

Introduction of Tax on Real Estate in Russia



The main goal:

- ◆ The tax system must be open and transparent;
- ◆ The tax system must attract investors;
- ◆ The tax burden must be fairly distributed among the fields of economy;
- ◆ The tax system must be an incentive in modernization of the Russian economy on the whole



The types of taxes that are imposed on land and real estate in the Russian Federation (current situation)

- ◆ The land tax – is established in relation to the land plots that are in ownership, the right of (permanent) unlimited use, the right of inherited estate for life;
- ◆ The property tax – is established in relation to the property that individuals and entities have

The land tax

- ◆ The land tax is a local tax.
- ◆ The fixed (max) rate is established by the federal legislation and is 1.5% from cadastral value of the land plot.
- ◆ The exact rates are established depending on the types of use of the land plots on the basis of local (municipal) legal acts.

The tax on individuals' and entities' property

- ◆ Is a regional tax, the exact rate of the tax is established by the laws of the subjects of the Russian Federation;
- ◆ The fixed (max) rate of the tax on entities property is 2.2%. For the individuals it is not established but as a rule it's approximately 1%.
- ◆ The property that is in ownership and on the basis of other rights and that is used in the main activity;
- ◆ It's withheld in % from inventory value (for individuals) and depreciated value (for entities)

The taxes that are planned to be introduced in the near future

- ◆ The tax on real estate will combine the land tax and property tax;
- ◆ The size of the rate should be reduced but the taxable base should be calculated on the basis of market value methods with mass approach application;
- ◆ The introduction depends on the performance of work of mass valuation of real estate units.

The main intermediate results of land tax application in the Russian Federation

- ◆ The size of the tax rate that is established by the decisions of local authorities on the whole has the fixed (max) 1.5% from cadastral value of the land plot;
- ◆ The land tax in the majority of municipalities does not provide the income base of municipalities. The reasons are:
 - ◆ Still the majority of the land is in the state or municipal ownership;
 - ◆ There is a significant number of the land plots (not kept in records) that cannot be used for the purposes of taxation;
 - ◆ A significant number of lands due to the legal regime are exempted from the land tax (e.g. the lands of military formations, the bodies that take state functions, the object of air infrastructure).
- ◆ On the whole the size of cadastral value of the land plot mostly influences the tax burden but not the tax rate does.

The cadastral value of the lands: the main element of the land tax

- ◆ The meaning: It is the basis for the tax base formation;
- ◆ It's made on the basis of mass approaches application;
- ◆ In accordance with the recent changes in the legislation it must not be higher than market value of the land plot. Earlier the Russian Land Code established that cadastral value of the land plot in % from the market value and that was interpreted by the courts as divergence (increase or decrease) (e.g. the cadastral value of the plot in Sakhalin region in the size of 1500% from the market value and was approximately 5000 \$ for 100 sq.m.)
- ◆ There are institutions of administrative appeal of the cadastral value (the commission in the Federal Service for State Registration, Cadaster and Cartography) and litigation in courts;
- ◆ As a rule, the cadastral valuation is calculated by the bodies of subjects of the Russian Federation.

The example of the separate disbalance in the cadastral value



The main factors and problem issues of the cadastral value

- ◆ In making the cadastral valuation it's important to solve two problems:
 - ◆ Classification (making groups) of the objects for the purposes of the valuation;
 - ◆ Credibility (actuality) of initial data.

The problems of making groups of the land plots in making of cadastral valuation (analogue remarks in the cadastral valuation of the real estate)

- ◆ The plots must be classified depending on the categories of lands and the types of permitted use;
- ◆ There is a clear point in the legislation that the category of the land is based on the purpose of use (7 categories). There is huge number of the types of permitted use – over 2000 types;
- ◆ As a rule the permitted use is a real type of activity that can be made on the land plot and that influences the market value of the plot. In practice the permitted use is primary, the category is secondary.
- ◆ There are no methods of making the types of permitted use of the exact land plot for the purpose of making mass valuation (these types are stated in methodology). Consequently there are significant errors.

The examples of types of permitted use

- ◆ For the Chart (established) types of activity. In accordance with the Chart it's possible to do everything that is not prohibited by the law – it means that the land plot can be used for any purposes;
- ◆ For construction of the trade center “Subaru”. The question is if the owner sells the “BMW” cars – it's an infringement;
- ◆ For the exploitation of the module – is maybe a use for the secret purposes.

Actuality (credibility) of initial data

- ◆ Actual and legal information about the land plots and the real estate objects can be in:
 - ◆ Common register of rights;
 - ◆ State cadaster of the real estate;
 - ◆ The bodies of technical inventory;
 - ◆ Forest register;
 - ◆ Courts acts;
 - ◆ Notary bodies;
 - ◆ Other public registers.

The majority of information is approximate and not exact – that causes the problems in the making of the model of the valuation and classification.

Some proposals to create an adequate system to define cadastral value and fair taxation are made

- ◆ It's necessary to have the public register of information about the transactions in the real estate market, the information about the market of the real estate rent is of a high importance too (very positive experience of West Germany). It's expected that public access to the portal shall be provided in the near future.
- ◆ It's necessary to make a transparent model of the lands classification. Currently there is a draft law that cancels the division of the lands into categories and introduces the institution of zoning.
- ◆ It's necessary to form united courts practice about cadastral value disputes.
- ◆ The approaches to define the payment for use (on the basis of the right of rent) of the state and municipal lands must be compared with the approaches to define the land tax (the real estate tax). Currently at the federal level the methodologies providing the solution of the problem are accepted. At the regional and local levels there is some lag in it.

Important remarks

- ◆ Currently an evaluator while making cadastral valuation takes into consideration not only the standards of the public acts but also the acts of self-regulated organizations. There are 12 self-regulated organizations in the register now.
- ◆ During the settlement of disputes in connection with cadastral value the situation when attracted evaluator from the third organization has his own corporate standards different from those of opposite parties and influencing the results of valuation may appear.
- ◆ Self-regulation in the market of valuation does not abide corporate standards in full.
- ◆ Public recommendations for making valuation require correction in the part of classification of the valuation objects (e.g. the lands of sea ports, oil transportation and electrical energy in spite of different income from such activities are related and different rules of definition of tariffs are related to one group).
- ◆ Evaluation of zones with special conditions of objects use are not considered.

The main risks that must be taken into account while investing in real estate and land plots

- ◆ There are approximately 50 types of special territories having some particular restrictions on real estate objects use;
- ◆ The ignorance of these territories restrictions results in nullity of the contracts concluded and the possibility to admit the subject to be unauthorized construction;
- ◆ Most of these territories are not included in governmental public registers, sourced from subordinate acts or out of date acts. This fact is difficult to define while providing Due Diligence procedures;
- ◆ The administrative procedures of statement, changes in status are subject to changes and further improvement.

The most typical special areas in investment practice

- ◆ Water Protection and Forest Protection areas – restrictions connected with property law;
- ◆ Buffer areas;
- ◆ Areas of historical and culture objects – restrictions concerning construction and reconstruction;
- ◆ Airport areas – any actions connected with real estate and land objects use must be reconciled with civil airport' s management;
- ◆ Areas of lands reserved for governmental needs – the term of reservation is 7 years and any improvements of land plots and real estate objects are not reimbursed within this period.

Conclusions

- ◆ The real value can be defined only for 10% of lands (not more than 5% actually). The market concerning other lands hasn' t been formed yet.
- ◆ In any case there are a lot of positive initiatives
 - ◆ 2014 Olympic Games in Sochi – Federal Law №310 (01.12.2007) regulates legal issues in this sphere;
 - ◆ APEC Summit in 2012 in Vladivostok – Federal Law №93 (08.05.2008)
 - ◆ The World Championship of 2018 – the draft law is in final stage and must be enacted;
 - ◆ The legislation acts mentioned above shorten the terms of preparing and endorsement of project documentation, make procedures of providing construction sites easier and provide substantial benefits for land plots use within the period of construction and till 2050.

Particular features of legal regulation

- ◆ The legislation system is represented by 3 main documents (Land Code, Town Planning Code, Civil Code of Russian Federation);
- ◆ Legislation acts are subject to regular renewals that leads to changes in rules in the market (for example, for 10 years of existing the Land Code of Russian Federation has been changes approximately 50 times);
- ◆ There are some shortcomings in legal regulation of real estate sector till nowadays (there is still no definite list of special territories of real estate objects);
- ◆ We expect dramatic changes in Civil Code and Land Code in the near future;
- ◆ The governmental participation in real estate and land turnover is still significant;
- ◆ The town planning system is not representative. The information in public register of real estate property rights is 30% of the full scope we need.
- ◆ The information concerning property rights is not systematized and is situated in different sources.

The main risks that must be taken into account while investing in real estate and land plots

- ◆ Land plots in Russian Federation are classified in accordance with categories and types of permitted use;
- ◆ There are 7 categories of land plots and infinite aggregate of types of permitted use;
- ◆ The classification mentioned above influences the price of a land plot;
- ◆ The process of making changes in land categories is too bureaucratized. The process of making changes in types of permitted use has no legal base in details;
- ◆ Currently the bill abolishing category classification is about to be approved. In the near future the types of permitted use classification list must be worked out. It will lead to decline in governmental influence on business.

The main governmental bodies making influence on investment relations regulation in real estate sector

- ◆ Ministry of economy development of Russian Federation – legal regulation of real estate turnover (The Department of real estate) and investment policy regulation (The department of investment policy and Private Public Partnership);
- ◆ Rosreester – the body of public statement of real estate objects;
- ◆ Ministry of regional development of Russian Federation – the body of area planning;
- ◆ Federal Agency of Property (Rosimushestvo) – the body of Federal real estate management;
- ◆ Municipal bodies;
- ◆ Advisory Council for foreign investments in Russian Federation.

The main conclusions

- ◆ Russian Federation is one of the leaders in investment opportunities;
- ◆ High administrative risks are equal to high revenues of investors stemmed from the right ways to avoid them;
- ◆ The understanding of main factors of risks and long-term strategy is the opportunity to gain stable profit.