

ECONOMY AND FINANCE

THE INEQUITY OF THE FISCAL SYSTEM IN ROMANIA

The case of property tax

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translated from Romanian



Although a small part of the Romanian fiscal system, property taxes are important for local governments because they are collected and used exclusively by administrative-territorial units.



This study presents an analysis of the property taxation in Romanian municipalities, showing the unfair and regressive nature of the present system.



Although a reform of the property taxation that would be based strictly on „market value” does not seem to be feasible nor opportune, a reform of the property taxation system is necessary in order to improve the efficiency of taxation of large fortunes, multiple properties, transfers of property and the rental market..

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in cooperation with



Contents

1.	IN AN UNDERDEVELOPED TAX SYSTEM ...	3
2.	... PROPERTY TAXES SUPPORT A MODEST PART OF LOCAL BUDGETS ...	5
3.	... AND IS BASED ON AN UNFAIR AND REGRESSIVE SYSTEM ...	7
4.	... WHICH CAN BE ADJUSTED THROUGH A TAX REFORM BASED ON MORE EFFICIENT TAXATION OF LARGE FORTUNES	9

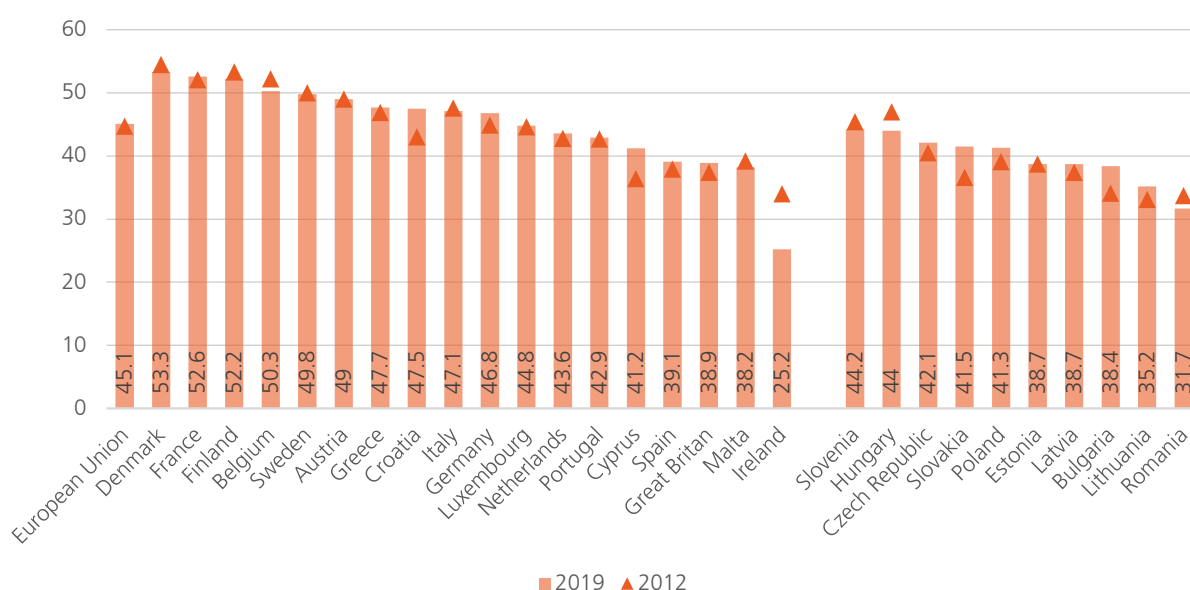
IN AN UNDERDEVELOPED TAX SYSTEM ...

In the last twenty years, Romania's economic growth has become more visible in statistics than on the streets of its towns and villages, as the country has set records in the European Union, but failed to solve communities' structural problems: underdeveloped infrastructures and underfunded, low-quality public services. While a number of government measures have stimulated investment - especially foreign investment - and enabled the engines of the economy to pick up speed, the state has failed to perform at an optimum level in its functions as a redistributor of wealth and a custodian of social solidarity. The study "Romania's weak fiscal state – What explains it and what can (still) be done" (Ban & Rusu, 2019)¹ shows that in the past ten years the country's economic growth has been accompanied by a decrease in the collection and management of society's available resources in relation to the size of the economy (GDP). As a matter of fact, Romania collects very little from the economy: in 2019, general government revenues accounted for 31.7%

of GDP, the second lowest level in the EU, only ahead of Ireland, a "tax haven" within the Union, and well below the European average of 45.1% (Figure 1). Compared to the weighted average of the other Central and Eastern European countries, in 2019 the Romanian state collected 9.7 percentage points less from the economy in the budget (Figure 2) - a difference that is equivalent to the total budget for the sectors of public health (4.7% of GDP in 2018), education (3.2%), housing (0.9%) and environmental protection (0.8%). In other words, **if the Romanian state collected as much as the countries in the region collect on average, the additional resources would allow these four budgets to be doubled.**

The issues raised by fiscal underdevelopment are numerous and they have been recently described in detail in the above-mentioned study by Ban and Rusu. According to the authors, these issues encompass a whole range of aspects ranging

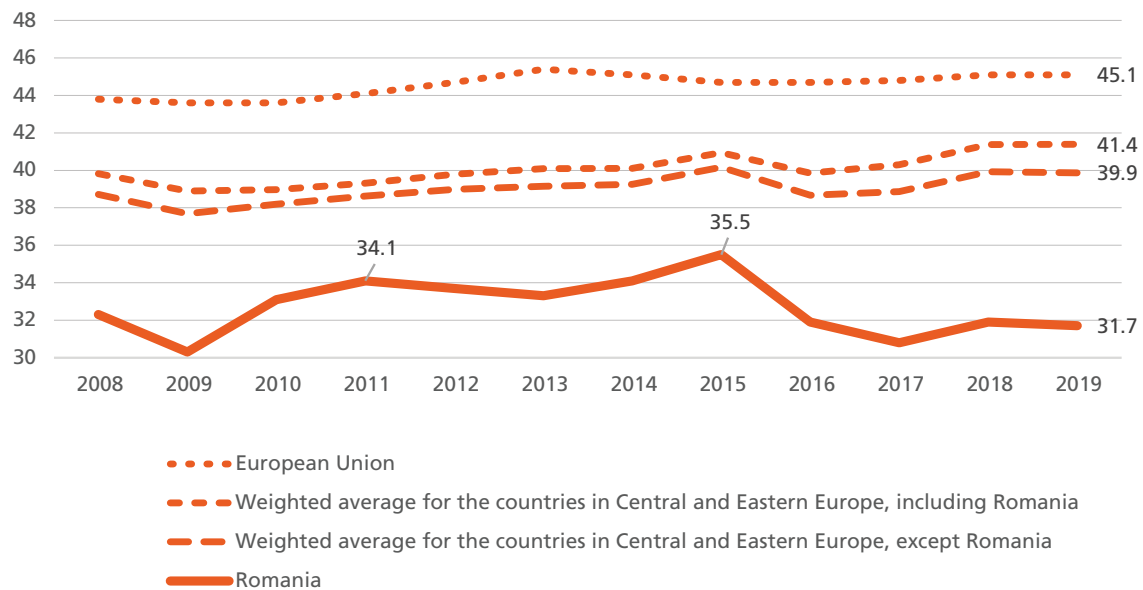
Figure 1
General state revenue, as a % of GDP



Source: Eurostat

¹ Cornel Ban, Alexandra Rusu, *Romania's Weak Fiscal State: What Explains It and What Can (Still) Be Done About It*, Friedrich-Ebert-Stiftung, 2019.

Figure 2
General state revenue as a % of GDP, evolution 2008-2019



Source: Eurostat

from underfunding of social services, a social deficit and “demographic haemorrhaging” all the way to dependence on external financiers for macroeconomic administration, especially the IMF, and sovereign bond market vulnerabilities. Also, many studies on taxation in Romania share another conclusion relating to the inequity that affects the relationship between labour taxation and capital taxation, to the detriment of the latter (a conclusion that also applies to the European Union as a whole, as well as to most countries in the world²).

Another feature of Romania’s tax system, one which most specialised studies support implicitly rather than explicitly, is the inequity that arises from taxation of low-income individuals in relation to taxation of high-income earners, or the taxation of poverty compared to the taxation of wealth.

In this report, we analyse the case of property taxation in Romania in order to illustrate the regressive nature of the Romanian fiscal system and the way in which it appears to favour well-to-do strata. Arguably, reform of the property taxation system and elimination of its current regressive nature play an agenda-setting role, as this could go some way in balancing the scales currently causing most of the tax burden to fall on the shoulders of consumers and workers, and shift it onto the shoulders of the well-to-do. However, while reform of the property taxation system alone cannot tackle all the inequities of the Romanian tax system, it could constitute an important step in the process of building a more equitable and efficient tax system.

² See Spencer Bastani, Daniel Waldenström, *HOW SHOULD CAPITAL BE TAXED?*, Journal of Economic Surveys, July, 2, 2020, <https://onlinelibrary.wiley.com/doi/10.1111/joes.12380>.

... PROPERTY TAXES SUPPORT A MODEST PART OF LOCAL BUDGETS ...

Although they represent a small part of the Romanian tax system - property taxes accounted for barely 0.6% of GDP in 2017-2019 - revenues from this source are important for local governments because they are collected and used exclusively by administrative-territorial units. In more detail, there are three categories of goods: buildings, lands and transport vehicles, for which the value of the tax is determined according to certain variables prescribed by national legislation and by local councils, yet in many cases calculation algorithms do not reflect the market value of taxable goods:

- for residential buildings, the tax charge is calculated based on values laid down in existing legislation, and depend on construction materials, age, utilities and the perimeter; also, the building is indexed according to the rating of the locality and to the zone where the residential building is situated;
- for non-residential buildings, taxable values are calculated either based on authorised proprietary valuation reports or on property transfer documents;

- the taxable value of lands is calculated based on the price in RON per hectare established by local councils within a minimum and a maximum value bracket provided in the Fiscal Code, and depend on the rating of the locality and the zone within the locality;

- for transport vehicles, the amount of taxes is calculated based on engine capacity, by multiplying each group of 200 cm³ or a fraction thereof by an amount stipulated in the Fiscal Code.

The three sources of revenue for local budgets generally cover a small part of local authorities' budget. For all 103 municipalities of Romania, property taxes accounted for only 12.8% of total local budget revenues in 2019 (table 1), of which 9.7% came from taxes and fees on buildings, 1.9% from land-related taxes and fees and 1.2% from taxes on transport vehicles. Regarding the taxation of buildings, most of the resources collected come from legal persons, which pay 2.6 times more than natural persons (this ratio remained unchanged during the years 2017-2019). In other words,

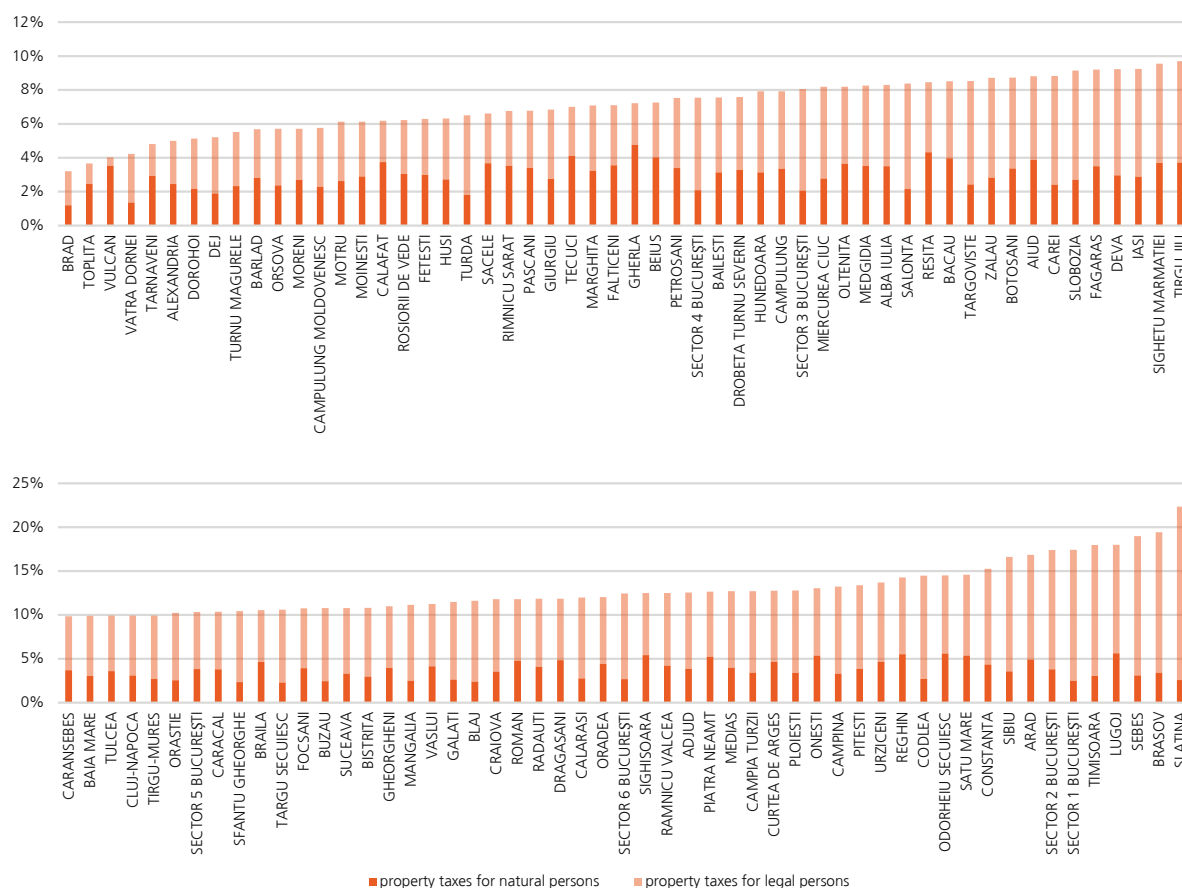
Table 1
Property taxes collected in 103 municipalities in Romania, in million RON and % of total revenues

	2017	2018	2019
Building tax from natural persons	640	695	726
<i>in % from total revenues</i>	2.3%	2.8%	2.7%
Building tax and fee from legal persons	1707	1771	1923
<i>in % from total revenues</i>	6.2%	7.0%	7.1%
Total building taxes and fees	2347	2466	2649
in % from total revenues	8.6%	9.8%	9.7%
Land tax for natural persons	229	218	232
<i>in % for total revenues</i>	0.8%	0.9%	0.9%
Land tax and fee for legal persons	248	230	252
<i>in % from total revenues</i>	0.9%	0.9%	0.9%
Tax on extravillan area	31	31	32
<i>in % from total revenues</i>	0.1%	0.1%	0.1%
Total land taxes and fees	508	479	516
in % from total revenues	1.9%	1.9%	1.9%
Tax on vehicles of transport of natural persons	394	451	507
<i>in % from total revenues</i>	1.4%	1.8%	1.9%
Total taxes on vehicles of transport	277	292	318
in % from total revenues	1.0%	1.2%	1.2%
Total property taxes	3132	3237	3483
in % from total revenues	11.4%	12.9%	12.8%
Total revenues	27376	25160	27202

Source: Reports on budget implementation by municipalities COFOG 3

Figure 3

The share accounted for by building taxes for natural and legal persons in the budget of municipalities, 2019



Source: Reports on budget implementation by municipalities COFOG 3

natural persons pay 28% and legal persons 72% of building taxes in municipalities, a level that has not varied much in recent years³.

There are also large variations in the ratio of property taxes generated for local budgets. While taxes on buildings from natural persons account for only 1.2% of total income in Brad, 1.4% in Vatra Dornei, 1.8% in Turda and 1.9% in Dej, at the opposite pole, in Onesti, Satu Mare and Sighisoara, these taxes account for 5.4%, in Reghin to 5.5%, and in Odorheiu Secuiesc and Lugoj 5.6% of municipal revenues. In the case of legal persons, variations are even greater: in the small municipalities of Vulcan, Toplita and Tarnaveni, building tax revenue from legal persons accounts for less than 2% of local budget revenue, while in large municipalities like Sibiu, Timisoara and Brasov they exceed 13 %, and in Slatina they even reach a level 19.7% (Figure 3).

While such variations in the share of property tax imposed on legal persons as a percentage of local budget revenue could be partly justified if we take into account particular variables,

like the level of development and the degree of capitalisation of companies, the differences in taxation of natural persons are most likely caused by factors relating to decisions by local governments (applicable tax rate, zoning, etc.) and to tax debt collection performance.

In 2011, Sorin Ioniță summed up the shortcomings of the Romanian property taxation system⁴; it would appear that some of his conclusions remain relevant even today, 9 years later:

- property tax in Romania is applied regressively, which means that the higher the value of the property, the lower the rate of tax levied on the property;
- the system creates distortions in the peripheral areas of large cities, as buildings in these areas are classified as if they were in lower-rated localities (designated as rural areas), their taxable value being consequently lower than their real value;
- differentiated treatment applied to properties held by natural and legal persons generates distortions due to tax evasion by companies that register commercial buildings on behalf of natural persons, etc.

³ The report „Property Tax in Romania - Revision of development and implementation in the context of practice in EU and OECD countries” conducted by the World Bank indicated that in 2014 „only 27% of recurrent taxes on immovable goods were generated by natural persons”. The rate has mostly remained unchanged.

⁴ Sorin Ioniță, *Impozit pe case la valoarea de piat ?*, SAR Policy Brief, No. 54, August, 2011, <http://sar.org.ro/wp-content/uploads/2011/09/Policy-memo54-2.pdf>.

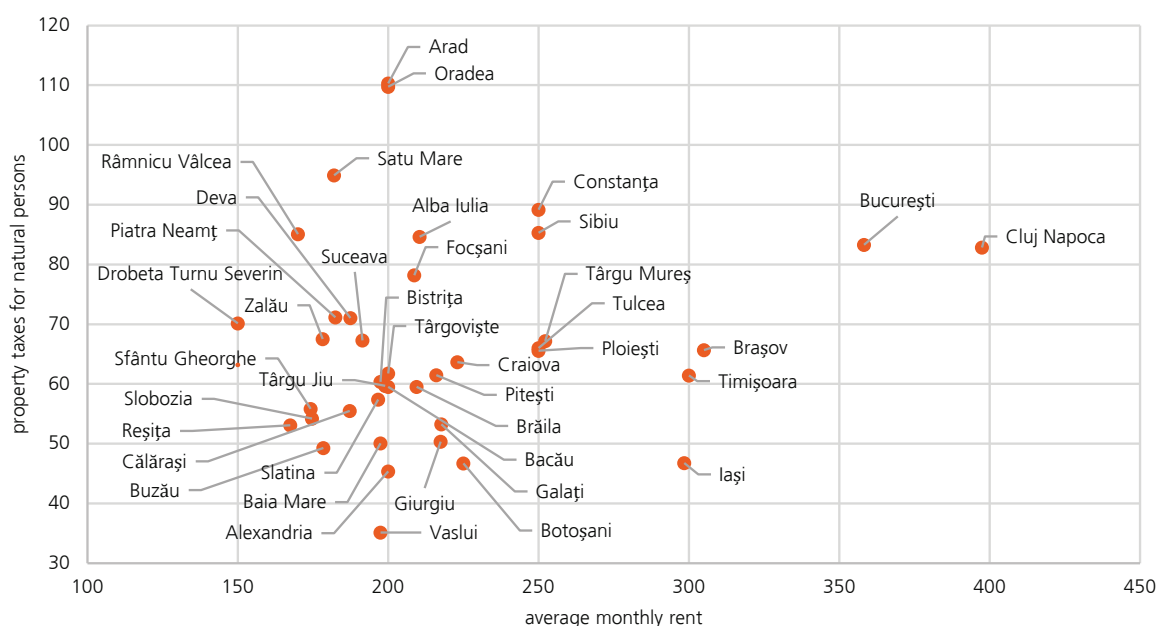
... AND IS BASED ON AN UNFAIR AND REGRESSIVE SYSTEM ...

Regarding the *regressive* nature of the property tax system in Romania, it can be argued that this is reflected especially in the *calculation of the taxable value of buildings* and it can be deduced from the table of “correction coefficients” that adjust taxable value in accordance with the rating of the locality and area where buildings are located. As we can learn from this table, the difference between the highest coefficient in Bucharest (the coefficient for the zone A in a 0-rated locality is 2.6) and the lowest coefficient from any other municipality in Romania is barely 23.8% (zone D in rating II localities has a coefficient of 2.1)⁵. In reality, the real estate market value of properties shows more significant differences: the median price of apartments in a small town such as Calafat (rating II)⁶ is € 310 per usable square meter, whereas, for example, in Brăila, one square meter can cost

€ 860 (2.8 times more than in Calafat), and in Cluj-Napoca the median is € 1800 per square meter (5.8 times more than in Calafat)⁷. In theory, the differences arising from the calculation of the taxable amount could be mitigated by applying lower rates in lower-rated localities and higher rates in higher-rated municipalities, considering that the Fiscal Code allows for a margin of flexibility in this regard - the rate of taxation can range from 0.08% and 0.2% according to the discretion of local councils. However, this does not correct existing inequities, firstly because the ratio between the maximum and the minimum share is 2.5, while the price differences between towns on the real-estate market can exceed the multiple of 5, and, secondly, because there is no explicit or implicit correlation between the rating of the locality and the established tax rate, with such

Figure 4

Building taxes for natural persons in lei/year per capita in 2018, compared to average monthly rent (for a 2-room apartment, Comfort-1, built during 1980-2000) in euros/month, average of the trimesters 1-4 2018



Source: Reports on budget implementation by municipalities COFOG 3, Real estate analysis

⁵ All the municipalities in Romania are classified as rating II, except for Bucharest (rating 0) and Bacău, Brașov, Brăila, Galati, Cluj-Napoca, Constanța, Craiova, Iasi, Oradea, Ploiesti and Timisoara (rating I).

⁶ Apartments for sale in Calafat, 20 August 2020, <https://www.imobiliare.ro/vanzare-apartamente/dolj/calafat>.

⁷ Residential real estate market, 2nd trimester 2020, Analize Imobiliare, <https://www.analizeimobiliare.ro/wp-content/uploads/2020/07/raport-t2-2020.pdf>.

Table 2

Calculation of the real tax rate of usable areas as a % of their market value, compared with the average price of properties in the residential market, 2018

Municipality	Property average price, lei /usable m2	Total usable rea, thousands m2	Total floor space, in millions RON	Building taxes for natural persons, in millions RON	Real building tax rate for natural persons
București	1162	40824	47437	177.54	0.37%
Cluj-Napoca	1434	7696	11037	26.86	0.24%
Timișoara	1151	7616	8766	20.20	0.23%
Constanța	1098	7024	7713	28.00	0.36%
Brașov	1033	6251	6457	19.02	0.29%
Iași	1082	5721	6190	17.59	0.28%
Craiova	1045	5864	6128	19.21	0.31%
Oradea	911	4331	3945	24.29	0.62%
Ploiești	874	4445	3885	14.98	0.39%
Galați	848	4551	3859	16.14	0.42%
Arad	833	4097	3412	19.52	0.57%
Sibiu	963	3541	3410	14.42	0.42%
Pitești	964	3161	3047	10.72	0.35%
Târgu Mureș	959	2898	2779	9.96	0.36%
Bacău	775	2960	2294	11.74	0.51%
Brăila	717	3040	2180	12.14	0.56%
Baia Mare	761	2624	1997	7.30	0.37%
Buzău	842	2334	1965	6.54	0.33%
Satu Mare	603	2710	1634	11.42	0.70%
Râmnicu Vâlcea	733	2091	1533	10.03	0.65%
Suceava	797	1909	1522	8.35	0.55%
Piatra Neamț	708	2140	1515	8.05	0.53%
Botoșani	765	1908	1459	5.63	0.39%
Alba Iulia	860	1695	1458	6.31	0.43%
Târgu Jiu	880	1634	1438	5.71	0.40%
Slatina	778	1675	1303	4.77	0.37%
Bistrița	694	1803	1252	5.67	0.45%
Tulcea	903	1314	1187	5.74	0.48%
Focșani	694	1668	1158	7.24	0.63%
Târgoviște	644	1649	1062	5.68	0.53%
Drobeta-Turnu Severin	627	1645	1032	7.51	0.73%
Călărași	564	1171	660	4.23	0.64%
Giurgiu	562	1124	632	3.39	0.54%

Source: Budget implementation reports for municipalities COFOG 3 (collected taxes), INS (total usable area), Profit.ro based on data from ANEVAR (average prices for properties). Information regarding the average cost of apartments in various Romanian municipalities applies to the 3rd trimester of 2018, published by Profit.ro, as reported by ANEVAR. See <https://www.profit.ro/povesti-cu-profit/real-estate-construcții/harta-interactivă-prețul-apartamentelor-cumprate-prin-credit-a-crescut-cu-7-6-ca-medie-nationala-cele-mai-mari-scupșiri-au-fost-in-arad-intr-un-singur-oras-au-fost-ieftiniri-18753345>

decisions being left to the discretion of local authorities entirely.

The consequence of this type of taxation system on buildings is a **large variation in real taxation from one locality to another, while there is a very weak correlation with the value of the properties**. We illustrate this aspect by comparing the tax on buildings payable by natural persons with the average monthly rental costs of the properties, which serves as an indicator of propriety value⁸. Thus, in 2018, the inhabitants of Arad and Oradea paid an average

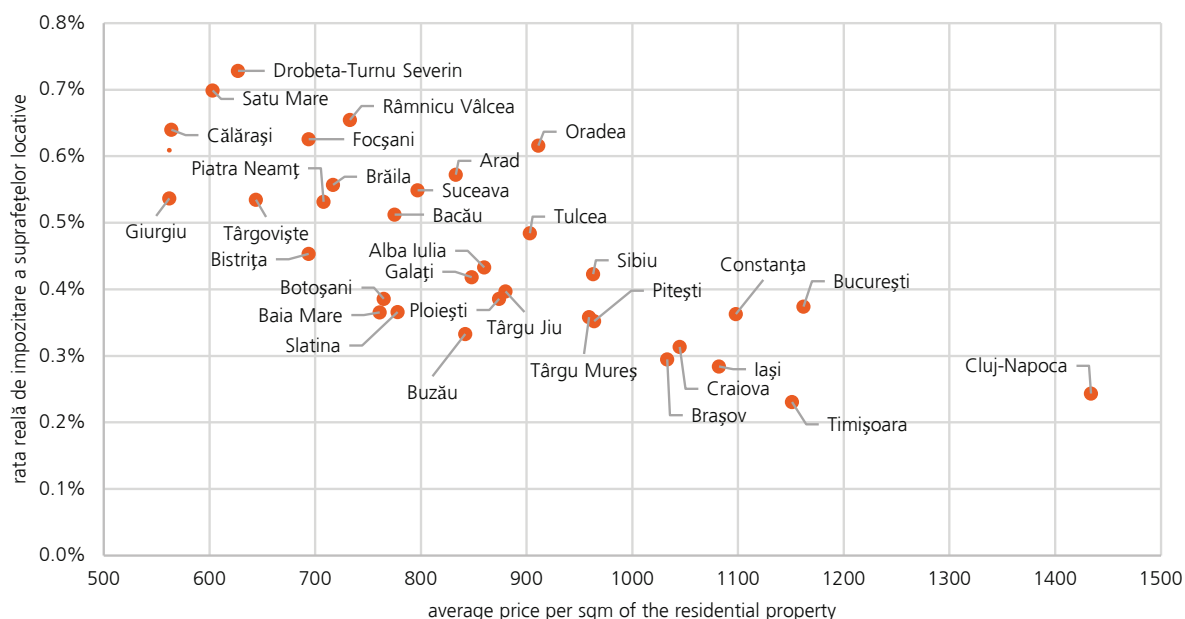
of RON 110 per capita in the form of building tax, while the monthly rent for a two-room apartment in these cities amounted to € 200. However, in Iasi and Timisoara, for example, where the rent for similar-sized units was €200 per month, the building tax paid by natural persons in 2018 was RON 46.8 and, respectively, RON 61.4 per capita. Taxes paid by the inhabitants of Bucharest and Cluj, where rental prices are the highest (€ 358 and € 398 per month in 2018, respectively), were in the realm of RON 83 per person in 2018, below the level of taxes imposed on inhabitants of Râmnicu Vâlcea or Satu Mare, who paid RON 85 and RON 95 in taxes, respectively, even though rental costs in these localities are two times lower than in Cluj or Bucharest (see Figure 4).

Inequalities become even more visible when we take into account the actual value of properties and the volume of

⁸ There is a direct correlation between the value of the properties and monthly rental costs. For the purpose of this paper, we mainly considered rental prices, as these are usually available for a larger number of localities. See the 2018 reports from Piata Imobiliară Rezidențială, <https://www.analizeimobiliare.ro>.

Figure 5

Real tax rate of usable areas as a % of their market value, compared to the average price of the property on the residential market, 2018



Source: Budget implementation reports for municipalities COFOG 3, Profit.ro based on data from ANEVAR

taxes collected in the main municipalities of Romania. On account of the large differences in property value between towns, real taxation is designed regressively: in the case of localities such as Călărași, Satu Mare, Drobeta Turnu Severin or Focșani, where in 2018 the average price for apartments was below € 700 per square meter, the real taxation rate for residential areas was over 0.6%, while in the four largest municipalities, where real estate prices exceeded € 1100 / m² in 2018, the real tax rate was below 0.4%. Surprisingly, the lowest levels were registered in Timisoara and Cluj-Napoca, at 0.24% and 0.23%, respectively (see Table 2). This does not mean that only the extremes of the taxation spectrum confirm the regressive nature of property taxation (at least for residential rental properties), as an inverse correlation also applies on a relatively regular basis for all municipalities (Figure 5).

... WHICH CAN BE ADJUSTED THROUGH A TAX REFORM BASED ON MORE EFFICIENT TAXATION OF LARGE FORTUNES

It is clear that the inequities reported above could mainly be ascribed to the rigidity of the calculation system used to determine the taxable value of buildings owned by natural persons, following a general tendency to push the tax burden downwards so as to limit high fiscal pressure on subsets of the population facing economic hardship⁹. One consequence of this policy is poor property taxation in general and tax revenue losses, especially for large towns. Indeed, property taxation in Romania is among the lowest in the European Union. According to data shown in the report “Taxation Trends in the European Union”, Romania ranks 6th from the bottom in the EU in terms of property taxation as a percentage of GDP (0.5% recurring property taxes and 0.1% other property taxes) and 7th from the bottom in terms of property tax revenues as a percentage of total taxation (2% recurring property taxes and 0.4% other property taxes). Only Estonia, Lithuania, Slovakia, the Czech Republic and Slovenia levy lower property taxes than Romania (Figure 6).

In addition to the recurrent taxation of buildings, another form of property taxation is taxation of transfers - yet in this respect Romania ranks much lower, collecting only 0.2% of the value of transferred properties¹⁰, which does little to compensate for the small volume of recurrent taxes.

Moreover, the comparison with the other European states confirms the fact that property taxation in Romania is in line with a more general trend of “fiscal poverty”. In the case of more than half of Romanian municipalities, taxation of buildings (owned by both natural and legal persons) accounts for less than 10% of municipal budgets. Although local authorities have some latitude in setting tax rates and zoning localities, this is scarcely a mechanism that could compensate for the structural deficiency of the system - the regressive

nature of building taxes payable by natural persons that favours the owners of expensive properties, allowing them to pay lower tax rates than the actual value of the property would warrant compared to owners of lower-value property.

WHAT NEEDS TO BE DONE?

There are a variety of methods available that could increase property tax revenues, most of them well-aligned to a policy fairly reflecting “market value”: the mandatory periodic valuation of properties carried out by the owner or by a certified appraiser¹¹, the use of statistical databases for real-estate transactions in order to determine taxable values¹², taxation based on “imputed rent” (theoretical estimate of the rent that a homeowner would pay to live in his own house) or, more recently, fully automated mass valuation systems supported by digital cadastre¹³ information¹⁴. Research conducted by the World Bank in Poland has shown that there are four necessary conditions for the introduction of a system of recurrent taxation based on the market value of properties: (1) full registration of properties, (2) reliable data sources on real-estate transaction costs, (3) a valuation infrastructure that meets international standards and (4) an efficient tax collection system¹⁵. In recent years, Romania has taken important steps to meet the first three conditions on the list above and reformation of the property tax system is not an unfeasible goal.

Nevertheless, modifying the system at work solely by adopting a mechanism that focuses on the “market value” of properties involves significant risks in Romania. Considering that a large part of the population have low incomes and are struggling to

⁹ Sorin Ioniță drew a similar conclusion in 2011: „for reasons of social affordability, the overall level of taxes tends to be aligned downwards, so as to enable the not so well-off to pay their taxes (and they do: the conformity rate in paying property tax is the highest among all direct taxes in Romania)”. See Sorin Ioniță, *Impozit pe case la valoarea de piață*, SAR Policy Brief, op. cit.

¹⁰ According to UHY International, Romania ranks lowest among the countries of the European Union, behind Ireland (1%), Italy (1.7%), Netherlands (2%), Poland (2%), Denmark (2.1%), Great Britain (3.5%), Germany (5%), Croatia (5%), France (5.1%), Spain (8%) and Belgium (11.3%). See <https://www.uhy.com/european-economies-levy-some-of-the-worlds-highest-property-purchase-taxes-on-prime-real-estate-uhys-global-study-reveals/>.

¹¹ Both options are available in Great Britain, see <https://www.gov.uk/guidance/annual-tax-on-enveloped-dwellings-pre-return-banding-checks#revalue>.

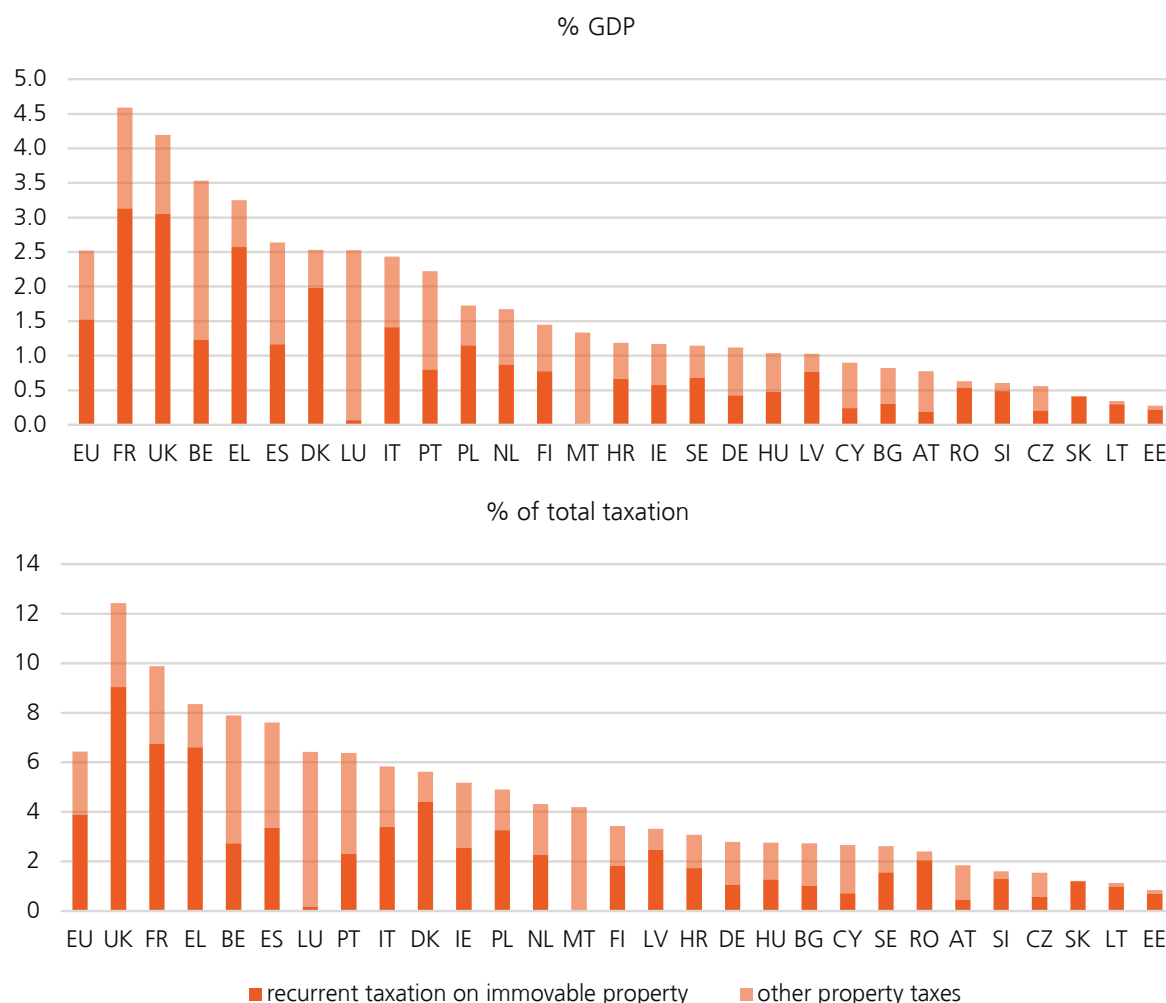
¹² This method is applied in Norway, see <https://www.skatteetaten.no/en/rates/tax-value-of-housing/>.

¹³ This method was applied in Denmark, Luxembourg and Netherlands. See „Housing taxation: a new database for Europe”, *JRC Working Papers on Taxation and Structural Reforms*, No. 08/2019

¹⁴ See the case of Lithuania: <https://www.registrucentras.lt/bylos/dokumentai/conferency/Mass%20Valuation%20System%20in%20Lithuania.pdf>.

¹⁵ See Richard Grover, *Property Valuation and Taxation for Fiscal Sustainability – Lessons for Poland*, Oxford Brookes University March 2019, https://www.researchgate.net/publication/332455664_Property_Valuation_and_Taxation_for_Fiscal_Sustainability_-_Lessons_for_Poland

Figure 6
Property taxes in the EU as a % of GDP and as a % of total taxation



Source: Taxation Trends in the European Union, Taxation and Customs Union

achieve a decent standard of living¹⁶ and that property prices have plummeted in recent years, the rigorous alignment of taxes to “market prices” could result in an excessive tax burden for an important part of the urban population. We must not forget that almost 96% of the Romanian population lives in owner-occupied dwellings (well above the European average of 69%)¹⁷, and that houses, a large portion of which were purchased decades ago, represent the only important property of families, but are scarcely a reflection of their level of wealth. Therefore, a mechanism relying strictly on “market prices” would lead to a substantial increase in taxes for families that have a low standard of living, it would penalise homeowners in the event of housing bubbles and it would also lead to a massive gentrification of large city centres.

Within this context, the reform of the property taxation system in Romania could build on solutions that take into account the national specificity, the distribution of properties and income (not only the wealth) of the population. Thus, a

reform of the property taxation system could include several solutions that **are part of a general logic of progressive taxation of large fortunes**:

- progressive taxation of multiple properties;
- progressive taxation of large and very large properties, with the possible introduction of threshold values;
- heavier and more efficient taxation of property transfers;
- greater and more efficient taxation and regulation of the rental market;
- more efficient taxation of properties for commercial purposes;
- a legal framework to ensure a greater homogenisation of property taxation systems between localities;
- ultimately, an automated calculating and indexing system for the “market value” of properties could also be considered in order to protect older homeowners from large price fluctuations in the real estate market.

¹⁶ See Stefan Guga, Adina Mihăilescu, Marcel Spatari, *Cosul minim de consum lunar pentru un trai decent pentru populația României*, Friedrich Ebert Stiftung, Septembrie 2018..

¹⁷ Source: Eurostat, ilc_lvho02.

LIST OF FIGURES AND TABLES

- 3 Figure 1
General state revenue, as a % of GDP
- 4 Figure 2
General state revenue as a % of GDP, evolution 2008-2019
- 5 Table 1
Property taxes collected in 103 municipalities in Romania,
in million RON and % of total revenues
- 6 Figure 3
The share accounted for by building taxes for natural and legal
persons in the budget of municipalities, 2019
- 7 Figure 4
Building taxes for natural persons in lei/year per capita in 2018,
compared to average monthly rent (for a 2-room apartment,
Comfort-1, built during 1980-2000) in euros/month, average of
the trimesters 1-4 2018
- 8 Table 2
Calculation of the real tax rate of usable areas as a % of their
market value, compared with the average price of properties
in the residential market, 2018
- 9 Figure 5
Real tax rate of usable areas as a % of their market value,
compared to the average price of the property
on the residential market, 2018
- 11 Figure 6
Property taxes in the EU as a % of GDP and as a % of total taxation

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The case of property tax



For all 103 municipalities of Romania, property taxes accounted for only 12.8% of total local budget revenues in 2019 (table 1), of which 9.7% came from taxes and fees on buildings, 1.9% from land-related taxes and fees and 1.2% from taxes on transport vehicles. One of the features of the current taxation system is the large variation of the real taxation between municipalities. As a result, in practice the property taxation system has a regressive nature.



The inequities could mainly be ascribed to the rigidity of the calculation system used to determine the taxable value of buildings owned by natural persons, following a general tendency to push the tax burden downwards so as to limit high fiscal pressure on subsets of the population facing economic hardship. The consequence of this policy is poor property taxation in general, among the lowest in the European Union. Romania ranks 6th from the bottom in the EU in terms of property taxation as a percentage of GDP.



Considering that a large part of the population have low incomes and are struggling to achieve a decent standard of living and that property prices have plummeted in recent years, the rigorous alignment of taxes to “market prices” could result in an excessive tax burden for an important part of the urban population. In this situation, the solutions should be based on a more efficient taxation of large fortunes, multiple properties, transfers of property and the rental market.

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