

# Is rent for forced lease of land subject to VAT? (3/48/20)

Does the land owner – a taxable person registered for Latvian VAT – have a right to demand payment of VAT in a forced lease of land? And should the amount of VAT be included in or paid on top of the rent? In this article we are looking for answers.

A civil case heard by the Supreme Court

In April 2020 an extended panel of judges of the Civil Division of the Supreme Court heard a civil dispute over recovery of arrears of rent for a forced lease of land and VAT from the owners of a building.

In this case, the Supreme Court stated that the obligation to pay VAT is a public relationship between the government and the land owner, and not between the government and the owners of buildings, or between the land owner and the owners of the building. The Supreme Court finds that the VAT Act cannot be invoked to have one subject of private law demand payment of VAT from another subject of private law.

The Supreme Court states that this procedure remains unaffected by the economic nature of the obligation to pay VAT, i.e. by the fact that a supplier of goods or services usually compensates for his public duty to the government in an economic sense by adding to the net economic value of goods or services some compensation for the amount of VAT normally paid by the end consumer (the principle “VAT included in the price”). The Supreme Court finds that a taxable person can only demand payment for goods or services that includes the required amount for paying VAT, yet he cannot demand VAT from the buyer.

The Supreme Court states that it was not the legislature’s intention to give the land owner a right to demand that the owners of the building pay compensation for VAT due in addition to the prescribed maximum rent.

These Supreme Court findings essentially lead to the conclusion that under the existing public relationship between the government and the land owner, he is liable to pay the government VAT on a land lease but has no right to demand that the owners of the building pay VAT in addition to the statutory rent.

These Supreme Court findings put the land owner in a particularly unfavourable situation, making him pay VAT out of his pocket.

However, four of the judges hearing the case expressed a dissenting opinion on key VAT issues and disagreed with the finding made in the ruling that the VAT Act cannot be invoked to have one subject of private law demand payment of VAT from another subject of private law. The dissenting judges based their opinion on the rules of Council Directive 2006/112/EC,<sup>1</sup> as well as referring to the case law of the Court of Justice of the European Union (“CJEU”)<sup>2</sup> and to the core principles for the functioning of the VAT system, stating that in collecting VAT, the supplier of goods or services essentially acts as a “cashier” for the government, and this duty is imposed on him by law.<sup>3</sup>

So, if the land owner is to carry out his duty to the government, he must first collect VAT from the other party to the private relationship: the tenant in a land lease and the owners of an apartment block in a forced lease.

A minority of judges disagreed with the position stated in the ruling that the rent prescribed by section 54(2) of the Privatisation of State Owned Residential Buildings Act includes VAT. The dissenting judges based their opinion on relevant findings by the Constitutional Court,<sup>4</sup> and on the SRS's interpretation of a forced lease of land, which is a taxable transaction within the meaning of the VAT Act.<sup>5</sup>

It follows from these facts that this provision of law excludes VAT. So, if the landlord is a taxable person registered for VAT, then VAT is payable in addition to the agreed rent for the land.

In summary, we can see that the current legal framework for paying VAT in forced leases of land is objectively unfair because –

- it creates inequality between the owners of an apartment block sitting on land owned by a taxable person and those whose house sits on land owned by a non-taxable person;
- it is questionable whether charging VAT on the rent for a forced lease complies with EU law.

An evaluation of the directive's rules on transactions eligible for VAT exemptions raises reasonable doubt as to whether the directive allows a member state not to exempt all types of real estate leases, in particular transactions such as a forced lease of land under apartment blocks.

So, the Constitutional Court is right to have referred this case to the CJEU for a preliminary ruling, something the dissenting judges feel should have been done by the Supreme Court in settling this dispute.

We hope that the CJEU ruling will shed some light on whether the rent for a forced lease of land is subject to VAT, and if so, then how.

We will be keeping an eye out for any progress on this topic.

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<sup>1</sup> Articles 1(2) and 73 of Council Directive 2006/112/EC

<sup>2</sup> CJEU ruling of 7 November 2013 on joint cases C-249/12 and C-250/12, Tulică and Plavoşin, ECLI:EU:C:2013:722

<sup>3</sup> Section 34(7) of the VAT Act

<sup>4</sup> The Constitutional Court's ruling No. 2008 34-01 of 13 February 2009

<sup>5</sup> The SRS's advance tax ruling No. 8.11-20/631491 of 1 August 2014