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Property Tax and Assessment News from Around the World

UKRAINE - February 2020

Ukraine loses billions with its low property tax rates

While the real estate market slowly recovers after a long recession, the government doesn't benefit from this rebound due to low and outdated taxes on property. Hence, Ukraine's government will continue to miss out on a key revenue source that finances police, roads, schools and a host of other local public services in Western nations.

With the national economy poised for growth this year, Ukraine's government will continue to miss out on a key revenue source that finances police, roads, schools and a host of other local public services in Western nations.

In many such countries, property taxes provide the backbone of local budgets — often accounting for more than half of tax revenues in some places. But in Ukraine, property tax contribution is worth only 3% of revenues.

Rates too low

Property owners in Ukraine are subjected to three kinds of taxes: an annual tax, a tax on the price when buying and another one when selling.

All of them — cumulatively called property tax — came into force in Ukraine in 2012 under the administration of ousted President Viktor Yanukovych. But even by 2016, the tax contributed less than 1% to Kyiv's overall municipal budget, for instance.

One of the reasons for such a modest contribution is that Ukraine's property tax rate is based on the size of the property. In most Western nations, the tax is based on its market value. Moreover, owners of flats under 60 square meters and houses under 120 square meters don't pay annual taxes at all.

But even when the property is larger, owners only have to pay 1% of the legal minimum salary for each additional square meter, depending on the city.

With the minimum salary at $190 today, 1% is merely $1.90 per surplus square meter per year. This means that the owner of a 70-square-meter flat has to pay just $20 a year. The amount is capped at 300 square meters for apartments and 500 square meters for houses — proprietors of real estate of that size pay flat $1,000 taxes.

Meanwhile, in Western countries, taxes are traditionally imposed on the basis of market value rather than square footage. In the United States, for example, taxes can easily reach tens of thousands of dollars a year for multimillion-dollar properties.

Taxation systems based on square meters like in Ukraine also ignore the disparities between city centers and rural areas.

A 100-square-meter property in central Kyiv is worth much more than a 100-square-meter property in a village, and the incomes of their owners are different, Nataliia Musiienko, a senior consultant of tax dispute resolution at auditor KPMG, told the Kyiv Post.

If the annual taxes were collected differently and attached to the market value of the property, the government could greatly benefit from Ukraine's real estate market rebound, Musiienko said.

Nataliia Musiienko, a senior consultant at auditor KPMG, speaks with the Kyiv Post on Jan. 28, 2020, about Ukraine's property taxes. Musiienko believes a taxpayer-friendly electronic system, as well as progressive rates for the property taxes, will make it easier to collect taxes. (Kostyantyn Chernichkin)

Market's ups and downs

"Real estate is the first indicator of the market," Natalya Romanyuk, the CEO of real estate agency Green Way Property, told the Kyiv Post.

Prices started to increase by 15–20% in the center of Kyiv after President Volodymyr Zelensky won in the presidential election in April 2019. A Kyiv apartment now costs $3,000 per square meter.

It is a welcomed rebound after a tumultuous decade, Romanyuk pointed out.

Ukraine enjoyed an economic boom in the decade prior to 2007, when gross domestic product growth of 8% set off a massive increase in property prices, before being slammed by the 2008 global financial crisis.

Another dramatic fall took place in 2014, when Russia's war in eastern Ukraine triggered two years of a deep recession that hurt all industries, including real estate.

While Ukraine's economy has been slightly recovering since 2016, property tax levels remain extremely low.

Ukrainians and foreigners only have to pay roughly 2% of the property value on purchases or sales if a residence they're selling was purchased over three years ago. The tax is slightly higher if the property was purchased within the last three years: Then it's considered a "profit sale" and increases the tax to a cumulative 8.5% — adding the 5% profit tax and the 1.5% military tax.

Ukrainians and foreigners in Ukraine pay largely the same taxes. The only situation when foreigners pay more is when they decide to buy or sell a commercial property. In this case, a tax of roughly 18% is added to the usual 2% and 1.5% in military levy, leading to the combined 21.5% tax.

Market transparency

Taxes on buying and selling property are changing slightly: The system is slowly switching to a market-based process, when real estate property is sold for its market value.

Romanyuk from Green Way pointed out that the market is getting more transparent thanks to a 2019 requirement for buyers and sellers to order an evaluation that shows the market price of a property. This, according to her, paves the way to bring in a "normal" market.

Romanyuk also praised the simplicity of the current taxation system and the fact that every step of the sale passes through an open, unified online register called the Real Estate Register.

KPMG's Musiienko agreed: "It is obligatory to send all the information about the property to a specified register, where everything is open and everyone has access to it."

'Legal optimization'

Despite the system's apparent transparency, however, low taxation and loopholes also attract foreign investors with dubious intentions.

Romanyuk called the real estate industry the number one way to launder dirty money in Ukraine. They refer to it as "legal optimization," she said.

"No one asks where the money comes from."

Those foreigners looking to legitimize shady money come to Ukraine and buy property.

They sell it in a week, just enough time to get all the needed documents.

“They just have to pay 21.5%, and the money is clean,” she said.

Raising taxes would also reduce the flow of dirty money into the Ukrainian market by increasing the “price” for the laundering process, experts say.

Burdensome legacy

The lack of high property taxes leaves a visible imprint on Ukraine’s cities.

In central Kyiv, low property taxes, real estate speculation and poor urban planning left the city with dozens of abandoned and decaying buildings, once the pride of Ukrainian architecture.

In Ukraine, property owners have gotten away without paying real estate taxes since the collapse of the Soviet Union in 1991, when private property was not allowed.

The low property tax, which was designed as an incentive for greater consumption to boost local budget revenues, has actually left a hole in government tax revenues. Another loophole in property taxation resides in the development sector, mainly driven by local investors.

As only finished properties with registered applications — commercial or residential — can be taxed, developers delay the completion of construction, which distorts the market.

It creates entire streets of unfinished yet already dilapidated, half-built structures. Besides financing essential public services, high property taxes in the West also discourage the kind of property speculation that is rampant in Kyiv.

Without a stiff tax, owners have no incentive to sell idle or vacant properties.