



Weekly Briefing

Latvia economy briefing:

The cadastral value of property in Latvia could double

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Introduction

The Ministry of Justice and the State Land Service have developed and submitted for public discussion the new Draft Law for changing the methodology of evaluating the cadastral value of real estate properties. The planned changes are expected to increase the cadastral value for many properties and could enter into force on 1 January 2022. The calculation shows that the cadastral value of properties in Latvia could double, thus increasing the government income from Real Estate Tax. This has led to broad public discussion since the expenditure on property tax of especially businesses is expected to significantly rise. The total tax income from commercial objects would thus increase by 120% or 54 million euros, but for production objects by 50% or 11 million euros.¹

The new changes in the cadastral values of properties in Latvia.

Cadastral values are used to calculate 16 different taxes, fees and charges, therefore it is important that they are calculated fairly and according to the same principles for everyone. Unfortunately, the current cadastral evaluation methodology opened wide possibilities for tax optimization and determined that, for example, for new projects the coherence of cadastral values to their actual value is lower than for older projects.² In monetary terms, this meant that, for example, Real Estate Tax on a supermarket built after 2000 was paid from a proportionately smaller share than on a building constructed during the Soviet times. Because of that the government of Latvia has developed a draft Law for changing the methodology for determining the cadastral value of buildings. As for the main criterion for changes in cadastral value have been taken building depreciation, materials, and construction period. In order to determine the value of the real estate properties, the location of the property and changes in the environment around the property have been considered - how the environment has developed or, on the contrary, degraded, and infrastructure - new roads, public infrastructure, etc.

¹ <https://www.lsm.lv/raksts/zinas/latvija/politiki-sapinusies-jauna-nekustama-ipasuma-nodokla-meklejumos.a370701/>

² <https://lvportals.lv/norises/318193-jaunas-kadastralas-vertibas-un-piedavata-nekustama-ipasuma-nodokla-reforma-2020>

The cadastral value of agricultural land is expected to increase throughout the country due to the increase in market prices. The value of agricultural buildings will practically remain the same or even experience decrement due to the recalculation of depreciation. Cadastral value will increase for apartments in new project buildings constructed after 2000, as well as for standard-type apartments in buildings built before 2000 in strategic development regions. In turn, the detached houses built before 2000 in areas where there is no market price increase will experience fall of the cadastral worth. However, the value of production objects will experience an increase, as well as new production buildings and commercial objects built after the Year of 2000.

Overall, the cadastral value of commercial objects is expected to increase for new project buildings built after 2000 in cities of national importance and in territories where the real estate market has expanded, but reductions of the cadastral value are expected in older buildings built before 2000, in areas where there has not been an increase in market prices.

Tax reduction for primary house owners

As the cadastral value is also the basis for the calculation of Real Estate Tax, the Ministry of Justice already a year ago prepared amendments to the State Real Estate Cadastre Law and amendments to the Law on Real Estate Tax, which provide for the abolition of Real Estate Tax for primary housing up to 100,000 euros. The Law envisaged that for the primary housing up to 100,000 Euros the real estate tax payment would be free of charge.³ This would mean that for a primary real estate property with a cadastral value, for example, 80,000 euros, the real estate tax payment would be 0 euros, but for a dwelling with a cadastral value of 120,000 euros, the real estate tax would be calculated from the value of 20,000 Euros.

It is already clear that it will be difficult to pass this Law since some coalition partners are criticizing the proposal emphasizing that this will mean a greater financial burden on entrepreneurs. As for example for some industrial parks, buildings, hotels and others Real Estate Tax payment could triple thus limiting the company's free funds for investing in development of their own enterprises.

³<https://lvportals.lv/norises/318193-jaunas-kadastralas-vertibas-un-piedavata-nekustama-ipasuma-nodokla-reforma-2020>

Is the increase of cadastral value valid and functional in today's Latvia's conditions?

The new approach for determining cadastral value has led to broad discussions in the society. It is envisaged that the cadastral value of properties will experience rise by more than 2 times on average. ⁴Thus, according to the calculations of the enterprises themselves, the Real Estate Tax payment for commercial properties and production premises may increase 3-5 times. Therefore, the rearrange and increase of the cadastral value has been criticized by experts as it has many flaws and will impact the available financial resources of both households and businesses of Latvia.

Additional incomprehension has been caused by the timing of changing the cadastral value as currently due to the consequences of Covid-19 Latvia is facing economic recession. While entrepreneurs surviving the COVID-19 crisis are looking for solutions to address the financial consequences of the pandemic, the state is providing the next “support tool” for entrepreneurs - an increase in the cadastral value of commercial and industrial premises and an increase of Real Estate Tax by up to 300-500%. This means that even bigger burden is being put on the commercial sector ignoring the challenges that are currently being faced in regards to business sustainment.

The Minister of Economics Janis Vitenbergs noted that the real estate tax must not become an additional burden on businesses, especially as the crisis caused by the Covid-19 virus has reduced business revenues. Imposing an additional tax burden on businesses will directly reduce both the number of jobs and the remuneration of employees. For businesses currently struggling with significant losses as a result of the Covid-19 crisis, the new Real Estate Tax rules will cause additional financial restrictions. Consequently, prices will rise, exporters will lose international competitiveness, leading to redundancies, rising unemployment, increasing rent payments, and decreasing real estate investment and other investment projects.⁵ The Minister of Economics of Latvia has additionally noted that Real Estate Tax rates must be predictable. When planning changes, it is necessary to consider the purpose of the Real Estate Tax and how these changes will affect real estate prices in the future, the availability of housing in general, investments in the real estate market, as well as Latvia's competitiveness in comparison with neighbouring countries.

⁴ Dārziņa, L. Cadastral value will be determined by new method. Available - <https://lvportals.lv>

⁵ <https://www.em.gov.lv/lv/jaunumi/28648-vitenbergs-nekustama-ipasuma-nodoklis-nedrikst-klut-par-papildu-slogu-uznemejiem>

Current estimates already suggest that changes in Real Estate Tax are disproportionate to our neighbouring countries. Riga lags far behind Vilnius and Tallinn in the construction of new apartments and office buildings, which also reduces the inflow of investments into the country and the creation of new jobs.⁶ In Latvia, the Real Estate Tax is significantly higher than in Lithuania and Estonia.⁷ By raising it even more, Latvia will become increasingly uncompetitive on a Baltic scale, as a result of which foreign investors will prefer Vilnius and Tallinn even more for their investment projects.

Furthermore, the Ministry of Economics predicts that the recovery from the Covid-19 virus pandemic will take about two years, so no tax increase cannot be faced in order to facilitate the economic recovery during this period. According to forecasts, the Real Estate Tax payment for offices, factories, logistics centers, hotels and other commercial facilities will increase on average three times.

Summary

Currently the new Draft Law for changing the methodology of evaluating the cadastral value of real estate properties has promoted a broad public discussion as it is seen that total tax for commercial objects would thus increase by 120% or 54 million euros, but for production objects by 50% or 11 million euros. Overall, the cadastral value of commercial objects is expected to increase for buildings built after 2000 in cities of national importance, in territories where the real estate market has expanded, but reductions of the cadastral value are expected in older buildings built before 2000, in areas where there has not been an increase in market prices. The new principle of evaluating the cadastral value of real estate properties is seen to be beneficial for primary dwelling owners, thus putting more financial pressure on enterprises in Latvia. This has caused incomprehension as Latvia is facing economic recession due to Covid-19 crisis and increasing the cadastral value of properties, thus raising the Real Estate Tax will cause an even bigger financial limitations as currently the enterprises of Latvia are focused on

⁶ <https://www.em.gov.lv/lv/jaunumi/28648-vitenbergs-nekustama-ipasuma-nodoklis-nedrikst-klut-par-papildu-slogu-uznemejiem>

⁷ https://appsso.eurostat.ec.europa.eu/nui/show.do?query=BOOKMARK_DS-471199_QID_-544AFF50_UID_-3F171EB0&layout=TIME,C,X,0;GEO,L,Y,0;NA_ITEM,L,Y,1;SECTOR,L,Z,0;UNIT,L,Z,1;INDICATORS,C,Z,2;&zSelection=DS-471199UNIT,MIO_EUR;DS-471199INDICATORS,OBS_FLAG;DS-471199SECTOR,S13_S212;&rankName1=SECTOR_1_2_-1_2&rankName2=INDICATORS_1_2_-1_2&rankName3=UNIT_1_2_0_0&rankName4=TIME_1_0_0_0&rankName5=GEO_1_0_0_1&rankName6=NA_ITEM_1_2_1_1&sortR=ASC_13&sortC=ASC_1_1_FIRST&rStp=&cStp=&rDCh=&cDCh=&rDM=true&cDM=true&footnes=false&empty=false&wai=false&time_mode=NONE&time_most_recent=false&lang=EN&cfo=%23%23%23%2C%23%23%23.%23%23%23

the financial sustainment due to the pandemic crisis. The current cadastral evaluation methodology opens wide possibilities for tax optimization and determined that, for example, for new projects the coherence of cadastral values to their actual value is lower than for older projects. However, there is a need to evaluate long-term impacts on raising the cadastral value of real estate properties in Latvia as there stands a risk that with the implementation of new cadastral values Latvia could lose its competitiveness on a Baltic scale.