HOUSING IN THE TAX ASYMMETRY PUZZLE IN BULGARIA

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Summary

Housing has been for centuries an attractive source of tax revenue. It is well integrated into both direct and indirect taxation of any modern state. Having regard to the influential work of Haig and Simons, who elaborated on a comprehensive personal income definition, this paper investigates the asymmetrical/non–neutral treatment of imputed and actual rent from own housing within the flat rate tax in Bulgaria. The country introduced it in 2008 at the rate of 10% and without personal allowance, despite having the lowest GDP per capita in the EU and its deteriorating income equality. Therefore, the instant contribution also analyzes the potential of property tax to correct personal income tax distortions in relation to own housing. The paper argues that property tax remains underutilized in Bulgaria. Since better utilization crucially depends on (slight) progressivity of the recurrent property tax, an increase of its burden, but not across the board, is recommended. Several measures are being proposed and critically evaluated in order to better utilize property taxation, whilst shifting its (additional) burden towards individuals with high ability to pay.

Key words

personal income tax, property tax, non–neutral/asymmetrical taxation, imputed rent, actual rent

JEL classification

H2, H24, H71

1. Introduction

The tax burden in Bulgaria is asymmetrically distributed over the broad economic bases. The implicit tax rates on consumption and labor, although declining, are still above 20% while the capital remains much lightly taxed [European Commission 2016]. The country reduced the nominal income tax[1] rates to 10% immediately before joining the EU in 2007. As an immovable part of the capital stock in the economy, residential property is also marginally taxed. The local governments in Bulgaria use to collect recurrent taxes on immovable property ownership up to 0,3% of GDP [European Commission 2016].

Many public finance scholars share the view that tax policy is an important factor behind the strong preference for immovable property and housing in particular. The underlying rationale is the plenty of tax incentives provided which guarantee favorable tax treatment of residential assets. Henceforth, large capital flows have been redirected and invested in housing ownership instead of in assets that are more productive. Such capital allocation is considered as a driving factor behind the housing price bubble, associated with financial crisis emergence in 2007 [IMF 2009; OECD 2010]. This paper subscribes to the notion that it is important to distinguish between land, business property, owner–occupied and rented housing. In this vein, the object of the instant study is the housing within the direct taxation framework in Bulgaria. It is further limited down to two direct levies: the personal income tax from and recurrent tax on immovable property[2]. The suitability and importance of the property tax have been comprehensively discussed concerning its potential to boost funding for fiscal decentralization in Central and Eastern Europe [Janoušková and Sobotovičová 2016; McCluskey and Plimmer 2011; Sedmihradská 2010].The analysis of housing as an intersection point of personal income and property taxes remains still less explored in the literature on public finance in the new member states of the EU. Therefore, the present research aims to:

1) highlight the most relevant theoretical contributions explaining the asymmetrical/non–neutral tax treatment of personal income, resp. utility from own housing;
2) critically review literature on the merits of property tax as a second best solution to the distortions of the personal income tax concerning own housing;
3) find out and analyze some manifestations of the lack of neutrality in taxation of personal income/utility from own housing in Bulgaria;
4) propose and discuss measures enabling the immovable property tax to mitigate the distortions of the flat income tax related to own housing in Bulgaria.

[1] Corporate and personal income tax rates.

[2] Property taxes encompass a variety of levies on the use, ownership, and transfer of property [Norregaard 2013].

The underlying methodology is based on a systematic survey of the influential theoretical concepts discussing own housing integration within personal income and property taxes and the economic impact of their legislative implementation in Bulgaria. In order to analyze the economic consequences, statistical data from reliable and trustworthy sources like the Eurostat, National Statistical Institute and Ministry of Finance in Bulgaria has been collected, processed and interpreted.

2. Housing within the personal income tax system

2.1. Public finance literature on housing income tax asymmetry

Public finance scholars consider personal income tax as an imposition on positive return (if any) of assets held in the individual's/household's portfolio. It is rather a restricted view on this tax object. Thus, reference should be paid to the highly reputable work of R. Haig and H. Simons. In the last century both tax economists elaborated on and delivered a much broader and wide accepted definition of personal income. It became popular as the H–S criterion. According to the latter, the individual income is the monetary value of 'the net increase to an individual's power to consume during a period. This is equal to the amount actually consumed (…) plus net additions to wealth' [Rosen 1991]. It does not matter whether the income is saved and/or consumed [Musgrave and Musgrave 1989].

Although much criticized for its fiscalism, the H−S criterion warrants neutrality and efficiency in personal income taxation as any source of potential increase in individual capacity to consume is equally treated by the personal income tax, being proportional or progressive in design. In like vein, looking at housing through Haig–Simons' lens on personal income, the former takes on dualistic features and is considered as a consumption and an investment good [IFS 2011]. If people live in own accommodation, they use to consume the utility flows from the owner–occupied dwelling provided on a day–to–day basis. Therefore, housing is a consumption good. The utility stream derived from it is not given a monetary value for taxation purposes. Nevertheless, it increases the ability of the owners/their families to consume because they can save on rental cost. Therefore, the "return" to an owner who consumes housing services is the imputed rent. In contrast, the housing rented by its owner to a third party is an investment good, expected to generate a market return[3]. In case of own rented housing the return takes on a monetary/pecuniary dimension, usually included into the personal income tax base. There is an obvious asymmetry/non–neutrality, stemming from Haig–Simons concept's implementation within the personal income tax practice: the rental income, realized from own housing, is recognized as a source of individual income, while the imputed rent from owner–occupied one is not.

The reason for such an asymmetrical tax treatment is the monetary estimate of imputed rent from own housing. Measuring it is a complex and hard to complete exercise for tax theorists, administrators and taxpayers. For more discussion on approaches for imputed rent's calculations at an individual/household level it can be referred to Frick and Grabka (2003), Frick et al. (2007, 2010). For precise imputed rent's appraisal they recommend the opportunity cost, the capital market and the self–assessment approaches. The first one requires very good command of econometrics; the second one relies on the alternative use of capital on the capital market. The third approach for imputed rent determination is prone too much to subjectivity. In general, all approaches mentioned require a lot of administrative as well as taxpayers' compliance costs. A simulation study, performed for six "old" EU member states, all applying progressive personal income tax, shows substantial rise in personal income tax take if the imputed rent of owner–occupied housing is estimated on individual level and included into the personal income tax base. The increase varies between 5,8% (Germany) to 27,1% (the Netherlands) [Figari, Verbist, Tsakloglou, Paulus, Sutherland and Zantomio 2012].

A further aspect of the theoretical reference to Haig–Simon's personal income definition concerns capital gains treatment. Haig and Simons defend the fiscal "appetite" of the state by requiring any capital gain, although unrealized (potential) one, to be included into the taxable income of individuals which is administratively difficult to implement. Still other authors point to the lock–in effect and inflation concerns of including realized capital gains into the personal income tax base [Rosen 1991; Mirrlees and Adam 2011]. In an environment of progressive marginal rates of personal taxation, the latter provokes lock–in effect that deters investors from alienating their (physical) property in the future. Compounded inflation, while holding residential property for a long time, further erodes any capital gain in real terms. Hence, it is argued that besides flat tax popularity, the trend of dualisation of the income tax is to be observed. Under the latter, labor income remains progressively taxed while all or part of the capital income is proportionally assessed and withheld [Schratzenstaller 2013]. Last but not least, it should be highlighted that what matters in the Haig–Simons' framework is the net increase of individual's potential to consume. Any costs, incurred while earning revenue, have to be subtracted from the individual gross income. As own housing becomes more and more widespread, partially due to mortgage loans, common opinion has it that in order to comply with H–S personal income definition, interest on mortgages should be deductible in a restrictive manner. Thereby, liquidity constraint or high indebtedness of individuals and their households might be prevented. Furthermore, 'subjecting imputed rent to personal income tax together with (…) limited deductibility of mortgage interest could make the taxation of immovable property politically more palatable' [Bloechinger 2015].

2.2. "Escaping" from Haig–Simons: housing within personal income tax in Bulgaria

Bulgaria ranks lowest among the EU member states in terms of its GDP/capita. For the period 2007–2015 this indicator ranges between 44% and 47% of the EU 28 average [Eurostat]. The country replaced in 2008 a slightly progressive personal income tax with a proportional flat tax applied at very low rate of 10% and without a personal allowance. Consequently, the latter is regressive – it is more burdensome to the low and middle income individuals than to the well–off ones. As most EU countries, Bulgaria does not tax the imputed rent of owner–occupied housing, leaving it

[3] Except a subsidized rented property.

outside the personal income tax base. Nevertheless, residential property return in Bulgaria is partially included into the personal income taxation, as the earnings from own residences rented to a third party are taken into account in the taxable income assessment of individuals.

For the sake of concrete evidence, the compulsory payments for two hypothetical flats in Varna[4] are compared (Table 1). They are assumed to be identical in all relevant aspects (*ceteris paribus condition*) in order to have the same taxable value of about BGN 100 000: i.e. useable area in sq.m., location according to Varna Municipality zoning, depreciation, individual characteristics, access to infrastructure. Let it further be assumed that the tenant in the rented flat pays BGN 6 000 (about € 3 000) annual rent to the landlord.

Since the owner – occupied flat is usually the main/primary[6] one for the household, it benefits from a 50% tax rate reduction, while the same flat – although rented, does not benefit at all. In addition, the owner of the rented property is liable for the income received from the tenant/s in the course of the calendar year. This hypothetical example shows that the total compulsory payments for the rented flat are more than four times higher than those for owner–occupied one given no income tax evasion occurs (last arrow in Table 1). The tax asymmetry is due to the non–estimation and non–taxation of the imputed rent within the personal income tax framework.

How much is the imputed rent in Bulgaria? According to the National Statistical Institute (NSI), the imputed rent of owner–occupied dwellings at macro level in Bulgaria varies annually between BGN 6 472 million and BGN 6 882 million for the period 2011–2015 [NSI, Main Macroeconomic Indicators 2015]. Relying on the official estimates and assuming imputed rent of owner–occupied dwellings had been included into the income tax base, the additional personal income tax revenue would have increased by more than BGN 540 million (ca. € 270 million)[7]. It is by 20% – 25% more than the collected annual personal income tax take in 2011–2015. It would have been a significant increase given the low rate of the proportional flat tax in Bulgaria. In reality, the higher amount of compulsory payments related to rented residence is prone to tax evasion. According to a sociological study commissioned by the National Revenue Agency in Bulgaria, about 47% of the respondents reply that the most evaded is the personal income tax on rental income, while 33% of the sample believes it is the VAT [Institute for Social Studies and Marketing 2014]. The taxpayers' attitude towards evasion is rooted in the persistently higher tax burden imposed on return from housing rented to a third party. The responses collected by the abovementioned study show that the 2011 tax policy measures introduced to prevent further tax evasion on rental income have proved ineffective[8].

Ignoring the imputed rent of owner–occupied residential properties at micro level renders the tax system less complex, further incentivizing individual preferences towards ownership of residential assets. A bulk of Bulgarian households' wealth consists of immovable property. Since the onset of the global crisis, housing prices came under pressure and the importance of residential wealth of Bulgarian households declined. Just at that time, the government of the country introduced a targeted personal income tax incentive. From 2009 on, young families[9] are allowed to annually deduct from the individual taxable income the interest payments on a mortgage principal up to BGN 100 000 (about € 50 000), provided it finances the first own primary housing of the family. Such a tax incentive is well designed concentrating income tax savings among young people in a country with heavy emigration outflows and aging population. In addition, the interest deduction seems to be efficient for the government budget as the bulk of households who own housing is debt–free. In terms of the latter, Eurostat ranks Bulgaria fourth in the EU, after Romania, Croatia and Lithuania [Eurostat, Distribution of

4 The third largest city in Bulgaria situated at the Black Sea coast.

5 The property tax in Bulgaria is administered in tandem with waste charge. At the beginning of the calendar year every housing owner receives an invoice from the municipality where both compulsory levies are included. Assuming both flats are situated in Varna, the immovable property tax is set at 2‰ and the waste charge is 0,98‰. Both rates apply to the flat's taxable value.

6 Main housing is the residential property where the family/household lives/spends the most part of the year.

7 In order to tax both kinds of rent neutrally, it is assumed that 10% presumptive share of cost is subtracted from the imputed rent.

8 Back in 2011 some legislative amendments against tax evasion came into force. If the rent paying person is an institution (public or private), it has to withhold and pay for the taxpayer the personal income tax in advance. If the rent–paying person is an individual/a family, the beneficial owner of the rent is liable for the levy on a quarterly period [The Personal Income Taxes Act, Art. 44].

9 By the time the mortgage contract with the bank had been concluded one of the married couple shall be under 35 years.

Table 1

Compulsory payments for an owner–occupied and a rented flat in Varna

Types of taxes / charges	Owner-occupied flat	Rented flat
Immovable property tax	2‰ × 50% × 100 000 = BGN 100	2‰ × 100 000 = BGN 200
Waste charge[5]	0,98‰ × 100 000 = BGN 98	0,98‰ × 100 000 = BGN 98
Personal income tax	None	BGN 540
Total compulsory payments related to the own flat	BGN 198	BGN 838

Source: own calculations based on: Ordinance on Determination of Local Taxes on the territory of Varna Municipality, Art.14 and Annex No1 to the Ordinance of Varna Municipal Council on Determination and Administration of Charges and Prices of Local Services Provided on the Territory of Varna Municipality in 2017, art.18 [accessed and retrieved by the author from the http://www.varna.bg on 23.06.2017].

population by tenure status 2015]. According to the annual tax expenditure reports of the Ministry of Finance, the tax "gesture" for interest on mortgages costs the central government budget on a cumulative basis BGN 12 704 820 (~ € 6,35 million) for seven years in a row. In relative terms, the tax expenditure, due to interest deduction for young families, declines and varies annually from 0,1% (2009) to 0,06% (2015) of the personal income tax receipts [Report on Tax Expenditure, different years]. Having regard to the negligible amount of taxes foregone by the government, it can be concluded that these well targeted incentives are much restricted in order to prevent households from further debt accumulation.

Taking into account the lock–in effect and inflation erosion possibility while holding a residential property for a long time before selling it, the government in Bulgaria becomes an alien of the housing owners by taxing their capital gain lightly only if it is realized. The tax policy distinguishes between speculative and non–speculative period of holding an immovable property. In Bulgaria, the realized capital gain from real estate alienation is not taxed if, while holding the housing property, more than three years had passed. A non–speculative period concerns also up to two other immovable properties and a non–restricted number of agricultural and forest land owned if the time between their acquisition and sale exceeds five years [The Personal Income Taxes Act, Art. 13 (1), point a]. With few exceptions, capital gains received from housing alienation are not taxed despite immobile tax base. Therefore, some authors warn that "the base itself may be physically immobile but its economic value is not" [Nicodème, 2012]. If the motive behind ownership alienation of housing is speculative[10], then any capital gain received is considered an income taxed at the flat tax rate of 10% after a presumptive share of normative costs has been deducted from the capital gain. Such a generous tax treatment supports the trend of personal income tax dualisation. While in the EU 27 the average highest personal income tax rate is 38,3% , resp. 25,9% on capital income, Bulgaria taxes personal income at 10% and capital one at a non–weighted nominal average of 7,7% [Schratzenstaller, 2013; own calculation].

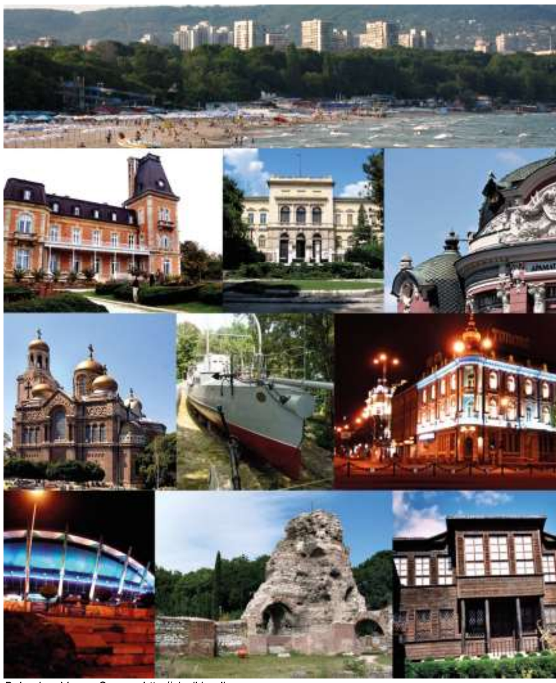
3. Housing ownership tax potential to correct income tax asymmetry

3.1. A brief literature review

The non–neutrality of the personal tax concerning income/utility from own housing has been both theoretically and empirically acknowledged. In contrast, the recurrent property tax targets ownership and applies annually to the gross value of residential property of individuals. Since the times of the Physiocrats, the literature on public finance has been paying extensive attention to real estate taxation matters as land, buildings and other improvements immovably fixed to the land have been for centuries a well–established and abundant source of government revenue.

Having regard to the topic of the paper, the current literature distinguishes two strands of scientific discussion about property tax. The first one raises the notion of the recurrent tax on housing as the second best solution given the shortcomings of the personal income one. This concept points to the interrelatedness of both taxes, which become instrumental in tax policy to achieve more neutrality concerning housing. Prominent public finance scholars stress that the distribution of wealth is more unequal than that of income [Musgrave and Musgrave 1989]. Hence, property tax is nowadays ascribed a control–and–supplementary role to income tax [Schratzenstaller 2013]. Still other authors also point to the "control mechanism" inherent in the property levy as it seems more capable to "catch" and impose evaded and/or exempt income under the personal income tax. It is argued that as far as evaders invest concealed income in immovable property, the tax on the latter's gross value collects at least partially the income levy missed [Blažic, Šimovic and Štambuk 2013; Presbitero, Sacchi and Zazzaro, 2014]. Norregaard [2013, p.16] also underlines the role of the residential ownership tax as a tool capable of counteracting the tax asymmetry due to not taxing imputed rent and capital gains, while deducting (part of) the interest cost on mortgages. Another scholar contribution to the interrelatedness of property and personal income taxes recommends the policy makers to increase the property ownership levy as the latter would implicitly tax the imputed rents, requiring "improved valuation practices in many countries" [Krelove 2012].

The second strand of publications deals with the particular merits of property tax. They are connected to the macroeconomic stabilization, thereby boosting this tax's potential as a second best solution. The stabilizing "property" of the property tax uses to narrow the amplitude of housing price fluctuations. The explanation is clear–cut: as the housing price rises, the property tax becomes a greater part of (imputed) rents, which decreases the net present value of the residence [Muellbauer 2005; Bloechinger et al. 2015]. As a result, increasing the effective tax rate (the ratio of property tax to imputed rent of owner occupied accommodation) counteracts further housing price increases. Another macroeconomic merit is connected to the resilience of the recurrent property tax to the business cycle. An empirical study shows that revenue from property tax is less volatile than from other types of state and local levies. This conclusion is due to the divergence of taxable and market value of real estate combined with increased tax rates during a downturn [Lutz, Molloy and Shan 2011]. Nevertheless, Bloechinger et al. recommend "raising property taxes only when both the housing market and the economy are in good shape" [2015, p. 16].



Bulgaria – Varna; Source: http://pl.wikipedia.org

[10] The residential property was held within period of time shorter than the non–speculative one.

3.2. The "accommodation" of housing in the Bulgarian property tax

Real estate taxation in Bulgaria belongs to the hybrid forms of area–based systems used in Central and Eastern Europe. They "…better proxy the capital value by using…zoning and indicators of quality…" [Norregaard 2013]. Before their implementation takes place, though, it comes to tax design matters, which have an asymmetrical setting. Despite that the levy on housing ownership constitutes own revenue for the local governments in Bulgaria, it is within the National Assembly's[11] discretion to design the property tax base. It is the taxable value of the real estate whose appraisal is undertaken by any of the 265 municipal (local) tax authorities at the beginning of each calendar year. The methodology for proper assessment of the taxable value is based on the following factors [Local Taxes and Charges Act, Art.20; Annex №2 to the Local Taxes and Charges Act, Art. 4]:

1) property area in m^2;
2) basic tax values per m^2 of the property area;
3) coefficients, adjusting the multiplication of points 1 and 2 according to the depreciation of the building, its individual features, location and infrastructure available (streets/roads net, water and sewage, electricity, communication access etc.).

The most transparent for the taxpayer is the first factor, while the remaining two require a relatively good command of property evaluation and taxation. The basic tax values (the second factor) are provided in monetary terms and depend on the construction and real estate type. They have remained constant since 1998 when the Parliament approved them for the first time. The third component for property tax base assessment refers to market factors taking into account the benefits derived from a good location and some local public services that are capitalized in the taxable value through both location and infrastructure coefficients. In addition to the property tax base, since 2008 the Parliament approves also the interval of tax rates variation: from 0,1‰ to 4,5‰ [Local Taxes and Charges Act, Art. 22]. Thus, the local governments' discretion is restricted – to annually decide on the particular tax rate applicable in proportion to the taxing value of residential properties.

How did the central and local authorities manage their responsibilities within this asymmetrical legislative setting during the financial crisis? Following the surge in immovable property prices, the National Assembly voted right by the time the crisis hit Bulgaria (2009) for raising monetary values of the property location coefficients. In fact, since then no major amendments had been effected in Bulgaria and it may be assumed that the main driving "force" behind changes in property tax revenue are the tax rates. They constitute a direct "avenue", through which the local governments influence the tax liability on housing ownership. Below you can find the dynamics of housing price per m^2 and the immovable property tax revenue in Bulgaria (Figure 1).

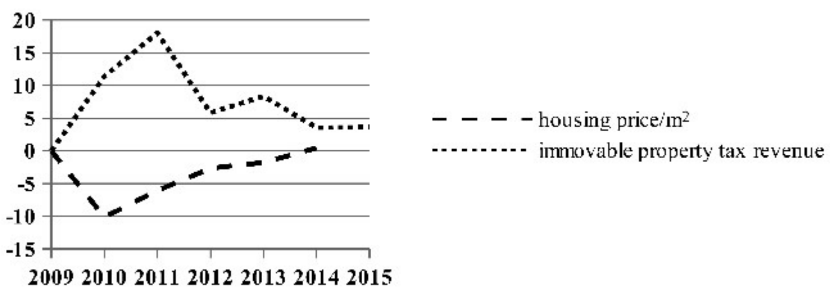
A symmetrical "movement" of the housing prices and property tax take can be observed. When residential prices are under pressure, then the local authorities in Bulgaria increase the property tax rates as there is a budgetary pressure too[12]. This is a pro–cyclical pattern of tax policy. It seems to contradict the economic logic: to raise tax rates in bad times and reduce them in good times. And indeed, when prices tend to stabilize after 2013[13], so do the property tax revenue (Figure 1), which indicates that the local governments tend to lessen the tax hike too. Within the regional landscape in Bulgaria, this way of matching immovable tax base and rates can be attributed to 1) the stability of the tax base and 2) setting a range for tax rates' variation.

For illustrative purposes, the receipts' fluctuations of the four broad based taxes in Bulgaria during the crisis and post–crisis period are presented (Figure 2). As expected, the sharpest "movement" pattern shows the corporate income tax that is apparently most cyclically prone. The levies on consumption (VAT, excise duties, etc.) are moderately volatile. The receipts from property and personal income taxes retain the positive changes observed during the period in consideration. The amplitude of fluctuations of the individual income tax, though, is higher, whilst the real estate tax revenue changes within a narrower band. It can be concluded that due to the tax design and immovable economic base, property tax receipts are less prone to cyclical fluctuations, which is particularly relevant in times of turbulent economic performance.

Despite being a stable revenue, through immovable property tax Bulgaria collects between BGN 107 million (2007) and BGN 305,9 million (2016), which is less than 0,5% of GDP [Eurostat; NSI]. Given this tiny share, is it feasible to increase the tax burden on housing in Bulgaria? Delving into this issue, some statistical evidence should be provided[14]. The tax on housing ownership is broad based as above 85% of Bulgarians live in own accommodation,

Figure 1

Immovable property tax revenue and housing price/m^2 in Bulgaria, 2009–2015 (percentage change)



Source: calculation based on data compiled by the author from: The National Statistical Institute of Bulgaria, www.nsi.bg.

[11] The Parliament in Bulgaria.

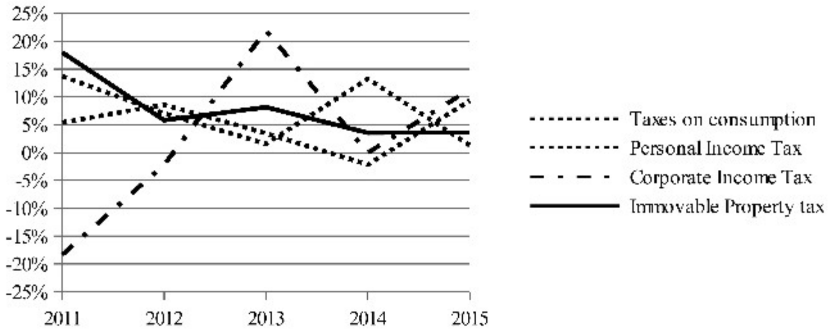
[12] It has been already stressed that since 2009 there have not been any changes in tax base determination, making the tax rates the only "driver" of the receipts from housing property tax in Bulgaria.

[13] The market prices of flats reached their minimum in mid–2013, before starting to recover. Despite it, by the end of 2016 flats price per m^2 remains by €220 lower than its peak value before the global crisis [Industry Watch 2017]. The report is accessed at http://www.iwatchbulgaria.com.

[14] All data concerning the statistical evidence are compiled by the author from Eurostat at: http://ec.europa.eu/eurostat.

Figure 2

Tax revenue from consumption, income and immovable property in Bulgaria, 2011–2015 (percentage change)



Source: calculation based on data compiled by the Author from: The National Statistical Institute of Bulgaria, www.nsi.bg.

while more than 75% of them have any outstanding mortgage or a housing loan. These statistics may point to a preserved ability to pay any (property) tax increase. In fact, such interpretation is quite misleading. In terms of the average GDP, a much rough indicator of individual ability to pay, Bulgaria ranks lowest in the EU 28. Moreover, the income equality is constantly deteriorating since 2007, reaching in terms of the S80/S20 coefficient its highest value of 7,9 in 2016. It indicates that the richest quintile of Bulgarian households receives about eight times higher income than the poorest one.

There is still another asymmetry in Bulgaria: the income inequality sharply contrasts to housing area equality. A household from the poorest quintile owns an average housing area of 64,2 m^2; in contrast, one from the richest quintile – 83,5 m^2, i.e. only by 30% more. Furthermore, "housing area rich but income poor" taxpayers might be one of the reasons for the non–satisfactory tax collection performance across the 265 municipalities in Bulgaria even in the post–crisis time. The average immovable property tax collection rate in 2015 was 68,32% and increased slightly to 73,43% in 2016. At the same time, more than 45% of Bulgarian municipalities have lower collection rates than the average ones [Ministry of Finance 2017]. Why is this statistics bothering? In contrast to the income tax, housing ownership one is hard to evade. First, its objects are visible and impossible to "hide" and second, the levy is administratively assessed[15]. Thus, the property tax is expected to have higher collection rates. However, the municipalities with the worst collection performance in 2015 and 2016 are among the poorest and most depopulated ones situated in north- and south-western Bulgaria[16].

In conclusion, against the background of having the lowest average GDP, increasing income inequality combined with the phenomena of housing–area–rich, but income–poor taxpayers and low collection rate, any further property tax increase in Bulgaria appears to be a "mission impossible". At the same time, though, the imputed rent of owner–occupied housing will be hardly included in the income tax base, whereas taxpayers perceive high tax evasion on actual rent. Such setting in Bulgaria does not fit into the observation that "a strong real estate tax tends to go together with rather light income tax on imputed rent and vice versa (…)" [Bloechinger, Égert, Alvarez and Paciorek 2015].

Bulgaria; Source: http://pl.wikipedia.org; Author: Agnada

4. Strengthening the correcting potential of housing ownership tax in Bulgaria: a ground for discussion

On sight of income being unequally distributed and revenue/utility from housing being asymmetrically taxed, property tax is expected to correct the "omissions" of the flat levy in Bulgaria. If approximated as a tax on imputed rent of owner occupied housing, property tax uses to compensate to some extent the revenue foregone due to "escaping" the comprehensive H–S criterion. The real estate tax collects an ever increasing share of the personal income tax missed given the non–taxation of (net) imputed rent. In 2016 it was above 50% of the latter. Nonetheless, this statistics does not account for the personal income tax evaded in Bulgaria. Overall, in this country the property tax remains partially utilized as a second best solution to the personal income one. In order to strengthen the second best alternative, the property tax burden has to increase. This process needs to be managed carefully, having regard to the obstacles in terms of insufficient ability to pay: lowest average GDP, deteriorating income equality, low collection rate due to housing–area–rich but income–poor people. Hence, any increase in the tax weight across the board seems to be contra–productive in Bulgaria. Instead, the (additional) tax burden has to target housing and income rich taxpayers who mostly benefit from the regressive design of the flat tax. Thereby, better utilization of the real estate levy hinges on its own (slight) progressivity. It can be achieved via the tax rates and/or the tax base.

As far as the tax base is concerned, the appraisal methodology for taxing purpose in Bulgaria contains implicit differentiation since the location coefficients of housing vary according to categories and zoning of the settlements[17]. The methodology has not been updated for a long time and the location coefficients might have eventually

[15] Indeed, the input for calculating the taxable value of housing is provided by its owner/s via a declaration filled in by the time the property is acquired/improved/changed.

[16] Vidin, Borovan, Boychinovci, Lom, Dimovo, Medkovec, Simitli, Trun, etc. There the property tax receipts are between 45% and 57% from the budgeted amounts in 2015 and 2016 [Ministry of Finance 2017].

[17] For a residential property located in the center of Varna (fist zone) the location coefficient is 88,9, while for a housing in the fifth zone it is 28,1. At the same time, for a posh villa situated in the villas' area of Varna the coefficient value is 60,8 [Annex No 2 to the Local Taxes and Charges Act, Art. 6, table No 3].

become inadequate. In other words, for an old flat in the city's (town's) center, one would owe more tax than for their luxurious new villa. Furthermore, in order to increase local revenue, the municipal councils may decide to change the zoning of the settlement. As a consequence, residential property could prove more expensive for taxation purposes. Such political measure would have an ambiguous outcome in terms of shifting the tax burden towards people able to pay.

Regarding tax rates, several alternative measures are considered. The first one encompasses a change in property tax design, i.e. introduction of a progressive rate–structure and non–taxable housing allowance. Anyway, the dwellings with taxable value up to BGN 1 680 (~ € 840) are tax exempt as their taxation is not cost–effective for the local revenue authorities. The immovable property allowance may be further increased. For the sake of progressivity, it could be mimicked by increasing rates according to the number of residential properties owned[18]. Such a design is administratively feasible as any municipality possesses the discretion to set the rates of the property tax. In neighboring Serbia, where the income inequality is even more severe[19], flat personal income levy goes together with progressive rates of property tax. The Serbian tax rates range from 0,3% to 2% applied to residences' "cataloque value" [Deloitte 2017]. Depending on the cadastral value of the residential properties of citizens, Latvia also applies progressive tax rates from 0,2% (for housing value up to € 56 900) to 0,6% (for housing value of above € 106 700) [KPMG 2015].

Several arguments can be raised in support of the aforementioned countries' experiences. First, even slightly progressive rates on housing taxable value may approximate increasing marginal rates of the personal income tax abandoned in Bulgaria in 2008. Second, a perception of more equity would be restored, even partially in the tax system in Bulgaria. Third, improved tax justice will not be at the cost of distorted individual decisions about labor market participation, investment in knowledge and human capital. In general, any change in the rates' structure of recurrent property tax will not aim at fiscalism, but at stimulating well off people to invest into productive assets in order to boost Bulgarian economy.

The second measure concerning tax rates is alternative to the first one. It aims at improving the proportional design of the property tax by revision of its incentives. Bulgaria provides 50% rate reduction for the primary housing of individuals (Table 1). In Sofia, the capital city, this incentive benefits more than 600 000 owners, whilst more than 1,6 million residential properties are registered with this municipality [https://arch.sofia.bg]. Some taxpayers, though, abuse this incentive by declaring the most expensive residential property they own as their main one. In the course of tax audit activities, the local revenue authorities in Varna detected some 5 000 residential property owners to declare possession of more than one main home, using the 50% reduction more than once.

Having regard to the tax incentive for main residential property, some flexibility is appropriate to be built–in. The 50% rate reduction shall be phased out when the taxable value of the primary housing is above a certain threshold. The incentive would phase in if the main residence is less worthy than the amount set by the threshold. The latter could be easily defined and administered. It would vary across municipalities, each one of them setting its amount to be equal to the average taxable value of a housing located in the respective territory. The rate would be determined as usually – by annual municipal councils' vote on it. The value of the relevant threshold should be transparent – i.e. stated on the annual invoices that the 265 Bulgarian municipalities use to send to housing owners in the beginning of each year.

The third measure is borrowed from the OECD. In order to fiscally protect housing–rich–but–income–poor taxpayers, the OECD, citing Messere, proposes conditional reductions or exemptions (OECD 2010: 93). This suggestion requires calculation of the effective property tax rate of any taxpayer that is a good measure of the incidence of a compulsory payment. If the effective tax rate is below a pre–determined benchmark value, the liable person is not allowed a property tax incentive. Such measure would not be suitable in Bulgaria due to the widespread income tax evasion that is considered "a national sport" [Smatrakalev 2011]. It distorts any effective tax burden calculation and could even provoke further abusive use of property tax incentives.

5. Conclusion

Although well integrated into the tax system, housing remains underutilized in Bulgaria as a revenue source. The flat rate tax treats income, resp. utility, from own housing asymmetrically. The imputed rent from owner–occupied residence is not estimated in monetary terms and non–taxed at micro level, while the actual rent paid remains under–declared and often evaded. The capital gains from housing alienation are tax–exempt, depending on the length of time holding the property. The immovable property tax in its current setting in Bulgaria cannot rectify the distortions of the personal income tax. This paper shows that the success of property tax' mission as the second best solution depends on its (slight) progressivity. To achieve it, different measures are proposed and discussed. They all aim at shifting any tax increase to residential property affluent owners who are able to pay it.

Bulgaria – Sofia; Source: http://pl.wikipedia.org

[18] For an illustrative example, for the main property a tax rate of 2‰ is applied, for the second housing – 2,07‰, for the third one – 2,21‰ etc.

[19] According to Eurostat, in 2015 the value of S80/S20 was 9 in Serbia – the highest in Europe.

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ASYMETRIA PODATKU OD NIERUCHOMOŚCI W BUDOWNICTWIE MIESZKANIOWYM W BUŁGARII

Streszczenie

Nieruchomości mieszkaniowe tradycyjnie stanowią atrakcyjne źródło przychodów podatkowych. Są integralną częścią opodatkowania bezpośredniego i pośredniego we wszystkich współczesnych gospodarkach. Przyjmując za punkt wyjścia kompleksową definicję podatku dochodowego opracowaną przez Haig i Simonsa, autorka analizuje w niniejszym opracowaniu asymetryczne/nieneutralne podejście do czynszu kalkulacyjnego i rzeczywistego dla mieszkań podlegających opodatkowaniu zryczałtowanemu, będących własnością osób fizycznych. Podatek ten wprowadzono w Bułgarii w 2008r. i ustalono na poziomie 10%. Pomimo najniższego PKB w Unii Europejskiej, jak i pogłębiających się nierówności gospodarczych, nie przewidziano zwolnień od przedmiotowego podatku. Stąd też, w artykule omówiono potencjał podatku od nieruchomości jako narzędzia do korekty nieprawidłowości związanych z poborem podatku dochodowego od osób fizycznych z tytułu posiadania nieruchomości mieszkaniowych. W artykule postawiono tezę, iż potencjał podatku od nieruchomości w Bułgarii nie jest w pełni wykorzystany. Zakładając, że jego lepsze wykorzystanie zależy od (niewielkiej) progresywności, zaleca się umiarkowane zwiększenie wymiaru tego podatku. W opracowaniu zaproponowano i poddano krytycznej ocenie kilka sposobów na bardziej efektywne wykorzystanie podatku od nieruchomości, polegające na przesunięciu jego (dodatkowego) ciężaru na osoby w bardzo dobrej sytuacji finansowej.

Słowa kluczowe

podatek dochodowy od osób fizycznych, opodatkowanie asymetryczne, brak neutralności podatkowej, czynsz kalkulacyjny, czynsz rzeczywisty