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10 April 2012

Online at <https://mpra.ub.uni-muenchen.de/42259/>

MPRA Paper No. 42259, posted 31 Oct 2012 12:10 UTC

Property tax in the Czech Republic and Slovakia since 1993¹

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Abstract

In the early 1990's it was expected that the property tax would play a significant role in the process of fiscal decentralization in the transition countries. Comparison of the development of legally granted and actually effected municipal autonomy regarding the property tax in the Czech Republic and Slovakia showed that increased autonomy led only to a limited extent to its effective exploitation and its contribution to increased accountability is questionable due to deteriorated transparency in the Czech Republic and significant tax exporting in Slovakia.

Introduction

If fiscal decentralization is to be successful, local governments must receive a reliable source of revenues. The property tax, or more precisely, the real estate tax, seems to be an appropriate candidate. However, in many transition countries the reliance on property taxes remains low and the autonomy of local governments regarding its tax rates and tax base is very limited although twenty years have passed since the beginning of the decentralization process.

The paper deals with property tax in the Czech Republic and Slovakia from the point of view of the autonomy municipalities have regarding the property tax. The division of Czechoslovakia in 1993 opened the way to the pursuit of different fiscal practices. While there was only limited movement in divergent directions in the area of the property tax until 2004 (see Bryson, 2005, p. 19 and 22), the two systems at the moment show quite different approaches.

The objectives of this paper are to compare the development of the property tax in the Czech Republic and in Slovakia with special focus on the autonomy granted by law to the municipalities since 1993 and on the actual usage of this autonomy in 2011.

Our research is composed of two main parts: legal analysis of the versions of the law on property tax pertaining in the individual years 1993-2012 in both of the countries and comparison of the tax rates actually implemented in 2011 in the Czech and Slovak district towns.

The paper first describes the role of the property tax in the process of fiscal decentralization and evaluates the extent to which the property tax complies with the characteristics of a good local tax. Then, a very brief overview of the property tax systems is presented. Next, a discussion of the legally granted autonomy and its development in the two countries is provided and, finally, the achievement of actual legal autonomy in the district towns is evaluated for the year 2011.

¹ The paper was elaborated as a part of the project IGA VŠE F1/1/2012 „Fiscal federalism in the Czech Republic”

1. The role of the property tax in the process of fiscal decentralization

Decentralization was an essential part of the transition process from a command to a market economy, as the total size of the public sector had to be reduced and new local governments had to receive appropriate responsibilities and institutional capacity in order to be capable and accountable for their decisions (see Bird, Freund and Wallich, 1994). Decentralization should improve (1) governance, i.e., local responsiveness, political participation and accountability, and (2) allocative efficiency. However, this is unlikely to happen unless local governments finance the services they provide either from user charges or taxes born by their residents (see Bird, 1993). A clear relationship between the services provided by a local government and their financing ensures that the right volume of the service is provided and it makes the local government directly accountable to the citizens regarding its decisions. In case this relationship is either nonexistent or weak it is unlikely that the expected gains from decentralization will occur.

Unfortunately, none of the major taxes, such as personal and corporate income tax, value added tax or excises, seems to be an appropriate candidate for a local tax, i.e., a tax for which the local government has some discretion regarding the tax base or tax rate (see Bird, Freund and Wallich, 1994, 154-156). So the property tax, exactly the real estate tax, remains the only potentially significant tax that could be assigned to local governments as a true local tax.

Property tax is a good local tax, although far from perfect (see Oates, 1999, 67). It complies, at least to some degree, with the characteristics of a good local tax: immobile tax base; sufficient, stable and predictable tax yield; reasonably fair or equitable; easy to administer; hard to export the tax burden to nonresidents; and the tax base is visible to ensure accountability (see Bird, Freund and Wallich, 1994, 214).

Compliance with these characteristics needs to be discussed in more detail:

1. Immobile tax base: While there are no doubts that a piece of land or a building will always stay in the territory of a particular local government, the tax policy of the local government may well influence the location decision of either residents or businesses. In any case, the tax base of the property tax is less mobile than that of any other tax. .
2. Sufficient, stable and predictable tax yield: Here, “sufficient” depends on the overall setting of the intergovernmental system and especially the availability of other revenue sources in each country. In the transition countries the property tax is rather a complementary source for local governments (see Sedmíhradská, 2010, p. 9). In these circumstances sufficient should mean that a local government can receive substantial additional resources from the property tax if it decides to use the discretion it has over the tax rate or tax base. Thus, if the property tax rate is increased for a few years, a sufficient amount is collected in order to finance, for example, a needed investment².

We need to evaluate “stable” from both a nominal and a real point of view. If the property tax is designed as an area based tax, the nominal revenues will stay almost unchanged. However, in the event of higher inflation or long-term unchanged tax rates real revenues may decline substantially (see also Dillinger 1998,

² My previous research (Sedmíhradská, 2009) in the Czech Republic shows that application of the local coefficient can bring significant additional resources to municipalities.

5 and 7)³. This may also occur in the case of the ad valorem tax if an assessment of the taxed property is not done regularly.

Predictability of the property tax should be adequate as the tax yields are less volatile than other taxes and as the property tax is assigned to local governments there are less frequent and significant legal changes than in case of the income and consumption taxes.

3. Reasonably fair or equitable: The property tax may not really fit with the ability to pay principle; the ownership of the real property may not reflect the current income of the taxpayer. At the same time the property tax complies to some extent with the benefit principle. Although not perfectly, but still more than most other tax bases, the property tax base is correlated with the benefits from services financed from property tax (see Dillinger, 1988, 13). At the same time local administrators often assume that the revenues from the property taxes on businesses exceed the costs of public services provided to them and that expanding the commercial and industrial share of the tax base reduces the property tax burden on residents (see Bland, 1989, 31-32). In the framework of a single local government the perceived equity is influenced by the extent of the tax exporting (see below), types and magnitude of the tax exemptions (see Bland, 1989, 32-33). When considering more local governments the differences among them have an influence as well.
4. Easy to administer: Except for the reasoning that the property tax base is readily transparent (real estate is difficult to conceal so the tax is difficult to evade), most of the features of the property tax make its administration difficult and expensive. The large number of taxpayers (see Dillinger, 1988, 5), combined with the relatively small tax yield, makes the property tax one of the most expensive taxes to collect⁴.
5. Hard to export: Tax exporting means shifting the tax burden to nonresidents. It is politically painless but economically inefficient because the link between the “tax price” and the service benefits is weakened or lost. Therefore there should be a constraint on taxing nonresidential property and local governments should not have a free hand in taxing businesses (Bird, 1993, 216).
6. The tax base is visible to ensure accountability: The visibility of the property tax to the taxpayers is both its advantage and disadvantage. As the taxpayers are aware of the volume of the tax paid, they are more interested in the way their tax money is spent and they hold local politicians accountable. On the other hand it may lead to political resistance to exploit the granted tax autonomy. The visibility is increased due to the fact that the property tax is not deducted at its source and that it is usually paid in a single large payment (Bird, 1993, 215).

³ In the Czech Republic there were no changes in the tax rates between 1993 and 2008. While the nominal revenues grew from 3 billion CZK in 1993 to 5.1 billion CZK in 2008, using the 1993 prices the revenues in 2008 were only 1.95 billion CZK. The share of the property tax declined from 0.29 % of GDP in 1993 to 0.13 % of GDP in 2008.

⁴ While the direct administrative costs of the entire tax system in the Czech Republic are estimated to be less than 2% of the tax revenues, Andrlik (2010, 18) estimates that in 2008 the direct administrative costs of the property tax were almost 50%.

2. Overview of the property tax systems

Until the beginning of 1993 there the same property tax system was in force in both of the republics, which comprised tax on land and tax on buildings. The collected taxes were revenues of the local national committees and since 1990 of the newly reestablished municipalities which also administered the tax. Since 1 January 1993 two new independent countries were established with new, western style tax systems. The property tax (real estate tax) was a component of both of these tax systems and its tax revenues were assigned to municipalities. In the Czech Republic the Act No 338/1992 Coll. came in force and in Slovakia Act No. 317/1992 Coll. In both of the countries the property tax had two components: tax on land and tax on buildings, while the tax on land was in most cases an ad valorem tax, the tax on buildings was an area based tax (see Table 1). Introduction of the new laws in both of the republics broadened the tax base and increased the number of tax payers (see Jakubíková and Bánociová, 2008, 313 and Peková, 1993, 134-135).

While the structure of the tax base and the tax rate were almost identical in both of the countries, there were two important differences from the point of view of the municipalities. First, since 1993 Slovak municipalities had more autonomy regarding the tax rates than the Czech ones and the magnitude of this autonomy grew over time (see section 3) and second, in Slovakia the administration of the property tax stayed in municipalities, while in the Czech Republic the tax offices started to administer the tax. For more detail on the property tax in the Czech Republic see Sedmíhradská and Bryson (2010).

Table 1: Tax rates (1 January 1993)

Land type	Czech Rep.	Slovakia	Building type	CZK/m ²	SKK/m ²
Arable soil, hops fields, vineyards, orchards	0.75%	Max. 1%	Residential houses	1.00	1.00
Permanent grass plots	0.25%	Max. 1%	Family houses and holiday houses for individuals	3.00	3.00
Economic forests and ponds with intensive industrial fish farming	0.25%	Max. 0.25%	Garages built separately from residential premises	4.00	4.00
Gardens	0.75%	0.10 SKK/m ²	Original agricultural production, forest and water industries	1.00	1.00
Finished building areas and courtyards	0.10 CZK/ m ²	0.10 SKK/m ²	Industry, building industry, transport, energy industry	5.00	5.00
Building plots	1.00 CZK/m ²	1.00 SKK/m ²	Other entrepreneurial activities	10.00	10.00
Other areas if they are subject to taxation	0.10 CZK/m ²	0.10 SKK/m ²	Other buildings	3.00	3.00

Source: Czech Republic - Act No 338/1992 Coll. and Slovakia - Act No. 317/1992 Coll.

With the exception of the tax rate on arable soil, hops fields, vineyards, orchards and permanent grass plots (changed in Slovakia after 1994 to 0.75%) there were no changes in the tax rates in Slovakia until 2005, when a new law came in force and in the Czech Republic until 2010, when the tax rates expressed in CZK/m² were doubled with the exception of buildings used for other entrepreneurial activities. In both of the countries an arrangement regarding apartments was included in the laws: In Slovakia there has been an independent tax on apartments since 1997 and in the Czech Republic a special arrangement for taxing apartments in the framework of the building tax since 2001.

In Slovakia the original law on property tax was replaced in 2005 by the law on local taxes and a local fee for municipal waste (Act No. 582/2004 Coll.). This law unified the approach to the land tax, which is now an ad valorem tax with the tax rate 0.25 %. The tax base, i.e. the value of the land is determined either in the enclosure to the law, based on other regulation or by the municipality itself in a decree. The tax on buildings and apartments is an area based tax with the tax rate 1SKK or 0.033 EUR per m². The tax rate can be adjusted by the municipality.

3. Local autonomy regarding the property tax

3.1 Legally granted autonomy

The analysis of the legally granted autonomy comprised careful study and comparison of the version of the law on property was valid in the individual years 1993-2012 in both of the countries and compilation of tables presenting the development. As there were numerous adjustments, especially in the 1990s in Slovakia, Table 2 and Table 3 present the initial state (1993 and 1994), the last year of the original law in Slovakia (i.e., 2004) and the current state (i.e., 2012).

Municipal autonomy regarding the property tax in the Czech Republic was very limited until 2009. While municipalities did not have any discretion regarding the land tax with the exception of the building plots, they could slightly modify the tax rates of buildings (see Table 2). There existed, and still exist, parallel two coefficients: a size coefficient and coefficient 1.5. Different values of the size coefficient were assigned to municipalities of different sizes (see Enclosure). The statutory tax rate for the building plots, residential houses and apartments is multiplied by the size coefficient. Municipalities have the discretion to lower the size coefficient up to three levels and increase it one level. There may be different size coefficients applied in different parts of a municipality and for the building plots and buildings. Depending on the size of the municipality the size coefficient can be reduced up to 0-100% and increased by 14-40 %⁵.

For the remaining building types (with the exception of the other buildings) a coefficient of 1.5 is applicable, i.e. the municipality can increase the tax rate by 50%. This coefficient may be introduced for some or all types of buildings in the whole municipality. Thus unlike the size coefficient, a differentiated approach to different localities in the municipality is not possible.

Since 2009 a so called local coefficient has been in force. It can take the value 2, 3, 4 or 5 and is applicable to all property types with the exception of arable soil, hops fields, vineyards, orchards and permanent grass plots and (similar to the coefficient 1.5) is uniform for the whole municipality. In contrary to the other two coefficients, application of the local coefficient can significantly change the tax rates and thus the tax yield. Since 2009 municipalities can also exempt arable soil, hops fields, vineyards, orchards and permanent grass plots from the property tax.

⁵ Until 2007 it was 14 – 100%.

Table 2: Municipal tax autonomy in the Czech Republic

	1993	1994	2004	2012
Arable soil, hops fields, vineyards, orchards				Can be exempted
Permanent grass plots				
Economic forests and ponds with intensive industrial fish farming				Local coefficient {2; 3; 4; 5}**
gardens				
Finished building areas and courtyards				
Building plots			Size coefficient <0.3;5>*	Size coefficient* <1;5>, local coefficient {2; 3; 4; 5}**
Other areas if they are subject to taxation				local coefficient {2; 3; 4; 5}**
Residential houses			Size coefficient <0.3;5>*	Size coefficient <1;5>*, local coefficient {2; 3; 4; 5}**
Family houses and holiday houses for individuals			Coefficient 1.5**	Coefficient 1.5**, local coefficient {2; 3; 4; 5}**
Garages built separately from residential premises				
Original agricultural production, forest and water industries				
Industry, building industry, transport, energy industry				
Other entrepreneurial activities				
Other buildings				Local coefficient {2; 3; 4; 5}**
Apartments	NA		Size coefficient <0.3;5>*	Size coefficient <1;5>*, local coefficient {2; 3; 4; 5}**

Source: Law on Property tax, 338/1992 Coll. and its amendments

Note: * can be reduced up to three levels and increased one level, ** Uniform for the whole municipality.

There has been much more development in Slovakia regarding legally granted autonomy between 1993 and 2004 (see Table 3). A size coefficient has also been applied (see Enclosure), which was gradually applied for each type of property taxed on its area base. The municipalities have been able to reduce the size coefficient to any rate they chose, i.e., not only in steps given by law as in the Czech Republic. At the same time municipalities could lower the tax rate for arable soil, hops fields, vineyards, orchards, and permanent grass plots and gradually received authority to modify the tax rate in the given band in both directions. Municipalities could set different tax rates or size coefficients for different localities within the municipality. The new law in force since 2005 basically gave municipalities a free hand to set the tax rates. The current regulation only prevents unjustified differences, i.e., more than twenty or forty times, in the tax rates for different property.

Table 3: Municipal tax autonomy in Slovakia

	1993	1994	2004	2012
Arable soil, hops fields, vineyards, orchards	Tax rate up to 1%		Tax rate up to 0.75 %	Tax rate can be adjusted, so that the highest tax rate is at maximum twenty times higher than the lowest tax rate in the particular municipality, The municipality may also determine the value of the land
Permanent grass plots				
Economic forests and ponds with intensive industrial fish farming	Tax rate up to 0.25 %		Tax rate up to 0.25 %	
gardens	Tax rate may be up to doubled		Size coefficient* <1;5>, tax rate may be lowered up to 90 % and increased up to 100 %	
Finished building areas and courtyards				
Building plots				
Other areas		Size coefficient <1;5>		
Residential houses	Size coefficient <1;5>	Size coefficient <1;5> tax rate may be lowered or increased up to 50 %	Size coefficient <1;5> tax rate may be lowered up to 90 % and increased up to 50 %	Tax rate can be adjusted, so that the highest tax rate is at maximum forty times higher than the lowest tax rate in the particular municipality
Family and holiday houses for individuals		tax rate may be lowered or increased up to 50 %		
Garages built separately from residential premises				
Original agricultural production, forest and water industries	tax rate may be lowered or increased up to 50 %	tax rate may be lowered up to 50 % and increased up to 100 %	Size coefficient <1;5> tax rate may be lowered up to 90 % and increased up to 100 %	
Industry, building industry, transport, energy industry				
Other buildings		tax rate may be lowered up to 90 % and increased up to 100 %	Size coefficient <1;5> tax rate may be lowered up to 90 % and increased up to 100 %	
Other entrepreneurial activities		tax rate may be lowered up to 90 % and increased up to 150 %	Size coefficient <1;5> tax rate may be lowered up to 90 % and increased up to 150 %	
Apartments	NA		Size coefficient <1;5> tax rate may be lowered up to 90 %	

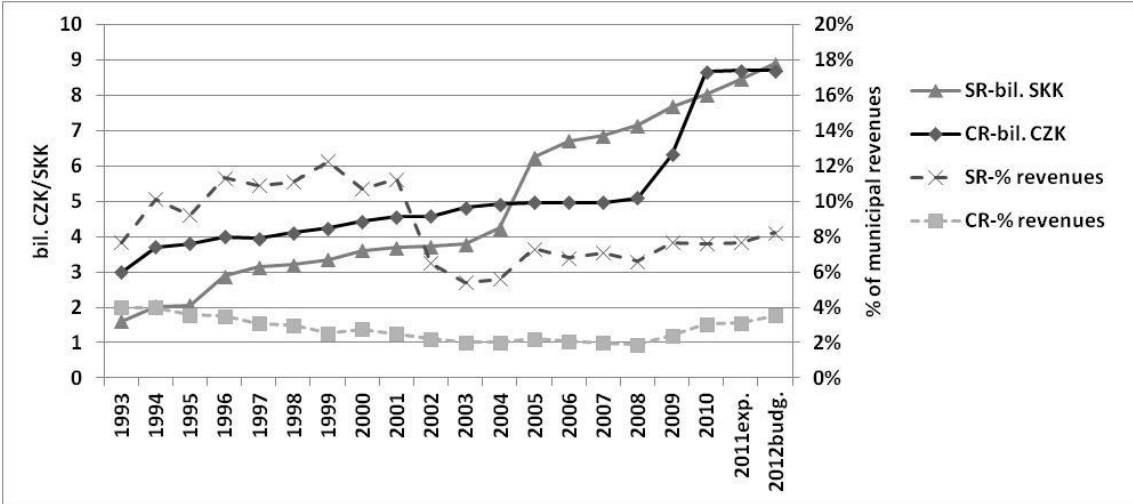
Note: *can be lowered

Source: Law on Property tax (317/1992 Coll.) and its amendments and Law on local taxes and local fee for municipal waste (582/2004 Coll.) and its amendments

To sum up, Czech municipalities can influence the tax rates through three types of coefficients which enforce quite a uniform approach to the entire territory of the municipality and, through the structure of the coefficients, to different types of property as well. While all the municipalities can increase the tax rate, only municipalities with more than a thousand inhabitants (only about 22% of municipalities) can slightly decrease the tax rate for building plots, residential houses and apartments. In contrast, the autonomy of Slovak municipalities has increased gradually since 1993; since the introduction of the new law in 2005 it has seen only minimal limitations.

Figure 1 shows the property tax revenues since 1993 in both nominal terms and as a share of total municipal revenues. The development of tax autonomy is mirrored there: sharp increase in the revenues in 2005 in Slovakia and 2009 in the Czech Republic. Of course the impact of the increase of the tax rates in 2010 in the Czech Republic was far more important than the introduction of the local coefficient.

Figure 1: Property tax revenues (billions CZK/SKK, share on municipal revenues, 1993-2012)



Source: CR for 1993-1996 Provozničková (2007), for 1997- 2009 ARIS, for 2010 ÚFIS, for 2011 and 2012 Proposal of State Budget for 2012, SR for 1993-2008 Nižňanský (2009) and Mikloš et al. (2008) for 2009-2012 Approved budget of public administration

Note: since 2009 the amounts for SR are recalculated from EUR to SKK using the conversion exchange rate 1 EUR=30.126 SKK

3.2 Real usage of legal autonomy

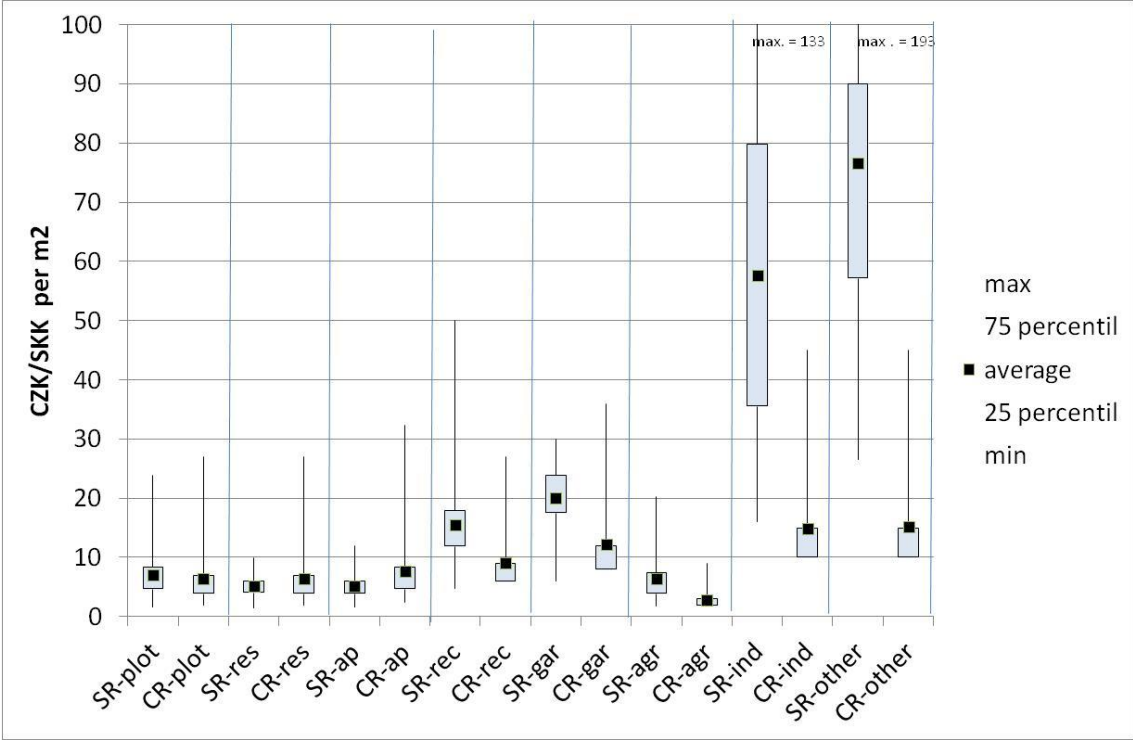
Our interest in the legal autonomy growing in these republics extends as well to the actual usage or exploitation of the potential autonomy of the individual municipalities in 2011.

The availability of data in both of the countries is different. While in the Czech Republic the Czech Tax Administration publishes a list of applied property tax coefficients in all municipalities, in Slovakia data are available only for 70 district towns provided by the Business Alliance of Slovakia. Therefore we have in case of the Czech Republic analyzed a sample composed of the 71 former district towns. We have excluded the capitals, Prague and Bratislava, as these cities are divided into districts and while in Prague the tax rates are uniform in all the districts, the differences in the tax rates across the Bratislava districts are significant. This inconsistency would bias our analysis.

The analysis is limited to the tax bases for which the area based taxation is used. Similarly to Figure 1 we use CZK and SKK, while the SKK are calculated from the actual figures in EUR using the conversion exchange rate. The tax rates for the Slovak towns were directly taken from the presented data files, for the Czech towns we have first identified all the coefficients applied in the different municipalities. In case a municipality applied different size coefficients for different locations, we have used the coefficient which was presented in the table provided by the Czech Tax Administration relevant for the entire municipality. Then we have multiplied the statutory tax rate by the applied coefficients.

The results of the comparison are shown in Figure 2. The average tax rates are higher in Slovakia for all tax bases except for residential houses and apartments. While the difference is negligible in the case of the building plots, it is about double in the case of recreational facilities, garages and spaces for original agriculture production. In case of spaces for industry and other entrepreneurial activities the difference is four and five times, respectively. At the same time the variance in the tax rates is very small for residential houses and apartments in Slovakia and very high for space for industry and other entrepreneurial activities in Slovakia and moderate in all the remaining cases.

Figure 2: Average tax rates for different tax bases (CZK/SKK per m2, 2011)

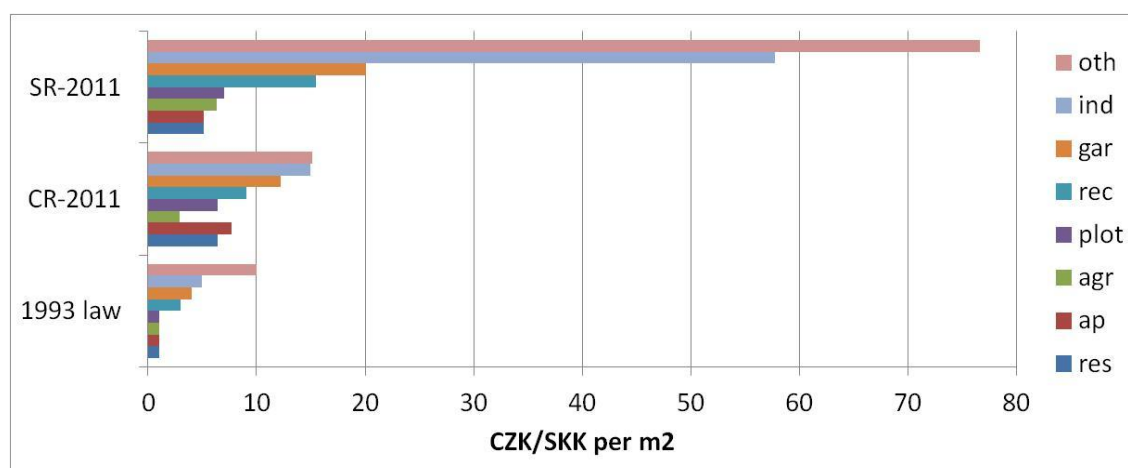


Note: plot - building plots, res - residential houses, ap – apartments, rec - family houses and holiday houses for individuals, gar - garages built separately from residential premises, agr - original agricultural production, forest and water industries, ind - industry, building industry, transport, energy industry, and oth - other entrepreneurial activities

Source: own elaboration based on data provided by Czech Tax Administration and Business Alliance of Slovakia

Figure 3 shows the differences in the average tax rates for different tax bases, i.e., it is a different arrangement of the data shown in Figure 2, together with the tax rates in the original laws on property tax from 1993. Comparison of the average tax rates in Slovakia in 2011 and the legislated rates in 1993 shows that the structure or ranking is unchanged. The highest rates or the biggest increases can be observed for tax bases which can be possibly exported to nonresidents, entrepreneurs or recreation facilities owners. The tax rates for space for original agriculture production remain lower than the rates for other entrepreneurial activities, but in comparison to the Czech Republic are twice as high. In the Czech Republic the differences are smaller, especially after the change in the legislated rates since 2010. Thanks to the size coefficients applied only to building spaces, residential houses and apartments, the tax residents are taxed on a higher tax rate than in Slovakia.

Figure 3: Average tax rates for different tax bases (CZK/SKK per m2, 2011)



Note: plot - building plots, res - residential houses, ap – apartments, rec - family houses and holiday houses for individuals, gar - garages built separately from residential premises, agr - original agricultural production, forest and water industries, ind - industry, building industry, transport, energy industry, and oth - other entrepreneurial activities

Source: own elaboration based on data provided by Czech Tax Administration and Business Alliance of Slovakia and Table 1

Conclusions

From a joint system of property taxation before 1993, two systems of property taxation have evolved which are quite different from the point of view of the municipal autonomy they provide. While the Slovak system is very flexible at the moment and poses minimal limitations, the Czech system still relies on a set of coefficients, mostly uniform for the whole territory of a municipality. The increase of the municipal autonomy designed to increase tax revenues, however, in the Czech case the central government's intervention, i.e., doubling of the tax rates, was far more important.

There are two major differences from the point of view of a municipality: impact of inactivity and flexibility. If the Czech municipality does not approve a decree, i.e., does nothing, it will still receive certain property tax revenues. In contrast, if a Slovak municipality does not approve a decree the property tax revenues will be very low, much lower than in 2004. This must have made Slovak municipalities more active in this area⁶.

The differences in flexibility influence the behavior of municipalities in at least two ways: (1) The system of coefficients makes the maneuvering space of Czech municipalities very limited, resulting either in inactivity or in the creation of various grant/gift systems of returning the paid property tax to selected tax payers. This behavior impacts the transparency of the municipal management and the visibility and accountability features of the property tax. (2) On the other hand the Slovak system obviously led to the highest possible increase of the business property tax share and substantial tax exporting. This significantly weakens the link between the property tax and local service benefits.

The examples of the two countries refute expectations that municipalities would welcome and eagerly exploit the possibility to get additional revenues thanks to the newly granted or increased property tax autonomy. The

⁶ In 2010 about 70 % of Czech municipalities did not use any property tax coefficient (see Sedmíhradská, 2010b)

change in the behavior lies more than in the extent and form of municipal autonomy in the overall design of the local government financial system and the availability of other financial resources.

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Enclosure: Size coefficient

Size coefficient	Number of inhabitants					
	Czech Republic			Slovakia		
	1993-2007	2008-2011	2012+	1993-1995	1996	1998-2004
0.3	less than 300	NA		less than 300	NA	
0.6	301-600			301-600		
1	301-1,000	less than 1000		301-1,000	less than 1,000	
1.4	1,001-6,000			1,001-60,00		
1.6	6,001-10,000			6,001-10,000		
2	10,001-25,000			10,001-25,000		
2.5	25,001-50,000			25,001-50,000		
3.5	above 50,001, spa towns*	above 50001, statutory cities , spa towns*		district towns, spa towns		
4	NA			NA	regional capitals	
4.5	Prague			Bratislava		

*Františkovy Lázně, Luhačovice, Mariánské Lázně and Poděbrady