PROPERTY TAX IN UKRAINE: THIRD ATTEMPT

The Fiscal Analysis Office traced all the legislative stages of the rise and development of various variants of property tax in Ukraine, beginning from the spring of 1995. The purpose of this analytical paper is two-fold:

- To determine whether it is possible to design a reasonably attractive property tax under present economic conditions in Ukraine; and
- To determine the administrative requirements to implement a property tax.

Executive Summary

The property tax is a particularly suitable revenue instrument for local governments. Currently, this tax exists only in the form of several draft laws in Ukraine. Although it would take several years to implement a market value property tax system in Ukraine, a unit value tax could be introduced in the near future. This would establish the property tax as a source of revenue for local governments and put a property tax collection system in place. A unit value tax would build on the information currently available to the Bureaus of Technical Inventory.

When the appropriate data are available and assessors are properly trained in market value assessment, it would be possible to move from a unit value assessment towards a market value assessment. Starting with a unit value property tax allows local governments to have an independent source of revenue and people to become accustomed to the idea of paying a tax on property. Over time, the property tax could provide a major source of revenue to local governments in Ukraine.

I. History of Property Tax Legislation in Ukraine

In Ukraine, the first attempt to pass a Property Tax Law was made in June 1995. This bill, submitted to the Parliament by the Cabinet of Ministers, managed to clear the hurdle of the first reading. The Resolution of the Verkhovna Rada # 224 of 7 June 1995 defined the two key obstacles that have hindered and continue to hinder the debut of the property tax: the lack of an acceptable method for assessment of real estate for purposes of taxation and the controversial nature of the privileges that were to be granted to taxpayers. In addition to these two problems, there was a third one: is it institutionally sound to divide the functions of property assessment and tax administration?

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The second draft property tax law was submitted by the Cabinet of Ministers in the winter of 1996-97 as part of an economic package that included ten draft laws for tax reform. Similar to the first draft law, it passed in first reading and then ran into problems, despite intensive lobbying efforts of the inter-faction conciliation parliamentary group. As part of this legislation, the replacement cost method of valuing properties was introduced and the basis for exemptions was changed from the number of persons occupying the property to the number of square meters per person. The way in which these exemptions were specified meant that the majority of properties would be tax exempt.

Table 1:
Comparative Characteristics of Major Provisions of the Three Real Estate Draft Laws

	1995 Draft Law	1996 Draft Law	1998 Draft Law
Tax base	*Buildings, premises, and constructions, owned by individuals*	*Buildings and constructions*	*The tax base is residential buildings. Taxpayers include owners of real estate and tenants in those properties that are owned by the state, a territorial community, or a legal entity. Tax liabilities for tenants will be included in public utilities bills.*
Assessment methodolog y	*Replacement value subtracted by depreciated value (so-called residual cost)*	*For buildings, the replacement method is proposed. For constructions, it is suggested to apply the cumulative balance value of the construction. The amount of amortization deductions cannot exceed 50 percent of the initial book cost of a construction.*	*In cities with population of more than 50,000, it is proposed that the tax base will be current market value assessment; in territorial communities with less than 50,000 people, the method of replacement cost would be used. Zoning coefficients would be applied to the replacement cost to adjust for location.*
Tax rates	*The tax rate is proposed to be set in the amount of 0.05% of the residual cost of the assets.*	*For both buildings and constructions, the tax rate is proposed at the level no less than one percent and no more than three percent of the tax base. The final rate is to be set by local government.*	*Tax rates are to be set by local governments but have to be between 0.1 and 0.3 percent of assessed value or 0.6 percent of assessed value for properties larger than 100 square meters*
Administra-tion of the real estate tax	*Assessment of real estate would be fulfilled by state-owned enterprises engaged in technical inventory. The tax would be calculated by state tax inspectorates at the place of location of real estate.*	*Tax liabilities would be defined by bodies of the state tax administration on the basis of the rates established for the next fiscal year. The tax base would be also defined by a body of the state tax administration.*	*Assessment would be carried out by the existing Bureaus of Technical Inventory which would be reorganized into state communal enterprises. Tax collection would be done by the State Tax Service, which would calculate tax liabilities and send out tax bills.*
Exemptions	*Privileges are proposed to be granted to invalids of war, persons who have special merits, Chornobyl disaster survivors, and handicapped children*	*The tax base of a building must be decreased by the amount calculated proceeding from 21 square meters of such building per member of the family plus 10 square meters for the family*	*No privileges for individuals are provided for. Exempted would be constructions located in the Chornobyl zone of alienation and unconditional settling out.*
Appeal of assessment	*Not envisaged*	*Envisaged*	*Envisaged*

The third draft Real Estate Tax Law was developed and submitted in June of 1998 to the Verkhovna Rada by People’s Deputy Yevhen Zhovtiak, the deputy head of the Budget Committee, and Roman Bezsmertny, the Permanent Representative of the President of

Ukraine in Verkhovna Rada. This draft law reduces the number of exemptions considerably, introduces the concept of market value assessment in larger cities, and extends the tax to tenants as well as owners. Table 1 summarizes key features of the three draft Real Estate Tax Laws.

II. Property Taxation in Ukraine in 1995-98: the Period of Rise

The property tax is an important source of local government revenue in many countries. The ability of local governments to levy their own taxes and set the tax rates with their own discretion (with some restrictions which are discussed later) makes them less dependent on the central government.[1] This gives local governments some fiscal autonomy and enhances their accountability. Property taxes are generally regarded as the most appropriate sources of revenue for local governments for the following reasons:[2]

- The tax can be relatively easy to administer because property is both immovable and visible.
- Property taxes provide no direct competition with taxes levied by the central government.
- The tax is related to the benefits received from local government services to the extent that local services are capitalized into property values.
- The tax is related to ability to pay to the extent that real estate holdings provide a measure of ability to pay.
- It is a relatively stable tax because revenues do not fluctuate greatly in times of economic slowdown or growth.

A property tax in Ukraine would provide an important source of revenue to local governments. To be realistic, although it might take some time to implement a full market value system, it is well worth starting to put in place a simpler form of property tax and then moving towards a market value system over time. This would allow (1) taxpayers to get used to the idea of a tax on property and understand the interrelation between the volume of real estate taxation and the level of local services; (2) local governments to derive some revenues from a property tax; and (3) the state tax administration to get some experience in administration of this tax, which is new both for the state and its citizens.

In designing a property tax system, it is important to satisfy a number of criteria:

- *ease of administration*: The property tax has to be easy to administer in terms of the assessment of property, the procedure for assessment appeals, the issuing of tax bills, the collection of taxes, and enforcement. The simpler the design of the tax, the easier it will be to administer.

[1] For example, on the 31st of July 1998, the open meeting of the section of small and middle towns of Ukraine of the Association of Ukrainian Cities applied to the Verkhovna Rada with a plea to pass the Real Estate Tax Law as soon as possible – with "its pilot testing in several Ukrainian cities/towns."

[2] These points are based on Kelly, Roy. "Implementing property-tax reform in transitional countries: the experience of Albania and Poland." *Environment and Planning C: Government and Policy*. Volume 12. 1994.

- *accountability*: Taxpayers should know how their properties were assessed and how their taxes were calculated. If they feel that their assessment is unfair or the tax rate is too high, they should know who is responsible. Again, the simpler the tax design, the easier it will be for taxpayers to understand, and the more accountable it will be.
- *neutrality*: The tax should not distort economic decisions such as the decision to invest in property or to improve one's property.
- *fairness*: The tax needs to be fair and also needs to be perceived to be fair by taxpayers. Fairness can mean that the tax is related to the benefits received from local government; fairness can also mean that the tax is related to ability to pay.
- *stability*: The tax should provide a stable source of revenue to municipalities. Revenues should not fluctuate dramatically from year to year.

III. The Choice of Tax Base

Two general assessment methodologies are used for property taxation in other countries[3]: area-based assessment and value-based assessment.

Area-based assessment

Under an area-based assessment system, a charge is levied per square meter of land area, per square meter of building, or some combination of the two (in particular, People's Deputy O.D. Shekhovtsov, when discussing the Real Estate Laws, proposed to take the volume of as the tax base). Where both measures of area are included, the assessment of the property is the sum of an assessment rate per square meter multiplied by the size of the parcel and assessment rate per square meter multiplied by the size of the building. It is necessary to determine the assessment rates – they can be the same for land and buildings or they can be different. For example, if there were a policy not to discourage development, a lower assessment rate could be applied to buildings.

A strict per unit assessment results in a tax liability that is directly related to the size of the land and buildings. Any variation to reflect location, market conditions, or the quality of the structures is not included in the assessment base. In practice, however, area-based assessments actually involve some adjustment to reflect different characteristics of the property. The most common adjustments are for location, quality of structure, and use of the property (residential, commercial, or industrial, for example).

When the assessment rate per square meter is adjusted to reflect these other characteristics, the pure unit system becomes unit value assessment. In a unit value system, market value has at least an indirect influence on the assessment base through the application of adjustment factors. For example, the assessment rate per square meter might be adjusted to reflect the location of the property within a particular zone in the city. Although the specific location of

[3] For a review of property tax systems around the world, see Youngman, Joan and Jane Malme. *An International Survey of Taxes on Land and Buildings*. The Netherlands: Kluwer Law and Taxation Publishers. 1994

the property within the zone is not taken into account, properties in different zones will have different values.

The main determinant of unit value assessment is the area of the property. The adjustment factors are derived from average values for groups of properties within each zone and do not reflect the characteristics of each individual property. When the groups are defined narrowly enough, however, unit value begins to approximate market value. For example, a zone could be defined anywhere from an entire city to specific neighborhoods to properties on one side of a street. The first steps towards such differentiation had been already made in Ukraine when establishing the amount of rental payment levied on communal property (See Appendix 1).

Value-Based Assessment

Value-based assessments are generally based on market value defined as the price that would be struck between a willing buyer and a willing seller in an arm's length transaction. Market value assessment estimates the value that the market places on individual properties. The valuation can be according to the property's highest and best use or according to current use. Some countries use rental value, which determines the value in current use. Rental value eliminates from the base increases in property values due to potential future use and speculation. When a property is being put to its highest and best use and is expected to do so in the future, there is a predictable relationship between rental income and market value. Market value is approximated by the stream of net rental payments, discounted to present value. If the current use differs from its highest and best use, discounted rental income will be lower than market value.

Three methods to estimate market value are used by assessors:

- Comparable sales: This approach involves looking at valid sales of properties that are similar to the property being assessed. It is used when the market is active and similar properties are being sold.
- Replacement cost: This approach values the property by estimating the land value as if it were vacant and adding the cost of replacing the buildings and other improvements. This approach is used when a property is fairly new, there are no comparable sales, and the improvements are somewhat unique.
- Income: Under the income approach, the assessor estimates the potential gross rental income that the property could produce and deducts operating expenditures. The resulting annual net operating income is converted to a capital value using a capitalization rate. This approach is used mainly for income producing properties.

In most places, some combination of these three methods is used.

IV. The Situation in Ukraine as of the Fall of 1998

There is currently a tax on land in Ukraine. Land is assessed for tax purposes as well as for other purposes such as privatization. Although the real estate tax law submitted by the

People's Deputies would impose a tax on residential buildings, it does not envisage any tax on improvements.

The assessment of property in Ukraine is currently dispersed among several agencies both private and State owned. They include the Bureaus of Technical Inventory (BTI's), the municipal departments of Land Resources, agencies certified by the State Committee on Land Resources, the State Property Fund, and private real estate agencies. There appears to be competition among these agencies to provide assessment services.

Under the above-mentioned draft law on real estate taxes in Ukraine, the Bureaus of Technical Inventory would be responsible for registration, record-keeping, and assessment of real estate. They are already entitled to carry out that function by the Instruction # 121 (June 9, 1998) of the State Committee on Construction, Architecture, and Housing Policy of Ukraine.

Bureaus of Technical Inventory

There are about 200 Bureaus of Technical Inventory in Ukraine. The BTI are on self-supporting: they do not receive funds from the budget[4]; they charge fees for the services that they provide to clients. BTI are dually subordinated: in the administrative terms – to local governments, on whose territory they operate; and in the methodological terms – to the State Committee on Construction, Architecture, and Housing Policy of Ukraine. The latter also coordinates the work of BTI. BTI are involved in keeping an inventory of properties, property registration, and valuation. BTI can confirm the right of ownership to a building.[5]

Currently in Ukraine, there is a national effort to register all property. A draft law is being prepared to provide for a National Registry, which would result in uniform registration throughout the country. The BTI is focusing on creating this uniform system of title search nation-wide. About seven of the BTI's are computerized and the rest will be computerized in the near future[6].

Assessment of buildings is done by the BTI for a number of reasons:

- Historically, property insurance was mandatory and required an assessment of buildings. This meant that all properties were assessed in the past by the BTI. This is no longer the case, however.
- When there is a change in ownership (from a sale, inheritance, or gift), a certificate is required from the BTI. The assessment of the property is also used to establish a minimum value for a stamp duty that is levied with a change in ownership.
- When a new house is constructed, a certificate of ownership is required from the BTI. When improvements are made, a certificate is required to legalize them.

[4] To the contrary, they are a source of the government's budget revenues. According to the Head of the Ukrainian BTI Association, A.Y. Kosher, the volume of tax payments paid by the BTI in 1997 is about UAH 70 mln.
[5] There is some question about whether BTI can guarantee that the registered right is lawful. See Hackett, Peter. 1998. "A Question of Property: Can Ukraine Guarantee Title?" *Eastern Economist*. June 8, 1998.
[6] According to information provided by the Head of the Assessment Department of the "Yanus" Real Estate Stock Exchange, Olga Ryzhkova.

At the present time, registration and valuation are undertaken only at the request of the owner and at the owner's expense. In other words, properties are not systematically assessed on a regular basis. This means not only that there is a substantial number of properties for which the assessment is out of date (assessment based on replacement cost) but also that there is no process for an annual update of all property values.[7] Given the high level of technical equipment in Kyiv, it is certain that it would take much more time to do the full up-dating in other municipalities, where the degree of computerization is not as high.

BTI's only assess the value of buildings and not land. Historically, they kept information on land (the size of land parcels but not the value) but the responsibility for land was turned over to Committees of Land Resources about five years ago. BTI's have generally kept the records of registration for land, however.

Assessment Methodology

The method of replacement cost is used to assess the value of buildings. This method is based on a 1982 Soviet manual. An assessor goes to the field to measure the size of the property in square meters and to determine its characteristics (such as basement, walls, internal walls, floors, roof, windows, heating). Floor plans are drawn, including all improvements and additions, and then the replacement cost of the property is assessed using the manual.

The assessment manual provides formulas for 240 different property types and applies coefficients, correction factors, and depreciation factors. Indexes for inflation are also used. The result is an estimate of value based on historical methods of calculating replacement cost. No account is taken of location in the calculation[8]. It is evident that replacement cost does not reflect market value anywhere. For example, in Kyiv, replacement cost is much less than market value; in Irpin, replacement cost is much greater than market value.

Bureaus of Technical Inventory currently do not collect the data necessary for assessing properties at market value (i.e. they do not collect sales data). The staff have no expertise in market value assessment. Rather, they inspect properties and calculate the replacement cost. Although they have written a computer program in Kiev, which replicates the manual, there is no software to implement market value assessment.

Other Departments and Agencies

The State Committee on Land Resources is responsible for the assessment of land for purposes of the land tax and privatization. Land is assessed according to a complicated formula that is based on the number of square meters of land and includes coefficients for the functional use of the property and for location[9]. Municipalities are divided into zones with different coefficients that reflect different market values in different locations (or zones). The

[7] According to the Head of Kyiv BTI, V.P. Polischuk, it would take about two years to update the Kyiv's assessment roll and about 50 percent of properties would need to be inspected.
[8] It should be mentioned, however, that some BTIs (such as the BTI in the town of Bila Tserkva) apply zoning coefficients when assessing property for purposes of its distribution between the spouses in the case of a divorce.
[9] In accordance with the Order # 76/230/325/150 of the State Committee on Land of Ukraine entitled "On the Procedure for Pecuniary Assessment of Land Plots Meant for Agricultural Use and Land Plots in Settlements."

State Committee has certified agencies to perform the assessment function including the delineation of zones.

Private real estate companies have been involved in assessment for a number of reasons. In the case of divorce, they have assessed common property for settlement purposes. They assess property for businesses to use as collateral for bank loans. The Association of Real Estate Agents, comprised of 38 agencies, has a database on sales prices that includes all major cities in Ukraine. Trends in the real estate market are tracked and an analysis is done of the factors that influence sales prices. There is also a training program for assessors that is run privately under license from the Ministry of Education.

V. A Property Tax for Ukraine

Thus, setting up a true market value assessment system will probably take about ten years and will need to be done in stages. For this reason, a unit value assessment system is recommended in the short run. After the uniform national registration process is complete, in about two years, a unit value system could be introduced.

Unit value assessment would be based on the number of square meters of the residential unit.[10] The tax liability would be directly related to the size of the building. Assessment rates would have to be determined depending on the amount of revenues to be collected.[11] Square meters could be adjusted to reflect the quality of the unit and the location. For quality, a factor could be determined which reflects the age of the unit and whether it has been renovated.[12] For location, each municipality could be divided into zones (as is currently being done for purposes of taxation or rental of land) to reflect differential market value.

A Numerical Example

A simple example will help to illustrate how a unit value property tax could work in practice. Table 2 shows how the property tax could be calculated for four different properties.

Table 2:
Calculation of Hypothetical Unit Value Property Tax

Property	*No. of sq. m.*	*Location coefficient*	*Quality coefficient*	*Weighted No. sq. m.*	*Hryvnia per sq. m.*	*Total Tax*
A	50	1.0	1.0	50	2	100
B	50	2.0	2.0	200	2	400
C	100	0.5	0.5	25	2	50
D	100	2.0	1.0	200	2	400
Total	300			475		950

[10] It could also be applied to land and to non-residential properties in the future.

[11] Municipalities would set their own assessment rates but the rates could be restricted in legislation.

[12] Quality is usually measured by the age of the building. A more appropriate measure of quality in Ukraine might also include whether a unit has been renovated or not.

Properties A and B are each 50 square meters; properties C and D are each 100 square meters. The location and quality coefficients would each be calculated as an index where the value for the average property would equal 1.0. In Table 2, the coefficients range from 0.5 to 2.0. These numbers were arbitrarily chosen for this example. In practice, to calculate the index, it would be necessary to estimate how sales prices vary by locat ion and by quality.

The two coefficients are multiplied together to derive an overall index and this index is multiplied by the number of square meters to calculate the number of weighted square meters. Property B, for example, is 50 square meters but the number of weighted square meters is 200.

If the municipality wanted to collect 950 hryvnia overall from the four properties, it would divide the amount it wants to collect by the total number of weighted square meters (950/475). In this example, the tax rate would be 2 hryvnia per square meter. The property taxes on each of the properties is shown in the last column of Table 2. As Table 2 shows, two properties of similar size (for example, 100 square meters) will pay different amounts of tax depending on their location and quality.

Reasons for Unit Value Assessment

There are several reasons for recommending a unit value property tax system in Ukraine at this time:

1. Given current resources and assessment techniques used in Ukraine, it could take about ten years to implement a proper market value system. Rather than wait that long to introduce a property tax in Ukraine, a unit value system could be put in place sooner. Unit value assessment would build on existing information (of the BTI) and techniques used for other taxes (such as the use of zoning coefficients used to calculate the land tax).
2. The assessment of property should be uniform across the country for the tax to be fair and to be perceived to be fair. This means that two similar properties should be assessed the same amount. Further, if similar properties are assessed differently, there will be incentives to move to other locations, to change the amount of investment in property etc. For these reasons, the differentiation between small and large cities (as is set out in the legislation) may not be a good idea because it will result in a non-uniform assessment system. Unit value could be applied uniformly across the country.
3. The tax on buildings could and should be combined with the tax on land in the future to have a real property tax. A different amount per square meter could be applied to the land portion than the building portion. For example, if the intent were not to discourage investment in improvements, a lower rate could be applied to the improvements portion. Under the proposed real estate tax law, the market value of properties is suggested for large cities and replacement cost with zoning coefficients to reflect location is suggested for smaller cities. This type of real estate tax potentially duplicates the taxation of land in the land tax.
4. One of the problems in estimating market value in Ukraine relates to the shadow economy. To the extent that the sale price recorded in contracts differs from the actual sale price in the transaction, the estimate of market value would not be able to capture the

true sale price. With a unit value system, it is not necessary to collect individual market value data.

5. It is anticipated that a unit value system would cost less to administer than a market value system because it would not require the training of a large number of assessors. This would mean that a fairly low rate of tax could be levied initially to cover administrative costs. Low rates would allow a property tax to be introduced as a revenue source to local governments even though the revenues would initially be small. Over time, bodies of local self-government would decide whether it is worthwhile to increase the rates within the range set by the Parliament.
6. In some other countries that have used unit value assessment, there has been a switch over time to market value. By defining zones more narrowly over time, unit value can eventually approximate market value. This means that unit value assessment can easily evolve into a market value system.

Tax Relief

In designing a property tax for Ukraine, it will be necessary to provide some form of tax relief to low-income households. Three methods are generally used: property tax credits, property tax deferrals, and subsidies. Some form of subsidy or exemption, restricted to low-income households, would probably work best in Ukraine.

Property tax credits provide a credit against income taxes for property tax payments: the higher the property tax and the lower the income, the greater the credit. Tax credits are refundable so that if property tax payments exceed income, a refund is provided. Tax credits would not be appropriate in Ukraine for two reasons: they require income tax filing by low-income taxpayers and they require households to pay property taxes and wait for a credit.

Property tax deferrals are generally used for low-income seniors. The government (central or local) pays the property tax and takes out a lien on the property. This program would likely be unpopular in Ukraine.

A problem with granting property tax exemptions (full or partial) for low-income families is the administrative complexity of verification of the right to such exemptions. This is suggested by the current situation with subsidies for communal services (a significant number of certificates that need to be filed, the necessity to up-dating them frequently, etc.). Such an approach would increase administrative costs significantly, but it requires more in-depth consideration.

VI. The Administration of the Tax

♦ The first step is to update and make consistent existing information of the BTI on properties within their jurisdiction. In particular, information that needs to be collected for each property includes: an assessment roll number of the property, the address, the owner(s) of the property, the area of the unit in square meters, the age of the unit, and whether or not it has been renovated. This information is available for most properties but, in many cases, would need to be updated. Since reassessments are currently triggered only by the owner for specific reasons, the information for many properties has not been updated. A question arises: who will incur costs of this labor-consuming work? Currently, BTI generate their own operating expenses through the fees they charge. Keeping in mind that the BTI may want to enhance their present operation with these new assessment duties, they have incentives to use some of their "profit" to fund needed improvements. This incentive may work to minimize additional costs.

- The information that is collected has to be reported in a consistent way and aggregated.[13] The report should be sent to the State Tax Administration for the purposes of preparation of tax bills, their sending out, and tax collection itself. It is reasonable to consider putting in place a process to update this information on an annual basis.
- Each property has to be placed within zones that reflect different locations in each municipality. Since zoning coefficients are established for land tax purposes, these could possibly be used for the purpose of the real estate tax as well. Real estate companies have sales data that could also be used to determine zones and zoning coefficients. Coefficients could then be set to reflect the differential market values associated with different locations.[14] Quality coefficients could also be determined based on age of the unit and whether it has been renovated.
- A process needs to be set up to send assessment information to taxpayers showing the assessment roll number of the property, the address, and the assessed value. Information should be provided on how to appeal the assessment including the date by which an appeal has to be made.
- In order to provide the required leadership and direction in implementing a nationwide property tax system, an implementation team with substantial authority needs to be developed at the State Tax Administration (STA). Many of the specific work elements need to be either carried out or directed by this STA team.
- A system of tax collection needs to be put in place. The STA, through its 630 rayon offices, could take on the collection of the real estate tax; it already collects the land tax. The STA would prepare a tax roll for each municipality based on the assessment roll for the year. The tax roll would show for each separately assessed property in the municipality: the assessment roll number of the property, the address, the owner, the assessed value of the property, and the total amount of taxes payable. Tax bills would be sent to each taxpayer with the same information as well as the date or dates on which taxes are due, the place or places where they can be paid, and the late payment charges which will be imposed on overdue taxes. A close cooperation between the STA and local BTI is required in accumulation of information, production of tax bills, provision of some control over the quality and tax collection. There will be significant costs before this system will work and generate revenues.
- While the unit value assessment is being set up, it is possible to collect sales price data. Then, it would be necessary to purchase software that runs regression analysis. At the

[13] The Bureau of Statistics used to require this type of reporting but it is no longer done.

[14] The capitalization of property taxes into property values over time will reduce the differentials between locations. For example, higher property taxes in desirable locations will reduce property values in those locations relative to less desirable locations. This means that location coefficients will have to be updated annually to take account of changes in location differentials.

same time, it will be necessary to train assessors in assessing properties at market value. This is a long-term project. Sales price data can be collected now but the training of assessors will take years to complete.

VII. Tax Rates

Under the proposed Real Estate Tax Law, tax rates are pretty much determined by the State with little discretion at the local level. The tax rate has to be between 0.1 and 0.3 percent of assessed value or 0.6 percent of assessed value for properties larger than 100 square meters.

For the real estate tax to be a truly local tax, local governments need to set the tax rates themselves. Accountability in local government requires that the governments making decisions on expenditures also be responsible for taxing those who benefit from these services. Through local taxation, local governments are made accountable to those who elect them. If the central government levies tax rates, the link between expenditures and revenues is not made. Further, it makes it easy for local governments to blame someone else for their expenditure and revenue decisions.

VIII. Estimating Property Tax Revenues

It is one thing to create an “academic” estimate of property tax revenue based on a draft law; it is quite another to realize the conceptual and administrative issues and tasks that must be addressed before any revenues can be realized. This paper strongly suggests that is will be at least two years before even a rudimentary statewide system of property taxation could generate revenues. If the administrative development process proceeds at a reasonable pace, a stable source of revenue likely could be realized in the next two years.

How much potential revenue is there? A fully developed market based property tax system on only residential property may be expected to have a total potential tax base roughly equivalent to the country’s GDP[15]. This would mean for Ukraine a property tax base approximating UAH 90 billion. At the proposed tax rates between 0.1% and 0.3%, this tax base would yield between UAH 90 and 270 million gross revenue. To put these amounts in comparative context, we should mention that this amount coincides, to some extent, with the revenues from local taxes and fees – 1997 execution was UAH 357 mln; 1998 planned target is UAH 385.7 mln. Additional operational costs need to be subtracted from these figures, however, yielding even lower figures. These figures illustrate that the rates proposed in the draft law are so low that they would yield little net revenues. If property taxes are to make a significant contribution, tax rates would need to be higher than those presently proposed.

If an interim, area tax were established, it would as east initially run against the tax base of “book values” presently established by the BTIs. Perhaps the STA has some insight into what the present national “book value” might be. Using that figure would allow a determination of

[15] See John LaFaver, *Administrative and Revenue Considerations of Establishing a Property Tax System in Ukraine*, 1998.

gross revenues based on alternative tax rates.[16] If the system is to progress to a true market price based system, adequate funding needs to be provided annually to build the required administrative infrastructure.

IX. Public Information Campaign

It, perhaps, goes without saying that a significant amount of public information should be provided to assist in the implementation of the new system. The old adage is, “The best tax is an old tax.” The meaning is, of course, that no matter what the theoretical advantages, people will not necessarily appreciate a new, unfamiliar tax. Ukrainians are not accustomed to a tax on their living space and may react unfavorably.

Some suggestions for improving the public perception of a residential property tax would be to tie its proceeds to a popular public purpose such as education or other national priority. It is purposeful that in many countries real estate tax is referred to as “school tax.”

[16] For 1998, the STA predicted revenues from property tax payable by individuals in the volume of UAH 5 mln. See “Calculation of Revenues from Real Estate Tax (Immovables)” submitted by the Cabinet of Ministers of Ukraine to the Verkhovna Rada for the second reading on 19 September 1997.

Appendix 1

This table demonstrates how local governments in Ukraine apply zoning co-efficients for setting up rent rates.

Rent rates for use of non-dwelling premises in the communal ownership of the city of Rivne (as percentage of the value of real estate assessed by way of expert's appraisal)

##	Establishments and enterprises by kind of profile activity of the leaseholder	Rent rates			
		Center	**Zone 1**	**Zone 2**	**Zone 3**
1	Establishments active in show business, night clubs, casinos, broker's offices, ad companies, and commercial banks	5	4.5	4.5	4.0
2	Trade outlets, public catering entities (including cafes and restaurants)	3. 5	3.0	2.5	2.5
3	Providers of consumer services (excluding automobile service centers), lawyer's offices, public notaries, branches of the Savings Bank, post offices, book traders, stationary trading companies, and drugstores	3.5	2.5	2.5	2.0
4	Public, political, and religious organizations, artists (painters, sculptors, craftsmen, other members of unions of artists), medical facilities:				
	Area up to 120 square meters	2.0	1.5	1.0	1.0
	Area more than 120 square meters	2.5	2.0	1.5	1.0
5	Specialized outlets selling children's foodstuffs, diary kitchens, kindergartens, educational facilities, facilities for physical culture and sports (except for budget-sustained facilities)	2.5	2.0	1.5	1.5
6	Establishments and enterprises renting cellars and basement, irrespective of their profile	1.5	1.2	1.0	1.0
7	Establishments and enterprises not listed here	5.0	4.5	4.0	4.0

Source: "Sim Dniv" (*Seven Days)* newspaper, 25 July 1998.