5. these farms may evade excessive tax burden by inclusion in either the tax on self-employment activity, or, once they have properly registered, in tax on corporate profit. Fully-fledged standard accounting would not pose a great difficulty for them since these would be modern, highly productive agricultural households,
6. one way to avoid the greater-than-what-is-just burdening of those whose production structure is more in favor of the activities with a greater share of costs in relation to the total income, would be that the law prescribes a percentage of regulated costs that is somewhat higher than the average – for instance, 60% instead of estimated 50%. Surely, this increase of prescribed standard costs would be useful for other payers too, but would also lower the number of complaints with regard to the new taxation system.

The idea of giving taxpayers the option to prove the real costs of the household if they do not want to use the prescribed standard costs may sound attractive. Their obligation would certainly entail keeping of standard accounting and complying with all complexities of the income tax. However, this idea has a huge disadvantage: the revenue of ***one*** part of production (the one that is reported, i.e. mostly such part that is sold to the formal sector) would usually get reduced by the costs of the ***entire*** production of the household, and this means that those parts that go into own consumption and on the green market would not be included. In other words, the farmers would be able, with the aim to increase the declared costs, to present all inputs they buy as the costs of the production that is getting taxed. In such an event, the costs would often turn out to be higher than the revenue. On the other hand, the attempt to establish what the costs are of the input solely for the production that goes to the formal sector is a priori doomed to failure. That is why it is generally better to use prescribed standard than actual costs.

Ad 2. The private farmers who realize a turnover that is less than that determined by the law would pay tax on the income estimated as a lump sum.

The Tax Administration would issue decisions by way of which it would determine the income of taxpayers, taking into account the surface area and quality of land, agricultural buildings, number and age of the members of household, and similar operating factors. The Tax Administration would obtain useful information from the value added tax system. In the first years of implementation, the computation of revalued or recomputed cadastral income could set the grounds for computation of lump sum income. In the inception period, the deviation of the

lump sum income from cadastral income should be made only in clearly defined and elaborated cases.

Taxpayers from this group would not be required to maintain book-keeping.

And the last thing to be done is ***to set the threshold of total income*** that would separate the households which will pay tax on the lump sum income from those which will pay the tax based on assessed income. This threshold surely does not constitute an objective category and cannot be determined empirically; it is rather determined by the tax policy.

This threshold should probably be set in such a way as to make the majority of households – consisting of small and medium-size ones – pay the tax on income from agriculture based on the income determined as a lump sum. There are three reasons for this approach:

- among the medium, and particularly among the less productive households, there are many farmers to whom even the moderate tax demands on assessed income (cash accounting, tax self reporting, etc.) would mean a considerable or hard-to-overcome difficulty (the illiterate, the old),
- The capability of the Tax Administration to monitor is restricted and it would be better to set to it a task that it can perform, rather than to take an overly ambitious approach and eliminate any possibility of controlling a larger number of taxpayers,
- the relatively modest volume of trade between these households and the formal sector, i.e. orientation of a major part of production to the green market and own consumption.

The Tax Administration will, there is no doubt, have data about the trade going on between these households and the formal sector from the value added tax system. This information will enable the Tax Administration to establish which households from the lump sum paying group are earning income above the threshold and should therefore pay tax based on assessed income.

Conclusion

Acknowledging the weaknesses of taxing the income from agriculture – extremely low budget revenue, shortcomings of cadastral income, and similar – some short term and middle term changes have been recommended:

1. in the short term, it is necessary to considerably revalue the cadastral income so that the farmers would take on them a part of the burden of financing the state,
2. in the medium term, it is necessary to introduce essential innovations in the system of taxing the income from agriculture, through introduction of the tax on assessed income as a difference between the declared revenue and prescribed standard costs,
3. in order to make it possible to do this efficiently, it is necessary

a. to introduce value added tax which provides data about the trade between agricultural households and the formal sector,
b. to conduct a systematic survey about revenue and expenditures of agricultural households so as to establish, *inter alia*, what is the share of the costs in the total income,

4. the tax on assessed income would be a first major step towards the tax on actual income of agricultural households, such as is in use in many developed countries.

IV Fees and Charges for Use of Natural and Public Goods

BASIC PRINCIPLES

One of the basic principles of efficiency in management of public finances demands that the structure of public revenues should be detached from the structure of public expenditures. This, on one hand, offers a choice of fiscal instruments, predominantly dependent on measurability of the tax base, its elasticity in relation to the tax rate and capacity of the tax administration. On the other hand, it enables adjustment of total volume of public expenditures to the objectively given fiscal capacity of tax payers and available real sources for financing the fiscal deficit, while it is the budget policy that, inside this general framework, defines the expenditures intended for specific purposes.

So-called specific purpose taxes, or the taxes that generate revenues which are in advance allocated, in whole or in part, to specific purposes, completely contravene the above-mentioned principle. In that case, it is the intended purposes of tax revenues rather than tax parameters that determine the choice of tax base on the revenue side, while budget policy is significantly limited in managing expenditures. Essentially, specific purpose taxes render impossible an efficient fiscal policy on the revenue, as well as on the expenditure side of public finances.

The second principle pertains to the division of competences between different levels of power with regard to determining and collecting public revenues – fiscal decentralization. Simply put, when public finances are at stake, the basic function of the central authorities is, on one hand, to ensure that the relative tax burden is evenly distributed on the taxpayers, and, on the other hand, to ensure more uniform volume and quality of public services. The former, as well as the latter, are a precondition for efficient economic policy management, which is, by definition, within competences of central authorities.

That, however, does not entail full centralization of public finances. On the contrary, a certain degree of fiscal autonomy as well as fiscal competition between local government units (LGU) is essential for efficient functioning of public finances. The independence of LGUs in managing the expenditure side of their budget is an important aspect of fiscal autonomy, although fiscal autonomy is in current debates most often associated exclusively with jurisdiction over the introduction and

collection of public revenues. Since the public functions of LGUs may also be financed from the taxes that are determined and collected at the national level, the choice of jurisdiction over the introduction and collection of taxes does not depend on the division of competences in performing public functions, but on effective tax collection; and the latter generally depends on basic tax parameters – in this case, on the shifting of tax base between different LGUs. Public expenditures that are determined at the national level must be distributed between different levels of the government taking into consideration the allocation of jurisdictions in conducting public functions and the taxing capacity of the individual LGU related to the fiscal instruments the regulation of which is within its competences.

Fiscal instruments whose regulation may be fully or in some elements within the competences of the LGU must meet the following requirements: firstly, the tax base should not be directly dependent on economic fluctuations, which means that it should normally represent a stock rather than a flow; and, secondly, the tax base is directly linked to the territory of the LGU, which means that it should be easy to identify the LGU which is the recipient of the revenue.

In the environment where LGUs have relatively small territory and fiscal capacity and where their administrations lack capacity and experience in managing budget policy, such as now in Serbia, the best way to execute basic functions of central authorities, and at the same time ensure the required degree of fiscal autonomy, would probably be to regulate two out of the three elements of fiscal instrument – the taxpayer and the tax base – at the national level, and to leave the LGU which receives the full amount of resulted revenues the authority to determine the tax rate. This authority of the LGU may be utterly unrestricted, that is, the tax rate may be anywhere between 0 and any maximum amount, which practically means that the LGU can chose not to introduce a particular fiscal instrument at all. Alternatively, the range in which LGU's determine the level of tax rate may be prescribed at the national level. The choice between those two possibilities can be influenced by the fluctuability of the tax base between LGUs as well.

In the current system of public revenues in Serbia, fiscal instruments the regulation of which is fully or partially within the competences of LGUs are identified as fees and charges rather than as taxes. Most of these fees and charges, although not all of them, have the essential nature of taxes. Contrary to that, the charges that are regulated by laws at the national level are usually the prices of public services (administrative and judicial) that are paid by users of such services.

According to the definition provided in the Serbian system of public revenues, the charges that are regulated by the national level laws should primarily serve the purpose of regulating the external effects that arise from utilization of certain goods, while their role as budgetary revenues should only be secondary. External effects occur when the economic actor fails either to appropriate the full amount of revenues,

i.e. the full benefit of his economic activity, or to bear the full costs of such activity.

The former is the case of positive external effects. That is essentially a state of affairs where the result of economic activity is goods or a service the consumption of which cannot be, without additional regulation, limited solely to the individuals who have borne the costs of its use or consumption, but is also extended to those who have paid nothing for its consumption (the problem of using a public good for free – free riding). The consequence is that the producer of such a good bears the full costs of its production while not capturing full revenues, which would be available if all consumers were paying the price of their consumption. Without regulation, there is no private interest for production of such a good; such a good would therefore either not be produced at all, or the volume of its production would be significantly below the optimal level. An example of such an activity is road building.

The latter is the case of negative external effects. In this case the economic actor who supplies a good or service does not bear full costs of their production while at the same time appropriating full revenues from such production. Without additional regulation, the volume of production of such a good would be higher than optimal. An example of such activities is the production, which causes direct pollution of waters, air and soil.

Even though entire budget expenditure policy can be viewed as a sort of regulation of externalities, the principal difference between the public goods and services that are financed from general taxes and the goods whose utilization is regulated is in general the following: no one can be excluded from the consumption of the first group of goods (pure public goods), or, the law prescribes the principle of non-exclusion (merit goods). The second group consists of goods and services for which, in case of full private ownership of the good (the right to: use, revenues from use, exclude others from the use and trade) and without regulation, the owner or user does not bear full costs of utilization or consumption. In case of such goods, it is necessary to provide either exclusivity of use, or clear identification of users. In such case, a fee, or a price for the use of a good or a service, would provide that the consumer bears the full costs of use of a given good or a service. Therefore, revenues from fees must primarily be directed towards their maintenance and/or renewal.

Selection of goods and services for the use of which the fee should be prescribed, regulation of acquiring and exercising the right to use, determination of relative significance of a good (national or local), as well as procedures for organizing and/or assigning maintenance and/or renovation of goods and services is, in principle, within the competences of central authorities. The level of fee must reflect real costs of efficient use of such goods and services, while competence over its determination depends on the relative significance of a given good or service. Maintenance and/or renovation of goods and provision of

services may be assigned to a public service or public or private company, pursuant the procedure prescribed by law. The revenues from the fee belong to the company or organization assigned with the maintenance and renovation of goods and provision of services.

In the Serbian system of public finances, there are many inconsistencies with the above discussed principles. They are evident in the choice of fiscal instruments and in the allocation of revenues between and within the budgets of the Republic and LGUs, which was fully elaborated in the previous study.[26] This deviation, however, is most obvious in the system of fees and charges and in the domain of local public finances, where regulation and procedures of revenues' and expenditures' side are at a rather rudimentary level. There follows below the analysis of the system of charges and system of the LGU source of public revenues.

In addition to the already mentioned, it is necessary to note yet another significant attribute of the numerous forms of charges and fees which shall be addressed below. Namely, fees and utility charges do not usually represent state levies in a conventional sense; rather, their nature is similar to the rent based relationship between the state and the individual user of a public good, such as the fee for the use of urban construction land or the fee for the use of waters, for instance. In both these cases it is the state that, as the owner of a given good, cedes the right to a legal or natural person, and thereupon justly charges the rent which is herewith referred to as a fee. It will be shown below that, with regard to many forms of fees (or rents), the question arises whether they should be regulated in any way or whether it would be better if they were determined on a competitive basis.

CHARGES

The Serbian Constitution and the Law on Public Revenues and Expenditures (Art. 12) prescribe that the law may introduce charges for the use of the goods of public interest. This Law also regulates allocation of revenues from charges to different levels of authority. The Law prescribes that all revenues from charges belong to the Republic (Art.23). This means that a substantive law, the law which introduces fees, also regulates allocation of revenue, while the Law on Public Revenues and Expenditures allows the possibility to allocate the revenues, from all the fees introduced, to the budget of the Republic. This Law does not provide an opportunity to allocate all revenues from fees to the budget of the Autonomous Region (Art. 24). Municipalities and cities may capture the revenues from the following charges: for the use of construction land; for building, maintenance and utilization of local

26 *Reform of Taxation System*, CLDS, 2003

roads and streets, and other public objects of significance for the municipality; for the use of natural curative factors; and for environmental protection and improvement (Art. 25).

The Law on Local Self Government (Art. 78) prescribes that source public revenues of local authorities include, inter alia, the following, the:

1) Charge for the use of construction land;
2) Charge for the adaptation of construction land;
3) Charge for the use of natural curative factors;
4) Charge for environmental protection and improvement, while the ceded public revenues (Art. 98) include:
5) Part of the charge for the use of mineral resources;
6) Part of the charge for the material extracted from waterways;
7) Part of the charge for the use of forests;
8) Part of the charge for the change of the purpose of agricultural land;
9) Charge for building, maintenance and use of local roads;
10) Part of the charge for environmental pollution;
11) Part of the charge for investments.

The Law on Local Self Government, therefore, compared with the Law on Public Revenues and Expenditures, extended the list of charges the revenues of which part go to the local authorities. In other words, these two laws are inconsistent, and they should be harmonized.

The individual charges are prescribed in ten following laws:

Charge for the Use of Construction Land

The Law on Planning and Construction (Art. 73) prescribes two types of charges:

- for the use of construction land, and
- for the adaptation of construction land.

The revenues of both charges belong to the municipality or city, and are used for the adaptation of land as well as for the construction and maintenance of the utilities infrastructure.

The Law on Planning and Construction defines construction land as land on which buildings are located and land required for the regular use of such buildings, and the land which is designated in land plans for erection of buildings and their regular use. The decision about the limits of construction land is within the competences of municipality or a city. Construction land may be the property of the state or private property[27] and it may be adapted.

27 It is interesting to note that this Law allows existence of the private property on this kind of land even though provisions of Serbian Constitution stipulate that urban construction land may be only in state or social ownership (Article 60): the Law uses the term construction land (without adjective: urban), so it is inferred that provision of Article 60 of the Constitution does not necessarily apply.

Table 1. Laws that Prescribe Charges

	Law	Charge for	The Funds Belong To
1	**Law on Waters** ("Official Gazette of the RS", No. 46/91, 53/93, 48/94 and 54/96)	Use of waters	Republic
2	**Law on Forests** ("Official Gazette of the RS", No. 46/91, 83/92, 53/93, 54/93, 60/93, 67/93, 48/94 and 54/96)	Use of forests	Republic
3	**Law on Roads** ("Official Gazette of the RS", No. 46/91, 52/91, 53/93, 67/93 and 42/98)	Use of roads	Republic/ Municipality
4	**Law on Agricultural Land** ("Official Gazette of the RS", No. 49/92, 67/93, 48/94, 46/95 and 54/96)	Change of the purpose of agricultural land	Republic
5	**Law on Planning and Construction** ("Official Gazette of the RS", No. 47/03)	Use and adaptation of onstruction land	Municipality/ City
6	**Law on Spas** ("Official Gazette of the RS", No. 80/92)	Use of natural curative factor	Municipality/ City
7	**Law on Mining** ("Official Gazette of the RS", No. 44/95)	Use of mineral resources	Republic/ Municipality
8	**Law on Environmental Protection** ("Official Gazette of the RS", No. 66/91, 83/92 and 53/95)	Use of merit good, environmental pollution	Republic/ City/ Municipality
9	**Law on Fishing** ("Official Gazette of the RS" , No. 35/94, 38/94)	Use of fishing area	Republic
10	**Law on Payment and Allocation of Charge Funds for the use of Goods of Public Interest to Production of Electrical Energy and Production of Oil and Gas** ("Official Gazette of the RS", No. 16/90)	Use of coal, water, oil and gas	Municipality

Table 2. Collection of the Charge for the Use of Construction Land, 2003

Total, in Millions of Dinars	3,802.4
Beograd, Novi Sad, Niš, Kragujevac	63.9%
Municipalities	36.1%

Source: Treasury of the Ministry of Finance

The Charge for the use of construction land is paid by the owner, or holder of the right to use, or the person who rents it. Further criteria, standards, level, method and terms for payment of this charge are prescribed by the municipality or city (Art. 74). Revenues from this charge belong to local communities, municipalities or cities on their territory.

As it can be seen from the previous table, the revenues of local communities from the charge for the use of construction land were 3.8 billion Dinars in 2003, which is approximately 1/20 of their total

revenues. Therefore, the revenue from this charge represents a significant source of revenues of local communities, especially for those cities in Serbia that possess the most valuable land and real estate.

For the reason that the Law on Planning and Construction does not specify the criteria for determining the level of charge but rather leaves that decision to the municipalities or cities, the relevant elements – the tax base, conditions for relief from paying the charge, the level of the charge – are now in Serbia determined in a large variety of ways. Let us examine the criteria for determining the level of charge for the use of construction land in a number of cities in Serbia.

Belgrade: depending on the surface area of the constructed facility; the inner city circle of Belgrade[28] has been divided into four location zones; facilities have been divided into 13 categories according to their purpose (residence and 12 types of business activities), and there are other additional criteria.

Valjevo: depending on the surface area of the constructed facility; division of the city into four location zones; facilities have been divided into four categories according to their purpose (residence, production related, business related and ancillary); Deviations are considered separately.

Paraćin: depending on the surface area of the constructed facility; division of the city into five location zones; facilities have been divided into two categories according to their purpose (residence and business).

Petrovac: depending on the surface area of the constructed facility; no division of the city into location zones, except for business premises which are divided into two zones; depending on the purpose, facilities have been divided into three categories (residence, production related and business).

Novi Bečej: depending on the construction land surface; depending on the surface area of facilities for specific purposes (residence, business premises and other) and for four specific activities (cumulatively); the city is divided into five location zones.

Pirot: depending on the surface area of the constructed facility; division of the city into six location zones; facilities have been divided into five categories according to their purpose, for industrial charge is the same regardless of the zone.

Kuršumlija: depending on the surface area of the constructed facility; division of the city into four location zones; facilities have been divided into two categories according to their purpose (residence and business premises).

Doljevac: depending on the surface area of the constructed facility; the city is considered to be one zone, facilities have been divided into residence and five categories of business activities according to their purpose.

28 Six suburban municipalities independently determine the level of the charge.

Kučevo: depending on the surface area of the constructed facility; the city is considered to be one zone; according to the purpose, facilities have been divided into the following categories: multi story residence, family residence, production, trade, catering, manufacturing crafts and other.

Irig: depending on the surface area of the constructed facility; division of the city into four location zones; facilities have been divided into three categories according to their purpose (residence, production and business premises).

Topola: residence buildings according to the constructed surface, and business premises according to the surface of usable land; division of the city into four location zones; facilities have been divided into four categories according to their purpose (residence and three types of business premises).[29]

Srbobran: according to the surface area of the land for the land which is not in state ownership; division to the four location zones; according to the purpose, facilities have been divided into two categories (residence and business premises).

Jagodina: extremely complex system: residential facilities – according to the surface area of the constructed facility; depending on the distance of the facility from: the city center, bus station, railway station, hospital and pharmacy, kindergarten, cinema and theatre, city library, primary school, high school, football stadium and sports hall, city park, supermarket, department store, green market, main post office, municipal administration and public accounting office; depending on the level of utilities infrastructure development at the location: traffic lane, pavement, water supply system, sewage system, telephone lines, electricity, heating system; similarly, the business premises are divided into five groups according to their purpose.

Consequently, common basic criteria for determining the level of charge for the use of the construction land are:

1. the surface area of the constructed facility,
2. location of the land/facility and
3. purpose of the constructed facility.

Surface of the constructed facility. Let us point out that the charge is not paid according to the size of the land in question, but in accordance with the surface area of the constructed facility. This seems to be a wrong approach since it is not based on the surface area of used land, which is completely in contravention of the essence of the concept of the charge for the use ***of land***, and represents, actually, the introduction of an additional tax on property.

29 System used in Topola introduces two interesting innovations: 1) in case of business premises rate is regressive regarding size, which favors bigger objects, and 2) representative offices of electric company and central post office are included in the highest category, probably because they are state companies of the Republic.

In spite of this, the above mentioned approach is fully justified. The value of the land depends exclusively on its intended purpose and (permitted) surface of the facility built on it. From the aspect of the land value, it is not irrelevant whether construction of smaller or a bigger facility is permitted on a given site: is it, for instance, a single-family house, multy-storey building or business premises. The value of land on which there is a multy-story building or erecting of such an object is permitted, is always higher than the value of the land with a single family house built on it. Naturally, these arguments would not be valid if the owner/user of the land had the free right to erect any kind of building or facility he chose, in which case the surface of the facility could be neglected and the use of land could be determined exclusively on the basis of the surface area of a given site. However, the user/owner does not have the right to build at his will, since these matters are defined in the regulation land plan, which prescribes maximum surface area of a structure on a given lot. Accordingly, the value of the land on the free market depends directly on the requirements of the land plan, prescribed purpose and surface of the planned or existing facility, thus resulting in the lower value of the lot on which the building of family house is permitted and the higher value of the lot on which a multistorey building is envisaged. By the same token, the surface area of the constructed facility is an important factor of the value of the land on which it is situated and it is only natural that it should be included in the formula for determination of the level of the charge for the use of construction land.

The disadvantage of the method of determining the charge according to the surface of the constructed facility rather than according to the surface of the used land, is that it presents a potentially adverse incentive to rational use of land, since a lower charge is paid by someone who is not making the best possible use of the land (measured by low ratio of the surface of constructed facility and surface of the land, and significantly below the parameters permitted by the land plan). In other words, management of urban land is very far from rational when those who possess a small building on a large lot, especially when this land is located in the centre of the city and its value is the highest, pay a low charge.[30]

However, this problem is unavoidable in the regime of construction land in state or social ownership with unlimited length of the right to use. Its solution, within the given institutional framework, may not be found in the management of the level of charge for the use of construction land, but exclusively in the field of urban planning. In other

30 In Belgrade, there was an attempt to solve this problem by increasing charge for the use of land on “deluxe” land, exceeding the area of the main building, by using regressive scale (Decision on Charge for the use of Urban Construction land, “Official Gazette of Belgrade”, December 2nd 2002). In other words, the larger the “extra” land, the corrective factor of charge increase is smaller, which still does not provide sufficient incentive for more rational use of land.

words, the degree of rational use of construction land depends exclusively on successful urban planning, and not on the system of charges for the use of construction land.

Location of the land/facility. First, the concept of location represents a measure of comparative advantage of a given location, which is, certainly an important factor of the land value and represents a common basis for determining the rent. In view of the fact that zoning in Serbian cities usually defines only a few zones (Belgrade has only four), the result is that so few zones cannot represent the variety of the comparative advantages of a given location. Especially since within particular zones there are significant differences in value between neighboring micro locations – for instance, between the main and side streets in the center of a city.

Second, location criteria should also represent infrastructural and utilities related facilitation, based on the assumption that better locations are better facilitated. However, this assumption is not always realized, since old city centers, which have the best location advantages, often have a lower level of utilities' and other infrastructural facilitation than newly built ones, in the suburban areas. Therefore, some cities and municipalities explicitly take into consideration elements of infrastructural and utilities related facilitation, amenities etc.

Purpose of the constructed facility. The commonest criterion for determining the level of the charge for the use of the construction land is the purpose of the constructed facility. Generally speaking, this approach is reasonable since, as in case of the criterion of constructed facility surface, the value of the particular lot of land is directly related to the planned purpose of the facilities on it. If it is envisaged that business premises be built on a lot, the market value of that lot is higher than it would be were a residential building of same size planned to be built on it. Therefore, using the criterion of the purpose of the facility, that is, categorization of the land according to the purpose of the facility is a rational solution and should be maintained in the future.

However, this criterion is often distorted in practice. Namely, when determining the level of charge for the use of land, some municipalities and cities differentiate between categories of purpose of a facility, in a manner that is not exclusively related to the categories of purpose – categories which are commonly included in spatial and land plans (residential, business, production) – but also include social and developmental elements. Thus the City of Belgrade differentiates between 12 economic and other activities and prescribes different levels of charges for each of them, while Kučevo differentiates between just five.

It is difficult to find a good reason for such an approach, since significant differentiation between purposes of the constructed facility might mean:

- that it is a result of an intention to facilitate collection of the charge, by increasing burden to those who are assessed to be able

to bear it, for instance, lower burden for craftsmen, higher for restaurants, lower for industry, higher for financial services (which turns the charge into an instrument of social policy),

- or that it is a manifestation of economic/developmental policy, by providing an incentive for some economic branches (production related) and disincentive to development of others (service related).

None of the above mentioned reasons should determine the level of the charge for the use of the construction land, since:

- it is unreasonable to conduct the social policy through the prices, and particularly through the prices of production factors, because it results in inefficient allocation of resources; social policy should be conducted through budget transfers to those who are really poor, and not through instruments which differentiate between richer and poorer individuals within certain categories of land users (for instance, between craftsmen and restaurateurs), and
- providing incentive for development of production activities as opposed to services related activities is a manifestation of an outdated and basically wrong approach to economic policy, since there is no valid reason for discrimination of the one against the other activity; economic policy should be allocation neutral in order to maximize total economic activity. Why should we have, for instance, extremely low charges for food, chemical, construction related, metallurgy and metal industry in the Belgrade city center? Wouldn't it be more logical, in view of the criterion of rational use of urban land, to configure the relatively high charge for the use of land in this case and to thus provide an incentive for those activities to move to less valuable land, i.e. towards suburban areas?

The best solution would be if the list of the categories of purpose for which the charge is levied were equal to the list of purpose categories prescribed by spatial and land plans. This is recommended due to the fact that spatial plans determine the value of the construction land by prescribing, among other things, the purpose of the land, but these purposes are limited to very few basic categories. Since value of the land depends on the purposes prescribed by the spatial plan, determination of the charge for the use of land should take into consideration the same purposes, because that would bring into line the value of the construction land and the level of charge for its use.

Even if we accept the above mentioned criteria for determining the level of the charge as well chosen, the issue of their quantification would still be unaddressed. Namely, each of them should be expressed in dinars or in points and no objective method of quantification is in place. This is clearly demonstrated by the differences in scores of particular criteria in different cities in Serbia. The ratio of levels of charges for business and residential surfaces differ: in the center of Petrovac it

amounts to 3.8, in Valjevo it is 5, in Paraćin it is 14.4 and in Belgrade 66.3 – which one is the best?

Consequently, there are significant conceptual and technical weaknesses of the method for determining the level of charge for construction land in Serbia. However, that is not all.

A very interesting and important question is – ***what is, in its essence, the charge for the use of construction land?*** What is it based on, why does it exist and what service does the state provide for collecting the charge?

The first answer may be the following: construction land is in state ownership, and all its users are actually renters, so it is natural and fair that they should pay the rent which is called charge for use. This argument is valid at the general level: the user/renter pays for the use of land which is not in his ownership. The name itself – charge for the ***use*** – implies a rental-based content. However, operationalization of the system shows that this is not a clear solution. Namely,

(1) the charge for the use is collected also for the land that is under state ownership (for instance, in villages like Paraćin, Pančevo, Velika Plana[31] etc.), which implies that the substance is not rental of state land, or, at least, that it is not only about rental, but that the charge may represent a combination of different charges. The Law on Planning and Construction permits the introduction of the charge for the use of land that is not in state ownership if it is facilitated with basic infrastructure paid for with state funds, and

(2) the purpose the collected funds from the charge may shed some light on the matter: according to the Law on Planning and Construction (Art. 73) it is used for the development of non-developed construction land (facilitation with basic utilities related infrastructure) and for construction and facilitation of utilities related infrastructure on other land.[32] Consequently, the funds are meant exclusively for utilities related infrastructure, which again stresses the relation between this charge and infrastructure.

It turns out that the charge for the use of construction land is a combination of two components, the first being the rent for the use of the

31 For instance "Decision on Criteria and Measures for Determination of Rental, Charge for Adaptation and Charge for the use of Construction land on the Territory of Municipality Velika Plana" (15th November 2004) stipulated that charge for the use (and adaptation) is collected at the level of settlements within the Municipality. The term settlement is defined in the following way: "Settlement represents construction area of a settlement defined in the appropriate spatial land plan and overall ancillary area – cadastral municipality". The latter part obviously widens construction area to village area which is probably clashing with the spirit of the Law on Planning and Construction.

32 For instance, in Pirot, the charge funds are used for the following purposes: maintenance and improvement of the pavement and traffic lane, vertical and horizontal signalization, public lighting, water supply and sewage system.

state owned land, and the second being the charge for funding utilities related activities and for further investment in them.[33]

It becomes obvious that this charge is not solely a charge on utilities related infrastructure after taking into account the fact that it is not determined exclusively according to the facilitation of the location with utilities related infrastructure, but rather, and in most cases, according to other criteria.

On the other hand, property taxes are also dual in character. Namely, according to the Law on Local Communities, the property tax is levied on facilities which are in taxpayer's ownership or are used by the taxpayer, based on rental or other contract, but construction land is not included in the calculation of the value of that facility, since it is, as a good, in state ownership,[34] only given for permanent use in exchange for charge for the use. This means that these two charges should be separated, i.e. that they are related to different parts of real estate and rights thereof, and that each of them has its meaning.

However, this normative concept does not function in the envisaged way. The basic factor which spoils the envisaged architecture of these two levies is the fact that the value of the facility taxed by the property tax also includes the value of the right to use the land on which the facility is situated. In other words, the market value of the structure – i.e. the price which someone is prepared to pay for it – also encompasses the right to use construction land on the given location. The fact that certain land is in state ownership does not fundamentally change the situation. The right to permanent use of land actually represents part of the ownership rights and by the same token has its market value. In other words, the right to use is very similar to full private ownership – the permanence of right to use, possibility of a rental etc. – so that in everyday life there is very little difference between right to use and rights which would be enjoyed based on full private ownership on that same land. The only significant difference is the possibility to fundamentally change the regime of the use of construction land, including privatization, which might compromise the right of current users to use the land. That risk, obviously, decreases the value of the right to use land and the market also takes that issue into consideration when forming the price for the purpose of trade.

If we start from the mentioned fact that the market price of a facility includes the value of the right to use construction land on which the facility is situated, it is noticeable that two different levies are paid for the right to use construction land – the first is a charge for the use of construction land, the second is property tax – which represents unnecessary double taxation and should be avoided.

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33 This other component was commonly mentioned as a reason for introduction of the charge of use of urban construction land, three decades ago.

34 Here we are disregarding possibility given in the new Law on Planning and Construction from 2003, that urban construction land may be in private ownership as well.

Let us go back to the dual character of the charge for use and let us pose another question: should that be so? Should those two components coexist, or should they be integrated into one single levy?

Rent. A component of the current charge for the use of the construction land which represents a rent for the use of land in state ownership should be maintained (at least while state ownership of land continues). This is because it would be neither fair nor efficient to let the users benefit from the land free of charge. For (private) use of the resources which are in anybody's, even the state's ownership, there should be a rent, regardless of its name (charge, rent, concession etc.).

If there were no charge for the use (in the sense of rent for the use of land) this would represent a gift from the state to the user, to the amount of the rent, which would not just be an economically inefficient solution – it would provide an incentive for irrational business use of land[35] – but it would ultimately be unfair, since the users of land would capture the rent, and those that are not users would be deprived of that opportunity by an administrative decision of the state (local community) which would determine who will be given such an opportunity, and who will not.

Rent can be charged only for land which is in state ownership, and not for land in private ownership. Therefore, rent should not be charged outside clearly defined areas of public property over construction land. Similarly, the currently predominant concept of a charge for the use of construction land – which is charged independently of land ownership, which means that it is charged also for land in private property – could not be maintained.

Infrastructure. A part of services of local utilities are collectable in full from their users (water, public transportation, district heating, etc.), but another part represents a public good, and it is not collectable. Namely, the use of some goods (for instance street traffic lanes and pavements, parks, street lighting and the like) has two unique attributes: 1) it is not feasible to exclude those who do not pay, and 2) the additional cost of another user equals zero. Due to the mentioned attributes, commercial supply of these utility related services is not possible, or is not efficient, and their provision and financing are conducted through local taxes by the state, or local communities. In many cities in Serbia, it is done through the charge for the use of construction land, which means that owners/users of the land pay for the services of local public goods through the charge for the use of construction land. The fact that local public goods should be financed is not in question here. However, the issue is whether it is necessary to have a separate levy – in the form of a charge for the use of construction land – or it would be better to use some other or several other levies.

35 Absence of rent could make profitable even extremely irrational and unsuccessful use of land.

The new concept. Reform of the charge for the use of construction land, starting from specifying its function, should cover the following:

1. charge for the use of construction land should be maintained, and it would represent a rent for the use of land in state ownership. Similarly, this charge would be charged only for the land in state ownership and not for the land in private ownership; due to different coverage – taxpayers are the same only in some cases – full integration of the charge for the use of construction land into the property tax would not be a good solution.
2. The base for the charge should be equal to the base of income property tax. There are several arguments in favor of this solution: first, the charge for use was established three decades ago as an (insufficient) substitute for property tax, which did not exist at the time; later the introduction of the property tax renders redundant this independently determined levy which is, in fact, a form of tax; second, the existing criteria for determination of the level of the charge in essence represents an insufficiently appropriate manner of determining the value of property through numerous quantitative parameters expressed in kind; the base of the reformed property tax represents a value, which is attempted to be determined through the existing criteria for determining the charge for the use of construction land; third, arguments in favor of using the property tax base are basically related to administrative simplicity: namely, it is much simpler and administratively more efficient to use the existing, properly established base of property tax, than to, in a fairly complex manner of applying system of criteria, in a roundabout way, try, and usually not succeed, to approximate the value of construction land. In other words, the law should prescribe that the tax base determined for purposes of property tax should be used as a base for the charge for the use of construction land.
3. The next question is which level of the state authority should determine the rate of the charge for the use of construction land, and which level should realize the revenue thereof.
   a. On one hand, it could be argued that there should be a unique rate for the whole territory of the Republic of Serbia, since the land for which the charge would be paid is in state ownership and it would therefore be natural that all users of land throughout Serbia pay an equal levy, thus ensuring equality before the law. Variations in value of the construction land would certainly be reflected in the value of the base for the charge, and by the same token, by the amount of the charge. The revenue from the use of construction land should belong to the budget of the Republic, since, in accordance with the current constitutional order, construction land is the property of the Republic, accordingly, based on ownership criteria, there is no sense in allocating the revenue from rent to local

communities. It should be pointed out here that revenues from all similar charges for the use of goods in state ownership go to the budget of the Republic.

b. On the other hand, transferring the revenues from charges for the use of construction land to the state level would entail a significant blow to the financial position of local communities, since these revenues currently represent one of the most important items on their revenue side, and that would entail significant change in the system of financing local communities. Besides, the following interpretation speaks in favor of maintaining the determination of the level of charge and revenues thereof at the local level: since the Republic of Serbia has transferred to local communities the rights to use and decide about the land (the right to design spatial land plans and the right to allocate land to legal and natural persons), it is only natural that the right to determine the charge and collect revenues thereof also belongs to local communities.

4. If, in the course of pending constitutional changes, ownership over construction land is transferred to municipalities and cities, which is the likely outcome – then the right to determine the rate of charge for the use of land would definitely belong to municipalities and cities. In that case there would be no, not even ownership related, reasons for the Republic of Serbia to regulate the charge as a rent, and local communities would be entitled to do that, collecting the revenues thereof included.

5. The second component of the existing charge for the use of land – the one for utilities related infrastructure – should be abolished, because:
   a. The charge, even if it is maintained, should be calculated on the base equal to the property tax base, since, as reiterated above, that tax base approximates the value of land better than the current charge for the use of land.
   b. The burden of financing local public goods should be equally shared by all inhabitants of a local community, regardless of their actual location in rural or urban areas; the rationale is that utilities related systems are gradually spreading to village settlements (or at least their centers); the burden of financing local public goods will decrease in future, since financing the development of those local utility systems which have clearly identified users (water supply, public transportation etc.) shall, in future, rely on self-financing from charging for provided services, and much less on fiscal funds.
   c. In a majority of municipalities and cities the current system of charge relies on the assumption that it is feasible to determine users of services of local public goods and to charge them through the charge. This is not realistic since in cities we have some owners of land without a sewage system, for instance,

who still pay the charge for the use, and in villages we have owners who do not pay this charge and still enjoy the benefits of having street lighting and pavements.

d. From a tax rationality point of view, there is no sense in having a separate levy – charge for the use of land – which will be equal to the property tax in every way; these levies may be integrated into one, i.e. the periodic property tax rate may be increased and the charge for use, in its infrastructural part, could be abolished; this would contribute to increasing administrative simplicity and tax efficiency.
e. The charge for use belongs, as in the case of periodic property tax, to local communities. So, possible abolition of this part of the charge, accompanied by an appropriate increase of property tax, would have no negative consequences for local community finances.

Charge for adaptation of construction land is paid by the investor, and the level is determined based on the contract between the appropriate municipal or city authority or company and investor (Art. 74 of the Law on Planning and Construction). The investor pays this charge for adaptation of the construction land, which entails its preparation (planning documents, displacement etc.) and facilitation of the land with utilities related infrastructure. In essence, the relation between the investor and the local community is a commercial relationship of contractual parties and, therefore, the charge for adaptation of construction land cannot be understood to be a fiscal levy. That is why this charge shall not be studied here.

Charge for Agricultural Land

Normative Solutions

The Law on Agricultural Land prescribes two charges that are related to agricultural land:

- The charge for change of purpose of agricultural land (Article 7),
- The charge for the use of agricultural land in state ownership (Art. 17).

Apart from charges, the Law on Agricultural Land introduces a specific tax on unused arable agricultural land which is paid by socially owned, mixed property companies and cooperatives (Art. 17à).

The charge for change of purpose of agricultural land. This Law prohibits the use of arable agricultural land of I, II, III, IV and V cadastral class for non-agricultural purposes. However, under certain conditions (public interest), the Law prescribes exemptions to this rule (construction of roads, railroads, protection of water-management facilities, enlargement of settlements etc.). In these cases there is a charge to be paid for the change of purpose of agricultural land.

Those liable to pay these charges are the investors who change the purpose. It is a charge made on a one-off basis, and it is paid at the following rates (art.10):

- For Cadastral Class I, at the rate of five hundred times of the cadastral revenue;
- For the Cadastral Class II, at the rate of four hundred times of the cadastral revenue;
- For the Cadastral Class III, at the rate of three hundred times of the cadastral revenue;
- For the IV Cadastral Class, at the rate of two hundred times of the cadastral revenue;
- For the Cadastral Class V, VI, VII and VIII, at the rate of one hundred times of the cadastral revenue.

For example, the amounts of charges, depending on the quality of land, for the city of Niš are shown in the table below.

Table 3. Charge for Change of Purpose, Niš

Class	Factor	Cadastral revenue	Amount of Charge
1	500	174.14	87070
2	400	131.65	52660
3	300	113.31	33993
4	200	83.60	16720
5	100	65.27	6527
6	100	48.04	4804
7	100	31.10	3110
8	100	15.55	1555

It is noticeable that the amount of the charge rises sharply with the quality of land: for the first category arable field it is 5.2 times higher than for the fourth category of arable field and 56 times higher than for the eighth class of arable field.

The Law also prescribes (Art. 11) six cases in which this charge shall not be paid (construction and adaptation of the family residential building or economic facilities attached to the agricultural household, location for cemeteries, water management facilities, regulation of waterways, construction and widening of country roads if they contribute to more rational use of construction land; foresting, if it is assessed that it will be more rationally used if it is forested; erecting field protection belts).

The level of charge for the change of the purpose in every particular case is decided by the competent authority of the municipality, on the request of the investor, (Art.12), while the revenue goes to the Republic.

Charge for the use of agricultural land in state ownership is paid by the user of that land, the level of the contribution is determined by the Government of the Republic of Serbia, and the revenue goes to the budget of the Republic.

Specific tax on unused agricultural land is paid:

- for unused arable agricultural land, by socially owned, mixed property companies and cooperatives (Art. 17a) as well as owners who do not live on the farmstead or in a village (Art. 17v), at the rate of 10 to 50 thousands of dinars per hectare depending on the cadastral class, and
- for unused plantations of orchards and vineyards, by socially owned, mixed property companies and cooperatives and owners who are not conducting agricultural production as their main activity, at the rate of 50 thousand dinars per hectare, and for plantations with irrigation systems up to 100 thousand dinars per hectare (Art. 17á).

This Law stipulates that a farmer, who is assigned the use of arable agricultural land, pays half the taxes on cadastral revenue for the period he is using that land (Art. 17d).

Analysis

Budget revenues from the two mentioned charges and specific tax are presented in the following table.

Table 4. Revenues from Agricultural Charges in 2003

	Thousands of din.
Specific tax on unused arable agricultural land	117
Charge for change of purpose of agricultural land	18,498
Charge for the use of agricultural land in state ownership	55
TOTAL	18,670

Source: Treasury of the Ministry of Finance

In 2003, the only prominent, although modest, revenue is revenue from the charge for change of the purpose of agricultural land (18.5 million dinars), while the other two raise almost negligible amounts.

Specific tax on unused agricultural land. The purpose of this tax is to provide an incentive to use agricultural land by additional taxing of unused land. However, this tax is unsustainable and should be abolished for several reasons:

- It impinges on the right of private owner to freely manage production resources and to use them, or abstain from use, if he considers it to be in his best interest.

- The only good incentive for agricultural development, and, at the same time for full use of agricultural land, is a favorable business environment which is based on abolition of administrative restrictions, moderate taxes and competition, as well as on potential budgetary and credit related opportunities – and not on legal punishment by taxing those who, in an unfavorable business environment (as was the situation at the time of enactment of these provisions in 1999), do not find interest in work on the land which is at their disposal.
- For that reason there is no sense in taxing the legal entities that use agricultural land in state property; they should pay an appropriate charge for the use of this land and surrender it (give it back to the state) if they do not need it.
- Implementation of this tax entails extremely high administrative effort for continuous supervision of several millions of agricultural holdings in Serbia, for which there are no available resources. This renders these provisions unenforceable and unreal, which can be seen from the indicative tax collection records shown above.
- The amounts of this tax are extremely high and at the time of its promulgation they were close to the value of the unused land, which is equivalent to confiscation.

Charge for the change of purpose of agricultural land. At first glance, this charge represents a disincentive for the change of purpose of agricultural land, especially in case of switching to construction land. The reason would be real or alleged societal need to protect agricultural land from the spreading of "hungry" cities, and their expansion at the expense of the agricultural environment. This is how the existence of this charge was defended in public, under the previous regime. However, this kind of logic is outdated and illogical, principally for two reasons:

- First, there are no economic and societal reasons which would prevent conversion of less valuable agricultural land into highly valuable urban construction land, since it is doubtless that from the point of view of general public interest and interest of owners of agricultural land[36], as well as its future users, it would be far better if the change of purpose occurred. The prime evidence for this is the relation of the price of land for these purposes: construction land is far more expensive and thus in an economic sense more valuable than agricultural land.
- The policy of land use which is conducted through the charge for change of purpose is, by all means, inefficient, since it cannot provide for preservation of agricultural land. A far more efficient instrument is the policy of urban planning and zoning, where the purpose of the land is determined directly.

36 Here we are principally assuming fair price (in congruence with the value of urban construction land) and not so-called market price from the Law on Expropriation, pertaining to agricultural land.

However, the charge for change of purpose may have a reason for existence in the current system of state ownership and private use of urban construction land. The significant difference in value of urban construction and agricultural land at the moment of the change of purpose is a rent which would, in the absence of instruments for its capture, be appropriated by the new user of construction land (investor or buyer of the real estate), with no merit whatsoever. On the other hand, there is currently a charge which, on a one-off basis, captures rent of the land in urban areas – that is the charge for adaptation of construction land inasmuch as it exceeds costs of infrastructural facilitation (which is usually the case).

Let us stress that in the regime of state ownership over construction land, the state collects the rent – the difference in value of agricultural and construction land at the moment of the change of purpose of a given lot, while the private owner of the agricultural land which is being expropriated receives a charge at the level of value of the agricultural land, and is thus left without the rent. On the other hand, in the regime of private ownership over land, the rent will be captured by the private owner of agricultural/construction land for he will sell it to the investor at market price that is at the price of construction land, which is much higher than the price of agricultural land according to the Law on Expropriation.

Consequently, the charge for change of purpose of agricultural land has a meaning in the regime of state ownership over urban land, since it represents an instrument for capturing the above mentioned rent by the state, from a private user. In the part of agricultural land which is being transformed into private urban land, which is allowed in the new Law on Planning and Construction, the existence of this charge is redundant, since there is no possibility provided for the new owner to undeservedly capture the rent, since he will pay the full price, including rent, to the old owner of the land, nor is there any basis for the state to capture the rent since it is not the owner, or a mediator, or a user. State revenue is in this case limited to property tax.

If agricultural land changes its purpose and becomes state owned for the purpose of building a road or other infrastructural facility, there is no need to raise the charge for change of purpose, since in this case it would be the state who would charge itself with a levy, which is not necessary.

Charge for the use of agricultural land in state ownership. In Serbia agricultural land in state ownerships encompasses 240 thousand hectares in Vojvodina and significantly less in central Serbia. It originates from the agrarian reform and census on nationalization after WW II, and is used by agricultural and agro-industrial firms in social and mixed ownership.[37]

37 See Law on Conversion of Social Ownership on Agricultural Land into Other Forms of Ownership ("Official Gazette of the RS" No. 49/92 and 54/91.

This charge by its essential nature does not belong to public revenues, since it does not come from *imperium*, but from *dominium*, i.e. represents a manifestation of the private relations between the state as an owner of agricultural land with those legal entities which use that land. It represents a rent for the state owned land which is used by agricultural and agro-industrial companies in social and mixed ownership.

Therefore, the charge should be paid for the use of agricultural land in state ownership, but the amount of revenues (55 thousand dinars in 2003) provides evidence that it is seldom paid in practice. If this failure to pay was tolerable at the time when state agricultural land was used by agricultural estates in social ownership, that practice should not be tolerated any more. In the course of the privatization process these companies are becoming private companies, and failure to pay the charge represents a straightforward subsidy to the private owner, i.e. it means free surrender of the state owned agricultural land for exploitation.

Suggestions

1. Abolish separate tax on unused agricultural land,
2. Re-examine the nature of the charge for the use of agricultural land in state ownership, i.e. it should be deleted from the Law on Agricultural Land (if the law itself is not redundant) and define it on the basis of a rental contract between the state and user (as a result of competition between potential users).
3. Regular collection of charge for the use of agricultural land in state ownership, as a rent.
4. The charge for a change of purpose of agricultural land should be kept at its current volume – only for transfers of private ownership into state ownership and its renting for the commercial purposes of private users.

Charge for Forests

Introduction

Serbia is relatively rich in forests (approximately 2.5 million hectares), and the most common trees are beech and oak.

Serbian forests are in mixed ownership: more than a half (1.37 million hectares) are in state ownership and somewhat less than half (1.16 million hectares) are in private ownership with over 500 thousand owners. Over 90% of state owned forests are managed by public companies Srbijašume and Vojvodinašume, 7% are managed by national parks and the rest by more specialized companies (water management organizations and cooperatives, Faculty for Forest Engineering, etc.)

Exploitation of forests in Serbia is strictly regulated by the Law on Forests, regardless whether they are in state or in private ownership. Cutting forests is not free even for private owners, and for such intentions the approval of the competent authority is required. The aim of regulation is maintenance and improvement of the forest stock. Public companies Srbijašume and Vojvodinašume conduct professional and technical works for private owners as well. The establishment and functioning of public company Vojvodinašume by the so-called Omnibus Law, by virtue of which certain competences were transferred from the level of the Republic of Serbia to the level of Autonomous Region of Vojvodina, have caused certain legal difficulties since the Law on Forests has not been changed, and these two laws have been mutually inconsistent for some time now.

Normative Solutions

The Law on forests introduces the following charges for the use of woods:

- For a cut wood;
- For the use of forest land on the basis of a rental;
- For the use of forests and forest land when used for grazing;
- For an area of cleared forest.

Payers of these charges, competences for determining level of charge as well as recipient of revenues is shown in the following table.

Table 5. Charges Related to Forestry

Charge for	Payer	Base	Level determined by Law in the amount of	Recipient of revenues*
Cut wood	Owner or user	Market value of felled timber determined at the loading site	3 %	Budget of the Republic
Use of forest land on the basis of za rental	User	The amount of paid rent	3 %	Budget of the Republic
Use of forests and forest land when used for grazing	User	The amount of collected charge for grazing	3 %	Budget of the Republic
The area of cleared forest	Owner or user	Value of the forest according to the Law on Expropriation	Five times	

* *Note:* not compatible with LLSG

The Law on Forests also prescribes:

- Market value of the felled timber is a price per unit, used by public companies Srbijašume and Vojvodinašume for selling wood, determined at the loading site.
- Calculation and payment of charge for the use of forests is made by the users, before 15th of the month for the preceding month.
- Owner of a forest is liable to pay the charge for a felled tree, within 15 days form the date of executed remittance.
- Calculation and determination of the level of the charge for a felled tree, paid by the owner, is done on the remitted document in the course of the procedure for approval of cutting.
- Regarding forcible collection, outdatedness, interest and other instances not envisaged by this Law, the provisions of the law regulating profit tax of companies and corporations are also applicable for forest owners – provisions of the law regulating individual income tax, if it is not regulated otherwise (Art. 54đ).
- Funds from the charge are used for foresting, melioration of degraded forests, production of forest seeds and planting material, as well as for exploration and programs pertaining to protection and improvement of forests (Art. 60).

Besides, Art. 54 of the Law on Forests prescribes also that users of forest shall set aside funds for reproduction of woods, in accordance with the federal law, and that companies which endanger forests in the course of performing their economic activity, shall set aside the funds in the form of a charge for repair of degraded forests and forest land.

Analysis

Although the basic motive for the introduction of four charges that are paid in accordance with the Law on Forests is the provision of fiscal revenues, so far the results have been modest. Total revenue from these charges amounts to only 74.4 million dinars, as is shown in the table below.

Table 6. Revenues from Forest Related Charges in 2003

	In thousand of din
Charge for the area of cleared forest	9,144
Charge for a felled tree	64,454
Charge for the use of forests and forest land when used for grazing	
Charge for the use of forest land on the basis of a rental	795
TOTAL	74,419

Source: Treasury of the Ministry of Finance

Only the charge for a felled tree brings more significant revenues, while the funds realized on the basis of other charges are very modest.

The weaknesses of the system of forest related charges are numerous and very grave.

First, all these charges represent specific purpose levies (funds are intended for the purpose of improvement of forests in Serbia, according to the Law on Forests), which is, as shown above, an inferior method of financing public expenditures.

Second, the logic they are based on is disputable, which brings the reason for their existence into question.

Charge for a felled tree. This charge is paid by public companies and private owners of forests, even though there are no apparent reasons for this. There is no sense in making the public companies Srbijašume and Vojvodinašume pay the charge for a cut wood to the state, since they are state owned companies established for management of state forests and since these funds are ultimately allocated back to them in the form of budgetary expenditures intended for forestry. If the net budget revenue is expected from exploitation of state owned forests – it is better then to realize it from the profit of a company, and not from every felled tree. Namely, the profit may be significantly higher than the revenue from the charge, the rate of which is only three percent. The existence of the charge for a felled tree may be interpreted as a rent for concession which the state gives to the company but that would be erroneous since it is a state owned company and since the charge rate is so low (3% of the value of the felled tree).

It is unclear why private owners pay to the state the charge for a felled tree if that tree is in their private ownership. The concept of a charge entails that payment is followed by some assistance provided by the state, and there is no such assistance here. On the other hand, limiting of cutting trees in private forests can be conducted through detailed regulation prescribed by the Law on Forests (cutting plans, approvals for cutting, responsibility for renewal of forests etc.), so a disincentive through fiscal levies is redundant.

The charge for a felled tree may be deemed to be indirect taxing (sales tax or production tax), which would mean additional taxing of forestry, or processing of wood, compared with other economic activities which are not burdened in that way. Given that the sales tax is usually paid in retail trade and that it is production that we are addressing here, we come here to the situation where two sales taxes are paid on wood: one in the production and the other in retail trade (furniture, paper etc.), which constitutes unnecessary discrimination against forestry.

Charge for the area of cleared forest. Clearing forests in Serbia is forbidden, except for two reasons: the first is improvement of forests by changing their shape (new tree species etc.) and the other is the public interest, if determined on the basis of law (change of purpose of land etc). The charges are charged only in the latter case and, principally

speaking, it makes sense for it constitutes a charge for destroyed forest. The total value of forests, from the public point of view (protection from erosion, oxygen, healthy natural environment etc.) far exceeds the value of forests from economic point of view. Therefore, relying exclusively on profit as a motivation for cutting forests, and disregarding other benefits from forests, might lead, very rapidly, to their degradation with all the devastating consequences.

Yet another issue is whether the level of the charge is properly determined, since it represents five times the value of the cleared forest, and the value is determined by the Law on Expropriation. Considering that this Law prescribes that the value of the forest is determined according to the market value of the timber (for old forests) or costs of raising (for young forests), and that total value of the forest exceeds its economic/market value, it is only natural that the total charge should be higher than that stipulated by the Law on Expropriation. However, factor five in relation to the economic value of the forest is very high and represents a clear manifestation of the policy that, even in case of valid public interest, provides an adverse incentive to clearing.

Charge for the use of forest land when used for grazing or when rented. Only legal entities managing forests pay this charge for renting forest land or for letting forest land for grazing. The reason for the existence of these levies is not clear since the charge is levied on the individual revenue of state owned companies. As a result, these revenues are taxed twice: by tax on revenues from renting and grazing, and by profit tax.

Third, Serbia needs reexamination of the methods of state forest management. The current system – in which two state enterprises exploit the state forest fund – is not rational. The condition of state forests is not satisfactory since its maintenances is inadequate and foresting insufficient. The financial results of state owned company Srbijašume are extremely modest: from the state forest fund and other businesses this company realized only USD 100 thousand in 2002. Instead of realizing net revenue from state forests, the Serbian budget subsidizes the public enterprises. The Government of Serbia therefore adopted a strategic plan of restructuring the company Srbijašume in 2003.

Without going into details on possible options for changes of management methods over state owned forests, it should be pointed out that some of them would inevitably lead to participation of the private sector in exploitation and management, for instance through concessions, rent of lots etc. which must be accompanied with changes to the current system of charges, rents and other levies.

Suggestions

1. The following charges should be abolished:
   - For a felled tree;
   - For the use of forest land on the basis of a rental;

- For the use of forests and forest land when used for grazing.

All three essentially represent unnecessary additional (discriminating) taxation of this activity, and it should be borne in mind that protection of forests is far more efficient when it is conducted through direct regulation than through fiscal disincentives.

2. Reexamine the level of the charge for an area of cleared forest, since the current one presents an insurmountable obstacle, even when there is a justifiable public interest.

Charges for Waters

The Law on Waters governs the protection of waters, protection from the detrimental effects of waters, the use and management of waters, the requirements for and the manner of conducting, organizing, and funding water management activity, and the supervision over implementation of the Law.

By virtue of this Law (Art. 81) the Public Water Management Company „Srbijavode“ (PWMC) was founded. The activity of the PWMC was registered as an activity of public interest. The scope of the PWMC activity (Art. 82) includes: management over water resources; monitoring, maintaining, and improving the water regime; maintenance and reconstruction of water management facilities; implementation of measures for protection from the detrimental effects of waters and the measures for protection of waters from pollution. The Law prescribes that in case of privatization the share of state capital in the PWMC shall remain minimum 51% (Art. 83), that no bankruptcy proceedings may be instigated against the PWMC, and that in cases where the PWMC is in a such situation that all the requirements are met for instigation of bankruptcy proceedings, the RS National Parliament shall undertake measures to ensure unimpaired operation of the PWMC and be a guarantor for its liabilities (Art. 85). The supervision over the operation of the PWMC, and supervision over the implementation of the Law is the responsibility of the competent ministry (Art. 108).

In the middle of 2002, however, by virtue of Omnibus laws related to the establishment of the authority of the Autonomous Region of Vojvodina (ARV), and without making any amendments to the Law on Waters, the Regional Assembly have founded the Public Water Management Company „Vojvodinavode“. This Company took over authority in the territory of Vojvodina, and, based on the balance of the division of assets, it also took over the resources of the PWMC "Srbijavode“. Although the types of charges and the method for determination of the level of charge underwent no changes, the allocation of the revenues from the charges did. The revenues from the charges for the use and protection of waters, and for the material extracted from waterways, that are payable by the payers from the territory of ARV were, on this occasion, allocated to the Budget of Vojvodina, and the revenues from the charge for irrigation, drainage and use of water

management facilities in the territory of Vojvodina were allocated to the PWMC "Vojvodinavode". In practice, this means that the existing system of revenue collection from waters is contravening the Law on Waters and the Law on Public Revenues and Expenditures.

The Law on Waters provides that the water management activity is funded from the charges and from the funds of the RS Budget (Art. 99). This Law introduced the following charges:

- for use of waters (surface, underground, and mineral);
- for protection of waters;
- for drainage;
- for irrigation;
- for the material extracted from waterways, and
- for the use of water management facilities and for provision of other services.

The table 7 shows who is liable to pay these charges, as well as the authority over determination of their level and the allocation of revenues thereof.

The law specifies the factors determining charge level, the manner in which the level of charge is determined, and the intended purpose of the revenues collected based on these charges. The RS Government each year promulgates a decree whereby it prescribes the level of the charges for the use of waters and protection of waters, and for the material extracted from the waterways. In addition to prescribing the level of charges, the Government prescribed in this decree that the computation and charging of payers with these charges is the responsibility of the competent ministry, and, from 2002, also the competent secretariat of the AP Vojvodina for the payers in the territory of Vojvodina. Beginning with this year, it has been prescribed by a decree that the revenues from these charges that are collected from the payers in the territory of Vojvodina belong to the Vojvodina budget. The decree also prescribes the timescale for paying the charges. The charge for the use and protection of waters is payable monthly, within the first 15 days of the month for the preceding month, and the payers must settle their liability to the Ministry, or regional secretariat, at the end of each quarter. The charge for the material extracted from waterways is paid based on the reports on the quantity of extracted material. The decree prescribes that this report is to be supplied to the ministry, or regional secretariat, on a monthly basis, before the 3rd day of the month for the preceding month.

The law determines that the level of the *charge for the use of waters* (surface, underground, and mineral) depends on the quantity, quality and intended purpose, and that the funds realized through the charge for the use of waters are to be used for funding erection of facilities for supplying private and corporate users with water and for regulation of waterways (Art. 103). The decree on the level of charge for the use of waters, charge for the protection of waters, and charges for the material extracted from waterways in 2003 ("Official Gazette of RS" 2/2003) prescribes eight different levels of this charge. They are shown in the table 8.

Table 7. The Charges referred to in the Law on Waters

Charge for	Payer	Base	Level determined by	Revenue Recipient
Use of waters	Users of the surface, underground, and mineral waters	Quantity of the extracted water, depending on the quality and the intended use of the water**	RS Government	RS Budget *Note: in practice – the ARV Budget as well*
Protection of waters	Companies, other legal entities and citizens who directly or indirectly release into the surface or underground waters, water with altered properties	Quantity, degree of pollution and type of waste water or other water with altered properties	RS Government	RS Budget *Note: in practice – the ARV Budget as well*
The material extracted from the waterways	The person extracting the material from the waterways	količina izvađenog materijala	RS Government	RS Budget *Note: in practice – the ARV Budget as well (incompliant with the LLSG)*
Drainage	The user, or owner of the land in the melioration area being drained, whether directly or indirectly	katastarski, prihod po jedinici površine	PWMC, approval of the competent ministry	PWMC
Irrigation	The owner, or user of the land for which the water has been supplied	Quantity of the extracted water expressed per cubic meter or unit of surface	PWMC, approval of the competent ministry	PWMC
Use of the water management facilities and for provision of other services*	The user	Depends on the service	PWMC, approval of the competent ministry	PWMC

* Law on Waters does not specify the types of these charges; it only stipulates (Art. 106) that the level of these charges is to be determined by the PWMC. This means that it is by the Decision on the Level of Charges that the PWMC issues each year that the types of these charges are determined in practice.

** EPS pays in proportion to the quantity of the produced electrical energy in the hydro-plants.

Table 8 Amounts of the Charge for the Use of Waters

No.	Quality and Intended Use of Water	Amount of Charge*
1.	Unprocessed raw water that is extracted directly	0.075 din/cub.m. of water
2.	Drinking water that is extracted for the purpose of sale to companies and other legal persons	0.215 din/cub.m. of water
3.	Drinking water that is extracted for the purpose of sale to private users	0.110 din/cub.m. of water
4.	Drinking water that is extracted for personal use	0.187 din/cub.m. of water
5.	The producers who bottle natural and mineral water	0.110 din/liter of sold water
6.	Fisheries – both hot-water and cold-water ones	3% wholesale price of kilogram of sold fish
7.	EPS – per kilowatt hour of produced electricity in hydro-plants	2.3% price of kilowatt-hour (1.47 din.)
8.	EPS – per kilowatt-hour of produced electricity in thermal plants with re-circulating cooling systems	1,25% price of kilowatt-hour часа (1.47 din.)

* The charge in 2003 remained unchanged from 2002 (the Decree on the Level of Charge for the Use of Water, the Charge for the Protection of Waters, and the Charge for the Material Extracted From Waterways in 2002, "Official Gazette of RS", 29/2002, 68/2002)

For the cases where a person liable to pay the charge does not have a measuring device, the Decree prescribes that the quantity of used water is determined based on the projected data on extractions of water, the data about the volume of production, or the determined standards on consumption of water in the particular business activity and "other elements of relevance" for determining the quantity of water.

This charge is a typical example of a specific purpose tax. The purpose of collected revenues as determined by the Law – erection of facilities for supplying private users and business sector with water and regulation of the waterways – is an expenditure on funding construction of infrastructure that would, in principle, be accessible to everybody, not only to the users of water who are identified as the payers of this charge. Moreover, selection of payers of the charges, determination of the level of charge depending on the business activities or intended purpose of the water used, and the selection of the bases on which charges are to be paid, may not be linked with the price for the use of water as a production input. With the exception of the charges that are paid for unprocessed raw water that is extracted directly and for the drinking water that is extracted for personal needs, which may be deemed to be taxes on water as a specific input, all other charges constitute separate sales taxes the burden of which is, through the price, transferred to the end user. In addition, the criteria that are used in selection of the level of individual charges are extremely ambiguous.

Nor are those liable to pay clearly defined. As arises from the Law, the payers are all users of surface, underground, and mineral waters, and it follows from the Decree that the selection of users who are liable to pay this charge is basically determined by the ministry, or regional secretariat, since they are the ones to submit decisions on payment of this charge. It may be indirectly concluded that the payers are basically legal and natural persons who are performing an economic activity. In addition, it should be kept in mind that one of the charges the revenue of which belongs to the PWMC is the charge for supplying industry with water.

The revenues that are collected from this charge are fairly small. In 2002, 206.9 million dinars were collected from this charge, where 189.2 million were allocated to the budget of the Republic, and 16.6 million to the budget of the ARV. In 2003, out of the total 478.9 million dinars that were collected, 449.2 million went to the budget of the Republic, and 29.7 million to the budget of ARV.

The prescribed administrative procedure for determination and control of payment of this charge is unwieldy and, in the part related to control over the level of the base for payment of the charge, it is practically impossible to implement. The production and delivery of the decisions to individual payers, and the prescribed records submittal and balancing, incur costs to both the administration and the payers, which, in view of all that has previously been said about this charge, may not be considered worthwhile.

The above arguments suggest that the charge for the use of water, as it is arranged now, is unjustifiable. However, it should not be abandoned; it should rather be entirely reformed, for there is a good reason for having the charge for the use of water. Namely, the waters are natural resources in the ownership of the state and the users of water should pay a charge for this use to the state budget, the same as they do for the use of construction land or for exploitation of minerals.

The payers of this charge should include all those legal and natural persons who extract the water directly, regardless whether it is from rivers, canals, accumulations, or lakes, or from underground waters. This would include both utility and industrial companies and other legal persons, and the individuals who have their own systems for exploitation of water.[38] Accordingly, the payer would be only a person who extracts water, and not the person who buys water from another person. Surely, the payer would, in full or in part, shift the burden of the charge paid for the use of water to the buyer of the processed water or other products. In the above way, the number of the payers would decrease and it would consequently make the supervision over payment easier.

38 For simplification purposes, the natural person who has a well could be released from the liability to pay this charge.

The number of the tariff items of the charge should be reduced since the state should not be interested in what the extracted water is used for – whether for processing into drinking water or for other industrial purposes. In this way, the charge for the intended purposes as referred to in items 1 through 5 in the above table could be made uniform. The charge for extraction of mineral and similar waters should be determined in a competitive procedure within concession proceedings.

In view of the fact that the charge for the use of waters is a charge for the use of a natural resource, the revenue accrued from the reformed charge should be revenue of the budget of the Republic, and possibly of the Autonomous Region as well, rather than revenue of the water management companies.

The level of the ***charge for the protection of waters*** depends on the type of waste water or other water with altered properties, or other matters influencing deterioration of the quality of waters and the conditions for its use, and the funds obtained in this way are used for undertaking the measures on protection of waters from pollution, and for purification of waste waters (Art. 105). This is one of the environmental charges the payment of which would mean that the polluter, of waters in this case, pays the full costs of the production of the good in which the pollution is generated. Its level should therefore reflect the costs that are necessary for maintaining the quality of water in which the polluting agents are released within the environmentally acceptable limits. Considering that, in the framework of the charges for the use of water management facilities and the use of other facilities, different levels of the charge for the drainage of water have been prescribed depending on the level of pollution which should reflect the level of the costs for purification, there are no reasons whatsoever for the existence of a separate charge for the protection of waters. The manner in which its level is determined suggests that its present character is that of a specific purpose tax, and not that of the charge for the costs incurred through pollution. It should therefore be abolished, and the issue of environmental protection should be regulated in a comprehensive manner. The same applies to charges with the same or similar purpose that have been introduced by the laws governing individual issues.[39]

The level of the ***charge for material extracted from waterways*** – sand, gravel, and other materials – extracted from riverbeds, sandbanks, abandoned riverbeds, and the banks of natural waterways, natural and artificial accumulations, and in the regions at risk of erosion, is paid according to the quantity of the extracted material, and the obtained funds are used for regulation of the waterway (Art. 105). The Law is quite reserved when it comes to the procedure for obtaining the right to extract material from waterways. It only prescribes that it is necessary, for extraction of the material from waterways, to meet the

39 See a part of the study that addresses the environmental charges.

water management requirements that are issued by the PWMC to whom the opinion of the RS Hydro-meteorological Institute should also be supplied beforehand.

The decree on the level of charge for the use of waters, the charge for the protection of waters, and charge for the material extracted from the waterways in 2003 ("Official Gazette of RS" 2/2003) has prescribed four different levels of this charge[40]:

- for the purpose of improving the waters regime, the sand, gravel and rocks which do not contain other beneficial components extracted from the waterways and river beds, this charge amounts to 20 dinars per cubic meter of the extracted material;
- for the material taken from the banks of the waterway, that is outside the bed, from the degraded soil, the charge amounts to 30 dinars per cubic meter;
- If in the above two instances, the material that is extracted is intended for the facilities funded from the budget of the Republic, the charge is reduced and amounts to 10 dinars per cubic meter of the extracted material.
- If the material is taken from the waterway banks, that is outside the bed, or from the agricultural, forest, or "other" land, the charge amounts to 50 dinars per cubic meter.

The charge for extraction of material from waterways should remain; however, it is necessary to reconsider the basis for its payment, the manner in which its level is determined, and the allocation of the revenues.

Firstly, this charge should correspond to the price of obtaining the right to extract the material from waterways which are natural resources, and not, as is now the case, the price of the cubic meter of material which is, even with the most careful analysis, difficult to determine correctly. This means that the law should prescribe the procedure and the requirements for acquiring this right. The best solution would be to have the interested persons apply through public tender and that the right in a particular territory be awarded to a person or to more than one person who offers the best conditions. The rights and obligations of the persons who obtained the right to extract the material from waterways could be regulated by a separate contract.

Secondly, this charge should be allocated to the LGU in the territory of which the waterway from which the material is extracted is located. There are two main reasons for this: firstly, the LGU would be directly interested in revenues which could be quite significant, contrary to what is the case with the budget of the Republic or ARV; secondly, the LGU authorities could be more efficient in monitoring and controlling the implementation of the contract. However, the law would still have to prescribe that it is in the authority of the competent ministry to

40 The level of these charges in 2003 was not changed from the level in 2002.

promulgate the plan whereby the locations or the requirements to be met by the locations in which the material is extracted should be defined, and, possibly, the locations of special interest for preservation of the water system of the Republic, for which specific requirements or restrictions would be prescribed.

The approach taken at present is to prescribe the price of a cubic meter of extracted material the level of which has been determined according to ambiguous criteria, and, besides, with the relief depending on the facility for which the material is used. This approach should definitely be abandoned since the funds from these charges end up in the budget of the Republic, or ARV, and are allocated for regulation of waterways in general, which gives it the character of a purpose specific tax, and not that of the price of the use of public goods.

Moreover, the revenues from this charge are quite small. In 2002, 33.3 million dinars were collected, out of which 22.0 million went to the budget of the Republic, and 11.3 million to the budget of ARV.

The law prescribes that the level of the *charge for drainage* depends on the level of costs of drainage and maintenance, functioning and erection of the facilities for drainage in the melioration area; and that the revenues obtained through collection of this charge are used for maintenance, functioning, and erection of the facilities for drainage in the melioration area (Art. 100). At the same time, however, it is also prescribed that the charge for drainage of agricultural land is computed and paid based on the cadastral income, per unit of surface (Art. 101). It is based on the cadastral income that the level of the charge for drainage of agricultural land, the level of the charge for the drainage of forest land and construction land, have been defined. The law prescribes that the charge for the drainage of forest land may not be lower than half of the charge for the drainage of agricultural land, while the charge for the drainage of construction land may not be lower than ten times the amount of the charge for the drainage of agricultural land or higher than twenty times the amount of that charge. It should be stressed here that it is not clear what the link is between the level of cadastral income and the level of the costs of drainage and keeping of the plants for maintenance, which were previously determined by the Law as a criteria for determination of the level of the charge for drainage.

The Decision on the level of charge for the drainage in 2003 ("Official Gazette of RS", 15/2003), issued by the Managing Board of the PWMC "Srbijavode" and approved by the Ministry of Agriculture and Water Management, makes it more clear who is liable to pay for this charge. Even though the Law prescribes that those are the owners or users of land in the melioration area which is, either directly or indirectly, drained, it follows from the above mentioned Decision that this includes all payers of the tax on cadastral income, all entrepreneurs, and all legal persons. Namely, by this Decision, all cadastre municipalities in Serbia have been divided in three groups for which

different levels of charge for drainage have been prescribed; namely for agricultural land, forest land, and construction land.

With regard to agricultural land, in the first group of cadastre municipalities, the level of charge for drainage amounts to 386.48% of cadastral income for legal person and 300.46% for natural person. In the second group of cadastre municipalities, legal persons pay the charge for drainage in the amount of 193.24% and natural person in the amount of 150.23% of cadastral income. In the third group of cadastre municipalities, the level of the charge for drainage in case of legal person is 96.62%, and in case of natural persons – 75.11% of cadastral income.

The level of charge for the drainage for forest land is less by half for each of the groups of cadastre municipalities and for legal and natural persons.

The level of charge for the drainage of construction land equals twenty times the amount of the charge for the drainage of agricultural land, for all three groups of cadastre municipalities and for all payers. It is determined based on the average cadastral income computed for each cadastre municipality separately.

The Decision also prescribed that the Tax Administration (which is mentioned in the Decision as the Republic Directorate of Public Revenues) computes, charges and collects this charge to natural persons, while the PWMC is responsible to issue the relevant decisions to legal persons, through water management centers for water areas of "Dunav", "Sava", and "Morava". It is necessary to note here that the Decision of the Managing Board of one public company prescribes that it is the authority of the Tax Administration to determine and collect the revenues of that same public company, which is in absolute contravention to principles of legal order.

Even though the procedure of ascribing the authority to the Tax Administration is absolutely inappropriate in legal terms, and it should be duly drawn attention to, this argument may be basically applied to the Decision on the level of charge for drainage in its entirety. Namely, by this Decision, firstly, the charge for drainage which was defined by the law as a price of public service was modified into a specific-purpose tax. Secondly, the payers are defined so as to include all persons who conduct a business activity (farmers, entrepreneurs, and legal persons) and not only the users of the drainage service. And, thirdly, the manner of determination and collection of tax as the revenue of a public company was determined. Such a "hidden" taxation procedure is utterly unlawful.

The charge for drainage as the price of a public service that is paid by those who use that service, and use it in that degree, should remain in the system. This means that it is necessary to change the manner in which its level is determined, as well as to identify the users of this service by the procedure prescribed by law. The level of this charge must be proportionate to the costs that must be borne in order to supply the

service. The level of the cadastral income, even if it was estimated correctly, does not reflect these costs in any way whatsoever. The revenues should go to the company, or the service in charge of rendering this service and maintaining the pertinent plants. If these costs are disproportionate to the paying capacity of users, and it is in the public interest to supply this service notwithstanding, then this activity may be subsidized, but only from the budget which are funded from general taxes.

The Law has defined that the level of the ***charge for drainage*** depends on the level of costs for maintenance and functioning of the facilities for drainage, and the quantity of drained water expressed per cubic meter or per unit of surface, and that the collected funds should be used for the maintenance, functioning, and reconstruction of the facilities for drainage in the melioration area (Art. 102). The level of this charge, and the level of the ***charge for the use of water management facilities and for provision of other services*** are determined by the PWMC upon the consent of the competent ministry (Art. 106). The text of the Law does not specifically define these services; it is in the authority of the PWMC to specify them.

The manner in which the provisions of the Law are implemented is apparent from the **Decision on the Level of the Charge in 2003** ("Official Gazette of RS", 15/2003) which was promulgated by the Managing Board of the PWMC "Srbijavode" and approved by the competent ministry. This Decision classifies the charges which are pertinent to the drainage and use of water management facilities and for provision of other services in the following five groups:

- The charge for the use of facilities of the Hydro system Dunav-Tisa-Dunav (Hs DTD) and the Hydro system "Nadela" (Hs "Nadela"),
- The charge for hydro melioration facilities for draining of purified, used, and other waters,
- The charge for the use of water management facilities and for provision of their services,
- The charge for the use of waterland for depositing of gravel and sand, accommodation and mooring facilities for the boats, ships – restaurants and other catering and entertainment facilities, for recreation purposes (leisure and excursion tourism), and for provision of other services and for other purposes,
- The charge for irrigation from accumulation lakes and canals.

In the further text, there is an overview of the charge according to the above groups.

There are 28 different charges for depositing and accommodation in total.

The annual charges per square meter occupied should be paid for the ***use of water land for depositing of sand, gravel, oil, and oil derivatives, hazardous matter and other matter***. The level of the charge depends on the matter that is being deposited and the river. Specially

Table 9. Charge for the Use of the Facilities of Hs DTD and Hs "Nadela"

Charge for	Basis	Amount	Note
Supplying industry with water	Installed capacity of the payer	59.60 din./liter	Monthly amount
	Employed capacity of the payer	580.70 din./1000 cub.m.	
Supplying fisheries with water	Installed capacity obveznika	256.05 din./hectare	Projected area of the fishery
	Employed capacity of the payer	427.68 din./1000 cub.m.	
	Employed capacityof the payer without the measuring device	4278.24 din./hectare	Maximum annual quantity that may be abstracted with the- installed capacity
Draining of purified and other used waters	Quality water is acceptable for the recipient	82.62 din./100 cub.m. of discharged water	To be increased in the case of pollution or altered properties of water
	Extent of pollution	from 92.84 to 2611.98 din. per kg of polluting agent in 100 cub.m. of water	Eight different polluting agents and eight different levels of charge have been defined
	Altered properties of water	from 440.58 to 1405.40 din./1000 cub.m.	Properties of water: color, temperature and pH value (three groups) – total of eight different levels of charge
	Oxidized matter in water exceeding the limit of 150 mg/lit	Increase of the charge based on pollution by 10, 20, 40, 50 or 75%, depending on the quantity	
Irrigation	Installed capacity of the payer	In din/hectare – 108.52 (short crops) – 126.59 (tall crops) – 145.58 (intensive vegetable cultures) – 181.73 (orchards)	
	Employed capacity of the payer	361.70 din./1000 cub.m	
	Employed capacity of the payer without the measuring unit	In din./ha – 361.70 (short crops) – 470.20 (tall crops) – 615.34 (intensive vegetable crops) – 723.84 (orchards)	
The use of the Hs DTD canal	Navigation	2.16 din. per ton 0,095 din po tona km	Registered payload of the vessel
	Lockage	720.00 din. for 1 lockage 1.44 din. per ton	

Charge for	Basis	Amount	Note
The use of the Hs DTD canal	Accommodation	– 1.38 din./sq.m. (vessels over 3 t) – 240 din. (boats without motor) – 480 din. (boats with motor)	The vessels over 3 tons pay per a day of accommodation, and the boats pay at the annual level
	Accommodation with the purpose of protection from ice and elements	36.00 din./sq.m.	From December 15th of the current year to March 15th of the ensuing year
	Foreign vessels	All charge doubled	

Table 10.
Charges for the use of hydro melioration facilities for draining of purified, used and other waters (with the exception of Hs DTD and Hs "Nadela")

Basis	Amount*	Note
Gravitational	615.80 din./1000m^3	Annual charge
Pumping or combined	1534.47 din./1000m^3	
Pumping with dilution	2081.12 din./1000m^3	
Degree of pollution	from 647.48 to 14122.05 din. per kg of polluting agent in 100 cub. m. of water	Eight different polluting agents and eight different levels of charge have been defined
Altered properties of water	from 309.93 to 973.94 din./1000 cub. m.	Properties of water: color, temperature and pH value (three groups) – total of eight different levels of charge
Oxidized matter in water exceed the limit of 150 mg/lit	Increase of the charge based on pollution by 10, 20, 40, 50 or 75% depending on the quantity	

* When the ultimate recipient is Hs DTD, all charge with the exception of the annual one, are decreased by 30%.

Table 11. Charges for the use of water management facilities and for provision of other services

Charge	Base	Amount	Note
Use of the accumulations and canals for raising of fish	Surface of the water	6115.20 din./ha	Annual charge; to be adjusted by the increase of the price of the carp for consumption on the market
	Cage culture of fish	672.00 din./ha	
	Purpose-built fishery	16934.40 din./ha	
Supplying with water	Installed capacity of the payer	59.60 din./liter	Monthly
	Employed capacity of the payer with and without the measuring unit	580.70 din./1000 cub.m.	Annually

separated are the rivers Sava, Drina, Dunav, Tisa, Morava, the canals of the HS DTD, while the remaining water land has been classified in the collective category "other places". The amount of the charge for depositing sand varies within the range of maximum 181.91 din./sq.m. to minimum 131.43 din./sq.m.; for depositing of gravel from 121.65 din./sq.m. to 87.65 din./sq.m.; for depositing of oil and oil derivatives from 181.91 din./sq.m. to 131.43 din./sq.m.; for depositing of hazardous matter from 218.30 din./sq.m. to 157.71 din./sq.m.; while for other purposes this charge amounts to 54.98 din./sq.m.

For the ***use of water land for accommodation and mooring of the vessels*** the annual charge is payable according to the category of the waterway, and also according to square meter of the area of water and waterside that they occupy. The level of charge was also determined by stationage. The amounts of these charges range between 192 din./sq.m. to 50.78 din./sq.m. of the occupied surface of water and from 96.02 din./sq.m. to 15.46 din./sq.m. of the occupied surface of waterside for the specifically mentioned waterways. The charge for accommodation on other waterways and accumulation is payable on an annual basis and it depends on the type of vessel and amounts à) for sport boats without motor 629.04 din., b) for sport boats with motor to 1258.07 din., c) for the vessels from 50 m to 2052.66 din., d) for the vessels from 51 to 100 m to 4105,30 din., and e) for the catering facilities it is increased by 155% in relation to the charges c) and d).

The ***charge for the use of water land for other purposes*** should be paid on an annual basis, specifically: a) 1026.33 din./sq.m. for temporary facilities for conduction of economic activity, b) 102.64 din./sq.m. for conduction of economic activity, c) 51.60 din./sq.m. for digging pits for sand and gravel from inundations and sandbanks in the river bed and d) 2313.95 din./sq.m. for conduct of agricultural activity.

The ***charge for the use water land for recreational purposes and conduct of other services*** is payable on an annual basis**.** Its amount depends on the type of activity, the zone in which the activity is conducted (Zone 1 – big city and tourist centers, Zone 2 – smaller cities and settlements, Zone 3 – rural settlements), and it also depends on whether it is payable by legal or natural persons. The natural persons pay from 4.00 din./sq.m. to 24.96 din./sq.m., and legal persons from 8 din./sq.m. to 49.94 din./sq.m.

And finally, the ***charges for irrigation from the accumulation lakes and canals*** are shown in the table 12.

Basically, the charges prescribed by the "Decision on the Level of Charges…" may be classified into three groups. The first group consists of services that are provided or that may be provided by the PWMC to the users. The second group encompasses a charge that essentially constitutes the price of the use of assets, which is at the disposal of the PWMC, and it would be more appropriate if the term 'rent' were used. The third group consists of the charges that are, apparently, the result of an effort on the part of the PWMC, but the

Table 12. Charges for irrigation from accumulation lakes and canals

Charge	Basis	Amount
Annual charge for irrigation from the hydro-melioration systems and accumulations	Installed capacity of the payer	542.55 din./hectare
	Employed capacity of the payer	361.70 din./1000 sq.m.
	Employed capacity of the payer without the measuring device	542.55 din./hectare
	The water taken over through high pressure pump station	542 din./liter in second
Charge for irrigation from the hydro-system	Installed capacity of the payer	678.17 din./hectare
	Employed capacity of the payer	0.63 din./ sq.m.
	Employed capacity of the payer without the measuring device	976,49 din/hektaru
	The water taken over through high pressure pump station	976.49 din./hectare

competent ministry as well, to secure more revenues for the PWMC by imposing different levies, which, other than by the virtue of the text of the Decision, can not be considered chargeable services.

The first group of charges includes the charge for irrigation, the charge for draining of purified and other used waters. It would be possible to leave these charges in the system, but only after a thorough reconsideration. It may sound utterly superfluous to mention it at all, but it is first necessary to check whether the PWMC actually renders one of these services to all the persons that are now liable to pay for them. In view of this, the most critical is the charge for supplying industry with water, which should be paid only by such operators who directly use the PWMC infrastructure. This should be followed, in all cases, by a thorough reassessment of the manner in which the level of charge is determined. If the principle that the level of these charges depends on the price of the service that was rendered is to be respected, there are no reasons whatsoever to make the level of these charges conditional upon the business activity of the user of such a service. Thus, for instance, it is utterly unclear why, in the case of irrigation from the Hs DTD č Hs "Nadela", the level of charge for irrigation to be paid according to the installed capacity should depend on the type of crops grown on the irrigated land. This difference that arises in the case of the charge that is paid according to the employed capacity for the users who do not have measuring devices may be reasonable only if there are valid indicators that different quantities of water are used in the cultivation of different crops. Additionally, it should be highlighted that no

such differences are present in the case of charges from other hydro-melioration systems and that it is therefore unclear why only the users in Vojvodina who cultivate, for instance, intensive vegetable cultures, pay more than those who raise short crops, when in other parts of Serbia everybody pays the same, depending on consumption.

Generally speaking, there are no apparent economic reasons for having different levels of charge for the use of the Hs DTD and Hs "Nadela" services as compared to other hydro-melioration facilities. This is particularly noticeable in case of the charges for draining of purified and other used waters. And why this is so may be seen in the table below which shows juxtaposed levels of charges, depending on pollution, for the use of the services from Hs DTD and Hs "Nadela" and other.

Table 13. Charge for draining of purified and other used waters
din./kg/100 sq. m.

Type of pollution/ Properties of water	Hs DTD and Hs "Nadela"	Other
HPK-bichromate	143.97	973.94
Suspended matter	143.97	973.94
Ammonium ion	435.05	2965.84
Oil, fat, and protein	2080.95	14112.05
Sulfides	4611.98	17680.88
Nitrates	92.84	647.48
Phosphates	828.42	5636.16
Sodium	470.49	3166.65
Noticeable color	440.58	309.93
Temperature over 30°C	440.58	309.93
pH 6.8 – 5.0 and 8.5 – 9.5	710.43	494.01
pH 4.0 – 5.0 and 9.5 – 10.5	1066.84	694.86
pH to 4.0 and over	1405.40	973.94

The charges based on pollution are much lower, and based on the properties of water they are much higher in the Hs DTD and Hs "Nadela" than in other hydro-melioration facilities. Considering that these charges are not systematically higher or lower, the differences can hardly be accounted for by technological reasons. And, considering the big differences in the levels of the charges, one gets the impression that the manner of their determination depends mostly on the structure of the local industry. In any case, there is a reasonable doubt that the level of these charge is actually related to the price of the service that was rendered.

With regard to the charges that are paid for the services rendered by the Hs DTD and Hs "Nadela", this group could also encompass the

charge for navigation on the canals and lockage of the vessels in the navigation locks.

The second group of charges, which basically constitute rentals, could cover the charge for the use of accumulations and canals for raising fish. Also, but conditionally, this groups may include the charges for accommodation of vessels in the canals of the Hs DTD, and those for the use of water-land for the loading pit of sand, gravel, oil and oil derivatives, hazardous material, and other materials. In both cases, the necessary requirement for paying the charge at all, but also for rendering the legal activities for which they are paid, is to use the special purpose-built facilities of the PWMC. Consequently, in case of the abovementioned charges, the level of charge per square meter may not be determined based on the location only, but also by taking into account the conditions, which were provided for the user. Such facilities, if there are any, should be rented, and the base for paying for them should be a contract between the owner and user of the facility and not, as is the case now, a Decision. These charges, as defined presently, basically constitute a tax, the purpose of which is the funding of the PWMC. Therefore, they should not be allowed to remain, in any form whatsoever.

Both in case of the first and the second group of charges, the base for payment should be a contract, not a decision issued by the PWMC.

The third group of charges, that is the charges whose main purpose is to secure revenues, consists of all other charges. All these should be abandoned since they are paid even though they are not based on the provision of any kind of specific services, which the "payer" gets in return. This gives them the character of a specific purpose tax that is, at the same time, the revenue of the PWMC.

To illustrate the rationale behind the taxation applied in the case of these charges, it would be useful to study the example of the levies that are paid for accommodation and mooring of boats, ship restaurants, and other catering and entertainment facilities for recreational purposes (leisure time and excursions). Firstly, it is not clear why such a charge should be paid to the PWMC and it is unclear for which service it is paid precisely. Secondly, the Law on Local Self Government prescribed that the LGU may introduce utility charges in cases which are almost identical to this one (Art. 83 LLSG – keeping and using floating installations and floating devices and other structures on water; keeping and using boats and water rafts; and keeping restaurants and other catering and entertainment facilities on water). Even though the solution from the LLSG can hardly be characterized as ideal,[41] it at least makes this charge a visible part of public revenues for LGU; in this case, it is a kind of local tax with no specified purpose, while the manner of selecting the tax base is quite outdated. Thirdly, the Law on Using,

41 See more details about this in the part of the study that addresses the issue of charges.

Carrying and Keeping of Goods also prescribes a tax duty in similar cases, while the revenues go in the RS budget, thus making the owners of these facilities taxpayers of the Republic. As a result, the owners of these facilities – at least according to the number of charges, fees, and taxes they pay – turn out to be the most significant taxpayers in Serbia. Anyhow, it is beyond doubt that the charges for provision of these services and other services that are paid to the PWMC should be abolished.

With regard to the administration, Article 107 of the Law prescribes that, in respect of the timescales for advance payment of charges, time barred debts, interest, renewal of procedure, and enforced collection procedure, and other issues that are not regulated by this Law, the regulations governing *corporate* profit tax apply in case of the companies with the status of a *corporation*, and the regulations on payment of individual income tax apply in case of all other payers. This only confirms that the essential nature of these charges is that of a tax. The recommendation that clearly follows from the above analysis, however, is that a more appropriate base of payment for the services or use of the resources that would remain, would be a suitable contract. In that case, the Tax Administration would have no role whatsoever. The advantages of this approach are twofold: firstly, the Tax Administration resources would be relieved from costly and unproductive work and could focus on other more profitable activities; and, secondly, the contractual relationship would encourage both contract parties to abide by its provisions. On one hand, the PWMC or the relevant service – entity would be encouraged to provide the service – for this would be the only source of revenue, and the first protective instrument in case of failure to pay would be to terminate the contract, or to stop provision of the service, or to prevent the responsible party from using a resource or facility. On the other hand, the user would know what he is paying for and why; also, in case he fails to meet his liabilities, the user would be faced with interrupted supply of a given service, which could incur further costs for him and his business; also, he would be granted the possibility to cancel the service if he is not satisfied with its volume or quality.

Accordingly, it is not only that Article 107 is outdated, due to the Law on Tax Procedure and Tax Administration which comprehensively regulates the taxation procedure and which has been promulgated in the meantime, but it should be completely removed from the Law.

Charge for the Use of Natural Curative Factor

The Law on Spas defines that a spa is an area in which one or more than one natural curative factor are located and used, and which meets the adaptation and outfitting related requirements for their use, as prescribed by this Law. The Law prescribes that a spa is a natural resource of public interest that is under the management of the state. The natural curative factor includes: thermal and mineral water, air, gas and

curative mud the curative properties of which have been scientifically examined. (Art.1)

The Law prescribes the requirements which an area must meet in order to be considered a spa (Art.2), the procedure in which an area is determined to be a spa (Art. 3), and also that the municipality in the territory of which a spa is located is responsible to take care of its preservation, use, improvement, and management (Art. 4).

Article 9 of the Law prescribes that health institutions and other legal and natural persons which practice medicine may use a natural curative factor in a spa for the purposes of prevention, treatment, or rehabilitation, on the terms specified in regulation on the practice of medicine, and that other legal and natural persons may use a natural curative factor in a spa provided they have, depending on the business activity they conduct, available suitable premises, equipment, and staff.

Domestic legal or natural persons are granted the right to use a natural curative factor in a spa by the municipality in the territory of which the spa is located, upon the approval of the Government of the Republic of Serbia; foreigners are granted this right in accordance with the law that governs concessions (Art. 10).

The user of the natural curative factor in a spa pays a charge for its use. The ***charge for the use of a natural curative factor*** is payable based on the quantity of the used natural curative factor and the level of charge is determined by the National Assembly. The obtained revenues go to the budget of the municipality and are used, according to the program developed by the Municipal Assembly in the territory of which the spa is located, for the preservation, use and improvement of the spa, subject to the approval of the Government (Art. 13)

Apart from prescribing a rather cumbersome procedure for determination of the level of charge, and the fact that no level of charge has been determined since it was adopted serves to prove that this Law has many other shortcomings.

Firstly, even though the Law generally promotes the principle of obtaining the right to use (in case of foreigners, it explicitly refers to the concession system), it never mentions the procedure for obtaining these rights in case of domestic persons, other than the right to use which is granted by the municipality upon the approval of the Government of Serbia.

Secondly, it is not clear what the criteria for determining the level of charge in the manner that is prescribed by the existing Law are; it is not clear either whether it is envisaged that the same charge is to be prescribed for every kind of curative factor as they are defined by the Law, which does not seem logical, or that the level depends on the "curative quality" of the factor, or on the location, or some combined criterion? The latter could be a very complex endeavor, with hardly any prospects of success.

Thirdly, in what way would the quantity of the natural curative factor that is used be measured, and what is the quantity that is used in case of each individual curative factor?

Fourthly, it is not clear why the income obtained in this way should be used exclusively for preservation and improvement of the spa, or for using the spa.

Considering that the National Assembly has not determined the level of this charge ever since this Law was adopted in 1992, probably, *inter alia*, because no answers were to be found to some of the above questions, it is the municipalities that determine the level of this charge in practice, based on different criteria.

The result of such a flawed regulation on the use of the natural curative factor are also modest revenues from this charge. In 2002 the municipalities obtained from these sources 17.3 million dinars, and in 2003 the revenue amounted to 18.2 million dinars.

It follows from the above said that significant changes in the existing regulations are necessary. Generally speaking, the use of a natural curative factor, just like any other natural resource, should be regulated through a system of concessions. If it is necessary to set apart the natural curative factors from other natural resources – possibly, due to its relatedness to the practice of medicine – the law that would govern its use would have to incorporate the provisions that prescribe the procedure for obtaining the right to use. This should doubtlessly be a kind of public tender. The current solution, according to which it is the municipality who grants this right, should be retained, but the above mentioned procedure would have to contain the criteria based on which the municipality would grant this right. The person, who, in the procedure prescribed by the law, obtains the right to use the natural curative factor in a spa, would conclude a contract with the municipality. It is also necessary to prescribe by law the elements that, as the rights and obligation of the contractual parties, are mandatory content of the contract. Certainly, one of main elements of this contract is the charge, which this person pays for the use of a natural curative factor.

In this way it would be possible to determine in each specific case the charge, which would, in the best way possible, reflect the price of the natural curative factor at issue. The potentially interested candidates for obtaining the right to use this fact would, through their tenders, create, at a certain point in time, a market situation, and the price they would offer or which they would accept would reflect their estimation of the economical value of this specific input. This in itself would make the administrative manner of determining the level of this charge superfluous.

However, that does not mean that the state would have to renounce the right to secure even such public interests, which are not connected with the maximization of public revenues. These public interests may be preserved by appropriate regulations – or by the price of services rendered by the holder of the right to use the natural curative factor, or by the structure of the services offered, or in another manner. All these elements would doubtlessly have to be regulated by the contract itself, and they would doubtlessly have an impact on the level of charge,

which the potential users of the right to use the natural curative factor would be willing to offer or accept.

In any case, the proposed procedure would, in the presence of the designated set of public goals, surely ensure a much better use of the natural curative factor, compared to the present situation.

Charge for the use of minerals

The Law on Mining (Art. 2) prescribes that a charge is to be paid for the use of mineral resources. The same Article specifies that mineral resources include all organic and inorganic minerals in solid, loose, plastic, liquid, and gaseous state or in natural dissolutions located in primary coal-beds, in drifts, in mining excavations and disposal pits and technogenous minerals, all of them under the collective name: minerals. Article 3 of the same Law prescribes that the minerals should be deemed to include:

- All kinds of coal and oil slates,
- Hydrocarbons in liquid an gaseous state (crude oil and gas) and other natural gases,
- Radioactive minerals,
- Metallic minerals and their usable compounds,
- Technogenous minerals,
- Non-metallic minerals and minerals for production of building materials,
- All kinds of salt and salt waters,
- Underground water from which useful minerals and geothermal energy are generated, and underground waters related to mining technology and gases that accompany them, where they are called collectively: underground waters.

Article 13 of the Law determines that the exploitation of minerals can be conducted by the company, or other legal entities entered in the court register for conduction of such activity, and which for the conduct of the activities of technical management, supervision and other expert activities determined by the Law employs persons who meet the prescribed requirements in respect of the type and degree of education, working experience, and authorizations for performance of such tasks. Also, the Law determined that foreigners may also engage in the exploitation of minerals under the conditions specified in that Law, and the law governing the rights of foreign legal persons in respect of the use of goods of public interest. The same Article determines that rinsing of precious metals and other minerals from river inundations may be approved to a natural person as well, provided that he offers all the rinsed quantities of metal to NBY at market prices, on a monthly basis. This Article also grants the right to the owners, or users of the land, and the companies which have been assigned the management over goods of public interest, the opportunity to, without approval of the competent ministry and payment of charge, exploit the minerals

for production of building materials for their own needs, with the following quantity restrictions in the course of one year:

- Legal person – less than 1000 cub.m. of broken stone, less than 200 cub.m. of sand and gravel, and less than 80 cub.m. brick clay;
- Natural person – less than 250 cub.m. broken stone, less than 10 cub.m. decorative stone, less than 40 cub.m. sand and gravel, and less than 25 cub.m. brick clay.

These persons are bound by Law to, upon completion of works, and not later than within three months after the day the exploitation ceases, restore the land to its original purpose, namely to undertake measures to protect the land on which they have executed the works.

The use of mineral resources (Art. 14) is to be granted by an act of the Government whereby the following is designated: the type of minerals, the space in which they are to be exploited, the conditions for the use of minerals, and the time over which the use of it is granted. Based on this act, the companies which have obtained the right to exploit mineral resources conclude contracts with the competent ministry, whereby the details of the conditions are set under which the mineral resources are to be exploited: the terms, mode and terms of payment of the charge for the use of mineral resources, and the rights and obligations in respect of the undertaking of measures to ensure public safety, environmental protection, and other measures pertinent to the use of a specific type of mineral resource.

The Law prescribes that the use of mineral resources is to be granted through public tender or by collecting bids (Art. 15). The same Article specifies what is the mandatory content of the announcement of public tender, which is to include the standard elements, as well as the event in which the collection of bids is to be undertaken. The collection of bids is undertaken in the event where the use of mineral resources of strategic significance for the Republic is to be granted, for the exploitation of which only a small number of companies qualify. The bids are to be collected by the competent ministry. However, in the remaining text of the Law it is not specified which mineral resources are considered resources of strategic importance for the Republic, nor what makes a company qualified to exploit them, and these aspects should doubtlessly be specified by the Law.

Article 16 of the Law prescribed the following:

- The level of ***charge for the use of mineral resources*** is determined by the RS Government, based on the criteria specified in the Law (type, quality, quantity of reserves for exploitation, market price, anticipated profit, and the intended purpose for which the mineral resource will be used – for their own needs or for the needs of the market).
- The funds obtained from the charge are 80% the revenue of the Republic and 20% the revenue of the municipality in the territory of which the exploitation of mineral resources take place and the municipality which has suffered detrimental effects of the mineral

resources exploitations; these funds are used in accordance with the programs that are developed by the municipality assemblies and the goal of which is prevention and remedy of any detrimental effects of the mineral resources' exploitation.

- In respect of the collection of payment, time barred debt, interest and control of payment of the charge for the use of mineral resources, the regulations governing the corporate profit tax apply.

The table below shows the level of charge for the use of mineral resources as prescribed by the **Decree on the Level of Charge for the Use of Mineral Resources** ("Official Gazette of RS", 28/2002).

Table 14. Charges for the Use of Mineral Resources
% market price, or din./measuring unit

Type of Minerals	Amount
Gems and radioactive minerals	8%
Boron minerals, talk, gold, silver, platinum and platinoids, molybdenite and titanium minerals	5%
Fluorite, phosphate, halite, and mixed flotation concentrates with an economically significant content of precious and rare metals	4%
Antimony, asbestos, copper, quicksilver, tin, magnesite, oil and natural gas, nickel, lead, zinc, sulfur, consumer coal, architectural-construction stone and chromite	3%
Bauxite, iron ore and coal for thermal power plants	2%
Underground and geothermal waters	1.5%
Bentonite, kaolin, and cement marl	20 din/t
Refractory and ceramic clay, diatomite soil, dolomite, quartzite, quartz sand and tuff	15 din/t
Brick clay, gypsum and lime	12 din/t
Technical stone	12 din/m^3
Sand and gravel as building materials	6 din/ m^3

The Decree prescribed that the market price is deemed to be the difference between the selling price of the mineral resource and the following costs: conditioning, refinement, out of mine transportation of mineral resource, shipping, quality control, insurance, work of the traders' and brokers' commissions.

Charges for the use of mineral resources basically constitute special taxes the purpose of which is specified in advance.

In cases where the charge has been defined as a percentage, the base is imprecise and essentially difficult to measure. Firstly, it is not clear why the base for the charge was determined as a difference between selling price and the specific costs. It seems that the intention was to exclude from the price the costs, which are not directly connected with the exploitation of resources. If that was the intention, then it is not

clear why only such costs were excluded and not all of them – that is, why were the profits not determined as the base for payment. Secondly, the very charge, as defined in the Law, is a cost the burden of which is transferred to the buyer, that is, it constitutes an integral part of the price. Thirdly, it is not clear whether the selling price is deemed to be the retail price, that is, whether the sales tax is included.

In cases where the base was defined as the quantity of resource, these charges are of the same nature as the excise taxes the revenues from which are likewise intended for a purpose specified in advance.

Furthermore, it is not clear why a difference is made between consumer coal and the coal for thermal plants. Considering that the price of the coal for thermal plants is lower, a conclusion may be drawn that it was the intention of the legislator to impose less burden on the production input than on the consumer product. This – in addition to entailing additional administrative costs due to the obvious incentive to present the largest possible part of the output as coal for thermal plants, regardless of what its intended purpose actually is – has no justification whatsoever from the perspective of the reason for existence of this charge; and that reason is the price of use of specific natural resources.

Moreover, the charges for underground and geothermal waters, as well as the charge for gravel and sand, obviously overlap with the charges for the waters referred to in the Law on Waters, and the charge for the use of natural curative factor referred to in the Law on Spas, while the charge for sand and gravel overlaps with a similar charge referred to in the Law on Waters. This is suggestive of the conclusion that the regulation of the use of natural resources and related public services should be reconsidered comprehensively and that the authorities of individual institutions and services should be precisely defined, which would help to establish a clear system of the rights and obligations of all participants.

The very implementation of the existing law is a separate issue. Considering that the revenues form these charges are very modest, the existing law is in all probability implemented very poorly or not at all. In 2002, a total of 4.5 million dinars was collected, out of which 3.6 million was allocated to the Republic and 0.9 million to the municipalities. In 2003, the revenues from this charge amounted to 5.5 million dinars, and out of this amount, 4.7 million dinars were for the budget of the Republic and 0.8 million dinars for the budget of the LGU.

Bearing in mind all the above, the existing system of payments for the use of mineral resources should be replaced by a system of concession rights. In the contract on the concession, the duration of which would be adjusted to the requirements of the exploitation process for each specific mineral resource, other obligations may be envisaged, such as environmental protection, for example. The revenue from the concession may be shared between the Republic and the LGU in the territory of which the deposits of mineral resources

are located; however, such revenue should never be assigned a purpose specified beforehand. Alternatively, at the level of the Republic, the deposits of national and local significance could be identified. The revenue from the former would, in whole or in greater part, belong exclusively to the Republic, while the revenues from the latter could, in their entirety, belong to the LGU.

Charges for roads

The Law on Roads determines that the roads are goods of public interest owned by the state over which the rights to use and the easement appurtenant may be obtained. (Art. 1). This Law classifies roads according to their significance, into public and uncategorized roads (Art. 2). Trunk roads, regional and local roads, and the streets in urban areas, are determined as the public roads. The uncategorized roads include rural roads, country lanes and forest roads, as well as the lanes on flood defense embankments. Maintenance, protection, use, development, and management of the trunk roads are under the authority of a separate organization of the Republic – the Republic of Serbia Roads Directorate (RSRD), while the local and uncategorized roads, and the streets in urban areas, are under the authority of the municipality, or the city (Art. 4). The Law, inter alia, regulated the building and reconstruction of public roads, maintenance and protection of the roads, and the mode of funding. The RSRD was founded by virtue of this Law which specified that it is the responsibility of the RSRD to manage regional and trunk roads, as defined in its internal organizational structure and competences.

In view of the funding of roads, the Law on Roads introduced thirteen charges for the utilization and the use of roads (Art. 52):

- The charge for the roads that is computed and charged though the price of oil derivatives (further in the text: charge for the roads);
- The charge for the roads that is paid for motor-driven vehicles which use gas or other energy;
- The annual charge for road motor vehicles, tractors, and trailing vehicles;
- The annual charge for the motor-driven vehicles other than those included under item 3) of this Article;
- The charge for extraordinary transportation;
- The charge for putting up notices on the roadside land;
- The special charge for the use of the road, a part of the road, or the road facility;
- The charge for rental of specific parts of roadside land and other land belonging to the public road;
- The charge for the use of agricultural land and other land belonging to the public road;
- The charge for the junction of the access road to the public road;
- The charges for putting up installations on the road;

- The charge for building, and the charge for the use of commercial facilities where access from the road is provided;
- The cumulative charge for foreign vehicles.

The payers of these charges, and the authority to determined their level and allocation of the funds are shown in the table below.

Table 15. Charges for the Roads

Charge for	Payer	Base	The level is determined by	The revenues belong to
Roads	Legal and natural persons engaged in trade in petrol and diesel fuels	Retail price of petrol and diesel fuels	The Government	100% of those collected on the highway and 95% of other – to the RSRD, and 5% of those collected outside the highway – to the municipality
The roads on which it is paid for the motor-driven vehicles using gas or other energy	Owner of vehicle	Lump sum	The Government	RSRD
Road motor vehicles, tractors, and trailing vehicles, annual годишња	Owner of vehicle	Tonnage of vehicle	The Government	Municipality
Motor-driven vehicles other than included in the above charge, annual	Owner of vehicle	Tonnage of vehicle	Municipality	Municipality
Use of the road, a part of the road, or road facility, specific	User of the road	Technical characteristics of the vehicle, mileage, and weight of the vehicle	RSRD	same as above
Extraordinary transportation	Applicant for extraordinary transportation	The extent of exceeding the load bearing capacity limit of the road	RSRD	Those collected on trunk or regional roads – to RSRD, and those collected on local or non-categorized roads – to the municipality
Building and use of commercial facilities where access from the road is provided	User	Absolute amount determined based on multiple criteria	RSRD	same as above
Putting up notices on the roadside land	User of right	Absolute amount determined based on multiple criteria	RSRD	same as above

Charge for	Payer	Base	The level is determined by	The revenues belong to
Rental of specific parts of roadside land and other land belonging to the public road	Rent payer	Absolute amount determined based on multiple criteria	RSRD	same as aboveo
Use of agricultural land or other land belonging to the public road	User	Absolute amount determined based on multiple criteria	RSRD	same as aboveo
Junction of access road to the public road	Investor	Absolute amount determined based on multiple criteria	RSRD	same as aboveo
Putting up installations on the road	Investor	Absolute amount determined based on multiple criteria	RSRD	same as aboveo
Cumulative charge for foreign vehicles	Driver of the vehicle	Absolute amount determined based on multiple criteria	Decision of the FRY authorities	RSRD

The Law on the Roads prescribed as follows:

- The funds from the collected charge for the roads shall be transferred by the payers to a separate account of the Republic of Serbia Road Directorate, within eight days from the day of collecting the charge for the roads; the payers shall keep records about the quantities of oil sold derivatives on which the charge for the roads is computed and charged; also, the payers shall deliver monthly reports on the quantities of sold oil derivatives to the Republic of Serbia Road Directorate, within the first 20 days of the month for the preceding month. (Art. 54).
- The funds obtained from the charge for the roads shall be used for repaying and taking foreign loans for building and reconstruction of roads and for maintenance and building and reconstruction of trunk and regional roads, and, exceptionally, the Government may allocate a part of these funds, but not more than 10%, for building and reconstruction of local and uncategorized roads, where the use of the funds for these purposes shall be subject to the decision of the Republic of Serbia Road Directorate (Art. 56).

- Companies and other legal and natural persons engaged in the activity of railway transportation, and transportation over rivers and lakes, shall be relieved from payment of the charge for the roads (Art. 57) for the quantities of diesel-fuel used for propelling motor railway vehicles and floating structures, and vehicles other than those participating in public traffic.
- The Yugoslav Army, foreign diplomatic and consular representative offices shall be relieved from payment of the annual charge for road motor vehicles, tractors and trailing vehicles (Art. 58) if the release from payment of this charge is envisaged by an international agreement, or where there is reciprocity; Ambulance, Red Cross, firefighting vehicles, and police vehicles.
- With regard to the collection of payment, control, interest, refund, barred debt, penalty and other not regulated by this Law, provisions of the law governing the sales tax shall apply (Art. 58à)

By the Decree on Cessation of the Validity of the Decree on Specific Charge for Use of Roads ("Official Gazette of RS", 22/01), however, the charge for the roads has ceased to exist in an indirect way. Namely, after this Decree which came into effect on March 31st 2001, no level of charge ***for the use of roads that is computed and charged through the price of oil derivatives*** has been determined. Consequently, this charge has not been charged. Considering that this charge constituted a specific purpose tax, it was correct that it was abolished. However, the abolition should be implemented in legal terms as well. This means that this charge should be deleted from the Law on Roads.

The level of the ***annual charge for road motor vehicles, tractors, and trailing vehicles*** was prescribed by the Decree ("Official Gazette of RS", 40/93, 56/93, 84/93, 112/93, 8/94, 21/94, 7/96, 9/96, 8/2000, 9/2002, 91/2002). This charge is paid for the use of local, uncategorized, trunk and regional roads. Its payment is a precondition for registration or renewal of registration and is payable in the month in which the vehicle is registered. Owners of tractors used solely for agricultural purposes are to pay this charge not later than before March 31st of the current year for that year. The level of charge amounts to 5% of the amount determined for the persons with the disability degree of 80% or over, if using the vehicle for personal transportation.

The Decree classifies all vehicles in 11 categories, and the level of charge is within each of these categories normally determined according to the tonnage, or cubic meter capacity of the vehicle. There are three exceptions to this rule. The first one is with regard to working vehicles, the vehicles specially adapted for transportation of shops and devices for traveling amusement parks, and specially adapted and attested vehicles for transportation of bees, regardless of their payload or weight. The second is with regard to special vehicles for transportation of specific persons. The third is with regard to passenger vehicles and combined vehicles used in public transportation of passengers (taxi) which are adapted to run on gas, which actually constitutes the ***charge for the***

roads that is payable for motor-driven vehicles using gas or other energy. In all three above cases, the charge is paid per vehicle.

Considering that in other cases the level of charge is consistently determined depending on the technical characteristics of the vehicle (tonnage, capacity) which may be associated with the impact such vehicles have on the road and, therefore, with the need for the maintenance of such road, it is necessary to review whether it is necessary to have these three exceptions to the basic rule. Additionally, since owners of vehicles that are adapted to run on gas, other than taxi drivers, do not pay any additional charge whatsoever, it seems that the additional charge for taxi vehicles adapted to run on gas is an attempt to, through the charge for the roads, capture a portion of the increased profits gained from taxi business due to lower costs of the fuel used (gas, versus to petrol or crude oil). In view of the fact that it cannot be positively asserted that these persons use the roads more and that this charge is paid for the use of roads, this charge should be abolished.

The level of ***specific charge for the utilization of the road, a part of the road, or a road facility*** is prescribed by the **Rules on Payment of Specific Charge (Road Toll) for the Use of Trunk Roads (Highways and Semi-highways) in the Republic of Serbia** ("Official Gazette of RS", 50/99) as issued, upon the previously obtained opinion of the competent ministry, by the RSRD Council. These Rules prescribe the procedure for collection of payment and authorized the RSRD to issue the pricelist for the use of Å70 and Å75 highways and Å75 semi-highway (further in the text: the highway) in accordance with the principles determined in the Rules.

According to their technical characteristics and registration, the Rules classify all vehicles that use the highway in nine categories. The vehicles that are registered in FRY are classified in Categories 1 through 4; the vehicles that are registered abroad are classified in Categories 6 through 9, and all the vehicles, regardless of the category, which are on any basis whatsoever relieved from the liability to pay the specific charge for the use of highway are classified in Category 5.

The pricelist that is issued by the director of the RSRD is composed based on three parameters: price per kilogram, the distance covered, and category of vehicle. The distance covered is paid 7 USD cents per kilometer, which is the price for a kilometer of the road covered by the passenger vehicle with two axles whose height is 1.3 meter or less when measured on the first axle, that is the vehicle of the main category. This is the average price, where the lowest price, regardless of the distance covered, for the vehicles with foreign registration may not be less than 5 DEM, and with domestic registration not less than 1 dinar. Also, the vehicles with domestic registration are allowed a discount of 80% of the above-mentioned average price. The fact that the road toll is five times greater for the vehicles with foreign registration cannot be justifiable from the perspective of the use of the road. However, the underlying reasons are not hard to trace – they doubtlessly arise from the

desire to collect more revenues. The question is, nevertheless, whether this solution is sustainable in the long run.

Exempted from the liability to pay a special charge for the use of the highway are the vehicles with blue M registration plates, vehicles of the Yugoslav Army with the registration plates of the YA, ambulance vehicles, escorted vehicles (vehicles escorted by police or military patrols in special motor vehicles and vehicles equipped with special devices for audio and other signals), and firefighting motor vehicles belonging to professional firefighting crews, associations of voluntary firefighters, and firefighting crews of the companies which have established the firefighting service in accordance with the regulation on fire protection.

In addition, the right to free passage on the RS highways may be allowed to the vehicles of the Serbian Automotive Association road assistance and information service, the organizations engaged in highway maintenance when on the road for that purpose, and the RSRD vehicles if serving the purpose of road toll collection. Also, there is a possibility of exempting from the liability to pay the road toll the vehicles employed in transportation of persons or material goods within the framework or domestic or international humanitarian actions. In order to obtain the right to be exempted from the liability to pay the road toll for all vehicles other than those visibly marked, it is necessary to possess the permit and appropriate designations which are issued by the RSRD.

Considering that the road toll is paid for direct use of the highway, namely that it is a price for the use of a public good, this charge is fully warranted. However, considering that they were adopted in 1999, the text of the Rules should be modified, regardless of the fact that it is still correct in its technical part, so as to reflect the changes that occurred in the interim period (name of the state, currency, individual institutions, etc).

The level of ***charge for extraordinary transportation*** has been determined by the **Decision on Level of Charge for Extraordinary Transportation on Trunk and Regional Roads of the Republic of Serbia, for Vehicles Registered in the Territory of the State Union Serbia and Montenegro**, issued by the RSRD Council on March 20th 2003 and approved by the RS Government by way of the Decision published in the "Official Gazette of RS", 56/2003.

The above Decision determined the level of the charge for extraordinary transportation on trunk and regional roads in RS for the vehicles registered in SCG, and specifically for:

- The charge for exceeding the maximum allowed dimensions,
- The charge for exceeding the maximum allowed total mass,
- The charge for exceeding the maximum allowed axle load.

The charge is to be paid by the applicant for the approval of extraordinary transportation, within eight days after the day when the RSRD determines the level of charge based on the data available to RSRD or based on the approved roadmap.

Considering that the vehicles, which in any of the above mentioned instances exceed the maximum allowed values that are acceptable for normal payload capacity of the road, expose the road to more wear and tear, the existence of this charge is fully justified.

The level of charge for building and use of commercial facilities for which the access form the road is provided, for putting up notices in the roadside area, for rental of specific parts of roadside area and other land belonging to the road, for the use of agricultural land or other land belonging to the road, for junction of the access road to the road, and for putting up installations on the road, has been prescribed by the **Rules on Level of Charge for Access and Junction to the Trunk and Regional Road and for Building and Use of the Facilities and Land that Belong to the Road** ("Official Gazette of RS", 50/99) that, after obtaining the opinion of the competent ministry, was issued by the RSRD Council.

The level of charge for ***building of commercial facilities*** was determined depending on the road from which the access is provided and the type of commercial facility – petrol station or other. The roads were classified in three groups, where the first two groups specify individual route directions, and the third group encompasses all the roads that are not included in the first two groups. This charge is paid on a one-off basis upon issuance of the building permit for the facility. The level of charge for ***the use of commercial facilities*** depends on the same parameters and is paid on an annual basis. The charge for newly-built facilities is payable upon expiry of twelve months from the day of commencing to use the facility or receiving the building inspection permit.

For the first group of route directions, the charge for petrol station building amounts to 100,000 dinars if gross surface of the facility is less than 500 sq.m., and if it exceeds this value – additional 2,000 dinars are paid for each square meter. For the use of petrol stations that are located next to roads of this group, the charge amounts to 100,000 dinars per year, and for the use of other facilities, it amounts to 200 dinars per a year.

For the second group of route directions, the charge for petrol station building is 80,000 dinars if gross surface of the facility is less than 300 sq.m., and further 1,000 dinars is paid for every additional square meter. For the use of petrol stations that are located next to roads of this group, the charge is paid at the rate of 80,000 dinars per year, and for the use of other facilities it is 100 dinars a year.

For the third group of route directions, the charge for petrol station building is 60,000 dinars if gross surface of the facility is less than 150 sq.m., and if its surface exceeds this value, further 500 dinars are paid for each square meter, while for other commercial facilities the charge amounts to 500 dinars. For the use of petrol stations next to roads of this group, the charge is paid at the annual rate of 60,000 dinars, and for the use of other facilities, at the rate of 50 dinars per year.

The level of charge ***for installation and use of commercial facilities of temporary (seasonal) character*** (kiosks, caravans, mobile shops, etc) amounts to 3,000 dinars a month, if a facility is installed next to the highway or semi-highway, and 1,200 dinars if the facility is installed next to other trunk or regional roads. The charge is payable upon issuance of a permit for the first month, and, for the ensuing months, before the 5th of the month for the preceding month.

For ***putting up notices in the roadside area, for rental of specific parts of the roadside area and other land belonging to the road, for the use of agricultural land or other land belonging to the road***, annual charges are paid at the rates shown in the table below. The charge for the use of agricultural land is payable upon conclusion of the contract for the first year of use, and for ensuing years, before January 15th of the current year for that year. Other charges from this group are payable in twelve equal installments before the 5th of the month for the preceding month and they are determined by way of a decision of the RSRD.

Table 16. Charge for putting up the notices; for rental of specific part of the land; and for the use of land

Charge	Amount	Base	Note
For putting up notices	400 din./sq.m.	The surface of the panel with the notice	Discount: 50% for every panel over 10, and 75% for every panel over 30
For rental of land for the access to or building of a facility	400 din./ sq.m.	The rented land surface	Maximum level: the amount of the charge for building of that particular facility next to the particular road
For rental of land	20 din./ sq.m.	The rented land surface	–
For the use of arable lands	1,400 din./ ha	The rented land surface	–
For the use of meadowlands	280 din/ha	The rented land surface	–

The level of charge ***for conjunction of the access road*** is 4,000 dinars, and ***for putting up installations on the road*** it is 2 dinars per linear meter of the erected installations the radius or width of which is less than 0.01 meter, and for installation the radius or width of which exceeds this value, the charge increases proportionately. Both charges are payable on a one-off basis before the prescribed permit is issued by the competent ministry, or the approval is granted by the RSRD.

These charges the level of which is prescribed by the **Rules on Level of Charge for Access and Conjunction to Trunk and Regional Road and for Building and Use of Facilities and Land that Belong to such a Road**, with the exception of the charge for the use of commercial

facilities, basically constitute the rent for the use of public spaces located next to the roads and as such are fully warranted. However, what is necessary to do is to review the specific amounts, having in mind that the Rules were issued in 1999 and that the absolute amounts of charges are presently, in real terms, much lower than they were in 1999.

The charges for the use of commercial facilities which were provided the access from the road, basically constitute a specific kind of tax on property, the base of which is merely the possession of a commercial building that is located next to the road. The existence of such charges is disputable, particularly if we bear in mind that the owners/users of these facilities, in addition to the one-off charge for building, pay, and rightly so, for rental of the land used for access to the facility. Therefore, this kind of charge should be abolished, and any increased income of the users of these facilities, which, *inter alia*, may result from the mere location next to the road, should be captured through a regular system of profit or income taxation.

Cumulative charge for foreign vehicles is a particularly interesting case which is an illustrative example of the inconsistency between different regulations that comprehensibly govern the collection of a charge.

The existence of this charge was determined in Article 52 of the Law on Roads which was issued in 1991 and last amended in 1998. Article 53 of the Law which prescribes the authority which is responsible for determining the level of charges, however, mentions nothing about in whose authority it is to determine the level of this charge. Article 55 of the Law, which determines allocation of the revenues from the charge for the roads, prescribes that the cumulative charge for foreign vehicles is the revenue of the RSRD. Accordingly, it clearly follows from the Law on Roads that this charge exists and that the related revenues are allocated to the RSRD. However, it is not clear from the Law who determines the level of charge and what is the procedure for its payment.

After a research endeavor, which literally was a search, it became evident that the level of this charge was determined by the **Decision on Charge for the Roads for Foreign Vehicles that Use the Roads in the Socialist Federal Republic of Yugoslavia** (“Official Gazette of SFRY”, 25/81, 27/81, 21/ 83; 75/91 “Official Gazette of FRY”, 36/92, 4/98, 7/98) which, based on the **Law on Transportation in International Road Traffic,** and based on the approval of the competent authorities in the Republic and Autonomous Region, was issued by the Federal Executive Council of SFRY .

This Decision prescribes that the charge is to be paid for:

- Freight motor vehicles, freight trailers and semi-trailers per gross ton-kilometer,
- Buses and bus trailers per each vehicle-kilometer,
- Other vehicles (working vehicles, tractors, working machines, self-propelling or on their own wheels, and similar).

This calculation is computed and the cash payment is collected by the customs authority at the border crossing. The Decision also prescribes a form to be filled out by the customs officer, containing the elements for computation of the level of charge. The Decision also defined the gross ton-kilometer, vehicle-kilometer, and the procedure for computation of the distance. What is interesting is that a distance meter is used for distance computing which is „agreed between the organizations of associated labor for the roads, or self-managing community of interest for the roads" (Item 13 of the Decision). The only significant changes to the text of the Decision occurred in 1983 ("Official Gazette of SFRY", 21/83) when the level of charge was determined in dollars, instead of dinars. Other changes are related to the procedure for computation of the value of foreign currency amount of charge expressed in dinars. The exception is the change of 1992 which, in addition to changing the name of the state from SFRY to FRY, prescribes that the charge is to be collected in the effective foreign currency or cheques in foreign currency, in the name and on behalf of the NBY.

It follows from all said above that this charge is determined at the level shown in the table below.

Table 17. Charge for the Roads, for Foreign Vehicles

Charge for	Amount (USD)
Freight motor vehicle, freight trailer and semi-trailer, per every gross ton kilometer	0.0030
Bus and bus trailer, not including the luggage trailer, per every vehicle kilometer, specifically	
– for the vehicle with less than 30 seats	0.0320
– for the vehicle with more than 30 seats	0.0410
Other vehicles (working vehicles, tractors, working machines, self-propelled or on their own wheels, and similar) per every gross ton kilometer	0.0041

It should also be noted that further ambiguity regarding this charge is created by the fact that a special account number for this charge was one of the pay-to accounts of public revenues which were introduced in 2002 after payment operations were relocated from the Office for Payment and Settlement Services to the banks. However, its title was "charge for foreign road motor vehicles ".

The table 18 shows the data about the revenues collected based on the charge for the roads in 2003.

The most revenue significant charge is definitely the road toll, that is the charge paid for the use of the road, a part of the road, or the road facility. The second ranked according to the revenue significance is the annual charge for road motor vehicles, tractors and trailing vehicles.

Table 18. Revenues from the Charge for the Roads in 2003
million dinars

Charge	Revenue
Annual charge for road motor vehicles, tractors, and trailing vehicles	863.8
Annual charge for other road motor vehicles	0.003
Charge for extraordinary transportation	8.9
Specific charge for use of the road, part of the road, or road facility	4920.4
Charge for junction of access road to the public road	0.1
Charge for putting up installations on the road	1.8
Charge for building of and the use of commercial facilities where the access from the road is provided	23.5
Cumulative charge for foreign freight vehicles	60.4
Charge for the use of land belonging to the road	1.3
Charge for putting up notices	0.6
Charge for rental of the land belonging to the public road	0.5
Charge for the use of agricultural land belonging to the public road	0.09

Source: Ministry of finance

Revenue significance of this charge could rise if the existing separate taxation of motor vehicles within the framework of the Law on Tax on Using, Keeping and Carrying Specific Goods were abolished, and if the amount of annual charge were increased proportionately. The total burden on the vehicle owners would not increase and the nature of the levy would be clearly defined. Revenues from other charges could gain in significance upon reviewing the amounts determined in 1999.

On the whole, it could be said that in the domain of the charges for the roads, regardless of the above-mentioned exceptions and ambiguity of the overall system, compared to other areas in which the charges were introduced, the principles for introduction and collection of the charge as a price for the use of public goods, were generally respected.

Environmental charges

Introduction

1. Comparative analysis shows that environmental policy in a large number of countries which have just become members of the European Union (primarily the Czech Republic, Hungary, Slovak Republic, Slovenia and others) had a significant role in the process of economic transition. Countries of Central and Eastern Europe face significant environmental problems such as: high level of air and water pollution and large quantities of industrial waste; environmentally inefficient heating systems are still in a large part based on coal, which contains a high percentage of sulfur, as well as oil; air pollution

thorough damaging emissions of exhaust fumes, due to high number of old cars; bad quality of surface and underground waters; pollution of land, due to poor waste management and excess use of chemical substances (for example pesticides, artificial fertilizers etc.); underdeveloped environmental infrastructure, particularly at the level of local communities (for example water distribution, collection of waste waters, illegal dumping of dangerous waste etc.).

2. Compared with the other countries of Central and Eastern Europe, the situation in the State Union of Serbia and Montenegro is particularly specific. Several years of isolation from world trends has significantly limited the state's ability to follow new achievements in the environmental area and has almost disabled the implementation of contemporary – efficient and economic – inventions in the area of environmental protection. The NATO bombing in the first half of 1999 significantly jeopardized the quality and condition of the living environment throughout the territory of the country, especially in the territory of the Republic of Serbia. For that reason, concern for environmental protection becomes even more prominent. On the other hand, the level of real GDP and earnings are very low, which makes development of environmental consciousness a very difficult task. Under circumstances such as low living standards, citizens regard the pollution problem as the problem of the state, and expect the state to react, within its competences, and try to solve the problem in the most efficient manner. That means that citizens are not ready to pay the price themselves for improvement of environmental conditions (through an "environmental tax or charge"). However, in spite of the economic backwardness of a country, environmental protection, in the context of harmonization with European and world wideworldwide standards, will have to become a part of national macroeconomic policy in the years to come. Accession to the European Union imposes frameworks for a radically different approach to solving the problem of environmental protection and improvement. Therefore, it is necessary to develop not only an environmentally conscious approach in building new industrial and production facilities, but also improvement in the quality of certain segments of the living environment, through implementation of adequate economic (fiscal) instruments. Lack of funds for investments increases the risk of further deterioration of the current environmental condition, through efforts to cut general costs by cutting environmental costs. In order to substitute for insufficient use of economic (fiscal) instruments in active environmental protection policy making, it is necessary to direct national environmental policy towards development of innovations and openness, in order to prepare the ground for better implementation of these instruments, as well as to provide incentives for transfer of financial and technical aid at the national and international level.

3. Economic and especially industrial restructuring, as well as the accompanying recession in the economy, influences the quality of the

living environment and increases the levels of damaging emissions. Hence, market oriented instruments may ensure more efficient and cost-effective solutions to environmental problems. The efficiency of such instruments comes, primarily, from the flexibility offered to the polluters in choosing the most cost-effective strategy for leading environmental policy. Besides, the economic environment as a whole significantly determines the actual effect of economic instruments on this policy. Necessary changes in consumption modes and the choice of technology are much easier to achieve within a dynamic environment. A market functioning (price oriented) mechanism is, by the same token, essential for efficient functioning of economic instruments.

4. The use of charges for harmful emissions in the countries of Central and Eastern Europe dates from early 80s. In the beginning, their function was exclusively of a fiscal nature, i.e. to provide financing for environmental causes. Only after the beginning of the process of economic and political transformation in these countries did the bulk of economic instruments turn towards a more incentive based approach. For example, charges for air pollution (which are among the highest in the world) created a strong incentive for introduction of measures for ameliorating pollution in Poland; introduction of charge for packaging influenced a growing number of companies to introduce waste recycling; a excise tax on aluminum cans led to increased recycling of such packaging in Estonia, etc.[42] Since it was demonstrated that the effects of environmental charges are considerable, more adequate determination of these levies' becomes more significant. This is due to the fact that only sufficiently high rates (but not too excessive), may facilitate pollution prevention (or at least, enable its decrease), or limit excessive use of scarce natural resources.

5. Besides environmental taxes (for example taxes on products such as engine fuels, packaging, lubricants, car tires, substances which damage the ozone layer, batteries etc.),[43] there are other fiscal instruments, namely environmental charges, aimed at accomplishment of the goals of environmental protection. Comparatively speaking, these charges have been part of environmental policies more often than taxes, not only in the countries of the Central and Eastern Europe, but also in the member countries of the OECD. However, it is very hard to draw a clear distinction between environmental taxes and environmental charges. Taxes, as well as charges in this area represent the "price" paid for releasing polluting agents into particular segments of the living

42 See: Jurg Klarer – Patrick Francis – Jim McNicholas, *Improving Environment and Economy*, The Regional Environmental Center for Central and Eastern Europe, Szentendre, July 1999, p. 37; also see: Nigel Jackson, *Economic Instruments in CEE: Recent Assessment of Experience*, Newsletter on Green Budget Reform, Issue No. 7, May 2000.

43 See: *Sofia Initiative on Economic Instruments: Sourcebook on Economic Instruments for Environmental Policy: Central and Eastern Europe*, ed. by Jurg Klarer – Jim McNicholas – Eva-Maria Knaus, The Regional Environmental Center for Central and Eastern Europe, Szentendre 1999, p. 32.

environment (air, water, land etc.) Also, both of these fiscal instruments have an element of coercion and absence of direct service offered by the state in exchange. The charge is a coercive, legally introduced payment *based on the initiative of a payer,* to the budget or a public company, for use of public goods, natural resources or some other services of a public company, where the collected amount corresponds, to some extent, to the value of the supplied service. Here we will not tackle charges for use of public goods, but only those charges which have direct environmental implications, which we would designate as "environmental charges".

Current situation

6. In the area of water protection, the Law on Waters[44], among other things, stipulates an obligation to pay a **charge for the protection of waters**. A charge for the protection of waters[45] is paid by companies, other legal entities and citizens depending on the quantity, degree of pollution and the type of waste waters and other materials (spoiling the quality of waters, or impairing conditions for its use), which are directly or indirectly released in the surface or underground waters. The charge for the protection of waters is determined as follows: [46]

1) Waste waters from production, processing and distribution of oil and oil products; ferrous metallurgy; non ferrous metallurgy; textile industry; chemical industry; production of paper, celluloses, leather and textiles; pig farms; slaughter industry and repair of vehicles and machines – 2,400 dinars per 1 m^3;
2) Waste waters from shipbuilding, electric power plants, production of rubber, thermal power plants with recirculation, the food industry, metal manufacturing and construction industry – 1,400 dinars per 1 m^3;
3) Waste waters from wood processing industry; production and processing of non-metals; production and processing of construction material; tobacco processing – 1,350 dinars per 1 m^3;
4) Waste waters collected by the sewage system – 0.100 dinars per 1 m^3;
5) Other types of waste waters – 0.700 dinars per 1 m^3;
6) Thermal power plant with open throughflowthrough flow cooling system for every kWh of produced electrical energy–1.25% of the prices of 1kWh (1.47 dinars)

44 The Law on Waters, *Official Gazette of the RS*, No. 46/91, 53/93, 67/93, 48/94, 54/96, 8/98 and 9/99.

45 See: Art. 99, 104 and 107, The Law on Waters.

46 See: Art. 3, Decree on the level of charge for the use of waters, charge for protection of waters and charge for extracted material from the riverbeds in 2003 (in the following text: Decree on the level of charge…), *Official Gazette of the RS*, No. 2/2003. Since the level of the charges should be determined by the Decree of the Government every year, it is worth mentioning that this year, due to political events in the country, there is still no Decree passed pertaining to the level of these charges (including charge for protection of waters for 2004).

The amount of charge for protection of waters increases depending on the pollution level of the recipient: 50% (for I class recipients), and 25% (for II class recipients).

If a payer of a charge for water protection releases waste waters, purified only by the equipment for primary purification (which includes objects and facilities which eliminate only some polluting agents /floating and rough substances, sand, fats and oils/ from the waste waters), and if purification of waste waters is provided throughout the year, that payer shall pay:[47]

1) 85% from the level of the charge for water protection, if purification results in 50% decrease in concentration of polluting agents, which are, according to the waste waters' purification program, to be eliminated from the water;
2) 75% from the level of the charge for water protection, if purification results in 90% decrease in concentration of polluting agents, which are, according to the waste waters' purification program, to be eliminated from the water;
3) 70% from the level of the charge for water protection, if purification results in 70% decrease in concentration of polluting agents, which are, according to the waste waters' purification program, to be eliminated from the water.

However, in cases when a payer releases waste waterswastewaters purified by equipment for secondary purification of waste waterswastewaters and purification of these waters is provided throughout the year, he shall pay:[48]

1) 50% from the level of the charge for water, if purification results in 50% decrease in concentration of polluting agents, which are, according to the waste waters' purification program, to be eliminated from the water;
2) 25% from the level of the charge for water protection, if purification results in 70% decrease in concentration of polluting agents, which are, according to the waste waters' purification program, to be eliminated from the water;
3) 10% from the level of the charge for water protection, if purification results in 85% decrease in concentration of polluting agents, which are, according to the waste waters' purification program, to be eliminated from the water.

Payers which have installed equipment for waste waterwastewater purification are exempted from the obligation to pay the charge for water protection if the quality of purified water corresponds to the prescribed class of water measured at the recipient.

The charge for water protection is paid monthly, within the first 15 days of the month for the preceding month, and the payer has to settle his obligation quarterly with the Ministry of Agriculture.[49]

47 See: Art. 3 , Decree on the level of charge…
48 See: Art. 5, Decree on the level of charge…
49 See: Art. 8, paragraph 1 and 2. Decree on the level of charge…

We wish to draw attention to a paradoxical situation pertaining to the determination of the charge for water protection. Namely, this mechanism implicitly allows water pollution for all those legal and natural persons who are ready to pay the charge, since the amount of the charge is not high enough to deter polluters from further water contamination, nor does it provide enough incentive to install purification equipment. Since the emission of waste waterswastewaters *per se* represents an increased danger for the natural environment, emitters should be held responsible based on increased risk for endangerment of the natural environment. However, problems arise when it proves impossible to say who has actually caused the damage, and therefore, the damage is divided between a large number of individual polluters. Therefore we recommend that the basis for collection of this fiscal levy should be the use of water by its recipients, for the disposal of waste waterswastewaters within certain limits.[50] In addition the fundamental character of this fiscal instrument should be examined. Judging by significantby significant elements (for example the subject, the way of collection determination, intended use of the funds etc.), it might be classified as a quasi fiscalquasi-fiscal instrument, which is, to a great extent, similar to a contribution (and not a charge).

7. In the field of forest protection, the Law on Forests[51] prescribes, among others, **charges for cut forest**, as well as **charge for felled trees,** essentially aimed at improvement of forest eco-systems, as well as improvement of the structure of forests and facilitation for performing primary forest functions. Cutting forests is allowed exceptionally for the purpose of altering tree species, growing forest plantations and nurseries, building forest roads and other facilities necessary for forest management and which enable improvement and performance of all forest functions. For those other purposes, **one time charge for cut forest** is prescribed at the rate of five times the value of the forest, determined pursuant to the regulations on expropriation.[52] Revenues stemming from this charge go to a separate account held by the competent ministry.

Forest users, as well as forest owners have an obligation to pay the **charge for a felled tree**.[53] The base for determination of this charge is the market value of the tree, determined at the loading site. The market value of a felled tree is deemed to be the price per unit of measure, quoted by the public company "Srbijašume" for selling trees from the forests they manage. The charge rate for a felled tree amounts to 3%.

50 Compare for example.: Dejan Popov, *Zaštita voda kao dela životne sredine* (*Protection of Waters as a Part of Living Environment*), Pravni život, No. 9/1997, p. 389.

51 The Law on Forests, *Official Gazette of the RS*, No. 46/91, 83/92, 53/93, 54/93, 60/93, 67/93, 48/94, 54/96.

52 See: Art. 41, para 2-3, The Law on Forests.

53 See: Art. 54a-54f Law on Forests; Decision on the level of the charge for a cut tree and charge for use of other forest products, *Official Gazette of the RS*, No. 70/91.

Revenues stemming from this charge go to a separate account held by the competent ministry…

8. In the area of protection from air pollution, there are no charges for pollution, or harmful emissions, although *de facto* there are a lot of sources of air pollution (for example thermal power plants, heating facilities, vehicle engines, industrial processes etc.).

9. In the area of waste management in Serbia, there are no charges for industrial and dangerous waste materials, in spite of the fact that this problem is becoming more and more acute. In this area there are penalties for legal and natural persons who dispose of waste against regulations, as well as charges for services of collection and disposal of waste (which is, in fact, a charge for a public utility services). In Serbia, there are no special environmental charges (nor taxes) for products which create dangerous waste, although they are hot topics in other countries in the region.

10. In the area of protection of flora and fauna there is a **charge for collection, use and selling of protected wild floral and animal species**.[54] Organizations managing a protected natural resource, or the owner of a protected natural resource, who collects protected floral and animal species, for his own use or for sale are liable for this charge. Import, export and transit of endangered and protected species of wild flora and fauna, as well as their development may only be conducted if that import, transit or export are not forbidden, or if that exported quantity, or number of specimens of endangered and protected species will not endanger the survival of that species in the country. The base for determining this charge consists of the market price per kilogram of weight of protected the species in the previous year, amended for published price growth in the current year. The charge rate for collection, use and selling protected wild floral and animal species is 5%, but use and selling of protected species grown on plantations and other nurseries, as well as collection and use of protected species for scientific and educational purposes are exempted from payment of the charge. The charge is determined in proportion to the collected quantity of protected floral and animal species and is paid simultaneously with a request for submission for issuing a license for collection, use and selling of protected species.

11. The Law on Environmental Protection prescribes two types of charges. The first type represents the source of funds for protection and development of protected public goods (Art. 54). That is the **charge for use of a protected natural resource,** which is paid by companies, other legal entities and citizens (users), to the organization for management of a protected natural resource (Art. 55). It is paid for different uses of protected natural resource (exploitation of a natural resource for tourist related purposes, trade related purposes, film making purposes

54 See: Art. 14. Instruction on controlling use and selling wild floral and animal species *Official Gazette of the RS*, No. 17/99.

etc., use of prepared areas for specific purposes – parking spaces, recreation and sports grounds, places for posting advertisements etc., making use of the name and sign of the protected natural resource, use of services of companies or organizations managing a protected natural resource.) The amount and method for calculation of this charge is determined by the company, or organization managing a protected natural resource, while the legal act determining the amount and method for calculation of the charge is subject to approval by the competent ministry. The other type represents the source of funds for prevention and rehabilitation of environmental protection in the Republic (Art. 88). Depending on the competences for determining the amount, there are two types of such charges. These are: **a) charge for protection and improvement of living environment** determined by and paid to a city or a municipality and **b) charge for pollution of natural resources** determined by the Government, paid to the budget of the Republic. Besides these charges, the Law prescribes (Art. 88) that the following funds be directed towards protection of the living environment:

a. funds from the budget of the Republic collected from tax on selling pesticides, detergents, plastic packaging and cigarettes at the rate of 5%, and from tax on selling coal, oil, oil products, powered vehicles at the rate of 1%;

b. part of the preliminary value of investment for the structure and works for which the law prescribes an obligation to develop an analysis of the influence these structures and construction works would exert on the living environment, at the rate of 1%.

The charge for protection and improvement of the environment introduced by a municipality or a city, which basically represents a local tax constitutes a separate fiscal problem. By comparing the provisions of the Law on Protection of Living Environment, which gives the right to a municipality or a city to introduce this charge, and the Law on Local Self-Government, which defines this charge as an original revenue of the ULG, it becomes obvious that this charge is a tax by its very nature, since its payment is not, in either of these two laws, linked to the use of a natural resource or the consequences of an activity for a natural resource. The problem lies in the fact that every tax, including this one, must have a legally defined payer, base and rate. The consequence of the current situation is that a municipality or a city may, at its will, designate even an individual payer and the amount of tax burden, without any limitation. Bearing in mind the increasing frequency of cases where sudden and arbitrary increases of the amount of this charge have been noted in municipalities in which foreign investors founded or took-over a company, this freedom of the tax authorities is surely in contravention with a stable and fair business environment and its beneficiaries are neither economic development nor protection of the environment.

12. Special attention should be drawn to the fact that, among funds for financing protection of the environment, there is a **charge for pollution of natural resources**, which may be characterized as a “pure”

environmental charge.[55] The Government has an obligation to determine elements of such an charge (its amount, method of determination, paying etc.).[56] However, there is no regulation in Serbia, which regulates this charge in greater detail. Also, we must draw attention to the question of terminology (which may have a content-related implication), whether the term "charge **for** pollution of natural resources" is adequate for this particular levy. Namely, the aim of this fiscal levy is to stimulate prevention of actions and processes polluting natural resources. Therefore, the term "charge **related to** pollution of natural resources" would be, in our opinion, more adequate.

13. In the Law on Local Self-Government[57] **charges for protection and improvement of the living environment** are defined as original revenue of the LGU. On the other hand, **charges for undertakings in the environment** (charge for pollution of the environment and charge for investments) are among the partially ceded (shared) public revenues[58] between the central budget and the budgets of local authorities.

14. Considering the facts presented in items 11 and 12, we would like to draw attention to another inconsistency, which creates significant confusion in the existing regulations, and is related to environmental charges. In Article 25 of the Law on Public Revenues and Public Expenditures, only the **charge for protection and improvement of the environment**[59] is mentioned in the list of all public revenues of local communities (municipality, city or the city of Belgrade), while the charge for pollution of the living environment and the charge for investments are not. The charge for protection and improvement of the living environment is paid by: (1) the owners, or lessees of apartments and other specific parts of the building, at the rate of 0.30 dinars per m^2 of living area; (2) the owners, or lessees of business premises, at the rate of 0.60 dinars per m^2 business premises; and (3) investors in the construction of industrial, agricultural and other structures for which the Law requires analysis of the impact of the structure, or its construction to the environment, and for which a license is issued by local authorities, at the rate of 0.5% of the preliminary investment value of the facility.[60] Since,

55 See: Art. 88, para 3, item 1) of the Law on Protection Living Environment, *Official Gazette of the RS*, No. 66/91, 83/92, 53/93, 67/93, 48/94, 44/95 and 53/95.

56 See: Art. 88, Art. 4, The Law on Protection of Living Environment.

57 See: Art. 78 The Law on Local Self-Government, *Official Gazette of the RS*, No. 9/2002 and 33/2004.

58 See: Art. 98. The Law on Local Self-Government.

59 See: Art. 16, para 1, item 6 of The Law on Public Revenues and Public Expenditures, *Official Gazette of the RS*, No. 76/91, 18/93, 22/93, 37/93, 67/93, 45/94, 42/98, 54/99, 22/2001 and 33/2004.

60 See: Art. 3, para 1, item 1-3. of the Decision on the specific charge for protection and improvement of living environment Official Gazette of the RS, No. 22/99, 6/2001. This Decision has come into force on January 1st, 2000, by which item 1, sub item 1.6. of the Decision of the highest level of lease of flats and price of public utility products and services *Official Gazette of Belgrade*, No. 74/95, 5/96, 9/96, 11/96, 7/97, 21/97, 1/98, 3/98, 12/98, 17/98, 18/98, 1/99, 4/99, 19/99, 18/2000, 21/2000, 22/2000, 1-2/2001 cease to apply.

the payers of this charge are, among others, investors building industrial facilities, there is an overlap, to a certain extent, between the charge for protection and improvement of the living environment and the charge for investments. Hence there is no need for a charge for endeavors inendeavors in the area of living environment, in the form of charge for investments, to be separated as a special environmental charge, as the Law on Local Self-Government currently prescribes.[61]

Funds collected from the special charge for protection and improvement of the living environment are used for: 1) financing programs of quality control, analysis and monitoring the state of the environment in a City; 2) financing programs of protection and development of protected natural resources in a City; 3) financing preventive and rehabilitation measures; 4) co-financing programs and projects for protection of the living environment or investments contributing to significant decreases in environmental pollution (in the neighborhood of industrial and other polluters, in contaminated areas, in the event of an accident etc.); 5)co-financing scientific and educational programs and projects etc. aimed at acquiring knowledge and raising consciousness about the significance of protection and improvement of the living environment etc.[62]

15. Available data on revenues realized based on different environmental related charges in 2003, are shown in the following table. Data for 2002 are not comparable due to different classification of paying accounts.

Table 19. Environmental Charges
In millions of dinars.

Charge	2003
Charge for protection of waters	468.4
Charge for investments, at the rate of 1% of preliminary value of ostructure and works	46.3
Charge for pollution of natural resources	1.0
Special charge for protection and improvement of the living environment	394.5
Charge for cut forest	9.1
Charge for a felled tree	64.4

Data from the table 19 show the effects of inconsistent regulation in this area of living environment protection. The only "pure" environmental charge hardly achieves an annual revenue of one million dinars. Charges of a tax nature – the charge for the protection of waters and the

61 Compare: about charge for investments and its elements: Art. 36-38. of the Montenegrin Law on Living Environment, *Official Gazette of the RM*, No. 12/96, 55/2000.

62 See: Art. 5, para st. 1-2, Decision on specific charge for protection and improvement of living environment.

special charge for protection and improvement of the environment – earn, in comparison to the former one, significantly higher revenues. On the one hand, if we look at them as tax revenues, these amounts are still relatively small in absolute terms. Also, previous analysis clearly shows that they do not play a significant role in protection of the environment.

Recommendations

16. Bearing in mind all the above said, we shall formulate the following recommendations:

- Environmental charges are mentioned (but their elements are not regulated) in various laws in Serbia (even if we exclude the charge for protection of waters, charge for cut forest and charge for felled trees, which could, in our opinion, be treated as environmental charges, and not as charges for the use of public resources). The laws in question are three laws from three different areas: the Law on the Protection of the Living Environment, the Law on Local Self-Governance and the Law on Public Revenues and Public Expenditures. Inconsistency in using terms for the two mentioned charges should be stressed again, because it creates confusion whether the two charges are the same or not. Thus, for example, the Law on Protection of Living Environment uses the term ”charge for pollution of natural resources”; the Law on Local Self-Government uses the following terms: ”charge for protection and improvement of the living environment”, as well as “charge for endeavors in the area of the living environment, which includes the charge for pollution of the living environment and the charge for investments”, while the Law on Public Revenues and Public Expenditures only mentions a ”charge for protection and improvement of living environment”.
- The texts of the following separate Laws (on waters, on roads, on waste) should be revised, as well as accompanying sub-legal acts, which are far too outdated. Specifically, the rates of existing charges (which have direct environmental implications) should be examined and adjusted, which would be the only way to justify their existence in the system of living environment protection. In their current form they have neither a fiscal character, nor do they provide incentives for environmental protection.
- Air pollution is not covered by fiscal instruments. In spite of relatively low level of economic development, polluters' emission in the atmosphere are significant, which is explained by inefficient use of energy, low technical efficiency of equipment, inadequate management systems etc. [63] The main sources of air pollution, in Serbia, are thermal power plants, heating facilities, engine driven

63 See, similar: *Sofia Initiative on Economic Instruments: Sourcebook on Economic Instruments for Environmental Policy: Central and Eastern Europe*, p. 309-310.

vehicles and industrial processes. However, the law does not prescribe a single charge for air pollution at the level of Serbia, which is in stark contrast to the prevailing practice in most of the countries of Central and Eastern Europe.

- A similar situation exists with the waste management, which does not relate to any environmentally oriented levy.
- Although the Serbian Law on Protection of Living Environment, which is currently in force, prescribes that one of the major sources for financing the living environment protection is the charge for pollution of natural resources, there is no regulation pertaining to this significant charge (which, according to the text of the Law, should be further specified by the Government, especially concerning the amount, method for determination, payment etc.). In other words, the lawmaker was aware of the need to establish a source of funds from which measures influencing prevention or decrease of damaging effects on the environment are to be financed (such as a change in the quality of air, water and land, level of noise, ionizing radiation; changes in the health of the population; changes in climate, eco-systems etc.), but, for some reason, he didn't follow through.
- Bearing all this in mind, and directly related to the previous suggestion, it seems rational to suggest regulation of the whole area of environmental protection through fiscal instruments, by means of two environmental charges: a charge related to pollutionto pollution of natural resources and a charge for protection and improvement of the environment. This would mean that the already established, but not regulated (and in practice unenforceable) charge for (related to) pollution of natural resources (with adoption of the above mentioned terminological suggestion) should cover different forms of endangerment of the environment in some of its specific segments (air, water, land, etc.). This charge should be paid by the polluters – legal or natural persons, who release polluting materials into the air (for example benzopyren, carbon monoxide, sulphur oxides, nitrogen oxides, gaseous inorganic compounds of fluoride, nitrogen oxides, gaseous inorganic compounds of chlorine, nickel, chromium, cadmium and mercury; manganese and copper, pyran, phenanthrene and anthracene, etc.); those who use fossil fuels (hard oils, light oils, coal, liquid oil gas etc.); those who use substances which destroy the ozone layer (chlorofluorocarbons), those who use lubrication oils (machine oils, engine oils, etc.); those who create or dispose of toxic waste in an unacceptable manner. That would enable the drafting of a sub-legal act (which would be based on the Law on Protection of the Living Environment) or, possibly, one separate tax regulation, containing different charges (*de facto* charges for use of resources in the public interest), which are, in the current system, "dispersed" over several separate (non-tax) laws (on waters, on

forests, on roads etc.) and sub-legal acts (primarily Decrees of the Government or Decisions of local authorities), and in practice overcome the deficiencies of the current framework and produce concrete environmental effects.

- We believe that this unified regulation would: a) provide better transparency in the domain of so called environmental charges, b) simplify the system (which would be reduced to two such charges, at most), c) facilitate their administration and reduce administrative costs and, in the final instance, d) create incentives (as well as disincentives) for potential polluters.
- We also suggest re-examining the usefulness of the charge for collection, use and selling of protected floral and animal species. This levy was introduced by Instruction (in 1999), and its legal basis is not clear.
- Finally, it would be useful to integrate the regulation of pollution protection of air, water and land into one law. When it comes to specific segments of the environment, integrated regulation would entail the following: first, determination of environmentally acceptable quality standards for all segments of the environment – water, air and land; second, determination of the criteria for identification of polluters; third, determination of criteria for differentiation of polluters into national level polluters and local level ones, depending on the possibility of locating the consequences of pollution or the lack of it; fourth, determination of institutions or services responsible for implementing the regulations operatively – identifying polluters, amelioration of the consequences as well as jurisdiction over making charges; sixth, determination of the intended use for collected funds for direct alleviation of damage caused by pollution, at the site of pollution; seventh, prescribing payment procedures, control of payment, as well as coercive collection of charge, with respect to principles of costs minimization, for the payer and for the competent service, without unnecessary red tape and administration. In principle the revenue from charge should belong to the budget of the Republic or the budget of the LGU in whose territory the service for amelioration of the pollution consequences operates. Since general measures for environmental protection provide a pure public good, they should be financed from general taxes.

Summarized Overview of the Proposed Solutions

The main conclusion that arises from the analysis of existing solutions is definitely that the complete system of charges needs to be thoroughly overhauled. Changes are necessary in all these elements:

- first – selection of public goods and services for which the charge is to be paid,
- second – identification of the payers of the charge or the contractual party,

- third – procedure for identification of payers or selection of contractual party,
- fourth – determination of the level of charge,
- fifth – procure for collection of charge,
- sixth – allocation of revenues from charge,
- seventh – manner of using the funds, mercy
- eighth – the authority to determine the above mentioned elements.

It is obvious that, in addition to the main principles mentioned in the introduction which primarily relate to the potential fiscal content of the charge, the regulation of this system requires a comprehensive and consistent approach to the regulation of the use of natural resources and related public services, which must be implemented in all the laws governing respective areas. It is also obvious that for implementation of these changes it is necessary to promulgate a completely new set of laws that govern these areas. Even though it would not be realistic to expect that such significant changes could be implemented in the short term, it is very important that such comprehensive regulation be undertaken as soon as possible, since the present situation is far from satisfactory.

In technical terms, as the elementary prerequisite for the implementability of the law, and, most of all, from the perspective of public finances, it is necessary to:

- ensure compliance between the Law on Local Self Government and the Law on Public Revenues and Expenditures;
- ensure compliance of all the laws considered above with the Law on Budget System (since they are outdated, the phrase "to be paid into a separate account of the ministry in charge of the relevant area" is used in these laws, whereas, after the adoption of the Law on Budget System, the ministries do not have accounts at all);
- ensure compliance of all the laws considered above with the Law on Tax Procedure;
- ensure compliance of all the laws considered above with the Law on Local Self Government,
- ensure mutual consistency between the Law on Waters, the Law on Spas, and the Law on Mining;
- abolish the Law on Payment and Allocation of the Funds from Charges for the Use of Goods of Public Interest in Electricity Production and Oil and Gas Production, which introduced charges for the use of coal, water, oil, and gas.

The table below shows proposals of the directions in which the changes should be made, as regards individual charges.

It is necessary to consider the regulation of the use of natural resources and related services in a comprehensive manner, to define precisely what is in the authority of individual institutions, and thus establish a clear system of rights and obligations for all concerned.

Table 20. Summarized Overview of Proposed Solutions

Charge	Proposed Solution
For the use of urban land	Redefinition – rental
Specific tax for unused agricultural lands	Abolition
For the use of agricultural lands in state ownership	Redefinition: price of the right, contractual relationship
For the change in use of agricultural lands	Reduction in scope
For cutting down trees	Abolition
For the use of forests and forest lands, when used for grazing	Abolition
For the use of forest lands, when rented	Abolition
For the area of cleared forest	Reduction
For the use of waters	Redefinition of the payers and the rate
For protection of waters	Abolition, comprehensive regulation of environmental charges
For the material extracted from waterways	Redefinition: price of the right, contractual relationship
For drainage	Redefinition – price of the service, contractual relationship
For irrigation, draining of purified waters, and supply of industry with water	Redefinition – price of the service, contractual relationship
For the use of the capacities of water management facilities	Redefinition – rental
The use of waterland for accommodation and moorage of vessels	Abolition
The use of waterland for depositing of sand, gravel, oil and oil derivatives, hazardous matter and other matter	Abolition
For the use of waterland for other purposes	Abolition
For the use of waterland for recreational purposes and provision of other services	Abolition
For the use of natural curative factor	Redefinition - price of the right, contractual relationship
For the use of mineral resources	Redefinition – price of obtaining the right, contractual relationship
For environmental protection and improvement	Abolition, comprehensive regulation of environmental charges
For the use of coal, water, oil, and gas	Abolition
For the roads, paid for motor-driven vehicles that use gas or other energy	Deletion from the text of the law (ensuring conformity of the Law with the factual situation)
For the roads, paid for motor-driven vehicles that use gas or other energy	Abolition
For roads, for road motor vehicles, tractors and trailing vehicles, annual	Increasing the amount of the tax on using, carrying and keeping goods, which should be abolished
For use of the road, a part of the road, or road facility, specific	Ensuring terminological consistency between the Rules and the institutional changes from 1999
For extraordinary transportation	No changes

Charge	Proposed Solution
For building of commercial facilities next to the road	Reviewing (increasing) the current amount
For putting up notices on the roadside land	Reviewing (increasing) the current amount
For rental of specific parts of the roadside land and other land belonging to the road putu	Reviewing (increasing) the current amount
For use of agricultural land or other land belonging to the road	Reviewing (increasing) the current amount
For junction of the access road	Reviewing (increasing) the current amount
For putting up installations on the road	Reviewing (increasing) the current amount
For the use of commercial facilities where the access from the road is provided	Abolition
Cumulative charge for foreign vehicles	Abolition of current solution and integration into the system of charges for roads which refers to domestic payers

ABBREVIATIONS
ARV – Autonomous Region of Vojvodina
EPS – Serbian Electric Company
LLSG – Law on Local Self Government
PWMC – Public Water Management Company
LGU – Local Government Unit
LUF – Local Utility Fee
NBY – National Bank of Yugoslavia
RSRD – Republic of Serbia Road Directorate
RS – Republic of Serbia
SCG – State Union Serbia and Montenegro
Hs DTD – Hydrostem Dunav-Tisa-Dunav

V Local Utility Fees

LOCAL GOVERNMENT FUNDING SOURCES

Funding sources for the activities of local government units (LGUs) are governed by the Law on Self Government, which was promulgated at the beginning of 2002. By virtue of this Law, the LGUs are financed from the ceded and source revenues.

The ceded public revenues of the LGUs are constituted of a part of the revenue from taxes and fees for which the tax rate or the level of liability is regulated by law, the act of the RS Government, or the line ministry. The source revenues of LGUs are the revenues from fees and charges for which the level of liability (the rate or the amount in absolute terms) is determined by the LGU authorities.

On average, two thirds of current revenues of the LGUs are ceded revenues. A half of the source revenues in 2002 and almost two thirds of source revenues in 2003 came from fees for the use of construction land and fees for the preparation of construction land. As much as four fifths of total LGU source revenues come from these two fees, two utility fees – for displaying company insignia and for keeping motor vehicles, and from the rent the LGUs get based on the rental of real estate. The table 1 shows the data about the ceded and the source revenues of LGUs in 2002 and 2003, and the relatively most significant individual types of source revenues.

In interpretation of the given data one should bear in mind that these figures show the average for Serbia as a whole and that the situation is different in different LGUs. If only the individual source revenues, which are relatively the most significant, are considered, it is apparent that the relatively poorest LGUs have an even smaller share in total current revenues. This is yet another argument in favor of redefining the overall concept that lies behind the system of local public funding in Serbia. When contemplating this issue, it is first necessary to find out what the link is between the real economic power, i.e. the resulting fiscal capacity, and the LGU's scope of authority. Only after this question is answered may we go on to tackle the issue of the measure of fiscal decentralization and its forms, and the relationship between the LGUs and the central authorities, which, by their very nature, should keep the pillars of fiscal policy within their scope of authority. However, it goes far beyond the remit of this paper to try to

Table 1. Ceded and Source Revenues of LGUs in 2002 and 2003

	Mil. dinars		Structure in %			
	2002	2003	2002	2003	2002	2003
Current revenues	56,300	70,509	100.00	100.00	–	–
Ceded revenues	44,895	52,475	79.74	74.42	–	–
Source revenues	11,405	18,034	20.26	25.58	100.00	100.00
Charge for the preparation of construction land	1,861	7,276	3.31	10.32	16.32	40.35
Charge for the use of construction land	3,675	3,802	6.53	5.39	32.22	21.08
Rent	1,464	2,148	2.60	3.05	12.84	11.91
Utility fee for putting up of company's insignia	1,328	1,224	2.36	1.74	11.65	6.79
Utility fee for keeping motor road vehicles and trailing vehicles	1,005	1,053	1.78	1.49	8.81	5.84
Voluntary local tax	576	665	1.02	0.94	5.05	3.69
Special charge for environmental protection	307	395	0.55	0.56	2.69	2.19
Utility fee for the use of public spaces for commercial purposes	213	231	0.38	0.33	1.87	1.28
Other source revenues	975	1,241	1.73	1.76	8.55	6.88

resolve this issue, because, *inter alia*, it is necessary to work out the pertinent constitutional, legal, and political issues before dealing with the fiscal ones. For these reasons, the local utility fees will primarily be considered within the framework of the existing local public funding system and in view of their justifiability both from the perspective of the LGU budget inflows and from the perspective of the costs incurred by the economic players who pay them.

Local Utility Fees – Assessment of Current Approach and Proposed Changes

The Law on Local Self-Government (Article 79-86) prescribes the most general elements of the local utility fees (LUFs): for what they may be introduced, who is liable to pay, and the authority of LGU to introduce them through passing their own acts within the framework of the prescribed elements. This part of the Law on Local Self Government is basically only a slightly changed part of the corresponding text in the Law on Utility Fees and Fees ("Official Gazette of RS", Nos. 11/92, 75/92, 52/93, 67/93, 28/94, 75/94, 53/95, 42/98, 49/99, 25/00) on the effective date of which the effects of the Law on Local Self Government ceased.

The Law on Local Self Government prescribes that the LGU Assembly may introduce local utility fees for the use of rights, facilities, and services. Generally, the LUF payer is defined as the beneficiary of the rights, facilities, and services for the use of which payment of the fee is prescribed. The time of commencement of the fee liability is defined as the day of commencement of the use of the right, facility, or service for the use of which the payment of a fee is prescribed, and this liability shall run as long as the use of such right, facility, or service continues. Government bodies and organizations, and bodies and organizations of territorial autonomy and LGUs are exempted from the liability to pay LUFs. The Law grants the right to LGUs to determine different levels for the same LUF depending on the type of business activity, the surface occupied by the facilities and technical characteristics of the facilities, and on the part of the territory, or zone in which the facilities and articles are located and services for which the fees are payable are provided. Also, the Law specifies which LUFs are to be calculated at a daily, and which at an annual level.

With regard to the procedure of introducing and collecting, the Law on Local Self Government only prescribes that it is by the act that is passed by the municipal assembly, whereby the local utility fee is introduced, that the level, reliefs, time and mode of payment for LUFs are determined. In no way whatsoever is the issue regulated of the time and interval for changing the level of LUFs; consequently, the LGUs may normally modify the level of liability as frequently as they find appropriate. Considering that we are concerned with fiscal liabilities here, this situation creates uncertainty for economic players with regard to the level of total costs they would incur, based on the public takings. Also, this creates great problems for the Tax Administration (TA) in administering this kind of revenue, where additional difficulty is produced by the fact that different LGUs have differently prescribed the Tax Administration's scope of authority with regard to the collection of public revenues.

The Law (Article 83) specifies 16 different events in which LUFs may be introduced. These events are shown in the table below together with the analysis of the answers, which the municipalities gave to a questionnaire. In the part related to LUFs, the questions in this questionnaire included the following:

- Which LUFs are introduced and collected in LGUs?
- Who is liable to pay the fee?
- What is the base for collection of LUFs?
- What is the rate/level of LUFs?
- What is the planned revenue in 2004 from collection of each individual LUF that is introduced in the municipality?

This questionnaire was disseminated to all LGUs in Serbia, not including the LGUs in the territory of Kosovo and Metohija – to 170 LGUs in total. Out of these 170 LGUs, 166 are the municipalities, and 4 are the cities: Belgrade, Nis, Novi Sad, and Kragujevac. The territories

Table 2. Minimum and Maximum Amounts of LUFs

LOCAL UTILITY FEE	Rate		Number of Municipalities 69		Number of Municipalities %		Amount
	Min.	Max.	Intro-duced by	Planned revenue	Intro-duced by	Planned/ Introdu-ced by	Max./ /Min.
Occupation of an area of public spaces or in front of the business premises, for commercial purposes (din./sq.m. per day)	0.5	400	67	54	97.1	80.6	800
Keeping of entertainment devices “entertainment games” (din./device/day)	2.0	50,000	58	34	84.1	58.6	25,000
Holding musical performances in catering facilities (din. per day)	29.0	7,800	53	24	76.8	45.3	269
Using advertising panels (din. per day)	0.4	550	61	44	88.4	72.1	1,375
Using the space for parking the road motor vehicles and trailing vehicles (din./sq.m./day)	2.0	300	37	15	53.6	40.5	150
Use of free space for the camps, putting up the tents and other structures (din./sq.m/day)	0.4	480	37	11	53.6	29.7	1,200
Use of the watersides for commercial or other purposes (din./sq.m./day)	0.7	210	24	6	34.8	25.0	309
Displaying company insignia at the business premises (din./year)	300.0	450,000	69	60	100.0	87.0	1,500
Putting up and inscribing the company’s insignia outside the business premises (din./year)	300.0	400,000	28	12	40.6	42.9	1,333
Use of glass cases to display goods outside the business premises (din/sq.m./year)	65.0	8,400	52	23	75.4	44.2	129
Keeping and using the floating installations and floating devices and other structures on water (din./vessel/year)	400.0	31,080	13	4	18.8	30.8	78
Keeping and using boats and water rafts (din./boat/year)	80.0	2,750	21	6	30.4	28.6	34
Keeping of restaurants and other catering and entertainment facilities on water (din./sq.m./year)	15.0	13,200	22	53	1.9	22.7	880
Keeping of road motor vehicles and trailing vehicles (din./year)	30.0	15,000	66	54	95.7	81.8	500
Keeping of pets and exotic animals (din. per animal)	100.0	575	15	6	21.7	40.0	6
Occupying public space with building materials (din./sq.m./day)	0.3	540	45	36	65.2	80.0	1,800

of these four cities cover 19 municipalities. Considering that the cities have been assigned the authority to introduce LUFs, the maximum number of LGUs of relevance for the LUF analysis is 151. The questionnaire was answered by 75 LGUs, and in the part related to LUFs, the answers were supplied by 69 LGUs. This means that the findings of the analysis of answers, in respect of LUFs, are based on a sample that constitutes 46% of the LGUs with the authority to introduce LUFs. Considering that it embraces all cities and larger municipalities, the sample covers 75% of the territory of Serbia. This means that the results of the analysis are based on a representative sample and it may be concluded that they are a true reflection of the actual situation.

The findings of the analysis that are shown in the table below highlight three major characteristics of LUFs.

- ***Huge difference in the levels of the fee liability for the same LUF in different LGUs***. This difference is the greatest in LUFs for keeping entertainment devices ("entertainment games»): the maximum amount here exceeds the minimum amount by as much as 25 thousand times. The second ranked according to this characteristic is the LUF for occupation of public spaces with building materials (maximum amount 1800 times exceeds the minimum amount). The third ranked LUF according to this characteristic is the LUF for displaying company insignia at business premises – its maximum amount exceeds the minimum one by 1500 times. Considering that this LUF basically constitutes taxation of business activity, such a difference in burdening of individual payers is particularly ungainly since it introduces regional differences in the level of tax burden for performance of a business activity that are completely beyond the control of the central fiscal authorities.
- ***Significant differences in the representation of LUFs in individual LGUs***. Only the LUFs for displaying company insignia at the business premises has been introduced in all LGUs. The second ranked as per the representation is the LUF for the use of the surface of public spaces (it was introduced by 97% the LGUs which responded to the questionnaire), followed by the LUF for keeping road motor vehicles and trailing vehicles (96%). The smallest number of LGUs has introduced the LUF for keeping and using floating installations, floating devices and other structures on water – only 19%. Taking into account that not all LGUs have the opportunity to have fee payers for this LUF, the least represented is the LUF for keeping pets and exotic animals. This fee was introduced by 22% LGUs which responded to the questionnaire. If we bear in mind the administrative demands pertinent to collection of this LUF, this finding should not be surprising.
- ***Uncertainty of the revenue from the largest number of individual LUFs***. For the 10 LUFs out of the total of 16 LUFs that were determined by the law, more than half the LGUs, which have

introduced them do not plan individual revenues from these fees, or even plan to collect them at all. Included in these 10 LUFs are all four LUFs that are related to the use of the watersides, waterways or still waters. Out of 13 LGUs which have introduced the LUF for keeping and using the floating installations, only four plan the amount of revenues from this fee; out of 24 LGUs which have introduced the LUF for the use of watersides for commercial purposes or any other purposes, only six plan the amount of revenues from this fee; out of 21 LGUs which have introduced the LUF for keeping and using the boats, six of them plan the amount of revenues; and out of 22 who have introduced the LUF for keeping restaurants and other catering and entertainment facilities, only five plan the amount of revenues from this fee. Among the LUFs for which more than a half of LGUs that have introduced them do not plan the amount of revenues are the LUFs for: holding musical performances in catering facilities, using free space for camps, putting up the tents or other facilities whereby the space is used for parking road motor vehicles and trailing vehicles, putting up and inscribing company's insignia outside the business premises, using of glass cases to display goods outside business premises, and keeping pets and exotic animals. In principle, the amount of revenue is truly difficult to plan for all these LUFs, considering the administrative demands which would be related to precise measuring of the base and consequently the collection of revenue. Moreover, even in the case of the LGUs which do plan revenues from these LUFs, the planned amounts are negligible and range between 2,000 and 7,000 dinars per year.

The analysis of the answers from the questionnaire also revealed the following.

- ***The LGUs differently determine who should pay the same LUF***. In this way, for instance, the LUF payers for using the area of the public spaces may, depending on the LGU in question, be: companies and entrepreneurs, only companies, only private companies and entrepreneurs, only privately owned catering and retail businesses. With regard to the LUF for displaying company insignia at business premises, the payers may, depending on the LGU in question, be legal and natural persons, or only legal persons.
- ***Some LGUs introduce LUFs which are not mentioned in the Law on Local Self Government***. Almost a third of the LGUs which responded to the questionnaire have introduced an LUF for erection of buildings (the amount of the fee is in the range between 3.6 and 13 din./sq.m. of the building) which is payable upon issuance of the decision whereby the erection of the building is permitted. One LGU has introduced a LUF for the use of street lighting which is payable by households in rural areas outfitted with street lights at the rate of 40 dinars a month.

The definition of the grounds for introduction of LUFs as provided by the law – namely, the use of the rights, facilities, and services – is utterly ambiguous and can hardly be used for the purposes of LUFs analysis. In this way, for instance, it is not clear for the use of what right, facility, or service the LUF for displaying company insignia at the business premises is payable. Is it for the right to put up the company's insignia? If so, then one must wonder in what way this right is obtained. Is it obtained through incorporation of the company, or through registration of an entrepreneurial activity? The same or similar questions may be asked with regard to any LUF that is determined by the Law on Local Self Government. In order to avoid such ambiguities, which inevitably result in huge inconsistency, as witnessed now among different LGUs in respect of the choice of the base, the payers, and the level of fee liability, the first step to take is to divide the existing LUFs in three main groups.

The first group is made up of the LUFs which basically constitute local tax. Their main characteristic is that the payment liability is not related to the use of a public good or service; rather, a payer's business activity or property is the base for paying the LUF. With regard to these LUFs, it is necessary that the law determines the base, the payer, and the range within which the individual LGUs would then determine the rate, or the level of liability. In addition, it is necessary for this group of LUFs that the law prescribes a procedure for determination and collection of the liability. The procedure for determination of liability that is prescribed by law should have defined timeframes for determination of the level of liability since the LGUs would be granted the right to determine the level of liability within the period of time prescribed by law. Accordingly, in order to establish a certainty in respect of the level of takings, which is at the same time the level of the costs for the payer, it is necessary to determine by law that the introduction and determination of the level of liability may be executed only once a year, or, more specifically, in the course of preparing and adopting the budget of the LGU for the ensuing year. In the process of budget preparation, the LGU identifies and plans all its incomes and outflows and that is why this is the most convenient time for it to adjust the level of liability to its budget policy. If the LGU fails to change the level of liability in the course of this process, it should be assumed that the level of liability from the current year shall apply in the year that follows it.

The second group is made up of the LUFs in which the payment liability arises only if the payer uses a public good or service. The LUFs of this group should be abandoned in the form of local utility fees and the base for collection of revenues should be redefined and given the appropriate form. The appropriate form, depending on the basis of the payment liability, may be the ***rent***, ***the payment for a service*** which may be payable only if it is clearly identified, or payment for the ***permit*** to commence and conduct a certain economic activity.

The third group is made up of the LUFs which are not sustainable, namely of those which should be simply abandoned. The LUFs which should be abandoned include all those fees for which no service is nor can be provided, or those in the case of which the identification of the base or the payers requires unduly costly administration, or those by way of which multiple taxation of a certain economic activity is imposed.

In order to enable their classification in one of the above three basic groups, all existing LUFs were divided, according to the type of the base on which they are paid, in the following four categories:

- The LUFs for the use of public spaces,
- The LUFs by way of which the business activity is being taxed,
- The LUFs which constitute taxation of individual selected business activities, and
- The LUFs by way of which the possession of certain goods is taxed.

The LUFs which are paid for the ***use of public spaces*** are the largest in number. The LUFs of this category are possible candidates for the second group, that is candidates to be redefined in respect of the basis of their payment and to be abandoned as LUFs. Further in the text follows the analysis and a proposal of the solution for this category.

- **The LUFs for the use of areas of public spaces or in front of the business premises for commercial purposes, except for the sale of newspapers, books, and other publications; products of old and artistic crafts and folkcrafts.** At the moment this LUF is determined in daily amount and most often in dinars per square meter of the occupied space, but different solutions are implemented as well. In some LGUs, level of the fee liability is determined depending on the surface (level of liability is different for different areas that are occupied), and in some LGUs, the monthly lump amount has been determined. The level of fee liability in all LGUs depend on the business activity and the zone in which the public space is occupied. From the perspective where all LGUs are put side by side, a tendency may be noted, although it is not systematic, that a higher level of fee liability is determined for certain business activities (catering facilities, retail outlets). When the level of fee liability is considered according to zones, it may be noted that all LGUs systematically determine the progressive tax liability where the liability is lowest for the most peripheral and the highest for the most central zones of the LGU. It was already mentioned that there is huge inconsistency in definitions of the payers, and that in some instances certain economic actors pay for the occupation of public space and certain other economic actors do not pay for it at all.

  From the general perspective, all economic actors which use a clearly marked public space (pavement, square, street) for conduct of their business activity basically use public property to

earn private income. Since it is true that you have to pay for using any resource, it follows automatically that you must pay for using public space for conduct of your business activity. However, in order to avoid any ambiguities in the definition of the right and the size of pubic space that is pertinent to that right, this LUF needs to be replaced by a system of permits and rentals. This means that the LGU would be responsible for issuance of permits for the use of certain public spaces and for collection of rents from the user who has obtained such a permit. In order to introduce the elements of market orientation in the process of obtaining permits and determining the level of rent, LGUs should be bound by the law to, within a certain time period, announce a public tender whereby individual public spaces would be offered for specific purposes. The public tender would also define the minimum amount of rent, and the permit would be obtained by the potential user who offers the highest amount of rent. The same approach could be taken in case of other, now existing, LUFs which essentially constitute the price of the use of some public space. To make the text easier to follow, and to avoid unnecessary repetitions, the situation where the LUF actually constitutes the price of the use of public space and the proposed approach may be therefore implemented, would, in the remainder of the text, be designated as PPS (price of the public space).

In case of temporary use of public space for specific events (concerts, exhibitions, fairs, etc), the LGU would issue a permit and the base for collection of payment in this case would have the character of the fee for the use of public good, rather than that of the charge. The level of this fee, the base of which could be a square meter of surface and the number of days of occupation, would be determined by the LGUs.

- **The LUF for using advertising panels.** At present this LUF is normally determined at a daily level per square meter of the panel surface. However, in this case too different LGUs apply different solutions, such as the annual lump sum per panel, for example. This LUF should be replaced by a system of contracts where rent would be paid. The LGUs first need to prescribe the places and the manner for erecting these panels. The procedure for selecting the contracting party and the amount of rent could be determined in the same manner as in the case of the above LGU (PPS).
- **The LUF for the use of the space for parking of road motor vehicles and trailing vehicles in the specially adapted and marked places.** This LUF is normally collected as a daily charge per square meter of occupied area, but some different solutions are also in place, such as depending on the type of vehicle and business activity of the vehicle owner, and similar. Here we find two different cases in respect of the base for charging. In the case where a vehicle is parked in a specially erected and fenced parking

space, both the space and the service are charged for. Namely, the user of the parking space in this case pays not only for the use of a parking place, but for the safety of his vehicle as well. In the case where the parking place is only a specially marked area of public space, the user of the parking place pays only for the use of public space. Regardless of what case is in question, this duty should be excluded from the system of LUFs and should be completely replaced by the system of charging for parking which the LGUs would set up and regulate on their own. In the system of public revenues, the revenue on this basis would have a character of the fee rather than of a tax.

- **The LUF for the use of free space for camping, putting up of tents, or for other structures that are used temporarily**. At present this LUF is normally collected on a daily basis per square meter of occupied surface. However, as with other LUFs, different LGUs take different approaches. This LUF should be replaced by a fee for the use of a service in cases where there is a specially erected area designated as a campsite, while in all other cases it should be abolished considering that the use of public space could be paid for this intended purpose in the same way as for other intended purposes, in accordance with what was proposed above (PPS).
- **The LUF for the use of waterside for commercial and any other purposes.** This LUF too is currently normally paid daily per square meter and different LGUs take different approaches. This LUF should be abandoned as a separate basis for collection of payment and any use of these public spaces should be incorporated into the above described system of charging for the use of public spaces (PPS).
- **The LUF for the use of glass cases for the purpose of displaying the goods outside the business premises.** At present this LUF is normally determined on an annual basis per square meter of the surface of the glass case and here as well different approaches are taken by different LGUs (an annual lump sum per a glass case, for example). This LUF too should be abandoned as a separate basis for charging and should be incorporated into the system of charging for the use of public spaces (PPS).
- **The LUF for keeping restaurants and other catering and entertainment facilities on water**. At present this fee is normally determined on an annual basis per square meter of these facilities. However, some LGUs have defined an equal annual amount per groups of these facilities, where all the facilities the surface of which falls within a specific interval make up a group. This is yet another LUF that should be abandoned as a separate basis for charging and yet another one to be incorporated into the system of charging for the use of public spaces (PPS).
- **The LUF for keeping and using the floating installations and floating devices and other structures on water, with the**

exception of the anchorage grounds used in border traffic on rivers. Currently this fee is normally determined on an annual basis per vessel and the LGUs take different approaches on it too. This LUF should be abandoned as a separate basis for charging for the use of public spaces and it should be integrated into the system of charging for the use of public spaces as well (PPS). In cases where the mooring facilities and access to floating installations and devices are provided, the approach of choice could be analogous to charging for the use of a parking place.

- **The LUF for keeping and using boats and rafts, with the exception of boats used by the organizations responsible for maintaining and marking navigation channels.** This fee is currently determined as an annual lump sum per boat, or raft. In some LGUs the level of this fee depends on the length of the boat, or the surface of the raft. In cases where there is a specially erected and fenced area for accommodation of boats and/or rafts, the fee for the service of accommodation should be charged instead of the LUF. In all other cases, this LUF should be abandoned as a separate basis for charging and it should either be integrated in the system of charging for the use of public spaces (PPS) or an analogous approach should be applied for charging for the use of parking space in the cases where it is reasonable, meaning where the mooring facilities and access to the boats, or rafts is provided.
- **The LUF for displaying and inscribing company insignia outside business premises, on buildings and in spaces that belong to the municipality** (**traffic lanes, pavements, green areas, lampposts, etc**). This LUF is now determined as an annual lump sum, the level of which depends on the business activity of the fee payer, and in some LGUs, also on the zone where the company' insignia is displayed. The payers are the same as in the case of the LUF for putting up the company' insignia at the business premises, which means that they are differently defined in different LGUs, and the level of this LUF as a rule equals the level of the LUF for displaying company insignia at the business premises. In view of the fact that the display of company insignia is charged for already, this LUF should be abandoned completely.
- **The LUF for the occupation of public space with building materials**. This LUF is now determined on a daily basis per square meter of occupied space. When erecting buildings, all investors pay a fee for preparation of the building land, the amount of which is determined in the contract between the LGU and the investor, and this entails the preparation of the land and outfitting the land with utility infrastructure. It is not logical that the investors in these cases should also pay a separate fee for occupation of public space with building materials. The potential payers of this LUF are the persons who are using the building materials for current maintenance of facilities. The determination

of the fee payers and the base (i.e. the area occupied with building materials) here can come about through mere chance more often than through systematic implementation of regulations. This LUF should be therefore abandoned completely.

The LUF which actually constitutes the ***taxation of business activity*** is the LUF that is paid for **displaying company insignia at the business premises**. This LUF is determined on an annual basis, and the law defines the term 'company insignia' as any name of the company or a name that suggests that a legal or natural person conducts a certain business activity. Also, the Law prescribes that when the same fee payer displays company insignia at more than one location on the same business building, he is liable to pay only for one such insignia. The LGUs determine the level of the annual fee, as was already said, depending on the kind of business activity, and in same cases also depending on the zone in which the business premises are located. Also, in one case, this fee is determined as a percentage of the total annual turnover. It arises from the law that one and the same fee payer should pay the fee for the company insignia displayed at the business facility of his own; however, this principle is not always implemented in practice: in a number of LGUs the payer of this fee is an economic operator, not a business facility.

The nature of this LUF is essentially that of a local tax: payment liability is in no way whatsoever directly linked to any public service or any use of public goods; it is rather a basis for charging for the very incorporation and conduct of a business activity. The existing system, however, in many ways deviates from the standard principle of correct determination of taxes. It is notably discriminatory in character – depending on the form of ownership or the business activity, and depending on the location of business premises, some economic operators are and some other economic operators are not liable to pay this tax. The level of this liability is arbitrarily and differently determined in different LGUs. Regardless of the efforts made to approximate the notional economic power of the taxpayer through determining different amounts depending on the business activity, it is not very likely that it would be possible to establish a systemic ratio between the level of liability and the results of economic activity, i.e. the economic power of the payer.

In order to determine the relative proportions of tax burden on this basis, the rate of the tax on the profit and income from the self-employment activity has been calculated; if applied to these tax bases it would produce revenue that would equal that from the fee for displaying company insignia. This rate has been calculated as follows: first, based on the data on the revenues from the tax on profit and the tax on income from a self-employment activity and the corresponding rates, the bases on which these two taxes were collected in 2002 and 2003 were identified; then the revenues that were collected in 2002 and 2003 from the LUF for putting up the company's insignia weighed against

the sum of these two bases. This calculation shows that in 2002 in Serbia the same average revenue from the LUF for putting up the company's insignia would have been realized had an additional tax at the rate of 4.1% been paid on the basis for the tax on profit and the tax on income from self-employment activity. For 2003 this rate was 2.4%. It is obvious that the base for the profit tax calculated as described above is not equal to the actual tax base in the fiscal year. The reason for this is that, on one hand, it does not take into account the revenues that were not collected because the taxpayers took advantage of different tax reliefs to which they are entitled by law, and, on the other hand, it took into account the revenues raised through the enforced collection and/or interest on the delays in payment of this tax. The same, and for the same reasons, applies to the calculation of the base for the tax on the income from self-employment activity. However, it might be said that the calculated rates actually are indicative of the figure of this quasi tax burden.

In view of the revenue significance of the LUF for displaying company insignia, its nature as a tax, and considerable shortcomings of this method of calculation, this LUF should be redefined into a local tax. The base for this tax would be equal to the base for the profit tax for legal persons, and to the base for the tax on income from self-employment activity for natural persons. These laws and the Law on Tax Procedure and Tax Administration have already laid down the method of determination of the base, the regular and enforced collection. LGUs would on their own determine the level of the rate of this local tax, within the interval prescribed by law, and in the timescale and manner as described above. This interval could be in the range between 0% (in the case of which the LGU may decide not to introduce this liability) and 3%. This level of the maximum allowable rate would incur no increase in the tax burden considering that both the profit tax rate (which new amending documents to the Law propose to decrease to 10% only), and the rate of the tax on income from self-employment activity (which would presumably also be proposed to be decreased to 10%, since there are no reasons to discriminate between entrepreneurs and the incorporated companies), are relatively low at the moment.

The simplest way which would in a consistent manner ensure the uniform implementation of this local tax throughout the territory of Serbia is through the appropriate amendments to the Law on Corporate Profit Tax and the Law on Personal Income Tax. These amendments would provide that the appropriate articles of these Laws which refer to the determination of tax rates prescribe a range of additional tax rates the actual level of which would eventually be decided by individual LGUs. The part of the law which regulates tax reliefs could prescribe that any reduction in tax liability does not apply to the liability based on the local tax. The part of the law which governs the procedure for determination of liability could prescribe the timescale within which the LGUs would have to decide on the change of the level of tax

rate, and the mechanism which would ensure that the rate from the current year is applied in case of the failure to issue the decision on the change of the rate for the ensuing fiscal year.

Two LUFs constitute the ***taxation of the specific selected business activity.*** These are the **LUF for keeping entertainment devices ("entertainment games")** and the **LUF for holding musical performances in catering facilities**. Both these fees are presently determined on a daily basis per entertainment device, or a day of the musical performance. Different LGUs take different approaches here as well: for instance, in some of them the liability is determined on a monthly basis. In all the LGUs the level of the LUF for keeping entertainment devices depends on the type of device, and the level of the LUF for holding musical performances in entertainment facilities depends on the zone in which the catering facility is located. A considerable number of LGUs which have introduced these LUFs do not collect them at all. If the LUF for displaying company insignia were replaced by local profit tax, or the tax on income from self-employment activity, a part of the payer's income that results from organizing different entertainment games or holding musical performances would be included through the payment of these local taxes; thus, there would be no reasons for additional taxation.

Bearing in mind the specific character of these two activities, the introduction of a system of permits could be considered according to which the potential payer would be liable, after he meets all the requirements for obtaining the permit, to pay for it. Such an approach, however, is not possible if the requirements which the payer would be liable to meet are not regulated. This regulation, as well as determination of the level of the amount which the payer would be liable to pay for the permit, should be wholly in the authority of the LGU. There would have to be one exception, however. That would be games of chance since games of chance are regulated by the law (and a proposal of a new law on games of chance is already in parliamentary procedure). In case of games of chance, the requirements for practicing this activity (that is, for installation of the devices) and the pertinent public takings are prescribed by law. In all other cases, the issue of permits and charging for them would be a specific local tax. The taxation of these activities, however, is of no macroeconomic significance; it can be, therefore, completely transferred to LGUs, under the presumption that the manner for regulation of the requirements for obtaining of the permit and the procedure for its obtaining are in conformity with the law. At the same time, in view of the fact that control is easy in a system of permits, the Tax Administration should not be responsible for the control and collection of these local taxes: if a person does not hold or has not paid for a permit, he may not organize these activities, and, if a person does organize them, he would be sanctioned by the closure of his business until he meets his liabilities.

The LUFs which constitute the ***taxation of property*** are the **LUF for keeping road motor vehicles and trailing vehicles, with the exception of agricultural vehicles and machines,** and the **LUF for keeping pets and exotic animals**. Both of these LUFs are now determined at an annual level, the former depending on the type and purpose of the motor vehicle, and the latter per animal.

The LUF for keeping road motor vehicles and trailing vehicles should be integrated into the annual fee for road vehicles as introduced by the Law on Roads, the level of which is determined by the Government and the revenues of which according to the existing regulations, belong to LGUs. Taking into account the level of the revenue that is in the territory of Serbia collected from this annual fee and this LUF, doubling up the amount of the annual fee concurrently with the abolition of the LUF would, on average, have a revenue neutral effect. In addition to the adjustment of the fee for road motor vehicles as proposed in the section of this paper which addresses fees, its increase, with concurrent abolition of the LUF, would result in two main positive effects, without affecting the revenue of LGUs. The first effect would be that the amount of the liability based on owning a motor vehicle would be equal for the owners of motor vehicles throughout the territory of Serbia. The second effect would be that the method of calculation and charging for the liabilities that are payable upon registration of the vehicle would be simplified, which would doubtlessly reduce the administrative costs.

It may be said that the LUF for keeping pets and exotic animals seems to be quite an imaginative way for indirect estimation and taxation of the personal wealth under the presumption that a person is able to have a pet only if his income is higher. Taking into account that only a small number of LGUs have introduced this LUF in the first place, and that an even smaller number of those plan any revenues from it, this imaginative endeavor has obviously failed. Therefore, this LUF should simply be abolished.

The levels of the revenue from individual LUFs that are shown in the table for 2002 and 2003 below are in essence the logical outcome of the above discussed shortcomings, or the unreasonableness and administrative requirements for determination of the prescribed bases, which can hardly be met, and not only in the current circumstances in Serbia, but also in the countries where the tax culture and administration is well advanced.

Total revenues from LUFs constituted 4.73% of the total current revenues of the LGUs in 2002, and 3.77% in 2003. In both these years, the revenues from the two LUFs – for displaying company insignia and for keeping road motor vehicles – account for more than four fifths of total revenues from the LUFs. The only significant share in the structure of revenues from LUFs is that of the LUF for the use of areas of the public space or in front of the business premises for commercial purposes. In 2002, its share in total revenues collected based on the LUFs

was 7.99%, and in 2003 it was 8.69%. However, the revenue from this LUF, as compared to the total current revenues, was insignificant: in 2002 it amounted to 0.38%, and in 2003 to 0.33%. The revenues from all LUFs which are classified in the LUFs for the use of public spaces constitute merely 0.56% of total current revenues of LGUs in 2002, and 0.53% in 2003. The revenues from the LUFs which constitute the taxation of selected business activities are insignificant in the structure of the revenues from LUFs. In 2002 they amounted to 0.66%, and in 2003 to 0.40% of the total revenues from the LUFs. Only the share of the revenues from the LUF for the use of parking space was of any significance in the total revenues from the LUFs in 2003 – it amounted to 2.67%. This means that, out of 16 prescribed LUFs in 2003, the share of individual revenues from 12 LUFs generated less than 1% of total revenues from the LUFs. Consequently, they are all completely insignificant in respect of the total current revenues of the LGUs.

Table 3. Revenues from the Local Utility Fees

	Mil. Din.		Structure in %			
	2002	2003	2002	2003	2002	2003
CURRENT REVENUES	**56,299.6**	**70,508.8**	**100.00**	**100.00**		
TOTAL LOCAL UTILITY FEES	**2,665.6**	**2,659.2**	**4.73**	**3.77**	**100.00**	**100.00**
Use of public spaces	**314.6**	**370.7**	**0.56**	**0.53**	**11.80**	**13.94**
Use of public spaces for commercial purposes	212.9	231.0	0.38	0.33	7.99	8.69
Use of advertising panels	28.9	21.0	0.05	0.03	1.09	0.79
Use of the parking space for road motor vehicles and trailing vehicles, in the specially adapted and marked places	44.5	69.3	0.08	0.10	1.67	2.61
Use of the free space for the camps, putting up the tents, or other forms of temporary use	0.1	0.7	0.00	0.00	0.01	0.03
Use of watersides for commercial or any other purposes	25.2	15.5	0.04	0.02	0.94	0.58
Use of glass cases for displaying the goods outside the business premises	1.4	3.0	0.00	0.00	0.05	0.11
Keeping the restaurants and other catering facilities on water	0.8	1.1	0.00	0.00	0.03	0.04
Keeping and holding the floating installations and other structures on water, with the exception of anchorage grounds used in border traffic on rivers	0.6	4.3	0.00	0.01	0.02	0.16
Keeping and using the boats and water rafts, with the exception of the boats used by the organizations responsible for maintenance and marking of navigation routes	0.1	0.1	0.00	0.00	0.00	0.00

	Mil. Din.		Structure in %			
	2002	2003	2002	2003	2002	2003
Putting up and inscribing the company's insignia outside the business premises, at the structures and in spaces that belong to the municipality (traffic lanes, pavements, green areas, lampposts, etc.)	0.0	1.7	0.00	0.00	0.00	0.06
Occupation of public space with building materials	0.0	23.2	0.00	0.03	0.00	0.87
Taxation of the business activity	**1,328.5**	**1,224.3**	**2.36**	**1.74**	**49.84**	**46.04**
Displaying company insignia at the business premises	1,328.5	1,224.3	2.36	1.74	49.84	46.04
Taxation of the selected business activities	**17.5**	**10.5**	**0.03**	**0.01**	**0.66**	**0.40**
Keeping entertainment devices ("entertainment games")	16.3	1.9	0.03	0.00	0.61	0.07
Holding musical performances in catering facilities	1.2	8.6	0.00	0.01	0.04	0.33
Taxation of property	**1,005.1**	**1,053.6**	**1.79**	**1.49**	**37.70**	**39.62**
Keeping road motor vehicles and trailing vehicles, with the exception of agricultural vehicles and machines	1,004.6	1,052.7	1.78	1.49	37.69	39.59
Keeping of pets and exotic animals	0.4	0.8	0.00	0.00	0.02	0.03

Taking into consideration, firstly, the analysis of the character of the base and the principles for determination of LUFs, and, secondly, the revenues that the LGUs realize from the LUFs, it is clear that this system needs to be completely reconstructed, even if the change in current approaches that are taken with regard to fiscal decentralization and the relationship between the fiscal authorities and LGUs are not taken into account. It seems that the existing system is essentially just another legacy of the former socialistic state and that it was taken over by the Law on Local Self Government, without any thorough analysis or review.

SUMMARIZED OVERVIEW OF PROPOSED APPROACHES

Generally speaking, the implementation of the proposed approaches would result in the disappearance of local utility fees from the system of public revenues in Serbia. The existing bases for charging would either be redefined into a local tax or into fees for the use of a public goods or services. In all the cases where the direct beneficiary can be identified, and in all other cases they would simply be abolished.

In this way, several desirable goals would be reached without affecting the volume of revenues of LGUs.

Firstly, the number of fiscal instruments would decrease and this means that the problem of complexity and non-transparency of the total tax system of Serbia would be alleviated and that its efficiency would be improved.

Secondly, a clear link would be established between the public goods and services that are payable by economic operators, as well as a direct link between the level of tax burden and the economic power of the taxpayer. This would make the tax system more comprehensible for tax payers and they would consequently accept it better, which is one of the elementary preconditions for voluntary payment of tax liabilities, which in turn is a key element of a successful tax policy.

Last but not least, this would enable the Tax Administration to know beforehand what its obligations are with regard to the collection of public revenues, and this is an elementary precondition for good organization of work and for considerable improvement of administration efficiency, and, as a result, for the collection of all public revenues.

The table below shows the proposed approaches in implementation of the changes, with regard to individual local utility fees.

Table 4.

LOCAL UTILITY FEE	PROPOSED APPROACH
Use of Public Spaces	
Use of public spaces for commercial purposes	Abolition. In case of the use for over one year – replacement by the system of permits, with payment of rent, and in case of the use n sporadic occasions – replacement by the fee for the use of public space.
Use of the advertising panels	Abolition and replacement by the system of permits, with payment of rent.
Use of the space for parking the road motor vehicles and trailing vehicles at specially adapted and marked places	Abolition and replacement by the system of charging for the use of parking space that would be regulated by individual LGUs, classification into the fees.
Use of the free surfaces for camps, putting up tents or other forms of temporary use	Abolition and replacement by the fee for the service, in case when there is a specially erected camping site, and in all other cases – abolition of separate charging and integration into the system of charging for the use of public spaces.
Use of the waterside for commercial or any other purposes	Abolition as a separate basis for collection of payment, integration into the system of charging for the use of public spaces.
Use of the glass cases for displaying the goods outside the business premises	Abolition as a separate basis for collection of payment, integration into the system of charging for the use of public spaces.
Keeping of restaurants and other catering facilities on water	Abolition as a separate basis for collection of payment, integration into the system of charging for the use of public spaces.

LOCAL UTILITY FEE	PROPOSED APPROACH
Keeping and using floating installations and other structures on water, with the exception of the anchorage grounds that are used in border traffic on rivers	Abolition as a separate basis for collection of payment, integration into the system of charging for the use of public spaces. In the cases when the mooring facilities and access to floating installations and devices is provided, opt for the approach that is analogous to charging for the use of parking spaces
Keeping and using boats and rafts, with the exception of the boats used by the organizations responsible for maintaining and marking the navigation routes	Abolition. In cases when there is a specially erected and fenced space, the fee for the accommodation service would be charged, and when the mooring facilities and access to the boats is provided, the approach analogous to charging for the use of parking space.
Putting up and inscribing company insignia outside business premises, at the structures and spaces belonging to the municipality (traffic lanes, pavements, green areas, lampposts, etc.)	Abolition
Occupation of public space by building material	Abolition
Taxation of Business Activity	
Displaying company insignia at the business premises	Abolition in the form of a LUF and replacement by a local tax whose base would equal the base of the profit tax for legal persons, and the base for the tax on income from self-employment activity for natural persons. The method of base determination, regular and enforced collection of payment is the same as already provided by these laws.
Taxation of Selected Activities	
Keeping of entertainment devices (“entertainment games”)	Abolition and replacement by a system of permits.
Holding musical performances in catering facilities	Abolition
Taxation of Property	
Keeping road motor vehicles and trailing vehicles, with the exception of agricultural vehicles and machines	Abolition, compensate the revenue by doubling up the annual fee for road motor vehicles the level of which is determined by the Government while the revenues, according to the current regulations, belong to LGUs
Keeping pets and exotic animals	Abolition