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**CENTRE FOR TAX POLICY AND ADMINISTRATION
ECONOMICS DEPARTMENT
PUBLIC GOVERNANCE AND TERRITORIAL DEVELOPMENT DIRECTORATE
OECD NETWORK ON FISCAL RELATIONS ACROSS LEVELS OF GOVERNMENT**

A EUROPEAN DEFINITION OF SHARED TAXES

(Council of Europe)

The attached note is submitted to Delegates of the Statistical Working Group FOR DISCUSSION at their meeting to be held on 12-13th January 2006.

A European definition of shared taxes

On 19 January 2005, the Council of Europe's Committee of Ministers unanimously adopted Recommendation Rec(2005)1 to member states on the financial resources of local and regional authorities. This legal instrument is appended to this note.

The Committee of Ministers is composed of the Ministers of Foreign affairs of the 46 member states of the Council of Europe. The draft of this recommendation was prepared by the Steering Committee on Local and Regional Democracy (CDLR), an intergovernmental body composed of representatives of the ministries in charge of local government in the 46 member states.

This Recommendation includes a number of definitions (see page 5).

The first fundamental distinction which is made is that between own resources (when the local authority has the capacity to modify their level) and transferred resources (when the level of such resources is set by another authority).

The Recommendation also makes a distinction between proportional resources (which depend directly on the amounts collected locally) and non-proportional ones and establishes that grants are non-proportional financial transfers.

In conclusion, according to the definitions adopted by the Council of Europe and included in its Recommendation Rec(2005)1, tax sharing arrangements may lead to:

- either surcharges, i.e. own fiscal non exclusive resources, (fiscal resources whose rates can be varied by the local authorities but are levied on a the same base as the one used for the tax levied by another authority);
- or the type of shared taxes discussed in COM/CTPA/ECO/GOV/(2006)1, in which central government retains the control over the tax rate and tax base; according to Recommendation Rec(2005)1, these non exclusive fiscal resources are financial transfers; if they are not in direct relation to the amounts collected locally, they are also considered as grants.

APPENDIX

COUNCIL OF EUROPE
COMMITTEE OF MINISTERS

**Recommendation Rec(2005)1
of the Committee of Ministers to member states
on the financial resources of local and regional authorities**

*(Adopted by the Committee of Ministers on 19 January 2005
at the 912th meeting of the Ministers' Deputies)*

The Committee of Ministers, under Article 15.b of the Statute of the Council of Europe,

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles which are their common heritage and facilitating their economic and social progress, and that this aim may be pursued, *inter alia*, by common action in economic, social, legal and administrative matters;

Considering that local self-government implies a degree of financial autonomy;

Considering the provisions of Article 9 of the European Charter of Local Self-Government, which it adopted as an international treaty on 15 October 1985 and which has now been ratified by a large majority of member states of the Council of Europe;

Having regard to the Resolution on local government finance adopted at the Conference of European Ministers responsible for Local Government in Lisbon in 1996;

Having regard to Recommendation Rec(2004)1 of the Committee of Ministers on financial and budgetary management at local and regional levels;

Having regard to the following reports of the Steering Committee on Local and Regional Democracy (CDLR):

- Local finance in Europe (1997);
- Limitations of local taxation, financial equalisation and methods for calculating general grants (1998);
- Effects on the financial autonomy of local and regional authorities resulting from the limits on national public debt set at European level (2000);
- Methods for estimating local authorities' spending needs and methods for estimating revenue (2001);
- Risks arising from local authorities' financial obligations (2002);
- Recovery of local and regional authorities in financial difficulty (2002);
- Budgetary procedures and budget management at local authority level (2002);

Having regard to Recommendation 79 (2000) of the Congress of Local and Regional Authorities of the Council of Europe, adopted in connection with the monitoring of the implementation of the European

Charter of Local Self-Government and concerning the financial resources of local authorities in relation to their responsibilities;

Considering that local taxation, state grants and financial equalisation mechanisms should be adapted to the needs of local communities so that their authorities can operate as effectively as possible, with due regard for the rules and codes of conduct applicable at national level;

Considering that the solutions to local authorities' financial problems should be adapted to the specific features of each state, as resulting, *inter alia*, from its structure, territorial organisation, distribution of powers between the different tiers of government and traditions;

Considering that this Recommendation, which was specifically developed for local authorities, may also apply, *mutatis mutandis*, to self-governing regional authorities and recalling in this respect the Helsinki Final Declaration on regional self-government adopted by the Conference of European Ministers responsible for Local and Regional Government in 2002;

Considering that the changes that have taken place since its adoption justify replacing Recommendation Rec(2000)14 of the Committee of Ministers to member states on local taxation, financial equalisation and grants to local authorities by this Recommendation,

Recommends that the governments of member states:

1. ensure a fair distribution of public financial resources between the different tiers of government, taking account of the responsibilities assigned to each of these tiers and changes in those responsibilities, as well as economic circumstances;
2. guarantee local authorities a system of financing their expenditure that is based on the following principles:
 - local authorities' resources and their allocation must be consistent with the requirement that they discharge their responsibilities effectively;
 - local authorities are entitled, within the framework of national economic policy, to raise adequate resources of their own;
 - a substantial proportion of transfers, and, generally, of their own resources, must not be earmarked for specific purposes;
 - the amount of state grants must be fair, transparent and foreseeable; fairness demands that allocation rules be universal, non-discriminatory, stable, and neither arbitrary nor negotiable on an ad hoc basis;
 - the financial equalisation system should allow local authorities to provide their citizens, if they so wish, with broadly comparable levels of services in return for comparable levels of taxation and charges; this system should take account both of disparities in the financial capacity of local authorities and disparities in their spending needs;
 - where the demands of national economic policy so require, measures should be taken to ensure that the system of financing local authorities is consistent, overall, with those demands; such measures should:
 - a. not be disproportionate to the demands in question;
 - b. should be negotiated with these authorities or their representatives; and
 - c. should be introduced by law;
 - specific limitations which apply to a limited number of local authorities should be lifted as soon as the situation permits.

3. review – if necessary – the legal and administrative framework for local taxation and grants to local authorities so as to encourage the improvement of services and their efficient provision, and the legal and administrative framework for financial equalisation, so as to ensure fairness and solidarity between authorities, with due regard in particular for the guidelines appended to this Recommendation;
4. involve local councillors in the debate on reforms needed in this area, particularly those undertaken pursuant to this Recommendation, and on arrangements for implementing such reforms;
5. translate this Recommendation into their official language(s) and circulate it to local authorities and associations of such authorities, inviting them to take note of the guidelines addressed to them, as set out in

Part II of the Appendix.

Appendix to Recommendation Rec(2005)1

Part I – Guidelines for central authorities

These guidelines are addressed to central authorities, in so far as they are responsible for defining the legal framework and supervising the activities of local authorities. In certain federal states, these responsibilities rest with the federated entities. In such cases, these guidelines are addressed to them. Central authorities are invited to bring the guidelines to their attention.

1. Definitions

Within the meaning of this Recommendation:

a. From the point of view of the authority's capacity to alter their level, resources may be classified as either own or transferred resources.

An authority's "own resources" are resources of which it can vary the level, possibly within a predetermined range. These resources may, for example, be fiscal or non-fiscal, exclusive or shared, etc.

An authority's "transferred resources" are resources whose level the authority may not vary. They may be, for example, fiscal or non-fiscal, exclusive or additional, proportional or non-proportional (grants), etc.

b. From the point of view of the authority's capacity to use their proceeds freely, resources may be classified as either earmarked or non-earmarked.

A local authority's "earmarked resources" are resources which must be used for a purpose (goods, property, a service, a programme) decided on by an authority other than the authority in question.

"Non-earmarked resources" are resources which may be used freely, with due regard for the legislation concerning the use of public funds, by the local authority.

c. From the point of view of the relation between the sum that constitutes revenue of the local authority and the total sum levied locally, resources may be proportional or non-proportional.

An authority's "proportional resources" are resources that depend directly on the amount raised locally. They may be, for example, fiscal or non-fiscal, exclusive or non-exclusive (shared), etc. Own resources are normally proportional.

"Grants" are non proportional financial transfers.

d. From the point of view of the number of authorities which share their proceeds, resources may be exclusive or shared.

An authority's "exclusive resources" are the resources whose proceeds, as a whole, constitute the revenue of the authority in question. They may, for example, be financial or non-financial, own resources or financial transfers, etc.

An authority's "shared resources" are resources that are raised by the authority in addition to resources raised by another authority on the same basis.

e. Other definitions

"Additional resources" are shared own resources.

"Surcharges" are fiscal additional resources.

"General grants" are non-earmarked, non-proportional financial transfers.

"Specific grants" are earmarked non-proportional financial transfers.

The "financial capacity" is the maximum revenue an authority can raise in standard conditions which are set at the national level. As a rule, financial capacity largely depends on the tax (fiscal) capacity. There are, however, authorities that can raise very substantial non-fiscal resources (revenue from property, in particular land and buildings, economic activities or financial investments); their financial capacity takes account of this.

An authority's "tax (fiscal) capacity" is its ability to raise taxes in standard conditions which are set at the national level. Tax capacity is therefore proportional to the tax base, and differences in tax base lead to differences in tax capacity.

An authority's "spending need" is the amount theoretically necessary for the authority to produce or provide goods or services or a predetermined set of goods and services at standard level. The differences between authorities' spending needs stem either from differences in the unit costs of the goods and services produced or provided by the authorities in order to meet the quantity and quality minima imposed on them, or from the number of services needed (economies of scale) to attain these minima, or from differences in the number of residents entitled to the services.

"Delegated tasks" are competencies for which the ultimate responsibility falls on a higher level authority but the implementation of which has been transferred to a local authority.

"Exceptional revenue" is revenue which does not occur on a regular basis.

"Fiscal pressure" is the ratio between the total compulsory contributions and the added value (for companies) or income (for families) on the considered territory.

2. General principles

1. States are invited to take note of and put into practice the fundamental principles to be observed in respect of local and (*mutatis mutandis*) regional authorities' financial resources, as set out in Article 9 of the European Charter of Local Self-Government.

2. The main objectives in developing intergovernmental financial relations should be to the following:

- to secure revenue for each tier of government according to the assignment of their responsibilities and standard financial needs (vertical fiscal balance);
- to achieve an equitable distribution among local authorities (horizontal fiscal balance);
- to enhance the efficiency of the public sector.

3. Local authorities should, within the framework of the national economic policy, be entitled to their own resources, which should be adequate, and of which they may freely dispose, in the exercise of their powers and responsibilities, within the limits of the law (financial autonomy).
4. Taxes (right to levy, proceeds and capacity to set the rate, if necessary inside a pre-established bracket) should be assigned to local authorities unless these taxes would exhibit significant horizontal spillovers, entail an inequitable pattern of revenue among local authorities, or discrimination or distortions among authorities, which warrants these taxes being administered at higher levels of government (subsidiarity principle). Where taxes are assigned to local authorities, they should also be given some power to intervene in their administration in order to improve their efficiency and to appropriate their proceeds (fiscal autonomy). Fiscal autonomy includes some tax policy discretion on behalf of local authorities, especially in the setting of tax rates.
5. To the greatest extent possible, each local authority should finance, from its own resources, the expenditure it decides on (fiscal equivalence at the local authority level).
6. Fiscal equivalence at individual level requires local authorities to charge, within a common regulatory framework, for local public services, and to tax citizens and local businesses in accordance with their use of local infrastructure (tax-benefit principle).
7. Local authorities should balance the financing of public services through taxation and charges, according to the public-private benefit they provide. When an authority deems it necessary to help a category of citizens to have access to a public service, it should not subsidise the service, but grant financial help to the users in question, in a targeted and, as far as possible, personalised way.
8. For regulatory purposes of local interest, local authorities should be able to levy fees, fines and emoluments and to grant permits and user rights to local businesses.
9. Where taxes are shared with local tiers of government, the local share should be commensurate with the local tax effort in order to encourage local officials to strengthen and develop the local tax base (derivation or origin principle).
10. Where there are large inter-jurisdictional disparities between local financial capacity and spending needs, central authorities should ensure the compensation of the financially weaker local authorities. These transfers should be unconditional and secure financing of a reasonable standard level of public service provision for all local authorities.
11. For local services of national interest (vertical spillovers) or for which some degree of national harmonisation is desirable, central authorities should guide local authorities through standard setting, and support these programmes through specific grants or service-related elements calculated for the general grants.
12. Where local authorities act as agents of a higher administrative level, the principal government must share the costs of these programmes (connectivity principle). Full funding is appropriate where the mandating government can control the administration of the programme; where this is not true, local authorities could be required to share some costs in order to contain their volume and to support the targeting and the effective administration of the programme.

3. Local taxation guidelines

a. Fiscal decentralisation

13. Financial autonomy of local authorities implies that local authorities have sufficient own resources to fund a significant proportion of the costs incurred in the discharge of their responsibilities, as defined in the Constitution or by law. This proportion should be sufficiently large to allow for and encourage substantial room for manoeuvre and accountability on the part of local authorities when they determine the expenditure to be incurred in the discharge of these responsibilities.

14. Shared resources of local authorities should primarily consist of non-earmarked additional resources and/or non-earmarked shared proportional resources decided by a permanent law.

15. A degree of tax decentralisation is therefore required. The following parameters may be used to determine this degree:

- the ratio of local authorities' tax revenues to total state tax revenues;
- the ratio of local tax revenues to total local resources;
- the ratio of tax revenues to the grants from the state and other public authorities;
- the ratio of local authorities' own tax revenues to the country's gross domestic product;
- the ratio of the maximum resources to the minimum resources that the authorities can raise by varying local taxation rates within the statutorily permitted range.

16. When the degree of fiscal decentralisation is considered low on the basis of the above parameters, the central authorities should consider, in conjunction with the local authorities, means of increasing the proportion of local authorities' own tax revenues and tax revenues transferred under a permanent law, without necessarily increasing overall tax pressure.

17. Local authorities should be able to establish the level of their (exclusive or additional) taxation, if appropriate within predetermined limits, so that they can vary the quantity and quality of their services according to local needs and preferences and so that elected representatives are more accountable.

18. When they can decide on the level of their revenues derived from taxes established at national level, local authorities should, in general, be able to vary the rate rather than the tax base. The rates fixed should reflect a local political choice, whereas the tax base should be assessed objectively and uniformly based on the law.

19. Local authorities' freedom in tax matters should be restricted only for reasons relating to fairness or national economic policy constraints.

20. Limitations on the financial autonomy of local authorities should not be disproportionate to the objectives pursued, and should be discussed with local authorities or associations of such authorities, provided for by law and lifted as soon as possible.

21. In general, when higher authorities take decisions that reduce the local authorities' tax base, compensation should be provided.

22. In order to send out a clear message to the public and ensure that local authorities are accountable, local taxation rates should vary essentially in accordance with their respective communities' choices as

regards level of services. For this reason, differences in financial capacity, and in particular in the local tax base and spending needs, should be subject to an equalisation system.

23. Minimum conditions regarding the openness of decisions concerning local taxation should be laid down by law, both for central authorities (publication of information on which decisions are based, national debates, consultation of local authorities or their associations) and for local authorities (public meetings, public votes or votes by roll call, publication of key documents before meetings at which decisions are taken, etc.).

b. *Structure of local taxation*

24. The tax revenues of a local authority should come from resident individuals or property or businesses on the territory of the local authority in question.¹

25. The structure of local taxation should be such as to ensure a fair, open breakdown of the burden of local taxation according to the taxpayers' ability to pay.

26. The structure of local taxation should be such as to ensure that the overall tax burden and its relation to the level of services provided for the individuals and businesses that bear it is clearly visible (as this is a prerequisite for the efficient allocation of resources according to local preferences).

27. Local authorities should be able to vary the rates of taxes that account for a substantial proportion of their revenues, so as to prevent slightly different levels of services from being matched by large differences in local taxation rates.

28. Local taxes should have a sufficiently high yield and low administrative and inspection costs.

29. Local taxation should be reasonably stable so as to make for continuity and foreseeability in public services, and have a certain degree of flexibility, so that tax revenue can be adjusted to changing budget costs.

30. Local taxes should be neutral and create little negative economic distortion (minimum impact on growth and the economic structure of the municipality), demographic distortion (so as not to prompt people to migrate) and social distortion (so as not to cause further problems for social groups in difficulty).

31. The central authorities should be able to help local authorities draw up local tax regulations. The establishment of a single database (or a single access point) for all local taxation can make for greater openness.

32. Care should be taken to avoid: unduly large or unduly rapid changes in the tax base or taxation rate introduced by the higher authority; the risk of incentives that are contrary to local interests; measures that undermine the incentive to collect the tax intended for local authorities and carry out the inspections necessary to this end; unduly long delays in paying the sums collected; and a lack of information about the amount collected.

¹ The CDLR studies show that local and regional authorities have greater financial autonomy in countries where they receive a share of revenues from income tax and all revenues raised in tax on land and buildings.

c. Tax collection and litigation

33. Consideration should be given to the possibility of the central authority's registering and collecting the taxes. The main advantage of such a system is that the regulations are drawn up by the central authority, registration costs are reduced and collection and litigation costs are lower, because there are economies of scale, and are borne by the higher authority.

34. If the taxes are collected by the local authorities, the central authority should provide them with logistic support (training, access to information, integrated, interoperable software, etc.) and set up special databases at national level.

35. When the tax is collected by a higher authority before being transferred to the local authorities, it is important that the sums concerned should be transferred within a reasonable time set by the law. A system permitting regular payments is of key importance to the municipality's cash management. The local authorities should be provided with transparent information about the calendar of transfers and the amounts paid.

36. It is desirable to have a single litigation procedure for local taxes, established at national level (or regional level in federal states). Failing that, it is recommended that the various procedures have as much in common as possible.

4. Financial equalisation guidelines

a. Equalisation systems

37. The purpose of financial equalisation should be to allow local authorities to provide their citizens, if they so wish, with services of generally similar levels for similar taxation levels.

38. When designing their equalisation systems, central authorities should take account of the fact that the differences in the tax burden that authorities have to impose on their residents to achieve the same level of services are generally the result of differences in their financial capacity, their spending needs or their managerial efficiency.

39. The equalisation system should compensate, at least in part, for differences in authorities' financial capacity (so as to provide more resources to financial weaker authorities) and spending needs (so as to provide more resources for authorities that either have additional responsibilities or, by virtue of their geographical location, demographic situation or other factors, are obliged to spend more in order to discharge their responsibilities). It should not compensate for differences in managerial efficiency or differences in cost stemming from the adaptation of service levels to local preferences.

40. A substantial degree of financial equalisation is a prerequisite for the success of fiscal decentralisation and sound local self-government. At the same time, financial equalisation is a prerequisite for the success of policies geared to economic stability and balanced, sustainable regional development. The decision concerning the desirable degree of equalisation is an eminently political one. There is no optimum level of equalisation at European level. It is important, however, that, once the decision has been taken, an efficient equalisation system is set up to implement it.

41. Local authorities should be provided with appropriate information about the way in which equalisation systems work, for they cannot accept a system with which they are unfamiliar or which they do not understand.

42. Equalisation may be achieved by means of grants from a higher authority (vertical equalisation) or the redistribution of local tax revenues, particularly if they are collected by central government departments (horizontal equalisation) or a combination of both. Vertical equalisation generally lessens the risk of resentment among local authorities. Horizontal equalisation (provided for by law, in accordance with the principle of solidarity between authorities of the same level) has the advantage of strengthening inter-municipal solidarity and giving local authorities greater independence from the central authority; it should be envisaged, in particular, in cases where local taxation capacity varies too much for it to be possible to achieve the desired level of equalisation solely by means of financial transfers from the state. The extent to which local authorities with above average per capita revenues are expected to contribute to horizontal redistribution should not be so great, however, as to discourage them from the exploitation and development of their revenue base. The volume of resources contributed by the national budget to vertical equalisation should reflect the priority of the services for which local authorities are responsible within the overall framework of public expenditure; their stability should be guaranteed by a permanent law and some form of indexation to the growth of aggregate national budget revenues is highly desirable.

43. The desired degree of equalisation of disparities in spending needs and in financial capacity should be clearly and foreseeably specified.

44. Equalisation systems should specify openly and foreseeably which local parties are eligible for financial transfers to equalise financial capacity and spending needs. Eligibility criteria should be laid down by law.

45. Although equalisation systems normally operate at national level, it may be worth encouraging systems for pooling certain local taxes or redistributing certain local taxes among local authorities that make up an urban area and, in particular, between municipalities that constitute the industrial and commercial heart of the urban area and those which are residential areas. A local equalisation system of this kind makes it possible to compensate, at least in part, for externalities and may be set up by means of an agreement among the municipalities concerned. In some cases, if it is impossible to reach such an agreement, it may be necessary to legislate.

46. In all cases, the mechanisms adopted to equalise among jurisdictions should be based on standardised (not actual) levels of revenues and expenditures. The standardisation of costs and revenues acts as a safeguard against implicit financial bail-outs that would otherwise eliminate the local authorities' (and their officials') accountability and result in wasted public resources. It also avoids moral hazard by local authorities because it precludes the manipulation of distribution criteria by recipient governments.

47. Central authorities should regularly check how their equalisation systems are working and consider, with local authorities, improvements that can be made in order to ensure that the adverse effects of an unequal distribution of resources and spending needs are effectively remedied.

b. Equalisation of spending needs

48. The equalisation of (standardised) specific spending needs should be effected through grants based on appropriate and objective criteria. Even when these grants are programme-specific, they should allow some limited discretion as to their use within programmes, and should avoid onerous monitoring and reporting.

49. Spending needs should be estimated primarily on the basis of criteria which:

- are objective and which local authorities do not directly control;
- are unlikely to affect local authorities' freedom of choice, within the limits of the budgets available;

- do not penalise local authorities that endeavour to streamline the management of their services to make them more efficient, either by lowering unit costs or by trying, by means of co-operation arrangements or mergers, to increase the number of users and units produced in order to obtain economies of scale, and which do not involuntarily provide incentives to indulge in behaviour that is contrary to the objectives of local accountability and efficiency in the provision of public services;
- take account, as far as possible, of demographic, geographical, social and economic features leading to disparities in costs.

50. The calculation formulae used to estimate spending needs should fulfil the following conditions:

- the weight afforded to the various individual indicators should be determined on the basis of objective information about the impact of variations in those indicators on the actual cost of local services;
- insofar as the assessment of needs nevertheless entails value judgments as to the weight to be afforded to the various indicators, it is necessary to identify and assess the results of these judgments in conjunction with representatives of the local authorities concerned or their associations;
- formulae for evaluating needs (models) should be as simple as possible, so that they are easy to understand and make for openness and accountability, but comprehensive and detailed enough to be reliable;
- formulae for evaluating needs should remain as stable as possible, to allow local authorities to make long-term forecasts and so that changes in estimated needs reflect genuine changes in the situation of local authorities over which they have no control.

51. The equalisation of spending needs should take account of as many local authority activities as possible, and in particular those that are very important or compulsory. A different formula should be drawn up for each spending need in respect of which equalisation is to apply.

c. *Equalisation of financial capacity*

52. The equalisation of (standardised) financial capacity should aim at reinforcing a deficient revenue base of a local government measured against a national yardstick (benchmark); such transfers should be unconditional general grants at the discretion of local authorities.

53. The estimate of the financial capacity of local authorities should preferably include all sources of revenue. The aim should be to gauge overall financial capacity.

54. Care should be taken to ensure that the equalisation of financial capacity does not undermine local self-government by, in practice, inducing authorities to provide the same level of services or apply the same taxation rates.

55. Equalisation of financial capacity should not deter local authorities from improving the tax base and ensuring efficient tax collection. The measurement of financial capacity for equalisation purposes should be based on the assumption that all local authorities levy taxes at the same rates and are equally efficient in assessing and collecting taxes, so that authorities are not penalised for the efforts they make or rewarded for laxity. This assumption should be used solely to calculate equalisation funds and should not undermine the authorities' right to vary the actual rates of the taxes levied. Local authority decisions should not directly affect the amount of equalisation funds received or paid.

56. In contrast to the equalisation of spending needs, where there is more than one local tax, equalisation should not take place for each tax: a representative fiscal system should be devised that reflects the total local tax-raising potential. A resource equalisation fund should be set up and the money allocated according to discrepancies between the various authorities' tax capacity and the average tax capacity.

57. Actual fiscal pressure should not be used as indicator of the financial capacity.

5. Grants to local authorities

58. Grants are provided by the central authorities for various reasons and may take various forms. In general, they should be provided for by law or decided on in the light of clear criteria laid down by law. The government's discretion in calculating and effecting transfers should be reduced in order to avoid objectivity and credibility problems.

a. General grants

59. The higher authorities' contribution to local budgets should mainly take the form of general grants.

60. The sum total of such grants should:

- cover the standardised cost of discharging delegated tasks and the structural shortfall in local authorities' resources in relation to their statutory responsibilities;
- take account of such factors as demographic changes and economic circumstances such as economic growth and rising costs, particularly when the level of local authorities' own resources and their ability to influence these resources do not make it possible to adjust them to meet expenditure increases caused by economic factors;
- take account of variations in costs generated by decisions taken at national level, in particular variations in such general factors as salaries and social security costs, minimum standards for local services and environmental protection standards applicable to local authorities.

61. States should assure local authorities of a degree of stability in this sum total, possibly by law or by virtue of arrangements designed to ensure economic stability, with the cooperation of all tiers of government. The sum total of transfers should not be subject to frequent, arbitrary fluctuations when the state's annual budgets are drawn up.

62. Criteria for the allocation of general grants should be clearly defined by law, or at least in accordance with the legal framework, on a non-discretionary basis. This should enable local authorities to calculate in advance the amount of the grants they will receive and adopt their budgets accordingly.

63. Any major redistribution of resources between local authorities resulting from a substantial change in the criteria for calculating grants, sharing out taxes or equalisation formulae should take place gradually, over a sufficient number of years to allow local authorities to adapt their budgets to the new funding levels without any excessive transfer of services.

64. Local authorities should not be in a position to influence the amount of the general grants they receive, unless this is one of the explicit objectives of a particular grant.

b. Specific grants

65. Specific grants restrict local authorities' freedom of choice as regards policy, are less effective than general grants in making good shortfalls in resources in relation to responsibilities and are not very useful

as equalisation tools. Recourse to specific grants should therefore generally be restricted to what is necessary to achieve the following objectives:

- (co-)financing capital expenditure as part of balanced, sustainable regional development policies;
- ensuring that certain local public services, for which minimum standards are laid down at national level, are provided at a standardised level throughout the country;
- offsetting any centrality costs affecting the provision of certain local public services, insofar as they are not compensated for by horizontal transfer mechanisms, following voluntary agreements or statutory obligations;
- financing certain public services that local authorities provide on behalf of the state or offsetting costs which local authorities incur when discharging responsibilities delegated by other authorities; while specific grants may be used for these purposes, particularly because they can serve as an incentive, general grants are often more effective; the central authorities should consider which solution is to be preferred, with due regard for local autonomy, in the particular situation in question.

66. Specific grants should generally be awarded on the basis of objective, transparent criteria related to spending needs. All the authorities eligible for such grants should be informed about the availability of funds and the relevant criteria and should be able to submit applications for such grants, which should be compared by means of transparent procedures.

67. Where specific grants are conditional upon financial contributions on the part of the authorities receiving them, the level of such contributions should be flexible so as to take account of the authorities' financial capacity. The central authorities should examine the possibilities of modulating the specific grants according to that capacity so that the financial effort, and not the financial input, of the authorities is comparable and the most disadvantaged authorities are not denied such grants.

6. Other financial resources

a. Fees and charges

68. Recourse to fees and charges can make a considerable contribution to local authority revenues. Their impact on the demand and on the access to services should, however, be examined.

69. Local authorities should be entitled to decide what to charge for the services they provide according to the situation and local preferences.

70. In the case of essential services, the central authorities may lay down minimum (quantitative and qualitative) standards and conditions of access for disadvantaged sections of the population (exemptions and subsidies).

71. If necessary, the central authorities may, in order to ensure equal access throughout the country, lay down maximum charges for essential services and minimum charges for convenience services.

a. Sundry resources

72. With regard to the sundry resources of local authorities (revenues from economic activities, property, investments, donations and legacies), and also to loans, states are invited to take note of the guidelines addressed to them in Recommendation Rec(2004)1 on financial and budgetary management at local and regional levels.

7. Borrowing

73. Local authorities should be able to borrow in order to finance their capital expenditure projects. Such projects are intended to benefit future generations, and recourse to borrowing may therefore make it possible to spread the burden fairly among generations. As future generations do not have a say in the choice of projects to be financed, however, financing through borrowing is mainly suitable for services for which the loan will be repaid by means of charges to users.

74. Except in the case of cash advances and in exceptional circumstances, local authorities should not be allowed to take out loans to finance current expenditure. Current expenditure benefits the current generations and financing it through loans would mean that the costs would be borne by future generations. In addition, financing current expenditure through borrowing would make elected representatives less accountable for the financial implications of their decisions.

75. Local authority access to borrowing may be restricted on account of national economic policy constraints, in order to limit the risk of non-repayment and to avoid decisions that would transfer an excessive financial burden to future generations. Any such restrictions should be fair, commensurate with the constraints in question, discussed in advance with the local authorities or their representatives and lifted as soon as the macro-economic situation permits.

76. In order to make decision-makers more accountable, local authorities should be held fully answerable for their decisions to resort to borrowing. The central authority should not offer guarantees for loans raised by local authorities, save in exceptional circumstances.

Part II – Guidelines for local authorities

1. General principles

1. Major decisions such as the establishment of taxation rates, charges payable by users for services provided and recourse to loans should be taken by the elected deliberative body (council or assembly) at a plenary meeting, and not delegated to the executive or a committee or other body subordinate to the elected deliberative body.

2. Financial and budgetary discussions should take place and the relevant decisions should be taken at meetings of the elected deliberative body that are open to the public.

3. The consequences of local authority decisions concerning sources of revenue should be made public. Budgetary documents should include overviews that are easy to understand on this topic.

4. In areas in which local authorities enjoy discretionary powers, major financial decisions should be grouped together and taken at specific intervals. In general, decisions concerning revenues and those concerning expenditure should be taken together when the budget is adopted and revised.

5. Associations of local authorities can play an important role in finding solutions that strike a balance between the various tiers of authority when national economic policy is framed; the same is true with regard to helping local authorities to draw up local tax regulations, for example.

6. Local authorities should use information technologies to improve managerial efficiency (collection and processing of information, preparation of decisions, follow-up to decisions). Priority should be given to “real-time”, open, evolutive systems that are, where possible, interoperable with the authority’s other systems and with systems established centrally or as a result of horizontal co-operation. Opportunities for payment by electronic means at a distance should be increased.

7. Local authorities should make sure to provide their staff with the various forms of training they are likely to need (legal, financial, fiscal, organisational, etc.) and regularly update key technical skills.

8. Local authorities should set up systems to enhance the professionalism and ethics of staff dealing with financial and, in particular, fiscal matters. They are invited to take note of the best practices pinpointed by the CDLR in the Public Ethics at Local Level Handbook, adopted at the Conference on Ethical Standards in the Public Sector, Noordwijkerhout (31 March-1 April 2004).

2. Local taxation

9. The basic principles for determining local taxation should be fairness (taxation should be commensurate with each taxpayer's ability to pay) and efficiency (a high yield and a low collection cost).

10. When they establish the level of local taxes, local authorities should do so as openly as possible, so that their decisions are clear to the public. Measures ensuring the transparency of fiscal decisions should include publishing (in paper and electronic version), posting up and possibly disseminating all draft fiscal decisions, the documents needed to understand them and the decisions actually taken.

11. Local authorities should vary the level of taxation only in order to adapt the level of services to local needs and preferences.

12. Local authorities should avoid introducing too many taxes, as this inevitably increases administration and is liable to increase the cost of collection, grounds for litigation, etc.

13. Although the incentive purpose of local taxation should not be overlooked, it should not render impossible activities that are otherwise lawful. Any incentive should respect the principle of the equality of citizens before the law. In such cases, the determination of the tax base, taxation rate and exemptions should be consistent with the objective pursued.

14. Untimely changes in the local tax framework that could cause excessive disruption to economic operators or households should be avoided.

15. The local authority should provide the public with information and explanations concerning any taxes in addition to tax levied by a higher authority. If they are exclusive taxes, it is up to the municipality to draw up its fiscal regulations and bring them to the attention of the public.

16. Local authorities should provide the public with comprehensive, readable information about the use made of tax revenues by the authority.

17. The means used to inform the public about local taxation should take account of specific local features: electronic publication, posters, direct mailing, telephone service, etc. Certain methods of prior consultation may also be useful, as may public meetings after the council has adopted regulations.

18. In the case of exclusive local taxes, the authorities should pay particular attention:

- to ensuring that tax bands are both simple and fair;
- to the quality of the drafting of tax regulations, particularly in small municipalities;
- to tax avoidance and evasion mechanisms that may be prompted by local regulations.

19. Information on the tax base should be regularly updated and founded on factors that do not lend themselves to contestation. Cooperation between local authority departments should be arranged in order

to obtain the necessary information (police, registry of births, marriages and deaths, etc). Cooperation with the higher authorities may enable local authorities to obtain the information needed to establish the tax base.

20. The bulk of local taxation should rest on a relatively stable tax base.

21. Registration and collection of local taxes right at the start of the financial year enable the municipality to have financial resources at its disposal earlier in the year and therefore to improve its cash flow. Steps should be taken to avoid delays that could lead to subsequent adjustments obliging taxpayers to pay, in the course of the same year, tax due in respect of several years. A system for following up unpaid taxes should be set up, both to protect the interests of the community and to take account of social situations.

22. Local taxes should require the least possible effort and the fewest possible formalities on the part of taxpayers, so that they do not inadvertently evade tax. Local taxation should not be based on taxpayers' prior tax returns.

23. Payment demands should allow taxpayers to check the accuracy of the information on which the amount of tax payable is based: tax base, rate, any exemptions, etc. The procedure to be followed for lodging a complaint should also be clearly mentioned, as should the procedure for requesting easy payment terms in the case of a sizeable tax.

24. Given the delays involved in court proceedings and the uncertainty surrounding such proceedings, it is desirable that litigation be reduced to a minimum. It is therefore recommended that every effort be made to limit it: laws and regulations should be clear, with few exemptions and special cases; it should be easy to obtain information; social situations in which easy payment terms are desirable should be identified, etc. Tax documents should mention the deadline for lodging a complaint, the method of doing so and the time-limit within which a decision should be taken and the possibility of appeal. Budgetary reserves should, where appropriate, be set aside to take account of trends in litigation.

25. Local authorities should carry out audits at regular intervals for each tax directly levied by the authority. Such audits should:

- compare collection costs (and changes in such costs) with the proceeds from the tax;
- indicate whether, for example, all taxpayers have been identified and whether they all pay the tax;
- assess the incentive and discouraging role of any taxes that have such an objective.

3. Fees and charges

26. As a rule, charges should not exceed the cost of services and the local authority should not seek to make a paper profit from the provision of public services.

27. The charges applied should not reduce demand excessively, particularly in the case of important public services.

28. The choice between financing through charges (in which case users pay) and financing through taxes (in which case taxpayers pay) should be explicit and taken by the authorities with due regard for the specific features and preferences of each authority. It should be taken, for each service, in the light of considerations of fairness and equality.

29. Local authorities should make sure that access to essential services is preserved for the most disadvantaged sections of the population.

4. Other resources

30. Local authorities are invited to take account of the guidelines concerning other resources (borrowing, income from economic activities, property, investments, donations and legacies) addressed to them in Recommendation Rec(2004)1 of the Committee of Ministers on financial and budgetary management at local and regional levels.

31. Exceptional revenue should only be used to finance capital expenditure and the reimbursement of debt.