

## Lithuania

**Antanas Dzinga, Dainius Zapereckas, Kestutis Adamonis**

**Sorainen, Vilnius**

### Key facts

#### Main tax rates

Corporate tax rate: 20%

VAT standard rate: 19%

Personal income tax top rate: 15%

Compulsory health insurance contributions top rate: 9 % (applies on the same taxable base as Personal income tax).

#### Population/GDP

Population: 3.4 million

GDP (2008): 32,3 billion

#### Currency

Litas, abbreviated here to LIT (Lithuania is not part of the Eurozone but the Litas is tightly pegged against the Euro at a rate of LIT 3.4528 to € 1).

#### Membership of economic groups

Member of EU,

#### Major industries

Services, retail and wholesale business, forestry

#### Website of tax/finance authority

[www.vmi.lt](http://www.vmi.lt) State Tax Inspectorate under the Ministry of Finance of the Republic of Lithuania

[www.finmin.lt](http://www.finmin.lt) The Ministry of Finance of the Republic of Lithuania

### Introduction

### Recent developments

There were made a package of a legislative amending in respect of tax legislation, which are applicable as from 1 January 2009.

#### *Corporate Income Tax*

The taxable profit of Lithuanian entities and permanent establishments for the tax period started in 2009 is subject to the corporate income tax at the rate of 20% (instead of the former tax rate of 15%).

Income from distributed profit (dividends) is also to be taxed at the corporate income tax rate of 20% (instead of the former tax rate of 15%).

A withholding tax at the rate of 20% is levied on certain income of foreign entities sourced in Lithuania as of 2009. Such income includes income from the sale, other transfer into ownership or lease of immovable property located in Lithuania, as well as income from performing activities and sports activities carried out in Lithuania, and annual bonuses to supervisory board members.

A new tax incentive for the corporate income tax rate was established. It applies to entities running investment projects (the conditions of such projects are defined), and corporate income tax in such case may be reduced up to 50%.

The dividend exemption has been amended. Until 31 December 2008 and after 1 January 2009, dividends are not subject to taxation if a shareholder holds at least 10% of voting shares for at least 12 months. However, from 1 January 2009, this exemption does not cover the total amount of the dividends paid, if the taxable profit of an entity paying the dividends is taxed at the rate of 0% or if the taxable income (or a part of the taxable income) of the entity is not taxed as a result of tax reliefs provided by the law. In the latter case the provision concerning dividend exemption does not cover the dividends paid out pro rata the taxable profit (or its part) which is actually tax exempt (including taxable profit taxed at the rate of 0%).

### ***Personal Income Tax***

As from 1 January 2009, all income, except for income from distributed profits, is subject to the personal income tax at the rate of 15% (until 31 December 2008, the rates of 15% and 24% were applicable). A 20% personal income tax rate has been imposed on income from distributed profits.

Certain tax incentives, including mortgage interest incentive, have been removed. A number of former provisions related to non-taxable income have also been amended, e.g., the minimum period of ownership of property other than residential property after which the income received from the transfer of such property is qualified as a tax deduction has been extended from 3 years to 10 years.

The tax exemption for securities has also been amended. In addition to the currently valid exemption conditions (shares are transferred into ownership not earlier than 366 days after the date of their acquisition and a resident has not held more than 10% of the shares of the entity for 3 years), a condition has been established according to which a resident himself or together with related persons may not have held more than 10% of the shares of the entity for 3 years.

As from 1 January 2009, taxation of self-employed persons engaged in individual activity has been changed.

### ***Value Added Tax***

The standard VAT rate of 18% has been increased to 19%.

As from 1 January 2009, the reduced VAT rate previously applied to passenger transport, books, pharmaceuticals, tourist services, organic foodstuffs etc. has been replaced by the standard VAT rate of 19%. The reduced rate of 9% will be applicable only to books and non-periodic information publications until 1 July 2009.

The reduced rate of 9% has been removed in respect of services related to construction, renovation and insulation of residential houses which are funded from the state and municipal budgets, as well as from soft credits granted by the State and from the resources of the special funds of the State.

Noteworthy that exemptions in relation to certain services (for example, housing services, event services, subscription services) are determined in order to apply a reduced VAT rate (5% or 9%), if such services were ordered in advance up to 31 December 2008.

### ***Compulsory Health Insurance***

As from 1 January 2009, the established amount of compulsory health insurance contributions payable by employers on behalf of their employees is 3% and the employees have to pay compulsory health insurance contributions in the amount of 6% themselves. The compulsory health insurance contributions were previously included in the compulsory social security contributions.

Natural persons engaged in individual activities pay compulsory health insurance contributions at the rate of 9% of the taxable income earned during a calendar year from their individual activities subject to personal income tax. Any other natural persons not mentioned above pay compulsory contributions

at the same rate, but their 9% contribution is calculated on the amount of twelve minimum monthly wages as of the date of the payment of the contribution.

As from 1 January 2009, the residents of Lithuania pay compulsory health insurance contributions at the rate of 6% of other income (not specified in the Law on Health Insurance) on which the personal income tax is calculated (e.g. upon the receipt of income from the sale of property). No compulsory health insurance contributions were paid on such income previously.

### ***State Social Security***

Different rates of state social security contributions have been established for individual categories of persons. In addition, in many cases a transitional period in respect of the newly established rates of state social security contributions has been provided.

## **Corporate taxes**

### **General outline**

Resident entities are taxable on their worldwide profits. An entity may deduct expenses related to provision of business activity of the entity and earning income. However, the laws establish list of expenses whose deduction is limited, as well as non-deductible expenses.

As a rule, non-deductible expenses are the expenses that do not relate to earning of income of the entity and are not related to ordinary course of business activity of the entity, including certain expenses occurred due to related party transactions and transactions with offshore entities.

The list of expenses with limited deduction includes depreciation and amortisation of fixed assets; losses of the tax year, business trip related costs, marketing and promotional costs; natural loss and bad debts, taxes, certain benefits granted to employees etc.

The standard rates for the depreciation and amortisation are established in the law. The rates of depreciation depend on the groups of the fixed tangible assets and vary from 3 up to 20 years (non residential purpose buildings – 15 years). In case of intangible fixed assets the maximum rates of 3 or 4 years are applicable, while the goodwill may be amortised during 15 years. As a rule, the fixed assets are depreciated or amortised according to the straight line method, however, for certain groups of fixed assets, including equipment and machinery, hardware and software, the double-balance method may also be used. No depreciation is calculated for land.

Certain limitations are applicable to transfer of losses of entities under the reorganisation.

### **Corporate tax rates**

The general corporate income tax (CIT) rate is 20%.

A reduced rate of 13% applies to smaller taxable units with maximum 10 employees and a maximum income during the taxable year of approx. LTL 500,000.

The taxable profit of legal entities running investment projects, i.e. investing in the fixed assets intended for the production of new, additional products or the provision of new, additional services or for the increase of production (or service provision) capacities, or for the introduction of a new production (or service provision) process, or for the substantial change of an existing process (or its part), as well as for the introduction of technologies protected by international invention patents, may be reduced by up to 50%.

Besides, a company with investments of EUR 1 million or more operating in the free economic zone (Klaipeda and Kaunas) is exempted from income tax 6 years and pays 50% in subsequent 10 years.

In principle, income of a foreign entity received through a PE situated in Lithuania, is taxed following the same rules applied to the taxation of income of the Lithuanian entities. Income is taxed on an annual basis by applying the 20% tax rate.

### **Capital gains taxes**

There is no specific concept of capital gains tax and, as a general rule, capital gains or losses are included in the taxable income of the company. The main exception to this is capital gains on the sale

of shares, which are exempt if they meet certain criteria, the main one being that the shares are held for three years. This does not apply where the seller is deemed to be consistently dealing in shares.

Under the general rule, capital gains of non-resident company should be taxable only in its home country, except transfer of real estate and transfer of the assets attributable to permanent establishment in Lithuania. Capital gains on the sale of securities in resident company are not taxable for non-residents.

### **Position of losses**

Losses may be carried forward for an unlimited period of time. Losses sustained from the transfer of securities and the derivative financial instruments may be carried forward only for 5 consecutive tax years. Those losses are accounted separately and may be covered only from profits gained from transfer of securities.

Losses occurred as the result of transfer of securities in entities registered or otherwise organized in EEA state or other state with which treaty on avoidance of double taxation is concluded and which is a payer of the corporate profit or similar tax, in which transferring party has more than 25% of shares more than 2 years (or more than 25% of shares more than 3 years in case of reorganization and transfer of the companies) may be accounted against profits gained from transfer of securities during that tax period and not covered losses cannot be carried forward to the next tax year.

Under the Lithuanian laws, an entity cannot carry losses backwards.

### **Group treatment**

Lithuanian tax laws do not provide for possibility to tax on the level of the company's group.

## **Withholding taxes**

### **Position of resident companies**

Resident companies are taxed on their worldwide income. The Law on Corporate Income Tax stipulates that gross revenue (total of sales and non-operating revenue) is the basis for computing the amount of taxable profit. The tax is applicable on an annual basis.

### **Position of non-resident companies**

The business profits of foreign entities will be taxable only in their home countries unless foreign entities carry on business in Lithuania through a permanent establishment situated in Lithuania (in which case the taxation rules are similar to the ones attributable to resident entities) or receives income via means of cross-border transfers that is subject to withholding taxes (including income received from lease or transfer of real estate, interest, dividends, royalties or annual bonuses for members of supervisory board).

Therefore, a non-resident company is subject to income tax in respect of income and capital gains that are attributable to a permanent establishment.

### **Dividends, interest and royalties**

#### *Dividends*

Dividends paid by resident companies to residents and non-residents are subject to withholding tax at a rate of 20%.

In case the dividends are paid to the Lithuanian companies, the payer of the dividends may deduct its profit tax payable on the account of the dividend tax withheld.

An exemption of dividend withholding tax applies if the shareholder holds at least 10% of the voting shares in the distributing company for an uninterrupted period of 12 months, unless the shareholder is registered in territory included in the Black List (tax haven). The Black List includes most of the typical offshore jurisdictions (approx. 60 jurisdictions are listed).

The exemption does not cover the total amount of the dividends paid, if the taxable profit of an entity paying the dividends is taxed at the rate of 0% or if the taxable income (or a part of the taxable income) of the entity is not taxed as a result of tax reliefs provided by the law. In the latter case the provision concerning dividend exemption does not cover the dividends paid out pro rata the taxable profit (or its part) which is actually tax exempt (including taxable profit taxed at the rate of 0%).

According to the official commentaries prepared by the Lithuanian tax authorities, the dividends may enjoy the above “participation exemption” even if the shares are held for the period shorter than 12 months, but the shareholder intends to hold them for such or longer period.

This participation exemption satisfies the requirements of the EC Parent-Subsidiary Directive.

The above rules apply irrespective of whether the dividends are distributed from the profits accumulated in periods prior to accession to EU.

### *Interest*

Interest is subject to a withholding tax of 10%.

Lithuania has been granted with a 6-year transitional period for the implementation of the Interest and Royalties Directive. Interest paid to the associated enterprises covered by the Interest and Royalties Directive (EU companies) will be exempted from withholding tax as of 1 July 2011. During the period of last two years of the six-year transitional period (from 1 July 2009 to 30 June 2011) interest paid to such enterprises will be taxed at a 5% rate.

Only the tax treaty with Latvia provides for a possibility to have interest paid to Latvian companies exempted from the Lithuanian withholding tax.

### *Royalties*

Royalties are subject to a withholding tax of 10%.

Lithuania has been granted with a 6-year transitional period for the implementation of the Interest and Royalties Directive. Royalties paid to the associated enterprises covered by the Interest and Royalties Directive (EU companies) will be exempted from withholding tax as of 1 July 2011.

Only the tax treaty with Latvia provides for a possibility to have royalties paid to Latvian companies exempted from the Lithuanian withholding tax.

## **Indirect taxes**

### **VAT/GST: main and reduced rates, exemptions**

#### *General Information*

The Lithuanian VAT legislation is based on the main principles set by the EU Sixth Directive.

Lithuanian VAT is applicable on the supply of goods and services within Lithuania, import of goods into Lithuania, as well as on intra-Community acquisitions that take place in Lithuania.

The standard VAT rate is 19%. A reduced rate of 9% are applicable to books and non-periodic information publications until 1 July 2009.

Certain supplies, such as transfer or lease of real estate, insurance and banking services, share transfer are exempt from VAT.

According to the general rule, the VAT payer must calculate VAT and transfer it to the budget. VAT has to be paid within 25 days as of the end of the taxable period. The entities where the VAT payable exceeds LTL 100,000 (approximately EUR 29,000) over three consecutive months have to effect advance payments.

#### *VAT registration*

A resident taxable person must register as a VAT payer, when its annual taxable turnover within the current twelve months exceeds LTL 100,000.

Foreign taxable persons must register as VAT payers in Lithuania from the start of their business activity, whose place for VAT purposes is in the territory of Lithuania, except cases when they supply goods or provide services that (a) are exempted from VAT, (b) are not subject to VAT, or (c) are taxed at a 0% VAT rate, or (d) create the obligation for the purchaser/customer to calculate VAT.

Both resident and foreign taxable persons may apply for the VAT registration, even if the obligation to register has not arisen. In order to comply with the registration requirements, the taxable person must conduct or have an objective to conduct taxable activities. The tax authorities may request from the taxable person to submit evidences of proof regarding the conducted or planned business activities.

### ***Right to VAT Deduction***

As a general rule, only VAT payers have a right to VAT deduction and a VAT refund.

A VAT payer may include input VAT into its deduction provided that the goods or services purchased are needed for provision of the VAT taxable activity. In case of mixed VAT activity, only a proportionate part of input VAT is deductible. Please note that income from sales of the real estate and securities should not be taken into consideration in calculation of the proportion between VAT taxable and exempt activity, if the sales of such assets is not customary business activity of the VAT payer.

If output VAT calculated during a taxable period is less than the amount of input VAT deductible during the same tax period, the VAT payer is entitled to a VAT refund.

Foreign taxable persons are also entitled to have the paid Lithuanian VAT refunded, however, such refund is subject to a number of restrictions.

### **Other indirect taxes**

Lithuania applies excise duties (amongst other things) on petrol, alcohol and cigarettes.

## **Personal taxes**

### **Domicile and residency requirements**

An individual is deemed a resident of Lithuania if:

1. natural person has permanent place of residence in Lithuania during the tax period, or
2. natural person whose place of personal, social or economic interests is in Lithuania rather than in a foreign country during the tax period, or
3. natural person who is present in Lithuania for a period or periods in the aggregate of 183 days or more during the tax period, or
4. any natural person who is present in Lithuania for a period or periods in the aggregate of 280 days or more during successive tax periods and who stayed in Lithuania for a period or periods in the aggregate of 90 days or more in any of such tax periods..

### **Main rates and bands**

The income tax rate for natural persons is a flat 15% rate, and the taxation period is annual year.

As it was mentioned, from 1 January 2009 the established amount of compulsory health insurance contributions payable by employers on behalf of their employees is 3% and the employees have to pay compulsory health insurance contributions in the amount of 6% themselves. The compulsory health insurance contributions were previously included in the compulsory social security contributions.

Therefore, formally income tax rate for natural persons (employees) is 15%, however in fact it is 21% (plus 6% compulsory health contributions).

### ***Dividends***

A 20% personal income tax rate has been imposed on income from distributed profits.

### **Social security/national insurance payments**

Employee rate – 3 % withheld from gross salary, employer pays 27.98% on top of gross salary.

Different rates of state social security contributions for individual categories of persons (self employed, actors, sportsmen).

## **Transfer pricing and anti-avoidance rules**

### **Transfer pricing rules (documentation requirements, APAs, etc.)**

In summary, the relevant Lithuanian transfer pricing regulations can be listed as follows: requirement to (i) apply arm's length prices in related party transactions; (ii) supply information to the Lithuanian tax authorities on related party transactions; and (iii) maintain a sufficient documentation of the related party transactions.

The Lithuanian transfer pricing regulations are applicable for Lithuanian entities, including branches and other permanent establishments of foreign entities. Lithuanian transfer pricing regulations have been prepared following the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations that are recommendable to use to the extent they do not contradict to the Lithuanian regulations.

Noteworthy, the Lithuanian laws establish rather broad definition of the associated entities and includes (i) related parties, as defined by the Law on Corporate Income Tax or (ii) any other entities that may have influence over each other resulting in the conditions of their mutual transactions or economic operations other than those where a maximum economic benefit is sought by each of the said entities.

According to the Order, the fair market price shall be determined based on all 5 transfer pricing methods, which are laid down in the OECD Guidelines. The comparable uncontrolled price method must be used first. In case not enough data is available, the resale price or cost plus methods must be used. The profit split and transactional net margin methods have the lowest priority and can be used provided that data are not sufficient to apply the first three methods.

#### *The Obligation to prepare written transfer pricing documentation*

The obligation to prepare written transfer pricing documentation applies to companies which meet at least one of the following criteria:

1. Lithuanian entities as well as foreign entities, the activities of which are carried out through a permanent establishment, if the income of the Lithuanian entity or income attributable to the foreign entity before the taxable year, when the transaction was in fact carried out, exceeded LTL 10 million (approximately Euro 2,898 million);
2. financial companies and credit institutions, the activities of which are carried out according to the Law on Financial Institutions;
3. insurance companies, the activities of which are carried out according to the Law on Insurance.

#### *Content of documentation*

The written transfer documentation should include:

1. information about the transaction parties (economic and legal relationship, the structure of MNE, cash flows, organization of control within associated persons, information concerning other associated persons and other information),
2. information about the controlled transaction (characterization of the subject matter of the transaction, its functional analysis and conditions, economic circumstances, business strategy),
3. information about the transaction method used and comparability (benchmarking) analysis (brief information how it was applied, what adjustments and calculations were made, what uncontrolled transactions were used, a functional analysis of the uncontrolled transactions, economic circumstances, business strategy (if possible), and
4. other information identifying sufficient circumstances concerning transfer pricing.

Noteworthy that the Lithuanian laws do not provide for the mechanism of obtaining advance rulings in related party transactions.

### **Anti-avoidance provisions**

There is general anti-avoidance provision in Lithuanian legislation known as principle substance over the form. In cases where a taxpayer's transaction, economic operation or any combination is concluded with a view to gaining a tax benefit (i.e. to defer, directly or indirectly, the deadline for the payment of tax, reduce the payable amount of tax or fully avoid the payment of taxes, or shorten the time limit for refunding the tax overpayment (tax difference), etc.), the tax administrator may apply the substance over the form principle for the purpose of calculating the tax.

In this case, the tax administrator may not take into account the formal expression of the taxpayer's activity and have a right recreate the distorted or hidden circumstances associated with taxation as provided for in tax laws and calculate the tax pursuant to the relevant provisions of the tax laws.

### Thin capitalisation/other interest deductibility rules

Interest and currency exchange losses on the debt in excess of the debt/equity ratio of 4:1 are non-deductible for corporate income tax purposes. This is applicable in respect of the debt capital provided by a creditor, who:

- directly or indirectly holds more than 50% of shares or rights (options) to dividends; or
- together with related parties, holds more than 50% of shares or rights (options) to dividends, and the holding of that creditor is not less than 10%.

This rule is not applicable if a taxpayer proves that the same loan could exist between unrelated parties. Financial institutions providing financial leasing services are not affected by this rule.

Notably, thin capitalization also applies to interest variable depending on the profits or turnover of the company and costs of currency exchange results.

Furthermore, it should be noted that under Lithuanian company law, the interest rate on shareholders' loans may not exceed the average bank interest rate valid in the location of the lender's business.

### Controlled Foreign Company (CFC) rules

The CFC regulations apply to the Lithuanian companies that directly or indirectly hold more than 50% of shares in the foreign company, provided that foreign subsidiary is registered in:

- offshore territory or zone, i.e. included into the Black List;
- territory included in the White List, but enjoying special privileged income tax regime in its home country; or
- in its home country is taxed at a income tax rate constituting less than 3/4 of the Lithuanian corporate income tax, i.e. 15%.

Lithuanian CFC rules are applicable both to active income and income gained from financial activity (loan interest, financial lease, copyright remuneration etc.).

However, active income of a foreign subsidiary is not attributed to income of the Lithuanian parent company provided that it satisfies the established requirements.

### Tax treaties

A table showing the various withholding rates is shown below:

Country	Dividends		Interest	Royalties (2)
	Individuals,	Qualifying		
	companies	Companies(1)		
	(%)	(%)	(%)	(%)
Armenia	15	5	10	5/10
Austria	15	5	10	5/10
Azerbaijan	15	5	10	10
Belarus	10	10	10	10
Belgium	15	5	10	5/10
Bulgaria	10	0	10	10
Canada	15	5	10	10
China	10	5	10	10



Croatia	15	5	10	10
Czech Rep.	15	5	10	10
Denmark	15	5	10	5/10
Estonia	15	5	10	10
Finland	15	5	10	5/10
France	15	5	10	5/10
Georgia	15	5	10	10
Germany	15	5	10	5/10
Greece	15	5	10	5/10
Hungary	15	5	10	5/10
Iceland	15	5	10	5/10
Ireland	15	5	10	5/10
Israel	15	5/10	10	5/10
Italy	15	5	10	5/10
Kazakhstan	15	5	10	10
Kirghizia	15	5	10	10
Korea	10	5	10	5/10
Latvia	15	0	0	0
Luxembourg	15	5	10	5/10
Macedonia	10	0	10	10
Malta	15	5	10	10
Moldova	10	10	10	10
Netherlands	15	5	10	5/10
Norway	15	5	10	5/10
Poland	15	5	10	10
Portugal	10	10	10	10
Romania	10	10	10	10
Russia	10	5	10	5/10
Serbia	10	5	10	10
Singapore	10	5	10	7.5
Slovakia	10	10	10	10
Slovenia	15	5	10	10
Spain	15	5	10	5/10
Sweden	15	5	10	5/10
Switzerland	15	5	10	5/10

Turkey	10	10	10	5/10
Ukraine	15	5	10	10
UK	15	5	10	5/10
USA	15	5	10	5/10
Uzbekistan	10	10	10	10
(1)	The reduced treaty rates will often apply if the non-resident company owns at least 25% of the capital (or sometimes the voting rights) in the Lithuanian company; no holding period is required. Other conditions can be applicable to obtain a reduced rate.			
(2)	The 5% rate is in the main applicable to the use of industrial, commercial or scientific equipment.			

## Miscellaneous taxes

### Taxes on payroll

There is no general payroll tax in Denmark.

### Taxes on capital

There is no capital contribution tax in Lithuania.

### Taxes on property

#### *Real estate tax*

Annual real estate tax (applicable on the real estate other than land) rate varies from 0.3% to 1% of taxable value of the real estate, depending on the decision of the particular municipality which has to determine the exact rate of the tax within its territory.

The annual land tax rate is 1.5% of the land value.

### Other taxes

#### *Stamp duty*

Stamp duty in case of registration of the company or changes in the share capital is not substantial (up to LTL 200).

Noteworthy that registration of the company or changes in the share capital is subject to notarisation requirement. Currently, notaries' fees may amount to LTL 1,000.

#### *Real estate transfer tax*

There is no real estate transfer tax in Lithuania.

However, one should take into account stamp duty related to the registration of the ownership to the real estate and costs of the notarisation of the real estate transfer.

The state duties for the registration of the change of the ownership rights to the real estate are not substantial and vary depending on the market value of the real estate and whether the owner is natural or legal person. The registration duties are calculated separately for each real estate object.

The notary fee amounts to 0.45% of the value of the transaction, however not more than LTL 20,000.