

B2B: Bad Times for Investors: New Taxation Regime on Non-Residential Real Property

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The legislature, in what appears to be a desperate attempt to replenish the emptying state treasury, has adopted a number of tax laws this month which are expected to have a great impact on the Russian tax system. Whether this impact proves to be beneficial or detrimental is a matter of time and point of view. However, it is crystal clear that some amendments will make the life harder for, among others, private investors whose main purpose is usually not to avoid taxation, but to save their wealth in a constantly changing and barely predictable Russian economic environment.

One of these amendments is a brand-new property tax on individuals. What makes the new tax principally different from the former one is the tax base. Earlier the tax was imposed on so-called inventory value of real estate belonging to individual taxpayers. Starting on Jan. 1, of next year, the basis for the calculation of the tax is going to be the cadastral value of real property, which can sometimes be even higher than its market value. And the question which comes to the foreground is the applicable rates.

For residential property like flats, cottages, etc. the maximum annual rate is reasonably established as 0,3 percent of the cadastral value. Not so for non-living premises.

Starting from last year, regional authorities, including Moscow, make a list of buildings comprising mainly commercial real estate (office buildings, shopping malls, restaurants, multi-functional trade and business centers). This list was previously compiled for corporate property tax only. Corporations have to pay tax on the cadastral value of their property (buildings and premises therein) in the list as opposed to other property belonging to them which was taxed at their book value.

Now the property in the list is taxed on the basis of its cadastral value if it belongs not only to corporations, but to individuals as well. The rate is 2 percent, and no deductions are

available. For instance, premises worth \$500,000 would invoke a yearly tax of \$10,000.

And here comes the problem with "apartments" (апартаменты), as they are called in day-to-day talk in Moscow. "Apartments" represent a type of premises that is legally not residential, but advertised and marketed as such. What that means in practice is that developers face less stringent construction requirements and have to undergo less cumbersome administrative procedures when building "apartment" blocks. On the other hand, there are some drawbacks for the owners of "apartments," like the impossibility to register them as a place of permanent residence (since "apartments" are not residential). As a result, the "apartments" are significantly cheaper than typical residential property of the same class. This made them a somewhat more attractive investment target, especially for middle-class private investors.

Not so attractive any longer, it seems.

There is a great chance that many "apartment" owners, especially in the business-oriented Moscow City district, as well of those still in construction would suddenly find themselves subject to 2 percent tax on the close-to-market value of their property. The buildings in which apartments are situated or land plots under them may be labeled as intended for commercial use which is a ground for including these buildings in "the cadastral list". A great deal of these building is likely to be already on the list.

So, for "apartment" owners it makes sense to check if their building is included in the "cadastral list" in order to learn what taxation they now face. For those who plan to acquire an "apartment," it would be reasonable to do the same thing before making a final decision about the purchase.

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