

Should derived public entities include real estate tax in taxable amount of land lease services for VAT purposes? (2) 3/51/23

In its ruling C26128713, SKC-201/2019 of 28 June 2019, the Supreme Court took a different view on the VAT Act's condition that the taxable amount should include only taxes payable in relation to a supply of services. The dispute involved a forced lease of land that stipulated a rent plus a compensation of real estate tax (RET). The Supreme Court was assessing whether VAT should be charged on the compensation. First of all, the assessment focused on what items attract RET and who is liable to pay it.

RET is chargeable on land, buildings and engineering structures.¹ RET is payable by Latvian or foreign individuals and entities and by groups of such persons set up under a contract or other agreement or by their representatives, who own or lawfully possess (or use in statutory cases) a piece of real estate.²

The owner of real estate is a person whose ownership has been entered on the land register or whose real estate (buildings and engineering structures) had been registered with a municipality or with the National Land Service before the Land Registers Act was restored.³ The Real Estate Tax Act defines the possessor, too.

RET on any state-owned real estate is payable by the person in whose name it has been entered on the land register. If the law names a person to whom the use of the state-owned real estate has been given, then RET is payable by the person who has a statutory right to use the property.⁴ For example, the Cabinet of Ministers' rules may determine the manager of state-owned real estate.

A tenant is not recognised as legal possessor of the property. Unless the law makes the user liable to pay RET in a particular situation, RET is the owner's liability.

These rules imply that RET is chargeable on the property and the landlord is liable to pay it, plus RET would be payable even if the property were not leased. On this basis, the Supreme Court found that RET is linked to real rights in property and to cases of lawful possession and use expressly prescribed by law. Apart from engineering structures, using real estate for certain purposes is not something that by law creates an obligation to pay RET. RET on land is payable by its owner, whether an individual or entity, whether or not the land is built up, and whether or not it's used in business, including lease services. So there is no reason to believe that RET, which the landlord pays to the municipality in fulfilling his statutory obligation, is directly linked to the land lease service supplied in a forced lease relationship.

According to the Supreme Court, RET is not a tax payable in relation to lease services, so any RET compensation should not be included in the taxable amount for VAT purposes. The Supreme Court also refers to rulings made by the Court of Justice of the European Union, finding that if taxes are to be part of the VAT base, they must have a direct link to the service. So VAT is only charged on tax payments that are directly linked to the service.

It's important to note that this ruling was made in relation to a forced lease, yet the court does not indicate that its forced nature prevents us from treating the RET charge as linked to the lease service. Although a forced lease is an exempt supply, it's still considered a supply for VAT purposes. So this should not affect the assessment. The Constitutional Court's ruling implies that if the parties to a lease have separately agreed on the rent and RET compensation, the latter should not be charged to VAT.

Accordingly, based on the Supreme Court's ruling, a derived public person leasing its own land might not include RET in the taxable amount if the tenant compensates the landlord for RET under the agreement. However, since the contrary opinion publicly expressed by the State Revenue Service still stands, we recommend seeking their approval for this issue if necessary. The landlord being a public person could not affect the VAT treatment as long as the public person, who is a taxable person for VAT purposes, has carried out the transaction in the course of business.

¹ Section 1 of the Real Estate Tax Act

² Section 2(1) of the Real Estate Tax Act

³ Section 2(2) of the Real Estate Tax Act

⁴ Section 2(5) of the Real Estate Tax Act