ABOLITION OF THE COMPENSATION FOR CONSTRUCTION LAND USE

Belgrade, March 2013
This document has been prepared as an integral part of the project “Strengthening the Voice of Business.” The project is being implemented by the Serbian Association of Managers (SAM) and the Center for Liberal-Democratic Studies (CLDS), in partnership and with the support of the Center for International Private Enterprise (CIPE) in Washington DC, USA. CIPE, SAM, and CLDS are working together to strengthen the voice of business in the dialogue with government on priorities for economic reform in Serbia. The partnership between the three organizations also focuses on building the capacity of the Serbian business community to participate meaningfully in the policymaking process. In preparation of this document, SAM and partners closely collaborated with regional Serbian chambers of commerce and business representatives in Valjevo, Niš, and Požarevac to jointly identify and select the issues that represent key legislative impediments for businesses in Serbia. Cooperation with regional businesses and chambers of commerce resulted in a broader consensus among private sector representatives and think tank experts on the top reform priorities. This document will be used by business sector representatives as a tool for advocating improving the overall business climate in Serbia.
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FOREWORD

Following land ownership transformation, a compensation for construction land use has lost its "raison d'être", which is something that the expert public, the Ministry of Finance and the legislator agree upon. However, as the years go by, nothing has changed and the compensation is still being charged, thus burdening citizens and businesses alike.

This text is aimed at reminding the public of this problem, at reviewing the nature of the compensation and reasons for its abolition, as well as at suggesting possible solutions in terms of compensating local governments for lost revenues.

This text has been prepared for the purposes of the Serbian Association of Managers.

I wish to thank Milica Bisić, Boris Begović and Marko Paunović for their useful suggestions.
INTRODUCTION

This study will address the following main issue: **what to do with the compensation for use of construction land and how to compensate local governments for a possible loss of revenues in case the compensation is abolished?**

*The compensation for use of construction land* was introduced at a time when construction land was socially-owned, i.e. state-owned. It has been charged for decades as a method of collecting the rent for leased land and its intertwining with a municipal rent, depending on location benefits. All this time, local governments were generating significant revenues from the compensation. The compensation still exists in the vast majority of Serbian towns and municipalities.

Now the question is what to do with this compensation? This question arises from the fact that the ownership of construction land has changed and so has the manner of disposing with and contracting of the land that has remained in state ownership, as well as from the resulting need to adjust the system of charges related to land. Namely:

1. the former system of state-owned construction land is being replaced by private ownership, and according to the Serbian Planning and Construction Act of 2009, the state-owned land shall be privatized by being given away to its current users, except for one group of privatization’s beneficiaries who are supposed to pay for it; and
2. socially-owned, i.e. state-owned land, used to be given away for free to socially-owned and state-owned legal entities, so the compensation for use was a logical way to collect the rent and subject the location rent to taxation; the state-owned land is now leased and the rent is paid as part of a transaction based on private law.
Due to the ownership transformation and changes in the disposal of state-owned land, relevant charges need to be modified. It is pointless to charge the compensation for use of construction land in this new system because it would be absurd to charge the usage of land (the rent or the compensation) from a private landowner or a lessee of state-owned land who is already paying the rent. All the more so, because the land is also subject to property tax, which is charged for the value of the land forming part of the property. Therefore, to retain the compensation would in fact imply double taxation of the land, i.e. the property. Further discussion of these matters, as well as a more detailed elaboration of the nature of the compensation, will be provided later.

Moreover, the compensation for use of construction land has serious shortcomings in terms of its efficiency and fairness due to a number of bad solutions that are currently applied in Serbia. Firstly, the compensation discourages economic efficiency in the use of construction land and secondly, the compensation is unfair because it is usually charged arbitrarily according to user types rather than according to objective criteria alone, which often results in discrimination of certain obligors in Serbia.

Finally, a parallel existence of the construction land compensation and property tax is problematic because there is no point in having two similar kinds of charges that both refer to real property and are calculated on the basis of property value, even though their calculation methods are totally different. Nevertheless, there are numerous advantages of the property tax over the compensation for the use of construction land and they will be addressed in more detail later.
THE REGULATORY FRAMEWORK GOVERNING THE COMPENSATION FOR USE OF CONSTRUCTION LAND

This section gives an overview of the regulatory framework governing the compensation for use of construction land and economic analysis thereof, which will serve as a basis for suggesting reforms with a view to enhancing the economic efficiency and fairness of the tax burden on property.

The regulatory framework consists of the applicable legislation of the Republic of Serbia, although its reach is rather modest since it only provides for basic solutions, and of more detailed regulations that are adopted by towns and municipalities in Serbia, which will be presented together with the basic solutions, without going into too much detail.

Legislation

The only basic provision of the applicable Planning and Construction Act that mentions the compensation for use of construction land reads: "The compensation for usage of construction land is paid in accordance with the Planning and Construction Act ("Official Gazette of the Republic of Serbia", Nos. 47/03 and 34/06) until the stated compensation is integrated into the property tax, but not later than December 31, 2013" (Article 220). This provision clearly indicates that the legislator treats the compensation for use of construction land as a temporary solution and believes that it should be abolished, i.e. that it should be integrated into the property tax because its "raison d'être" has ceased to exist.

With regard to the compensation for use of construction land, the 2003 Planning and Construction Act provides the following basic solutions:

The scope of the compensation: state-owned developed and undeveloped construction land; privately owned developed construction land if public resources were used to equip the land with basic utility infrastructure facilities (electric power network, water supply,
access road, etc);¹ and privately owned undeveloped construction land that was not put to its intended purpose or offered to be bought off by the municipality within two years from the day of the adoption of the Urban Development Plan.

*Obligor:* an owner, user or lessee of a facility located on the developed construction land, or a user of undeveloped construction land.

*Criteria for determining the amount of the compensation:* the level of the land development, location benefits, available utility infrastructure, amenities, etc., which are highly flexible criteria that may be operationalized in different ways. Specific criteria, the amount of the compensation, including relief and exemptions thereof shall be regulated by towns and municipalities, respectively. The revenues from the compensation belong to the towns and municipalities.

Quite expectedly, a decentralized decision-making process concerning all the elements of this compensation has resulted in huge differences in policies governing the construction land compensation, ranging from non-existence of the compensation to various elements that serve as a basis for determining its amount.

Belgrade

The City of Belgrade has its own decision governing the system of construction land compensation, which is only applicable to ten urban municipalities, while seven suburban municipalities are supposed to enact their own decisions. The system that applies to the urban municipalities will be presented below.

The compensation for use of construction land is charged in Belgrade for both developed and undeveloped land, as well as for state-owned land and land belonging to different types of owners.

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¹ It is interesting to note that neither the Act nor municipal/city decisions governing the compensation provide for a procedure by which one can prove whether the utility infrastructure in a village or a suburb was built by using public resources or perhaps through self-contributions or private funds that were paid for connections to various utility services.
The main criterion for determining the construction land compensation is based on the floor area of the building that is located on the land. In order to determine the value of different buildings and differentiate the rates accordingly, three criteria have been established – the floor area in square meters, location and purpose of the building.

A separate decision was issued for zoning purposes within the Belgrade city limits. The city is divided into ten zones. The most expensive zones include the so-called "extra" zones for residential or business purposes, which differ among themselves. The "extra" zone for residential purposes includes Dedinje and a part of Čukarica, while the "extra" zone for business purposes includes downtown Belgrade and a part of New Belgrade. Other areas of Belgrade are divided into four zones, while the next four zones include suburbs. The last zone, the so-called "special purpose zone", includes an open-pit mine in Lazarevac and an ash landfill site in Obrenovac.

Construction land evaluation with a view to determining the rates is done separately for the residential category and for certain categories of business activities, such as manufacture; productive, transport and other services; trade and catering services; protected activities; financial, technical, business and other services. Each of these categories, except residential, contains two sub-categories: A (lower) and B (higher), which include construction land users that are listed according to detailed activity codes. Hence, the most expensive business categories (financial and other services in category B) include: electric power and gas distribution and trade, commercial brokerage, transport services (shipping, etc.), commercial segment of PTT services, wireless telecommunications, banks and savings banks, investment funds, stock exchanges and stock brokers, financial leasing, insurance, advertising and property rental agencies, casinos and betting parlours.

The table below shows the respective compensation rates for construction land per zone and business activity, as well as per categories A and B:
<table>
<thead>
<tr>
<th>Purpose/Zone</th>
<th>&quot;Extra&quot; zone</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>Spec.</th>
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<tbody>
<tr>
<td>1 Residential</td>
<td></td>
<td>2.87</td>
<td>2.71</td>
<td>2.32</td>
<td>1.92</td>
<td>1.43</td>
<td>1.31</td>
<td>1.08</td>
<td>0.77</td>
<td>0.66</td>
</tr>
<tr>
<td>2 Manufacture</td>
<td>lower</td>
<td>2.44</td>
<td>2.30</td>
<td>1.97</td>
<td>1.87</td>
<td>1.54</td>
<td>1.42</td>
<td>1.00</td>
<td>0.72</td>
<td>0.62</td>
</tr>
<tr>
<td></td>
<td>higher</td>
<td>8.02</td>
<td>7.59</td>
<td>6.52</td>
<td>6.10</td>
<td>5.05</td>
<td>4.64</td>
<td>3.21</td>
<td>2.29</td>
<td>1.97</td>
</tr>
<tr>
<td>3 Productive, transport and other services</td>
<td>lower</td>
<td>7.17</td>
<td>6.79</td>
<td>5.83</td>
<td>5.44</td>
<td>4.31</td>
<td>3.96</td>
<td>2.74</td>
<td>1.96</td>
<td>1.70</td>
</tr>
<tr>
<td>4 Trade and catering services</td>
<td>lower</td>
<td>20.45</td>
<td>19.35</td>
<td>16.62</td>
<td>16.00</td>
<td>12.90</td>
<td>11.86</td>
<td>7.72</td>
<td>5.53</td>
<td>4.75</td>
</tr>
<tr>
<td></td>
<td>higher</td>
<td>94.98</td>
<td>89.90</td>
<td>77.17</td>
<td>74.21</td>
<td>59.97</td>
<td>55.14</td>
<td>35.74</td>
<td>25.56</td>
<td>22.03</td>
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<td>5 Protected activities</td>
<td>lower</td>
<td>0.90</td>
<td>0.83</td>
<td>0.73</td>
<td>0.66</td>
<td>0.53</td>
<td>0.49</td>
<td>0.28</td>
<td>0.20</td>
<td>0.18</td>
</tr>
<tr>
<td></td>
<td>higher</td>
<td>2.37</td>
<td>2.25</td>
<td>1.93</td>
<td>1.75</td>
<td>1.43</td>
<td>1.31</td>
<td>0.72</td>
<td>0.52</td>
<td>0.44</td>
</tr>
<tr>
<td>6 Financial, business and similar services</td>
<td>lower</td>
<td>76.01</td>
<td>71.94</td>
<td>61.76</td>
<td>59.43</td>
<td>47.61</td>
<td>43.79</td>
<td>29.09</td>
<td>20.80</td>
<td>17.92</td>
</tr>
<tr>
<td></td>
<td>higher</td>
<td>190.06</td>
<td>179.88</td>
<td>154.42</td>
<td>148.57</td>
<td>119.06</td>
<td>109.49</td>
<td>72.70</td>
<td>51.99</td>
<td>44.81</td>
</tr>
</tbody>
</table>

Table 1.

Rates per zone and purpose in Belgrade, in dinars/m²
It is interesting to note the differences along these two lines. On the one hand, the location-based differences, where the ratio between the "extra" zone and zone 8, i.e. between the most expensive and the cheapest zones depending on the use of the building, is 4-5 to 1. For example, the rate per square meter of constructed floor area of a residential building is only 4.3 times higher in Dedinje than in the village of Besni Fok across the Danube. Also, the rate per square meter of floor area of a luxury shop in downtown Belgrade is only 4.3 times higher than that for a shop in Besni Fok. This ratio certainly does not correspond to the value of the land or real property, i.e. the value of buildings of the same floor area at these two locations.

On the other hand, there are huge differences in rates in terms of the purpose of the building, i.e. the type of business activity performed therein. Thus, the ratio between the construction land compensation rate for the most expensive category of activities (financial, technical and business services in category B) and the cheapest one (manufacture in category A) is 72-78 to 1, which means that the rate is 72 to 78 times higher for the most expensive category than for the cheapest one, depending on the zone.

It is noteworthy that the second most expensive category (referring to the same activities as above, but belonging to category A) includes government bodies, except those in charge of defense and policing, as well as law firms, accounting, auditing, advertising and travel agencies and similar services. On the other hand, since city and municipal authorities belong to the category of protected activities, republic authorities have to pay a compensation that is 32 to 40 times higher than that for city authorities, depending on the zone. This discrimination of republic authorities in the same country is certainly out of place and the policy of attempting to selectively take the money from somebody else's budget is improper.

Apart from the basic method of calculating the compensation rate on the basis of the floor area of a building, there are two adjustment mechanisms that also apply in Belgrade, but they are used for residential buildings alone.
Firstly, the compensation is charged for the land around a residential building only if its user/owner actually utilizes the land (yard, garden, etc.). Therefore, if the surface area of the land exceeds 100 m², excluding the land that the building is built upon, the rate is increased as follows:

- by 20% for a surface area exceeding 1,000 m²,
- by 40% for a surface area between 701 and 1,000 m²,
- by 80% for a surface area between 401 and 700 m²,
- by 150% for a surface area between 201 and 400 m²,
- by 250% for a surface area between 101 and 200 m².

What we have here is an obvious trend of levying a much heavier burden on family houses surrounded by small plots of land (2-4 acres), and there are many of them in Belgrade, while a much lighter burden is levied on buildings surrounded by bigger plots of land (8 acres and more), including large apartment buildings. Even if we accept as reasonable this logic of charging a much higher compensation for family houses, the issue of huge differences in rates will still remain because their application leads to unacceptable results: the total land compensation that is charged for a house surrounded by a yard covering one are is twice as higher than that for the same house surrounded by a yard covering 21 acres. The logic behind such a steep digressive scale is the following: "the larger the plot, the lower the compensation rate for construction land". This is not fair and it fails to yield favorable economic results.

Furthermore, this method of differentiation is bad from the point of view of rational use of land as it prompts the creation of more land around residential buildings due to the above logic of charging lower rates for bigger plots of land. This is irrational and it certainly stimulates inefficient use of construction land, which is a valuable resource in Belgrade. The system of charges should actually prompt the owners to downsize their plots, rather than increase them in order to pay a cheaper compensation.
Secondly, the construction land compensation for both residential and business purposes may be reduced as follows:

- by 10% for buildings at locations lacking water supply or sewerage or proper pavements,
- by 20% for buildings at locations lacking water supply and sewerage, and
- by 30% for buildings at locations lacking water supply, sewerage and proper pavements.

This adjustment of the compensation for locations which are poorly equipped with proper utility infrastructure is good and natural because the quality of housing or business is certainly much different at locations where such infrastructure is available. However, the question is whether a 30% reduction is enough for the land where water supply, sewerage and proper pavements (and maybe even phone and central heating connections) are unavailable? The lack of basic utility infrastructure should in fact result in a much bigger discount and maybe even in total exemption from the compensation because nowadays the land that is fully equipped with utility infrastructure is the main prerequisite of normal life and business. Otherwise, the land is totally worthless for any purpose whatsoever.

Here is an overview of some specific cases:

1. for facilities that are used for purposes of bodies of the Republic of Serbia that are in charge of defense, interior affairs and security, the rate is 50% higher than that for residential buildings,
2. for office buildings wherein no business activity is performed the rate is five times higher than that for residential buildings,
3. for usage of state-owned undeveloped construction land that the city or municipal authorities have placed on lease, the lessee pays a 30% lower rate than that for residential buildings until the building has been constructed,
4. an exemption from payment of the compensation for the land around the building, provided that it is solely utilized by its owner or user, applies to all types of traffic
routes, utility system installations, shelterbelts, landfill sites, cemeteries, public parking lots, as well as to the land that is utilized for the purposes of religious communities and public authorities in charge of defense, interior affairs and security.

Novi Sad

The city of Novi Sad also applies a basic system of cross-referencing location benefits with the purpose of constructed facilities. This system is specific because, unlike most other towns and cities in Serbia, Novi Sad is not divided into zones, but instead applies a number of objective criteria to determine the benefits of each location and score it accordingly.

Business activities are divided into ten categories. The highest and most expensive category includes: manufacture; power generation, transmission and distribution; banking and financial leasing; insurance; gambling and betting; while the cheapest one includes crop farming; veterinary activities; government bodies, education and health care institutions, as well as other social activities, defense, police, judiciary and mandatory social insurance.

The rates for certain categories of activities differ significantly: in 2010 the rates in the most expensive category were 72% higher than those in the second most expensive category and even 46.5 times higher than those in the cheapest category.

The construction land compensation in Novi Sad is determined according to the purpose of the facility, location benefits and available infrastructure. The city of Novi Sad has elaborated a complex scoring system for all locations according to their relevant features. There are three general types of purpose - residential, manufacturing and business - to which separate scoring systems are applied.
Residential buildings are scored according to the following criteria:

- **the level of development of the land on the street where the building is located:** availability of central heating, water supply and sewerage systems, developed traffic routes and connections to the power supply system, gas pipeline and phone network;
- **convenience:** availability of different kinds of shops measured by their distance from the center of the so-called "spatial unit" and population density; availability of health care institutions, schools, cultural institutions, sports facilities, banks, green markets, etc.;
- **distance from the city center:** technically speaking, this is a distance between the center of the spatial unit (there are 29 spatial units in the city of Novi Sad and another 17 settlements and villages around the city) and Trg Slobode (the "Freedom Square", the main city square in Novi Sad) measured by a land surveyors map; availability of bus lines to the city center;
- **population density:** lower population density of a spatial unit gets a higher score.

Only the criterion referring to the availability of utility infrastructure is scored separately for each street, while all the other criteria are scored on the level of spatial unit.

As for manufacturing facilities, the following three groups of scoring criteria apply:

- **the level of development of the land on the street where the facility is located:** the same criteria as those for residential buildings apply, but the scores are slightly different;
- **production benefits at the spatial unit location:** transport and warehousing facilities, distance from the city center, combined with the number of bus lines to the city center;
- **public transport connections** with other parts of the city; in this case, the number of bus lines to the city center is scored.

A similar scoring system applies to other business premises:
- **the degree of development of the land on the street where the premises are located:** the same criteria as those for residential buildings and manufacturing facilities apply, but the scores are slightly different;
- **benefits for doing business:** possibility of re-supply, distance from the city center, combined with the number of bus lines to the city center;
- **public transport connections** with other parts of the city; in this case, the number of bus lines to the city center is scored.

The compensation is determined on the basis of the purpose, level of equipment, floor area of the building, i.e. the surface area of the land, and the total score.

The following types of land are exempted from the construction land compensation for use: the land used for defense purposes, places of worship, forests and parks, sports and recreation grounds in public areas, streets, roads, etc.; land used for the purposes of water supply and sewerage, central heating and gas pipeline systems, power stations; and undeveloped construction land used for farming, including facilities used by farmers for performing farming activities; as well as landfill sites and cemeteries.

In certain cases, the compensation is charged according to the surface area of the land, mostly during construction phases. There is a special case when the floor area of constructed business premises is smaller than the surface area of the land - then the compensation will be based on the surface area of the land. This is a rational solution from the point of view of rational use of land, as it prompts more density in construction in proportion to the amount of the compensation, of course.

Persons receiving social assistance for their families are exempted from the compensation.
Leskovac

Within the Leskovac city limits, the compensation for use of construction land is charged for the inner city and ten big villages around the city.

The main criteria for determining the amount of the compensation is based on the availability of utility infrastructure, location and type of business activity.

Utility infrastructure. The compensation is determined on the basis of the level of development of construction land for both residential and business purposes. This is measured using the following six criteria: connections to the public water supply system, electric power grid and sewerage system, availability of pavements and phone and central heating connections. The availability of each of these segments of infrastructure is scored separately and the compensation is determined on the basis of the total score, with adjustment coefficients. Since water supply and electricity get the highest number of points and given their availability to almost every household in Leskovac, they generate the biggest revenues for the local government.

Location. Just like in the vast majority of towns and cities in Serbia, location is an important criterion for determining the construction land compensation in Leskovac. Construction land is divided into six zones, of which zones 1 to 5 are located in the city itself, while zone 6 covers ten big villages around the city. Different zones have different coefficient values, ranging from 1 for the worst zone to 3.5 for the best one. The same coefficient applies to both residential and office buildings.

Business activities are divided into two categories, based on scores. A more expensive category includes businesses that are deemed most profitable (beverage production, health clinics, law firms, accounting services, restaurants, non-governmental organizations, trading activities) or less popular among average citizens (shops selling liquor and tobacco, gambling and betting parlours, saunas); as well as branch offices of
republic public enterprises and institutions (power and gas companies, postal and telecommunications services, government bodies, defense, mandatory social insurance), as well as institutions whose headquarters are mainly located outside Leskovac (insurance companies and pension funds, banks, transport systems). This category also includes various manufacturing activities, such as manufacture of chemicals, paper, rubber, plastic, glass, metal and machinery, food, etc., although it remains unclear why higher compensations are charged for these activities (perhaps depending on the owner?). It is interesting to note that the manufacture of leather goods is in the more expensive category, whereas manufacture of leather garments is in the cheaper category. We can only speculate the reason why this is so. However, the difference in rates between the two categories is not so big: the ratio is 7:4 dinars per point, which means that, among Serbian towns and cities, Leskovac has the least discriminating approach towards companies in terms of type of business activity, presumed ability to pay, headquarters, ownership type, etc.

The total amount of the compensation is calculated on the basis of the above elements, by multiplying the scores for the level of development, floor area, zone-based coefficient with the value of points. In 2012, residential buildings were worth 0.80 dinars per square meter in the last zone, and 7 and 4 dinars, respectively, for business premises. Hence, the construction land compensation in Leskovac is 5 to 9 times higher for business premises than for residential buildings in the same zone.

The compensation for undeveloped construction land utilized by legal entities is 1.50 dinars per square meter of land in zone 5. This means that the rate per square meter of undeveloped land is almost twice as higher as that per square meter of a building on developed land utilized for housing construction purposes! Such a discrimination of legal entities is indeed excessive.

Furthermore, the compensation is charged in Leskovac even for some devices that cannot be classified as traditional buildings whose space is measured in square meters, such as electric, telephone and cable TV poles, power stations, Telekom boxes and billboards.
Since these devices are the property of republic public enterprises, except billboards that belong to big advertising companies based in Belgrade, there is an obvious trend of levying a heavier burden on companies that are headquartered outside Leskovac.

There is an interesting provision saying that if a tenant fails to pay the compensation, the owner or the right holder are obliged to do so. This kind of joint and several liabilities is probably out of order.

Aranđelovac

Although the system of determining the construction land compensation in Aranđelovac is similar to solutions applied elsewhere in Serbia, it has some specific features, as well.

The same compensation for usage of residential buildings and ancillary structures (garages, sheds, etc.) is charged all over the town, irrespective of location. The rate is 1.5 dinars per square meter for residential buildings and 0.65 dinars per square meter for ancillary structures. Aranđelovac is a small town and the application of the same rate irrespective of location shows that all locations in this town are valued equally although it would be much better if the town had been divided into at least two residential zones.

As for business premises, the system of determining the compensation is based on zones, which are location based, and purpose according to the type of business:

Table 2. Rates per zone and type of business activity in 2011, in dinars

<table>
<thead>
<tr>
<th></th>
<th>Zone 1</th>
<th>Zone 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial activities, power generation and distribution, PTT, mobile telephony, trade in oil and oil derivatives and branch offices of such companies</td>
<td>25.40</td>
<td>19.05</td>
</tr>
<tr>
<td>Trade, catering, repair and maintenance services</td>
<td>13.15</td>
<td>6.35</td>
</tr>
<tr>
<td>Manufacture</td>
<td>9.25</td>
<td>6.95</td>
</tr>
<tr>
<td>Other activities not mentioned above</td>
<td>7.15</td>
<td>3.60</td>
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<tr>
<td>Empty premises, unused</td>
<td>5.10</td>
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</tbody>
</table>
As shown above, business premises are divided into two zones and four categories of activities. This comparatively small number of business activities can be supported because it is helpful in avoiding a potentially serious problem of corruption that may occur with setting of lower rates for companies favored by current authorities. On the other hand, it is evident that the highest rates are charged to companies whose headquarters are mostly based elsewhere, especially in Belgrade. This category also includes some state-owned companies. Even though the overall differences in rates are not so excessive – around 4:1 between the most expensive and the cheapest categories – what is problematic is that the most expensive category pays 2-3 times more than the next category, which includes trade and catering. Here the burden of the compensation is undoubtedly shifted from local businesses to those that are based elsewhere in Serbia.

Just like in Belgrade, for certain types of business activities in Arandelovac the construction land compensation is determined not only on the basis of the floor area of the building, but also on the basis of the surface area of the land around the building in which the business activity is performed. There is a separate list of such activities, including retail trade in oil and oil derivatives, several types of wholesale, local intercity bus station, manufacture, ore extraction and catering activities, but only those catering activities that refer to outdoor swimming pools and related sports activities, air domes, outdoor pitches, etc. These businesses are obviously subjected to higher compensations, which places them in a worse position than others. It is unusual that the surface area of the land where such activities are performed is added to the floor area of the building in order to calculate the total amount of the compensation.

Dimitrovgrad

Dimitrovgrad applies a traditional system of calculating the compensation per square meter of constructed facility, in combination with its location and purpose.
This municipality is divided into five zones: zones 1 and 2 are located in the town itself, zone 3 includes the Gradina border crossing (with Bulgaria), zone 4 covers two villages that are included in the master plan, while zone 5 covers other villages in the municipality.

There are only three types of purposes: residential, manufacturing and commercial. The table below shows the amounts of the construction land compensation in Dimitrovgrad:

Table 3. Rates per zone and type of business activity in 2012, in dinars

<table>
<thead>
<tr>
<th></th>
<th>Zone 1</th>
<th>Zone 2</th>
<th>Zone 3</th>
<th>Zone 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>8.08</td>
<td>6.93</td>
<td>5.83</td>
<td></td>
</tr>
<tr>
<td>Manufacture</td>
<td>34.65</td>
<td>28.77</td>
<td>69.00</td>
<td>19.55</td>
</tr>
<tr>
<td>Commercial activities</td>
<td>63.24</td>
<td>51.74</td>
<td>126.47</td>
<td>34.65</td>
</tr>
</tbody>
</table>

As shown above, the difference in rates between zones is not so large – around 2:1 between zones 1 and 4, which is probably too little given their respective location benefits and property value. On the other hand, there are considerable differences in rates when it comes to purpose, where the ratio between commercial and residential purposes is around 7:1. Manufacture is somewhere in between.

The construction land compensation is also charged for those parts of land intended for housing purposes, which are adjacent to the constructed building and exceeding 800 m2. This land is charged with 50% of the above rate applicable to residential buildings. The land adjacent to a building, which is utilized for manufacturing or commercial activities, is charged with 10% of the relevant rate from the table above.

Exemptions from the compensation apply to buildings and land that are intended and utilized for military purposes, as well as to children's playgrounds, sports and recreation grounds, green areas and parks, water supply and sewerage facilities, cemeteries, landfill sites, places of worship, social welfare institutions and land utilized by indirect beneficiaries of the municipal budget.
The same exemptions apply to newly-erected facilities intended for manufacturing or commercial purposes for the period of three years from commissioning, which is the result of a policy aimed at attracting investors and creating a more favorable investment climate.

The exemptions also include the land intended for farming purposes, ancillary farm buildings and yards.

**Surdulica**

The construction land compensation in the Surdulica is specific because it also covers Mt. Vlasina, along with other areas belonging to this municipality. This is due to the fact that Mt. Vlasina is a popular holiday resort where many weekend houses and catering and commercial facilities are located.

Similarly to other places, the compensation is charged on the basis of the location of constructed facilities, their floor area in square meters and their purpose. The compensation for unconstructed land is based on surface area alone.

Construction land locations in the Surdulica municipality, excluding Mt. Vlasina, are divided into five zones. Zone 1 includes the center of the town, zones 2 and 3 include an area outside the town center, while zones 4 and 5 include the suburbs and villages. Mt. Vlasina is divided into three zones, where zone 1 includes four separate locations.

Constructed facilities are divided according to six purposes: residential; three types of business activities, one of which includes budget beneficiaries (public utility companies, social welfare, health care and education institutions, administration, political parties, religious communities, various associations), and unmentioned premises.
The highest and most expensive category of business activities includes financial, accounting, medical, legal, geodetic surveying, technical and commercial services that are private sector-based, as well as power and gas generation and distribution, trading in oil derivatives, PTT and telecommunications services, publishing, etc. The next category includes trade, catering, tourism, transport, small businesses, handicrafts, repair and maintenance services. The lowest rate applies to manufacture and related activities (industry, farming, forestry, water resources management, fishery, energy raw material extraction, civil engineering, etc.).

Table 4. Annual compensation per m2 in 2012, in dinars

<table>
<thead>
<tr>
<th>Category</th>
<th>Zone 1</th>
<th>Zone 2</th>
<th>Zone 3</th>
<th>Zone 4</th>
<th>Zone 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>0.59</td>
<td>0.47</td>
<td>0.36</td>
<td>0.24</td>
<td>0.18</td>
</tr>
<tr>
<td>Financial and other services</td>
<td>23.95</td>
<td>21.55</td>
<td>19.15</td>
<td>11.97</td>
<td>5.98</td>
</tr>
<tr>
<td>Trade and other services</td>
<td>10.77</td>
<td>8.38</td>
<td>5.98</td>
<td>3.59</td>
<td>2.87</td>
</tr>
<tr>
<td>Manufacture</td>
<td>7.18</td>
<td>5.98</td>
<td>4.78</td>
<td>3.59</td>
<td>2.87</td>
</tr>
<tr>
<td>Budget beneficiaries</td>
<td>3.59</td>
<td>2.37</td>
<td>1.20</td>
<td>0.59</td>
<td>0.47</td>
</tr>
<tr>
<td>Other activities</td>
<td>2.39</td>
<td>1.79</td>
<td>1.20</td>
<td>0.59</td>
<td>0.47</td>
</tr>
</tbody>
</table>

Just like in other places, the differences in rates in Surdulica are smaller in terms of zone than in terms of purpose. The rate in the most expensive zone is only 2.5 to 4 times higher than that in the cheapest zone, while the difference between the highest rate in terms of purpose is 33-50 to 1 as compared to the residential category, and 2.1-4 to 1 as compared to the manufacture category. Thus the burden is obviously lifted off the residential category.

Higher rates apply to Mt. Vlasina, where the rate for trade and similar services and manufacture is 10-20% higher than in the Surdulica town. Another important difference is that the construction land compensation on Mt. Vlasina is also payable for weekend houses, which are subject to a twice higher rate than residential buildings in the town.
THE FINANCIAL IMPACT OF THE COMPENSATION

Generally speaking, the compensation for use of construction land is not such a heavy a burden on businesses. However, this burden is still considerable for certain business activities and companies that are being discriminated by local authorities in terms of the rate they have to pay. Although the compensation does not generate large revenues for the state budget of the Republic of Serbia, it still remains a big source of revenues for some local governments. This has become evident over the past few years since transfers of funds from the state budget to the local level have decreased significantly due to a difficult situation in the state budget. This is illustrated in the table below:

Table 5.
Revenues from the compensation and total revenues of local governments in the 2008-2012 period, in millions of dinars

<table>
<thead>
<tr>
<th></th>
<th>Construction land compensation</th>
<th>Total current revenues</th>
<th>Share of the compensation, in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>9,015</td>
<td>183,284</td>
<td>4.9</td>
</tr>
<tr>
<td>2009</td>
<td>11,439</td>
<td>165,453</td>
<td>6.9</td>
</tr>
<tr>
<td>2010</td>
<td>16,072</td>
<td>170,621</td>
<td>9.4</td>
</tr>
<tr>
<td>2011</td>
<td>14,519</td>
<td>197,208</td>
<td>7.4</td>
</tr>
<tr>
<td>2012</td>
<td>14,580</td>
<td>237,429</td>
<td>6.1</td>
</tr>
</tbody>
</table>

Source: The Treasury Department of the Serbian Ministry of Finance

As shown above, the share of the compensation in the overall current revenues\(^2\) of local governments is between 5 and 10 percent, depending on the year. The impact of the construction land compensation grew in the 2008-2010 period after the transfers from the

\(^2\) Current revenues = total revenues – property sale – borrowing.
state budget diminished, which jeopardized normal operation of local governments. Deteriorated financial standing of local governments in the 2008-2010 period created a need for maximum use of own revenues, i.e. the need to increase the compensation and to try harder to collect more revenues not only from the construction land compensation, but also from other sources.

However, with the adoption of the new Law on Local Self-Government Finance in mid-2011 and its application since October 2011, which provides for a significant increase in local government revenues, the impact of the compensation has diminished since 2011, causing a drop in revenues in comparison to 2010, and remained at the same level in 2012. Processes that are opposite to those from the end of the last decade are obviously at play now: a more lenient policy of charges is now being pursued both in terms of rates (it suffices that they are not increased according to annual inflation) and in terms of efforts to collect the compensation in an increasingly unfavorable economic situation.

A very important question is: which groups of obligors actually shoulder the burden of the compensation and to what extent, i.e. what is the burden on legal and natural persons, respectively? Since fiscal statistics do not include this information, unfortunately we are not in a position to present the exact figures. However, it is generally believed that legal persons account for a much bigger share in the payment of the compensation than natural persons. This is also confirmed in an analysis based on data from a number of Serbian municipalities, whose author, Tony Levitas, claims that 70-90 percent of the total compensation is collected from legal persons, while the rest comes from individuals.

Upon closer inspection, a major difference is perceived in the impact of the construction land compensation on local government revenues in certain towns and municipalities in Serbia. The chart below shows a histogram of distribution of the share of revenues collected from the compensation and property tax in the overall revenues of local governments:

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Major differences are noticeable in property-related charges, including those for land. Their impact is comparatively low (below 5%) in most towns and municipalities. The impact is higher or very high (above 10%) only in 10 towns and municipalities. The highest share of the compensation in municipal revenues is in Ub (31,4%), Svilajnac (18,0%) and Lapovo (16,3%). On the other hand, some other small municipalities, such as Žagubica, Opovo, Plandište and Sečanj, have no revenues from the compensation. The highest concentration of revenues from the compensation is in Belgrade, where as much as 57.5% is collected, and in Novi Sad, where the collection rate is 64,1%.
THE ANALYSIS OF THE COMPENSATION CONCEPT

*What is the compensation for use of construction land?* What is the logic behind it and what are the grounds for its existence? These questions have to be answered in order to assess the existing compensation model and to suggest changes.

As for the history of this compensation, it was created several decades ago in order to charge for the usage of state-owned, i.e. socially-owned land for the benefit of local governments. Thus it became a kind of a permanent rent that was paid by the user of the land - a company or a tenant in an apartment building. Since the land market was nonexistent at the time, i.e. the land was not traded with and so it was impossible to assess its price (its value), the rent was imminently calculated according to physical characteristics of the land rather than according to its value. The first method was to take into account the land itself, i.e. its surface area, coupled with its location and other benefits (available utility infrastructure, etc.). Thereby an approximate value of the land was determined in order to assess the construction land use compensation rate, which would be in line with the purpose of the charge itself (for land usage) and would enable a more rational use of land as the rate would motivate people to abandon the extra land they did not need or to move from a more expensive location to a cheaper one, etc.

This concept of determining the compensation on the basis of surface area of the land is problematic because it prevents or hinders the integration of various social, economic and financial goals that local governments might have, and they often do. For this reason, such a concept would not be in line with the idea of giving a privileged status to certain categories of users (for instance, to citizens as compared to businesses), or favoring certain types of economic activities (for instance, the industry as compared to trade), or charging the compensation according to the user's ability to pay or their financial means, or protecting users who dispose with (too) big chunks of land, etc.
Due to these reasons, a more suitable method was to take into account the floor area of the building, which in combination with the location, purpose of the building and availability of utility infrastructure gives an approximate value of the property (the building, plus the land) by means of physical parameters. This method was praised for its ability to intertwine the compensation, to a greater or lesser extent, with the so-called location rent, which means that the usage of the land at a better location, which is more valuable, should entail a higher compensation than that for the land at a cheaper location. However, it is evident that what is charged here is not the land itself, but an approximate value of the property, even though it is poorly approximated. Namely, the property value cannot be deemed too closely approximate to the value of the land because it (the property value) greatly depends not only on the value of the land, but also on the value of the building that is constructed thereupon. Even in the former country, at the time of the state-owned, i.e. socially-owned property, the value of a building partly included the value of the land because the right of usage of land also entailed some elements from the set of ownership rights: the land was used permanently rather than being seized on the basis of arbitrary decisions of local authorities; it was possible to rent it to somebody else or inherit permanent rights to use it, together with the building, etc. Hence, the idea to charge the rent for the land was a starting point that later led to a poorly regulated property tax because, regardless of its name, a levy on the overall value of real property is no other than property tax.

There is a certain reason to believe that the land compensation might be interpreted as a charge that serves to finance the local utility infrastructure, such as water supply, sewerage and central heating systems, local roads, streets, parks, garbage disposal, etc.⁴ In many Serbian towns and cities, including Belgrade where this appears to be a formal budgetary decision, the revenues from the compensation are intended for what is broadly defined as maintenance and improvement of utility infrastructure. However, it seems that such a formulation is too general because every budgetary revenue, even that from

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⁴ Since power distribution, telephony and gas supply are services that are provided from the republic level and are funded from the state budget, and through citizens' individual bills, they cannot be subject to local charges.
payroll tax, can be allocated for financing the maintenance and improvement of utility infrastructure.

Moreover, one may ask how good or even necessary it is to rely on the budget for financing local infrastructure or if it would be better to seek other funding methods. Thereby certain utility services may be charged directly from the users and their maintenance may be separated from the budget: financing construction from the budget or from revenues of relevant utility companies, while financing standard operation and maintenance through paid utility bills. If there is a subsequent need to expand the existing capacities, then the necessary funds may be provided from the local budget or through loans. To tie investments in standard maintenance with the collection of utility bills from the users whenever possible would be a much fairer and more efficient method than to finance them from the budget. This method would be fairer because it is inappropriate to socialize individual utility costs, i.e. to allow only some citizens to benefit from a particular service (e.g. central heating) and let everyone else bear its cost, even those who will never be connected to central heating. This would be more efficient because when utility services are financed through charges that resemble taxation it is very difficult to control the costs and identify people's individual preferences (e.g. whether they prefer to use gas, in terms of their readiness to pay the full cost of connection to a gas supply network).

It is impossible to provide individual financing of certain utility services, such as streets, public lighting, parks, etc. Such services must inevitably be financed by the local government, perhaps even from the budget. The government, taxes and budget system are there to finance such needs that cannot be financed through utility bills.

This means that a separate charge like the construction land compensation is unnecessary for financing the normal operation and improvement of utility services. They can be financed through utility bills in combination with user participation in the construction of some infrastructure facilities and general budgetary revenues.
THE ANALYSIS OF SOLUTIONS IN SERBIA

This section offers a detailed analysis of the main characteristics of the construction land compensation in Serbia, which will enable its final assessment.

As shown in the previous section referring to the solutions applied in some towns and cities of Serbia, the main criteria for determining the amount of the compensation usually include:

1. the floor area of a constructed building;
2. the location of the land/building;
3. the purpose of a constructed building;
4. the surface area of the land, as an additional criterion.

The floor area of a building. It can be easily perceived that the compensation is not usually charged according to the surface area of the land, but according to the floor area of a building constructed on that land. This is not a good approach because a compensation that is not based on surface area of the land which the obligor uses or owns undermines the whole point of the land use compensation. In other words, the land of the same surface area may contain several buildings of different floor area that are used for the same purpose, but these buildings would probably be subject to different compensation rates. There is no justification for this since the land upon which the buildings are constructed covers the same surface area and it would be logical to charge a single rate for the land, independently of the floor area of the buildings constructed upon it.

The size of the building only influences the value of the land in a specific way - through urban development regulations. An owner/user of the land in Serbia does not enjoy the right to free construction, but is restricted by the regulation plan that usually prescribes

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5 The fee is also paid according to the surface area of undeveloped construction land, but since this is a less important characteristic of the situation in Serbia, it will not be addressed here.
the maximum number of floors and floor space in a building constructed on a given plot of land. Therefore, even on the free market, the value of the land directly depends on applicable urban development conditions, i.e. on the purpose and floor area of the designed or existing building, so the value of a plot of land that is intended e.g. for individual housing construction is much lower than the one where a big apartment building is supposed to be built.

The floor area may approximately match the surface area of the land only in one specific case – when a building with the maximum floor area allowed in the relevant construction and urban development documents is built on the land (the building's foundation surface area in comparison to the surface area of the land and the number of floors in the building). In all other cases, the value of the land that is calculated according to the floor area of the building is lower than its potential value, i.e. the value that would be obtained if a building of maximum size allowed in urban development regulations was constructed. Therefore, it is evident that the existing construction potential is not utilized, as the floor area of the building does not match the potential value of construction land. The construction land use compensation does not properly cover the actual value of the land, which is bad for two reasons.

One reason is the loss of fiscal revenues, because the current system generates fewer revenues than those that could have been collected if the full value of the land had been included in the calculation. The second reason is the fact that this system discourages rational use of land because a lower compensation is charged for irrational use of land (measured by a low ratio between the floor area of a constructed building and the surface area of the land, which is significantly below the values allowed in the regulation plan). In other words, if an owner of a small building on a large plot of land pays a small compensation even if the land is centrally located, and therefore is the most valuable, then we can hardly speak about rational use of urban land.

The location of the land/building. Location measures location benefits, which is indeed an important factor in determining the value of the land. Some locations are more suitable
for doing business, while others are more suitable for housing or manufacturing purposes, etc. What is crucial here is that the property value (the land plus the building) depends on the value of the land and thus:

\[
\text{Property value} = \text{value of the land} + \text{construction value of the building}
\]

Hence, different locations may contain buildings of equal value, but the property value will vary due to different values of the land. For example, a house in Dedinje is worth several times more than the same house in Resnik, due to differences in locations.

In most Serbian towns and cities, the usual practice of evaluating location is based on the zoning system. However, a small number of zones within that system cannot reflect the whole variety of location benefits. All the more so, because there are major differences in value within certain zones themselves between some micro-locations at short distances from one another – e.g. between the main street and a back street in the center of a town or a city.

The location-based criterion should also reflect the availability of utility infrastructure and other amenities since better locations are presumed to be better equipped than worse locations. However, this presumption is not always true as better quality of infrastructure is often found in suburbs than in the Old Town. Therefore, in certain towns and cities the availability of utility infrastructure, amenities and other conveniences at a certain location is explicitly included in the calculation.

To sum it up, the existing methods of assessing location benefits in Serbian towns and cities, which are mainly based on zoning or scoring systems, are not even close to properly approximating the value of location benefits, i.e. the value of the land. For example, the ratio between the construction land compensation rate for residential purposes in Dedinje against that in the village of Besni Fok is only 4.3:1, which certainly does not correspond to either the objective or the subjective value of the land at these two locations, i.e. their market value.
It is important to note that the score ranges between the best and the worst locations are usually very small, especially when compared to different purposes of buildings at these locations, which makes it impossible to properly approximate the real differences in location benefits. Such a harmonization of criteria based on location benefits practically results in subsidies for owners and users of the best locations at the expense of those at the worst locations, which is neither fair nor economically rational.

The purpose of a constructed building. Another standard criterion for determining the amount of the compensation is the purpose of a constructed building. Generally speaking, this approach does not make any sense because there are no reasons that would make one purpose seem more lucrative than another. Construction of an apartment building can be equally lucrative as construction of an office building. Admittedly, an uneven supply of premises of a particular purpose may exist in some towns and cities, where one type of premises may be in higher or lower supply than others, which may result in different rates and different values of land according to its purpose.

However, this criterion is distorted in Serbian practice. In determining the construction land compensation for constructed buildings according to their purpose, most Serbian towns and cities do not only use as a starting point those purposes that may be relevant to the value of the land – such as standard purposes listed in the regulation plans (residential, business, manufacturing purposes) – but they in fact adjust many purposes and rates to the obligors’ presumed ability to pay, which should be a rationale behind the profit tax or income tax, for example, rather than behind the construction land compensation. Hence the discrimination against legal persons in comparison to natural persons, against some business activities in comparison to others (the lowest rate applies to handicrafts, while the highest applies to financial and service-based activities) and against companies that are headquartered elsewhere, etc.

It is difficult to support such an approach because differentiation of constructed buildings according to their purpose actually means that:
either it is driven by a desire to collect the compensation in the easiest possible way, which is why higher rates are charged to those who are presumed to be able to pay for it more easily - e.g. crafts shops pay less, restaurants and bars pay more, industry pays less, financial institutions pay more (a kind of a welfare policy),
or it reflects the economic/development policy of stimulating the development of some sectors of industry (e.g. manufacture), while discouraging others (e.g. service-based sectors).

None of the above reasons should be decisive in setting the construction land compensation because:

- it is irrational to pursue a cost-based welfare policy, especially the one that is based on the cost of factors of production, as this would result in an inefficient allocation of resources; the welfare policy should instead be pursued through budgetary transfers to the poor rather than through instruments which fail to distinguish the poor from the well-off (e.g. craftsmen from owners of bars or restaurants) within certain categories of users, even though both categories exist in each type of business; and

- to stimulate development of the manufacturing industry as compared to service-based industry is a reflection of an archaic and erroneous approach to economic policy, because there is no reason good enough to discriminate one type of business compared to another; the economic policy should be allocatively neutral in order to maximize the overall economic activity. Why are the compensation rates extremely low, for example, for numerous types of industry, such as the food processing, chemical and construction material industries, metallurgy, metal processing and other industries in central Belgrade? From the perspective of rational use of urban land, wouldn't it make sense to configure the compensation to be relatively high in this case in order to stimulate those industries to move somewhere else towards a less valuable land, like the one on the outskirts of the city?
It would be best if the list of purposes of buildings to which the compensation is applicable was equal to the list of purposes of buildings that is provided in the regulation plan or urban development plan because, as stated above, the value of construction land is determined in these plans, which, among other things, provide for particular purposes of certain buildings although they are mostly limited to the basic ones. Since the value of the land depends upon the purposes mentioned in the regulation plan or urban development plan, the compensation could also be set according to these purposes, which would help harmonize the value of construction land and the rates for its usage.

Even if we accepted the criteria for determining the compensation as well-chosen, a serious issue of their quantification would still remain. Namely, each of them should be expressed in dinars or in points, but there is a lack of objective quantification method, which is clearly illustrated by differences in certain scoring criteria in towns and cities of Serbia. Which ratio of the compensation that is charged for business and residential premises, respectively, is the right one - is it 8 for the most expensive zone in Petrovac, or 17 in Aranđelovac, or 40 in Surdulica, or 66 in Belgrade?

**Determination of the compensation according to surface area of the land.** In some towns and cities in Serbia, the surface area of the land is used as an additional criterion for determining the construction land use compensation, but under certain conditions. This criterion sometimes applies to the extra land beyond a certain arbitrarily drawn boundary of a plot (e.g. in Belgrade, where it is determined according to a scale) and sometimes it applies to certain types of land, usually those that are used for certain purposes (e.g. in Aranđelovac, for certain types of business activities). There is no doubt that behind these *ad hoc* inventive methods lies a desire to collect additional funds.

**Advantages and disadvantages.** The construction land compensation has thee advantages with moderate impact:

1. it brings in large revenues to local governments;
2. it was introduced a long time ago and obligors have grown accustomed to it (which, of course, does not mean that the compensation is good in economic terms); and
(3) the liability of legal persons is determined by calculating physical indicators, i.e. according to the same criteria that apply to natural persons rather than according to the book value that is used for calculating the property tax.

As shown above, the compensation has considerable weaknesses:

(1) it has lost its "raison d'être" due to the ownership transformation of construction land, which used to be state-owned and now is becoming privately owned, so the government no longer has the right to charge the rent on the land that it is now in private hands;

(2) this *compensation* is actually not a compensation at all because payers are not getting any service in return; what could have been deemed the rent until recently is now turning into a charge that resembles tax;

(3) it essentially represents a duplicated and poorly regulated property tax, especially following privatization and establishment of private property over the land; duplication of a single tax is unnecessary as it only generates additional administrative costs as compared to the standard property tax;

(4) the method of determining the basic rate is not good because the criteria used to determine the compensation rates had failed to approximate what they were supposed to approximate – the value of the land; all the three basic criteria - the floor area of a building, its location and purpose - have contributed to this failure, which has brought about adverse social and economic effects and especially prompted irrational use of land;

(5) the rates are extremely differentiated according to the purpose of buildings, which is unfair in most cases because it places an unequal burden on the equals and vice versa;

(6) it discourages rational use of construction land as the most valuable resource in Serbian towns and municipalities, thus causing adverse economic effects as a result of these predominantly purpose-based criteria where housing, state-owned buildings and manufacture enjoy privileged status, while service-based activities and companies that are headquartered elsewhere (especially republic public enterprises) are being discriminated;
(7) the compensation is uneven in different towns and municipalities in Serbia, even in terms of the method of determining its rates, which should not be the case because it places citizens and economic operators into different positions.

WHAT TO DO?

Introduction

The construction land compensation should be abolished because it is evident that:

- it has lost its "raison d'être",
- it is unfair,
- it is economically irrational,
- it incurs unnecessary administrative costs.

In that context, the expert public has no dilemma whatsoever as it is generally believed that the compensation should be abolished\(^6\) due to the above reasons.

Even the legislator himself is inclined towards abolishing the construction land compensation, which is illustrated in the aforementioned provision of the Serbian Construction and Planning Act, whereby the compensation is paid "until the stated compensation is integrated into the property tax". Therefore, the legislator sees it as a temporary charge that should be abolished soon due to clear and compelling reasons.

On September 26, 2012, even the current minister of finance called for abolition of the compensation, stating that the loss of local revenues could be compensated by increasing revenues from property tax (by increasing the tax base for legal persons) or from other charges.\(^7\)

\(^6\) See B. Begović, B. Mijatović and D. Hiber: Privatizacija državnog zemljišta u Srbiji, CLDS, December 2006; Poreska politika u Srbiji, pogled unapred, FREN, 2010; NALED Šiva knjiga V, Preporuke za uklanjanje administrativnih prepreka za poslovanje u Srbiji 2012/2013, NALED, 2012

\(^7\) [http://www.rts.rs/page/stories/sr/story/13/Ekonomija/1180556/Br%C5%BEe+do+gra%C4%91evinske+]
The business community has long since sought the abolition of the compensation because they are the ones who are affected the most. The Serbian Employers’ Association made such a request two years ago, invoking the need to avoid duplication of essentially the same charges (the property tax and construction land compensation).  

The only ones who currently oppose the idea of abolishing the compensation are local governments for fear of losing a major source of revenues without necessary compensation. However, they would be willing to accept the abolition of the compensation on condition that local self-governments were provided with sufficient compensation.

Different options in terms of charges that might compensate local self-governments in Serbia for the loss of revenues from the construction land compensation will be discussed below. There are three basic options: to impose a similar charge with a different name; to strengthen the property tax; or to reform the system of local self-governments finance.

The introduction of public utility fee

A realistic option would be to impose a similar charge with a different name. The new name would eliminate complaints that the construction land compensation cannot be retained in the new system of private property, i.e. that the government has no right to charge private owners for the use of their own property. Over the past few years an idea has been circulating to rename this compensation into a public utility fee and thus retain it practically without any modifications.

To rename the compensation and thus retain it would solve the problem with the name, but all the other problems would remain: the fee would still be unfair and economically irrational and would still be a duplication of property tax and incur administrative costs.

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dozvole.html
8 http://www.poslodavci.org.rs/vesti/ukinuti-taksu-na-gradsko-gradjevinsko-zemljiste?id=34
As early as in November 2011 the Serbian parliament passed the Public Utility Act that contains a provision that introduces a new charge – public utility fee – which shall be "determined and collected" by the local government. However, the Act restricts the compensation in two ways: in terms of purpose for which it may be imposed and in terms of limiting the autonomy of local governments in regulating basic arrangements in that regard.

First, the public utility fee may only be imposed for financing public utility services for which "it is impossible to identify the end user". Thus its purpose is much more restrictive than the one provided for the construction land use compensation, which could include every public utility service, from standard maintenance to investment. If our interpretation of the Public Utility Act is correct, revenues from the public utility fee may not be used for water supply, sewerage, garbage disposal and similar services whose end user is identified and billed. This provision only applies to streets, parks, public lighting system, etc. Second, the Act gives extensive rights to the government: to create a list of obliged payers, to lay down calculation basis and criteria, to set the maximum amount of the fee and provide for exemptions, etc., while the local government will more closely regulate the zones, coefficients, etc. (Article 27 of the Public Utility Act). This would prevent (1) excessive rates from being charged to certain categories of users, and (2) current diversity of solutions related to the construction land use compensation in Serbia.

The introduction of the public utility fee is currently blocked due to the lack of by-laws that are supposed to be enacted by the Ministry of Finance. However, the Public Utility Act makes it imperative that the construction land use compensation be abolished and that the public utility fee be introduced not later than January 1, 2014, which clearly indicates that these two charges are interlinked. Still it is possible that, by that time, the Act will have been amended and that local governments will have been properly compensated in a better way than through the public utility fee.
Generally speaking, a total misconception of public finance in Serbia has prevailed over the past few decades, which has resulted in a belief that every governmental or para-governmental agency, directorate or fund should impose their respective special charges that are solely aimed at financing their own activities. This is wrong because it may result in:

1. a scattered and intransparent system of public revenues, which is made up of hundreds of different levies and which causes uncertainty that affects people and businesses alike;
2. a very inert system of levies that never change, except for indexation purposes, that is insufficiently controlled by local assemblies or even by the parliament, which hinders their decisions-making process concerning revenues and expenditures;
3. a system that incurs big administrative costs because it requires regulation and collection of hundreds of different levies and control thereof, unlike some simpler and cheaper tax systems whereby abundant revenues are collected through a smaller number of taxes.

In other words, the Republic of Serbia, and especially the local governments, should turn to tax types that generate abundant revenues, and should abolish a large number of small levies. This would boost the transparency of taxation and enhance the choice of budgetary policies, and revenues and expenditures of the parliament and local assemblies, respectively, and would strengthen tax types that are fairer, better regulated, more economically rational, simpler and cheaper to administer. The Ministry of Finance is currently working on this, but the main results are still expected.

In this context, the public utility fee should be deemed as an unnecessary charge, because the same goal of financing public utility needs can be better achieved through municipal budget revenues. Even according to fiscal textbooks, streets and public lighting are examples of local needs that must be funded from the budget, i.e. from budgetary revenues of local governments. For this reason, there is no need to impose such a levy in Serbia since public lighting and similar utility services can be funded from the local
budget, regardless of whether the source of such funding is from own revenues or from transfers from the state budget.

**Strengthening of property tax**

**Benefits and problems**

A standard approach to compensating local governments for the loss of revenues due to abolition of the construction land use compensation would imply advocating for stronger property tax, i.e. for an increase in revenues from this type of tax. Such a solution has several obvious benefits:

- it provides stable and predictable revenues,
- it replaces an economically irrational charge with a better one,
- it limits taxation to local taxpayers, i.e. it prevents its spillover to other areas, which is good because the benefits of the local budget would be mostly limited to the given local community,
- it streamlines local revenue collection as the number of charges is reduced one at a time,
- it gives more fairness to the local revenue collection system,
- it enhances the transparency of local budgets and increases the possibility of priority setting in keeping with budgetary needs,
- it does not increase local governments’ dependency on the state budget because property tax and compensation are regulated and collected for local purposes, so the abolition of one levy and strengthening of another will leave the relations with the Republic and its budget intact.

Property tax is a popular method in developed countries and its increasing use as a method of accelerating economic growth has been advocated in recent years.⁹

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The main weakness of the above compensation concept lies in the fact that the property tax base for legal persons in Serbia is determined according to their accounting records. Thereby, the tax base is often significantly reduced because the book value of the property is usually much lower than its actual value. Recently there have been many exceptions to this practice because good companies indeed report in their books the actual value of their property according to market prices, either because (1) they are required to do so according to international accounting standards they must apply, or because (2) they wish to report the actual value of their property in order to get more favorable bank loans. Nevertheless, most companies in Serbia fail to report the actual value of their property according to fair market prices. Although this trend is also present among individuals, its occurrence is still more frequent among companies, which is why they are in a more privileged position than individuals. The tax base is determined according to the book value of property for reasons of administrative simplicity and availability of relevant data in the annual statements of accounts, which is why more complex evaluation methods are not needed. Still, this is a serious problem in terms of fairness and adverse economic effects, which requires a more favorable and fairer solution.

Abolition of the construction land use compensation and shifting its burden to the property tax would in turn affect the fairness of property tax at the expense of the population. This would be an undesirable and unpopular political move. The core of the problem undoubtedly lies with the Serbian Tax Administration that avoids embarking upon a complex task of assessing the actual market value of immovable property of companies and individuals, but instead sticks to technically simpler method that yields wrong results. A serious and well-organized property tax system would unavoidably entail an assessment of fair market value of property. Although it is impossible here to engage in a detailed elaboration of the best method of assessing legal persons' immovable property, one method that might be suitable for Serbia on certain conditions will still be presented below.
Interim self-evaluation

Since the process of embracing standard techniques of assessing the actual property value is imminently going to be a gradual and time-consuming, it is necessary to find an alternative method that would be used in the meantime. One of possible and promising interim methods is self-evaluation of property by taxpayers, which would be applicable to legal persons alone. As for natural persons, the existing assessment system should also be modified towards including the market value of property, but this issue will not be addressed here.

The main idea of self-evaluation of legal persons' real property is to overcome limited capacities of the Tax Administration and to facilitate and improve the quality of evaluation by:

- reducing requirements concerning information that must be supplied to the Tax Administration through the use of information that is already available in the legal persons' accounting records (the list of facilities, floor area of each facility, invoices, depreciation, etc); and
- reducing the involvement of the Tax Administration staff through the use of professional capacities of taxpayers themselves.

The Tax Administration would provide the relevant self-evaluation methodology and global parameters (such as price movement, etc.), while taxpayers would fill out the forms and calculate the estimated property value, including the amount of their liability.

The main risk that this method involves is a possibility of underestimating the property value due to a taxpayer's interest in minimizing his/her liability. This is a true risk although it is currently less relevant, because self-evaluation will certainly result in higher property values than the current book values that are underestimated or will
sometimes result even in property values that are equal to the book values if they are properly estimated.

Another barrier to underestimated values would be the Tax Administration, which is entitled to:

- review the self-evaluation forms and re-assess the property if necessary, or hire an independent appraiser; and
- punish unconscientious taxpayers.

The self-evaluation method is widely used in former Socialist countries (Russia, Czech Republic, Poland, Hungary, Romania, etc.), as well as in many developing countries (Turkey, Thailand, Tunisia, etc.).

The reform of local self-government finance

Compensation for lost revenues due to abolition of the construction land use compensation may be found in a probable reform of local government finance system. This system implies an innovative concept that was rounded off in the 2006 Law on Local Self-Government Finance, but whose logic was regrettably undermined by ad hoc modifications (first through major reduction in transfers from the state budget and then through increasing the local governments' share in the collection of payroll tax from 40% to 80%). Nevertheless, the Ministry of Finance is preparing a number of reforms on the revenue side, which will imminently impact local finance. Since the system of local government finance is certainly going to be reviewed, perhaps a solution regarding compensation for lost revenues due to the abolition of construction land use compensation may be found within broader reforms, without having to make special changes just for the sake of that compensation. In other words, the construction land use compensation could be abolished simultaneously with the local finance system reform on

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condition that local governments are provided with sufficient funds from all other available sources and in keeping with Serbia's economic and financial capabilities.

Concluding remarks

Of all the above mentioned compensation methods, the last one seems to be the only realistic solution in the short term. This method implies a reform of local government finance and redistribution of revenues between the republic and local levels. Even though the construction land use compensation should soon be abolished (the deadline provided in the Planning and Construction Act is December 31, 2013), it is unlikely that other options can be prepared on time – even for the shift to self-evaluation. Therefore, the order of moves might be the following:

1. abolition of the compensation simultaneously with local government finance reform, provided that the level of local government revenues remain unchanged;
2. commencement of the process of strengthening fairness of property tax and collection of abundant property tax revenues, starting with the self-evaluation method;
3. a shift to assessment of fair value of individual property of both legal and natural persons.

Economic operators in Serbia would certainly be happy with the abolition of the construction land usage as they would be relieved of a charge that has almost exclusively affected legal persons. Furthermore, this compensation was causing uncertainty of business operations, as well as discrimination of certain business activities; it was intransparent and it prompted irrational use of land. In an effort to boost the efficiency of the market economy it had better be abolished.