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IMMOVABLE PROPERTY TAXATION POLICY IN LATVIA

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Abstract
After the restoration of independence, Latvia took a path towards a market economy and private land ownership and which mentioned wide land privatization process and building an immovable property cadastre to collect information on immovable properties. Transition to private land ownership meant that immovable property taxation will start to tax privately owned assets not assets rented from the state, a model similar to other market economies. Initially, there were two laws on the taxation of the property – The law on land tax and the Law on Property Taxation to tax commercial assets and unfinished construction objects which were adopted in December of 1990 even before the starting of land reform and privatization. In 1997 new Law on immovable property tax was approved by the Latvian Parliament and it is still in force with numerous amendments which due to the rapid development of the immovable property sector have been approved until today. Before the global economic-financial crisis in 2008 prices of immovable property were increasing rapidly followed by contraction during the global economic crisis. Immovable property tax is often considered as taxing accumulated wealth however it may have distortions and disproportionate impact on those owners who did not contribute to immovable property value growth. Therefore, the aim of this research is to evaluate the development of the immovable property taxation system development in Latvia and to compare it with the systems of neighbouring countries. Therefore, to achieve this aim following objectives were set: to analyse legislative acts regulating immovable property taxation in Latvia, and practices of other countries and to draw research conclusions.
Key words: tax, immovable property, property, land.

Introduction

During the existence of the Soviet Union, all land in the territory of Latvia belonged to the state and there were no other landowners. In December of 1990, two legislative acts on taxation of the property were adopted – one law on land taxation and another law on taxation of commercial assets and unfinished construction objects. It means that the immovable property taxation system was created even before the full restoration of independence and it was intended to collect taxes from land users and owners of commercial assets. During the last few years many discussions on immovable property taxation were conducted both on a political and expert level, however, there is no agreement so far on what changes could be made to immovable property taxation.

After the restoration of independence in 1991 Latvia started to transform into a market economy just like in other democratic countries where it is based on private ownership of assets. This radical change required to implementation of land reform and privatization process as well as the developing immovable property cadastre to collect information on immovable property properties. Several legislative acts, such as law “On land reform in cities of the Latvia Republic”, law “On land reform in rural areas of the Latvia Republic” and law “On land privatization in rural areas of the Latvia Republic” were developed and adopted by the Latvian Parliament to ensure privatization of land and other assets, including residential and commercial buildings. Transition to private land ownership meant that immovable property taxation will have private land and assets as a subject for taxation purposes making Latvian taxation policy similar to other market economies meanwhile providing necessary financial means for municipalities and national government to finance their functions. In 1997 new Law on immovable property tax was approved by the Latvian Parliament to regulate taxation both of land and other immovable property assets. In scientific literature, most attention regarding immovable property-related taxation is given to so-called betterment tax, broad base or special area tax, and tax on immovable property transactions or transfer tax. In this article, authors will concentrate mostly on broad base immovable property tax while highlighting some aspects of so-called value capture aspects. Immovable property tax traditionally is considered a local level tax that is to be paid into the local municipality budget. There are the following main criteria that are attributed to taxation instruments as a part of the system of public finances: efficient, equitable, administratively practical, and cost-effective (Abelson, 2018). The principle of equitable tax means that payment should be based on the ability of a household to pay and benefits should go to those in greatest need. The principle of efficient tax means that it is levied on benefits that can be earned from land use irrespective of whether they were or were not earned to ensure that land is used efficiently for economic gains and development. It is also supported by other authors who state that experience highly developed states demonstrate that immovable property tax serves as an objection to inefficient use of land and inappropriate allocation of capital in geographical terms (Hozer, Kokot,2005). Another important aspect is that the base for land tax should be calculated accurately as this substantial issue in case of land value uplift. Therefore, it is important to have a quickly reacting cadastral valuation system that can catch sometimes very rapid changes in the immovable property market, in particular, if there are rapid booms and busts. At the same time, the immovable property taxation system should be flexible enough to take into account the needs and ability to pay of specific target groups.

Methodology of research and materials

This research aims to evaluate the development of the immovable property taxation system development in Latvia. Therefore, to achieve this aim following objectives were set: to analyse legislative acts regulating immovable property taxation in Latvia, and practices of other countries and to draw research conclusions. Immovable property taxation system development in Latvia was chosen as a subject for this research, as well as immovable property taxation system of Latvia was compared with those of Lithuania and Estonia. Relevant legislative acts on immovable property taxation in Latvia, as well as in Estonia and Lithuania were chosen for analysis. Monographic descriptive method, analysis, and synthesis methods were used for the research of immovable property taxation system development, theoretical aspects, and problem identification. Logical construction and interpretation methods were used to conclude the research.

Discussions and results

Immovable property taxation in Latvia, as mentioned earlier, has been started in December 1990 when the Parliament approved two very important legislative acts on taxation. One of them was Law on land tax but another one was Law on Property Tax. It is important to stress that at that particular moment, the independence of Latvia was not yet restored “de facto” and land reform and land privatization were not yet implemented therefore taxation, in principle, was oriented toward land users but not land-owners. It should be mentioned that in 1997 new Law on immovable property tax was approved by the Latvian Parliament and the since that numerous changes have been made to the regulation of immovable property taxation and therefore authors consider it necessary to highlight the most important aspects in the initial legislative acts and currently enforced law “On Immovable Property Tax”. These aspects are described and compared further in the text and tables below.

Table 1

Comparison of some aspects of the immovable property tax laws adopted in Latvia since 1990

Aspects	**Law on Land Tax, 1990 – 1997 (not valid anymore)**	**Immovable property tax law introduced in 1997 (currently in force)**
Aim of the Law	To encourage land users and local municipalities in better management of land as well as to get rent payment from land users.	Not stated
Land tax rate	Average amount per hectare of agricultural land in each municipality the Double the average amount per hectare of non-agricultural land Specific amount per square metre cities	To be set by the local municipality in a range from 0.2 % up to 3% of immovable property cadastral value. If not decided by municipality: 1) 1.5% of land cadastral value; The tax rate for unfinished buildings
Land tax rebates	100% rebate for farmers but not longer than 5 years Rebates are available for retired people, disabled people, families with at least three children, poor families, young families, and charity and religious organizations (upon request and subject to the decision of the municipality)	Rebate up to 90% for poor persons and householdsThe rebate, 50% for families with three and more children for politically repressed persons A municipality may decide on rebates for other categories of immovable property owners and rebate size can be 90% or 70% or 50% or 25%.
Increased tax rate	Not set, subject to the decision of the municipality	Tax rate to be increased by 1.5% for unused agricultural land

It is worth mentioning that the Immovable property tax law does not state the ultimate purpose of the immovable property tax. It is possible to refer to Law on taxes and fees which defines tax as a statutory and mandatory periodic or one-off payment for ensuring revenues of the State budget or local government budgets (basic budget or special budget) and funding the functions of the State and local governments (Law on taxes and fees). However, this definition does not provide a specific rationale for immovable property tax and this could be considered a substantial deficiency of the legislative process.

The law on Land tax stated that this law aims to encourage land users and local municipalities to better management of land as well as to get rent payments from land users. Land that by decision of the state institution was allocated to or owned by the natural or legal person was subject to taxation. It is important to mention here that already then there were several exceptions on what kind of land should not be taxed, among them was land that is used for private residential buildings as well as the land where by law or decision of the state institution economic activity is prohibited. There were different tax rates set in the law for each of rural area and these were set as the absolute amount of money as cadastral values did not exist at that time. For a purpose of setting these tax rates quality of agricultural land was used as a reference point.

It can be seen from the comparison that at the beginning of the nineties, the strong role of the state and very centralized regulation at the level of the central government was prevailing in taxation policy as Law set tax rates for each small municipality as well as differentiated tax amounts and rebates were set for various land use categories. This probably could be explained not only by the highly centralized governance approach but also by the fact that there was no mass cadastral valuation done at this moment. After developing an immovable property cadastre and introducing immovable property mass cadastral valuation more decentralized approach for immovable property taxation became possible and was as a consequence implemented as it is possible to see from comparison with current regulation. It is interesting to mention here that Land tax law stated a differentiated approach towards tax for agricultural land, forestry land, and land in cities somewhat similar to the model of Poland which was more in detail described in an article by Maria Heldak and Vivita Baumane which was devoted to a comparison of tax systems in Poland and Latvia (Heldak, Baumane, 2014).

Currently, each municipality is free to choose what tax rate it is willing to set depending on local circumstances and what rebates in addition to those set by the law could be determined by the municipality. Current regulation may be considered rather flexible because it allows municipalities both to set immovable property tax rates and set numerous rebates for various categories of immovable property owners according to the principles set in the Immovable property tax law. The main principles for the decision-making on tax rates and rebates which should be abided by the local municipality are as follows: 1) objective grouping or categorization of immovable properties or immovable property owners; 2) efficiency principle to ensure that income from tax covers administration costs; 3) principle of responsible budget planning; 4) principle of stability which requires to set tax rates for two year period if tax base did not change more than by 20%. In addition to that municipality is allowed to apply two more principles:1) the principle of entrepreneurship support; 2) the principle of territorial development and rehabilitation. These principles are very much in line with those mentioned above and once again underline how much power regarding immovable property taxation is delegated to the local municipalities.

The law on Property Tax was abolished in the year 2000 and regulation of property taxation was partially transferred to the Immovable property tax law. Before that this law stipulated that only commercial assets and unfinished buildings are subject to taxation. Under the Immovable property Tax law thereby was no anymore separate tax on land and separate tax for property and there was, in general, only immovable property ownership as a subject for taxation. Another substantial difference is that it is not anymore clearly stated that only those buildings that are used for commercial activity are subject to tax. Still, in the year 2000 when the Immovable property law was enforced, it set the single tax rate for immovable property in the whole of the country, initially, it was set at 1.5% and for the period from the end of the year 2002, it was set at 1%.

There were more exemptions on tax in the Immovable Property Tax law when it was adopted in comparison to both of the previous laws. It should be noted that residential buildings and flats in multi-apartment houses since 1998 were exempt from tax unless these are used for commercial activity, however, it was stated in the law that this exemption will be in force until 31 December 2003. Since the beginning of the year 2003 also those buildings used for agricultural production were subject to exemption until 31 December 2003. After the end of 2003, both exemptions were kept without a specific winding-up deadline until the beginning of the year 2010 when a new amendment to the law Immovable property Law was enforced which excluded previously existing exemptions for residential buildings and flats in multi-apartment houses. Since then differentiated tax rates for residential buildings were introduced and there were differing tax rates for land and residential buildings. Currently enforced regulation on the tax rate is described in table 2 below.

Table 2

Comparison of some aspects of the immovable property tax laws adopted in Latvia since 1990

Legislative aspects	**Law on Property Tax, 1990-1999 (not valid anymore)**	**Immovable property tax law, introduced in 1997 (currently in force)**
Aim of the Law	To tax fixed assets, commercial assets, and unfinished buildings.	Not stated
Property Tax rate	Specific fixed amount and additional percentage depending on the value of the property. As larger the value of the property as the larger the tax rate is.	To be set by the local municipality in a range from 0.2 % up to 3% of immovable property cadastral value. If not decided by municipality: 1) 0.2 % of residential building cadastral value if it is less than 56915 Euros; 2) 0.4 % for the share of residential building cadastral value which is in range of 56915 - 106715 Euros; 3) 0.6 % for the share of residential building cadastral value which is above 106715 Euros. The tax rate is 3% for unfinished buildings. The tax rate is 3% for buildings that degrade the local environment, are collapsed, or dangerous
Property tax rebates	Municipalities may approve 90%, 50%, and 25% rebates Specific differentiated rebates up to 50% if serving state procurement	Rebate up to 90% for poor persons and households Rebate 50% for families with three and more children Rebate 50% for politically repressed persons A municipality may decide on rebates for other categories of immovable property owners and rebate size can be 90% or 70% or 50% or 25%.
Increased tax rate	Not set	Tax rate to be increased by 1.5% for degraded buildings and building dangerous for the environment

Residential buildings became subject to tax because of the very poor budget situation both at the national and municipal levels during the global economic crisis that started in 2008. There is no clear reasoning mentioned in an annotation to amendments of the Immovable property tax law which introduced taxation of residential buildings however authors consider that budget needs could be the main reason. It should be noted that initially, tax rates for residential buildings were 0.1%, 0.2%, and 0.3% depending on their cadastral value but these rates were doubled later in 2012. It meant an additional tax burden on residents and allowed the central government to compensate local governments for a decrease of their income from personal income tax which is a main source of municipal budgets. It should be mentioned that there are differing tax rates for land and for residential buildings which creates some confusion in public even though tax for immovable property is to be calculated considering both cadastral values of the land and residential building. The reason for such confusion is sometimes made by the comparison by immovable property owners when the market price of a private residential building or apartment in a multi-apartment house with included land value is compared with a similar building or apartment without land value included.

In Estonia rate of land, tax shall be 0.1-2.5% of the taxable value of land annually. It is to be paid by the land-owner to the respective municipality (Land tax law, Estonia). In Estonia, residential buildings and apartments are not subject to tax but only land under them. Land tax will not be imposed if the calculated tax payment is less than 5 Euros. In comparison, in Lithuania, immovable property tax is to be paid by the Lithuanian and foreign natural and legal persons and tax is to be paid into a municipality budget. In Lithuania, immovable property tax is set to be in a range from 0.3% up to 3% but usually, municipalities set it at a 1% rate. Immovable property tax is to be to paid only for the value of property exceeding 150 000 Euros (so-called taxable value) but for families with three or more children or with children in need of permanent care this threshold is 200 000 Euros. Immovable property tax in Lithuania has progressive tax rates – 0.5% for part of the value of immovable property in a range from 150 000 Euros up to 300 000 Euros, 1.0% for part of the value of immovable property in a range from 300 000 Euros up to 500 000 Euros, 2.0% for part of the value of the immovable property which is over 500 000 Euros. Land tax in

Lithuania includes payment only for land and the tax rate can be set from 0.01% up to 4.0% of the land value. (Immovable property tax, Lithuania).

Table3

Comparison of tax exemptions in the immovable property tax laws adopted in Latvia since 1990

Legislative aspects	Law on Land Tax (1990-1997) and Law on Property Tax (1990-1999)	Immovable property tax law, - 1997 (currently in force)
Main exemptions to Land tax	The land where economic activity is prohibited Land under roads, communication lines Land under residential buildings Land under municipal buildings Land under objects of culture, communal services, education, healthcare, and sports facilities	Land under roads, communication lines Land in nature protection areas where economic activity is prohibited Land under reforestation Land under cemeteries and related buildings
Main exemptions to Property tax	Property of natural persons if not used for commercial activity Property used for agricultural production Monuments of culture Communal services and municipal buildings Residential buildings Property of NGO's and religious organizations (subject to the decision of the Government) Public roads and communications Property used for nature protection and fire security	Roads, communication lines, streets, public water areas Immovable property owned by the municipality and foreign countries (for diplomatic relation purposes) Immovable property owned by religious organizations Monuments of culture, except if used for residence or economic activity Buildings and engineering infrastructure used solely for agriculture Buildings owned by the state or used by state institutions Buildings used by museums, libraries, National Opera, state theatres, and concert organizations

There are numerous exemptions from the tax in Latvia and it should be mentioned that other Baltic states follow rather a similar approach as can be seen from their respective legislation. It is worth mentioning that Latvia has set a more flexible approach towards the possibility to grant tax rebates for various categories of immovable property owners while Estonia allows municipalities to decide on rebates for retired people, people partially or fully without the ability to work and politically repressed persons while Lithuania only uses a differentiated threshold of taxable value for families with three or more children. It should be mentioned that in Estonia only land is subject to tax while in Latvia and Lithuania value of both land and buildings are subject to immovable property tax. It should be mentioned that the Estonian taxation system is considered one of the most liberal and simplest systems in the world and Estonia is mentioned as a European pioneer in introducing flat tax rates (Mazure, Viksne, 2014). Local level budgets constitute rather a small share of the national GDP in Baltic states and property taxes which are single own-resource income is about 10% of the total municipal budget (Bernardi, Chandler, Gandullia, 2017).

Immovable property taxation has become one of the important political discussion subjects after Latvia joined the EU in 2004 and the Latvian economy overheated before the global economic-financial crisis of 2008-2009, thanks to the inflow of EU funding, a substantial increase in remuneration of public sector and rather relaxed credit policies of the commercial banks. Much of the financing made available by commercial banks were directed to the immovable property sector and many new residential area projects were built-up. This massive flow of investment into the immovable property as a consequence was increasing immovable property prices, creating an immovable property bubble that went bust when the global economic-financial crisis arrived. It created large disparities between immovable property prices and immovable property cadastral values which meant that due to inappropriately low levels of cadastral values set immovable property tax payments were lower than they actually could be according to the current market situation. Considering that new developments mostly took place around and in Riga and other largest cities it needs to be mentioned that the largest disparities between cadastral value and market price were also there.

Another important immovable property segment that experienced substantial changes was the agricultural land market. When Latvia joined the EU in 2004, there was an exemption set in national legislation that provided that citizens of other EU states will not have a right to buy agricultural land until 2011. This restriction period was prolonged by the Parliament to make it effective until 2014 arguing that there is sufficient evidence that after the end of the transitional period (seven years after accession to the European Union), there will be serious disturbances or the possibility of such disturbances in the Latvian agricultural land market. However, after this additional restriction period, agricultural land prices have grown substantially year-by-year as competition to buy agricultural land in Latvia was increasing. As the growth of agricultural land prices was so rapid it was logical that cadastral values should also be adjusted. It would have a further consequence for immovable property tax on agricultural land which would grow likely similar to the market price growth and would raise for farmers. That is why Parliament decided to limit the growth of immovable property tax for agricultural land in order to allow it to grow not more than 10% year by year.

There have been discussions in the political environment on reshuffling the immovable property tax system however this discussion stopped for a while because of disagreements over the cadastral value base which is a basis for further discussion on immovable property tax developments. It should be also mentioned that discussion on overall taxation policy would be needed but considering Parliamentary elections in October 2022 they may probably start in the year following the election year.

Conclusions and proposals

1) Immovable property taxation in Latvia has had many developments since 1990 and the most important ones are the decentralization of immovable property taxation decisions from central regulation of tax rates, the introduction of taxation of residential buildings, growth of the number of exemptions from the tax, and increase in the number of tax rebates;
2) Latvia's immovable property taxation system is most flexible as it allows large room for municipal decisions on the tax rate and tax rebates for various categories of immovable property owners;
3) Latvia has the highest immovable property tax burden among the three Baltic states which can be seen as a consequence of the fact that the global economic crisis hit Latvia more than its neighbours;
4) It is possible to conclude that Latvia and Lithuania have similar immovable property taxation approaches as both land and buildings are subject to taxation while Estonia's approach is to tax only land;
5) It would be necessary to consider an opportunity to legislate a single tax rate for land and residential buildings in Latvia as well as to minimize the use of tax rebates and introduce minimum immovable property value which is not subject to tax.

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