

LEX MUNDI PUBLICATION

Lex Mundi European Union: Accession States Tax Guide

LITHUANIA
Lideika, Petrauskas, Valiunas ir Partneriai

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A. General information

Lithuania has been experiencing rapid economic growth since 1996, supported by the second highest labour productivity growth rate in the EU. Over the period 2001 - 2006 real GDP growth averaged 7.6%. In 2006 GDP amounted to LTL 81,554 million (approx. EUR 23,620 million) at current prices. The key goal of fiscal policy is the reduction of the structural deficit below or to 1% of GDP.

Set out below is a summary of the General Government Budget[1]:

Revenue	2004 (Thousand LTL)	2005 (Thousand LTL)	2006 (Thousand LTL)
Taxes			
Income and profit taxes	4223131	5074006	6349255
Taxes on property	247914	251491	278425
Taxes on goods and services	6467811	7415339	8794754
Taxes on international trade and transactions	147487	158396	182944
Other Revenue			
Property income	402497	468917	383089
Revenue from goods and services	652651	705302	779973
Revenue from fines and forfeiture	68403	84343	109274
Other revenue not elsewhere classified	75531	103395	91195
Revenue from sales of fixed assets	101116	138613	202210

Transactions in financial assets	28209	59720	28986
Total revenue:	12414749	14459520	17200106
EU assistance	1389794	2020716	2162284
Total revenue:	13804543	16480236	19362390

[1] All the data is taken from the official website of the Ministry of Finance of The Republic of Lithuania

B. Corporate income taxation

1. Which are the taxable entities?

The Lithuanian Law on Profits tax establishes two types of corporate taxpayers – Lithuanian and foreign entities.

Enterprises registered in Lithuania must pay the corporate income tax on profits earned both in Lithuania and abroad. Withholding taxes paid abroad and not exceeding the tax payable in Lithuania on foreign income may be credited. Moreover, relieves may be applied according to applicable international treaties. Partnerships and personal enterprises are considered as taxpayers and are taxed at the same rates as companies. Non-profit organizations are entitled to certain tax relieves.

The tax liability of foreign entities is limited to the income sourced in Lithuania, including income earned through a permanent establishment (PE). Permanent establishments of foreign entities must be registered with the local tax authorities as payers of the Lithuanian corporate income tax. No tax is applied on repatriated profit of branches (permanent establishments).

Certain types of income received by foreign entities not through their PE in Lithuania are subject to the withholding tax (please see question 6 on Withholding taxes).

2. How is the taxable income determined?

The tax base for local entities (*i.e.* those registered in Lithuania) comprises all income sourced inside and outside Lithuania and all or part of the positive income of the controlled foreign entities.

The tax base for foreign entities (*i.e.* those registered in foreign countries) comprises income received from activities carried out through permanent establishments in Lithuania and other income sourced in Lithuania, such as: interest, dividends, royalties, proceeds from rent/sale of immovable property, *etc*.

For the purpose of computing the taxable profit of a Lithuanian entity or of a PE of a foreign entity, the following is deducted from the income:

- non-taxable income;
- allowable deductions;
- limited allowable deductions.

Non-taxable income includes insurance indemnity received (with certain limitations), income derived from revaluation of fixed assets and securities, default interest (forfeit) received, as well as certain other income.

Allowable deductions are all expenses actually incurred in the ordinary course of business of the entity and necessary for that entity to earn income or derive economic benefit.

Limited allowable deductions include: depreciation expenses, maintenance, repair and reconstruction expenses of fixed assets, business travel expenses, advertising and representation expenses, natural losses, taxes, bad debts, contributions for the benefit of employees, losses within the tax period, *etc.*

Under the tax legislation inventories are accounted for on FIFO (first-in first-out) basis. Upon a taxpayer's request and taking account of the nature of the entity's business, the local tax administrator may allow the taxpayer to account for inventories based on other method.

Depreciation of fixed assets should be computed using directly proportional (straight-line) method or a double-declining-balance method and applying the depreciation rates not exceeding the maximum rates (in years) set in the law.

3. What are the applicable tax rates?

Please see Appendix 1.

4. Are capital gains taxed separately?

Capital gains earned by Lithuanian entities or permanent establishment of foreign entities are included in the taxable income for corporate income tax purposes and taxed accordingly, i.e. at a standard 15% tax rate, unless 13% rate may be applied.

5. May losses be carried back or forward and to what extent?

Tax losses may be carried forward for 5 consecutive years (ordinary losses). Losses incurred as a result of disposal of securities or derivative financial instruments are calculated separately and may be carried forward for 3 years by deducting them only from the future gains from disposals of securities and/or derivative financial instruments. Tax losses may not be carried back.

6. Are there any withholding taxes and at which rates?

There are two rates of withholding tax established in Lithuania – 15% (applicable only to dividends) and 10% (applicable to other types of income). The domestic withholding tax rate can be lowered under the tax treaties to which Lithuania is a party.

Dividends paid out are subject to withholding tax at a rate of 15%. However, dividends received by a foreign/Lithuanian entity wherein the recipient has been controlling over 10% of voting shares (ownership interests) for a continuous period of at least 12 successive months including the moment of distribution are not subject to withholding tax. This relief is not applied if the payer of dividends is not subject to taxation at the 15% or 13% tax rate in Lithuania (except for the cases when the payer of dividends is established in free economic zone) or recipient of dividends is registered or otherwise organised in an offshore territory included in the specific list approved by the Ministry of Finance.

The following income sourced in Lithuania and received by a foreign entity is subject to withholding tax at a rate of 10%: interest; royalties; income received from transfer or assignment under the licensing contract of the right to use an object of industrial property or a franchise; income received in consideration for information provided about industrial, commercial or scientific know-how; proceeds from the sale, transfer (with a title) or lease of immovable property located in Lithuania; indemnities received for the infringement of copyrights or neighbouring rights, *etc.*

Withholding tax on the income sourced in Lithuania must be withheld and paid to the state budget by both Lithuanian entities and permanent establishments in Lithuania that make the payments.

The EC Interest & Royalty Directive has been implemented in the Lithuanian domestic tax law. Lithuanian withholding tax on interest and royalties paid to related parties, EU tax residents, will be 10% until 30 June 2009. From 1 July 2009 to 30 June 2011 withholding tax on interest will be 5% and on royalties - 10%, and from 1 July 2011 the tax rate will be reduced to zero.

7. Are there any preferential group taxation rules in force?

Neither group consolidation nor transfer of losses within a group of companies is possible for corporate income tax purposes.

8. Which are the anti-avoidance rules currently in force?

Transfer pricing

All the transactions between the related parties should be effected at arm's length. In other words, transactions should be made under such conditions, as if the affiliated companies were not related ("third parties"). If the transactions are not effected at arm's length, the tax authorities have the right to adjust the prices of transactions. All entities, the annual revenue of which exceeds LTL10 million (approx. EUR 2.9 million), as well as all banks, insurance companies and credit institutions are required to have transfer pricing documentation.

Thin capitalization

The part of the capital lent by a controlling lender to a Lithuanian entity for remuneration exceeding the proportion 4:1 of the lent capital and fixed capital is deemed to be the controlled lent capital for the Lithuanian entity. The interest paid for the use of controlled lent capital is not considered to be related to the earning of income, thus, it is non-deductible. The above provision will not apply, if the Lithuanian entity proves that the same loan would be provided under the same conditions between independent (not related) persons. The fixed capital of the Lithuanian entity means its equity capital on the last day of the tax period, excluding the financial results of that period (profit/loss).

Controlled foreign company

A controlled foreign company (CFC) is defined as a foreign company in which another company (or individual): (i) directly or indirectly holds more than 50% of shares or rights (options) to dividends; or (ii) together with related parties, holds more than 50% of shares or rights (options) to dividends, and the holding of the controlling company is not less than 10%.

The positive income of a CFC is attributed to a Lithuanian controlling party on prorate basis. The positive income does not include the payments that are non-deductible for the Lithuanian controlling company. The CFC's active business income and non-distributed dividends (subject to certain conditions) are also not attributed. The CFC regime does not apply if the CFC's income is comprised only of dividends from the Lithuanian controlling company or is less than 5% of the Lithuanian controlling company.

The Lithuanian controlling company is entitled to deduct the corporate income tax paid on the positive income abroad from the corporate income tax payable on the positive income in Lithuania.

9. Which are the main administrative requirements to comply with the local tax authorities?

Generally the taxable period is the tax year, which normally coincides with a calendar year. Upon request, the local tax authorities may allow a taxpayer to use a tax year (financial year) that is different from the calendar year, subject to the condition that the taxable period is equal to 12 months.

Annual financial statements and annual corporate income tax return must be filed with the tax authorities by the 10th month of the calendar year following the tax year. Companies must make (with some exceptions) quarterly advance payments of corporate income tax during the current tax year. The advance payments are credited against the final corporate income tax liability for the year. Any excess of advance payments is refunded. The final corporate income tax is due by the deadline for the annual tax return. For other taxes and tax returns different deadlines for payment and return submission are established.

10. With which countries have double taxation conventions already been concluded?

Please see Appendix 2.

11. Are there any special laws providing tax incentives to certain taxable entities?

Free economic zones

Significant tax incentives apply to companies in the free economic zones (FEZ). A company registered in a FEZ, except for credit institutions and insurance companies, is exempt from the corporate income tax for 6 years, and for the 10 following tax years the corporate income tax rate applicable to the company is reduced by 50%, if all the following conditions are met: (i) the capital investment in company is at least EUR 1 million; (ii) the company possess the auditor's report proving the said amount of capital investment; and (iii) at least 75% of the income in the tax year is comprised of income from production, manufacturing, processing or warehousing activities performed within a FEZ.

Small company relief

A small company is subject to a reduced corporate income tax rate of 13% if its average number of employees does not exceed 10 and its taxable income during the taxable period is less than LTL 500,000 (approx. EUR 144,810).

In the case of sole proprietorships and partnerships where the average number of employees does not exceed 10 persons and the income during the taxable period is less than LTL 1 million (approx. EUR 289,620), the profit up to LTL 25,000 (approx. EUR 7,240) is taxed at a 0% rate and the remaining profit is taxed at a 15% rate.

However, the aforementioned incentives are applicable with certain limitations established in the law.

In the case of non-profit organizations where their business income does not exceed LTL 1,000,000 (approx. EUR 289,620), the amount of LTL 25,000 (approx. EUR 7,240) is taxed at 0% tax rate, the remaining amount by 15% (certain restrictions apply).

Other

Certain tax incentives are established for insurance companies, investment companies with variable capital, agricultural producers, credit unions and companies employing disabled, unemployed or convicted persons.

C. Individuals

1. Which are the taxable persons?

The taxpayers of personal income tax in Lithuania are distinguishable according to their residence, *i.e.* resident and non-resident individuals. Resident taxpayers are subject to income tax on their worldwide income, whilst non-residents are taxed on their Lithuanian source income only, except that foreign-source income derived through a fixed base in Lithuania is also included in the taxable base of non-residents.

2. How is the taxable income specified?

The Lithuanian individual income tax system is a scheduler tax system in which personal income tax is imposed separately on different categories of taxable income. However, the taxpayer may choose to aggregate the income of all categories, except for business income subject to the lump-sum taxation, in order to take into consideration the personal deductions and allowances in calculating the final tax liability.

The categories of taxable income are as follows: employment income, income from individual business activities, distributed profits, including dividends, interest, royalties, income from leasing of immovable property, income from sports and entertainment activities, capital gains from the disposal of movable or immovable property, or securities, positive income imputed from controlled foreign companies (CFC income).

A basic personal allowance (tax exempt amount) of LTL 320 (approx. EUR 93) per month is applied in calculating the taxable income of residents. For non-residents, this allowance is granted only in respect of their Lithuanian-source employment income. An additional personal allowance (additional tax-exempt amount), equal to 1/10 of the basic personal allowance, is granted to resident taxpayers (parents or adoptive parents raising one or two children in respect of each child). Special basic personal monthly allowances are granted to certain categories of taxpayers, e.g. to parents with three or more children, to single mothers and fathers, etc.

The following expenses may be deducted from taxable income: life insurance premiums; pension contributions paid to pension funds; interest paid on the loan taken out for the building or acquisition of housing; payments for studies; payments for one personal computer unit with software acquired during the period of 2004-2009 and/or for the installation of Internet access. The total amount of deductible expenses listed above may not exceed 25% of taxable income received during the calendar year.

3. What are the applicable tax rates?

Please see Appendix 1.

4. Are capital gains taxed separately?

Capital gains are not taxed separately in Lithuania. A 15% rate of personal income tax applies.

5. May losses be carried forward or back?

Loss carry-back or carry-forward is not possible for personal income tax purposes. Offsetting of one type of loss with other types of income is not allowed.

D. Capital

In outline, which are the main taxes on capital, if any?

Capital related taxes in Lithuania are as follows: real estate tax, land tax, state-owned land lease tax, tax on inherited property.

Real estate tax

Real estate tax is imposed on the real estate (except for land) located in Lithuania and owned by (i) Lithuanian or foreign entities or (ii) Lithuanian or foreign individuals and used by the latter for their business or individual activities, or transferred for use by legal entities for a period longer than 1 month. When the real estate is transferred to a legal entity for its use, the obligation to pay and declare the real estate tax arises for that legal entity.

The annual rate of the tax is set every year by the local municipalities in the range of 0.3%-1% of the taxable value of the real estate. The taxable value is deemed a market value determined during the massive evaluation by the Lithuanian Real Estate Register. Corporate tax payers have to pay advance instalments on a quarterly basis. Individuals have to pay the tax by the 1st of February following the tax year.

Land tax

Land tax is imposed on the land owned by the legal entities and individuals. The annual rate of the tax in question is 1.5% of the taxable value of the land determined by the Lithuanian tax authorities.

State-owned land lease tax

The annual rate of the state-owned land lease tax varies from 1.5% to 4% of the taxable value of the land, which is calculated according to the methodology approved by the Lithuanian Government. The particular annual rate of this tax and the terms of its payment are being established by the councils of respective municipalities within the territory whereof the land plot is located.

Tax on inherited property

Residents are subject to this tax on a worldwide basis, whereas non-residents are subject to inheritance tax only on movable property subject to legal registration in Lithuania and on immovable property located in Lithuania. The tax rate is 5% for inherited property up to LTL 0.5 million (approx. EUR 0.14 million). If the value exceeds the said limit, the whole amount is subject to a 10% rate.

There are some exemptions from the tax which include *(i)* property inherited by a spouse, children, parents, persons under guardianship, guardians, grandparents, grandchildren, brothers, sisters; *(ii)* property with taxable value not exceeding LTL 10,000 (approx. EUR 2,896).

E. Indirect taxes

In outline, which are the main indirect taxes, if any?

The main indirect taxes in Lithuania are Value Added Tax (VAT), excise duties, and customs duties.

VAT

The Lithuanian VAT system is made compliant with the Sixth VAT directive with effect as of 1 May 2004. Taxable persons include both residents and non-residents. It is obligatory to register as a VAT payer for residents (both legal entities and individuals) if VAT taxable income within the last 12 months exceeds LTL 100,000 (approx. EUR 28,962).

The standard VAT rate is 18%. There are 5%, 9% and 0% reduced rates set forth in the Lithuanian Law on VAT.

Excise duties

Excise duties are imposed on the following goods produced in or imported into Lithuania: ethyl alcohol and alcoholic drinks, including beer and wine; cigarettes, cigars, cigarillos and smoking tobacco; fuel, including petrol, kerosene, gasoline, fuel oil and their substitutes and additives; electric power (as of 2010); coal, coke and lignite (as of 2007).

Customs duties

Customs duties have to be calculated and paid only for the imported goods from the non-Community countries by the importing company after the import of goods is effected. Customs duties established in the territory of the Community should be applied.

F. Other duties

In outline, are there any other taxes, if any?

Other taxes established in Lithuania are as follows: social security contributions, payments to the Guarantee Fund, tax on natural resources, oil and gas resource tax, pollution tax, sugar tax, lottery and gambling tax.

G. Enforcement- Litigation procedure

1. In outline, which are the existing measures in order to ensure compliance with the tax legislation?

The tax authorities administer assessment and payment of taxes and other contributions that are paid to the state budged and funds. The tax authorities are entitled to charge the default interest of 0.04% per day and to impose a fine equal to 10-50% of the underpaid tax amount. The amount of the actual fine imposed shall be conditional on the type of violation, on whether the taxpayer has cooperated with the tax authorities, on the acknowledgment of having committed a violation of tax laws and on other circumstances which the tax authorities deem to be relevant when imposing a smaller or larger fine.

2. What is on average the duration of the litigation procedure for the final resolution of tax disputes?

The average duration of the litigation procedure for the final resolution of tax disputes is approximately 9 months.

APPENDIX

INCOME TAX RATES

Corporations	**Partnerships**	**Individuals**	**Other entities**
Standard tax rate is 15%, which is applicable to the taxable profit of Lithuanian entities and permanent establishments of foreign entities in Lithuania. Starting from 1 January 2006 a temporary social tax is established. In effect it represents a surcharge of 4% in 2006 and 3% in 2007 on top of the corporate income tax, because the taxable base for temporary social tax is the same as for corporate income tax.	Partnerships are considered as taxpayers and are taxed at the same rates as companies.	A 27% income tax rate (starting from 1 January 2008 – 24%) applies to employment-related income (e.g. salary, bonuses), benefits-in-kind, income from individual business activities if allowable expenses are deducted, *etc*.	Personal enterprises are taxed at the same rates as companies.
13% rate is applicable if entity's average number of employees does not exceed 10 and the income does not exceed LTL 500,000 (approx. EUR 144,800) (certain restrictions apply).		15% rate is applied to income from distributed profit; interest income; royalties, remuneration under copyright agreements; sale or other transfer of assets not used in individual business activity; income from lease of assets; income from individual activities, if the individual chooses not to deduct allowable deductions there from; *etc.*	
10% rate is applicable to certain types of income sourced in Lithuania and received by foreign entities not through their permanent establishments.			
		Non-taxable income includes: income from sale of property if it was acquired more than three years before its sale; income from sale of securities if they were acquired more than 366 days before their sale and the individual has been the owner of not more than 10% of securities for three years preceding the tax year during which the securities are sold; non-life insurance benefits to compensate for expenses, *etc*.	

Country	Interest/withholding tax rate	Royalties/withholding tax rate	Dividends /withholding tax rate	
			Individuals, companies	Qualifying companies
Armenia	10	10	15	5
Austria	10	5/10	15	5
Azerbaijan	10	10	10	5
Belarus	10	10	10	10
Belgium	10	5/10	15	5
Bulgaria	10	10	10	0
Canada	10	10	15	5
China	10	10	10	5
Croatia	10	10	10	5
Czech Republic	10	10	15	5
Denmark	10	5/10	15	5
Estonia	10	10	15	5
Finland	10	5/10	15	10
France	10	5/10	15	5
Georgia	10	10	15	5
Germany	10	5/10	15	5
Greece	10	5/10	15	5
Hungary	10	5/10	15	5
Iceland	10	5/10	15	5
Ireland	10	5/10	15	5
Italy	10	5/10	15	5
Israel	10	5/10	10	5
Kazakhstan	10	5/10	15	5
Latvia	0	0	15	0
Luxemburg	10	5/10	15	5
Malta	10	10	15	5
Moldova	10	10	10	10
Netherlands	10	5/10	15	5
Norway	10	5/10	15	5
Poland	10	10	15	5
Portugal	10	10	10	10
Romania	10	10	10	10
Russian Federation	10	5/10	10	5
Singapore	10	7.5	10	5

Country	Interest/withholding tax rate	Royalties/withholding tax rate	Dividends /withholding tax rate	
			Individuals, companies	Qualifying companies
Slovak Republic	10	10	10	10
Slovenia	10	10	15	5
Spain	10	5/10	15	5
Sweden	10	5/10	15	5
Switzerland	10	5/10	15	5
Turkey	10	5/10	10	10
Ukraine	10	10	15	5
United Kingdom	10	5/10	15	5
United States	10	5/10	15	5
Uzbekistan	10	10	10	10

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