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Tax & Legal Alert
provides the latest information on changes in Lithuanian legislation most urgent to our clients.

In this special issue: main amendments to the Lithuanian tax legislation which came into effect as of 1 January 2009.

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Tax news

Main amendments to the PIT Law

PIT rates

As of 1 January 2009 all personal income is subject to 15% PIT. PIT rate of 20% will be applied to income from distributed profits (dividends, etc.).

Tax exempt amount of income (TEA)

The application of TEA was changed significantly. Monthly TEA shall be applied only to employment related income of Lithuanian tax residents:

- TEA of LTL 470 per month shall be applied to individuals whose employment related income does not exceed LTL 800 per month;
- TEA shall be proportionally reduced for larger amounts of income, and if income amounts to or exceeds LTL 3,150 per month, no TEA will be applied.

If employment related income exceeds LTL 800 per month, monthly TEA shall be calculated according to the following formula: monthly TEA = 470 – 0,2*(an individual's employment related income per month – LTL 800).

An additional TEA of LTL 100 shall be applied to Lithuanian tax residents having one child, and TEA of LTL 200 shall be applied for every subsequent child. The application of additional TEA does not depend on the amounts of employment related income received.

Annual TEA shall be calculated at the end of the tax year taking into consideration not only employment related income but also such income as maternity (paternity) benefits, income from individual activities, income from the sale or other transfer of property other than that used for individual activities, income from the rent of property, interest, income from distributed profits, income received by a member of an unlimited civil liability entity from the entity's taxed profits, income received under copyright agreements, royalties, annual payments (tantiems) to the Members of the Board or Supervisory Board, etc. Therefore, while applying for TEA, tax payers should take into consideration this fact, since if it appears that the TEA applicable for 2009 tax year in fact had to be lower than the applied one, the individual will be obliged to file the annual personal income tax return and cover the income tax difference by 1 May 2010.

Benefits-in-kind

Article 9 of the PIT Law provides a completed list of income which shall not be treated as benefits-in-kind. Income which is not included on this list shall be treated as taxable benefits-in-kind.

Non-taxable income

The following income, among other types of income, was included on the list of non-taxable income:

- Income from the sale of housing (including land) located in an EEA Member State, if the individual's place of residence was declared there during the last two years prior to the sale. If the place of residence was declared for a shorter period but income received from sale was invested into the acquisition of another housing located in an EEA Member State where the place of residence was declared, such income would also be treated as non-taxable. The provision regarding income from sale or transfer of other immovable property acquired more than three years prior to its sale or transfer remains valid, i.e. such income is also non-taxable;
- Income received as a gift from brothers and sisters;
- Income from the sale or transfer of securities acquired after 1 January 1999 if the securities are sold or otherwise transferred not earlier than 366 days after the date of their acquisition and the individual, alone or together with related parties, did not hold more than 10% of the shares of the entity whose securities are sold or otherwise transferred for 3 years preceding the end of the tax period in which those securities were sold or otherwise transferred. This relief, excluding other limitations, shall not apply if the shares which were received for free by the shareholders in proportion to the number of shares owned as a result of the increase of the authorised capital are sold. In case of increase of the nominal value of shares, the relief shall not apply to that part of income which is equal to the amount of increase in the nominal value of shares.

PIT relief

PIT relief shall not apply with regard to mortgage interest paid to banking or other credit institutions on mortgages taken out after 1 January 2009 for the building or acquisition of housing. However, interest paid by a Lithuanian tax resident to banking or other credit institutions on (or its part) taken out before 1 January 2009 for building or acquisition of housing or financial lease interest may be deducted from his/her income.

As of 1 January 2009 payments for vocational training or studies can be deducted from income only if during such studies the first university degree and (or) the first relevant qualification is obtained. The amendments to the PIT Law provide that payments made for 2008 - 2009 autumn semester may be deducted from income irrespective of which university degree and (or) qualification is obtained during the studies and (or) training.

Expenses related to the acquisition of a personal computer incurred in 2009 cannot be deducted from income.

Main amendments to state social security (SSS) and compulsory health insurance (CHI) contributions

Income received by employees working under employment contracts shall be subject to additional CHI contributions at 6%. Individuals receiving income from individual activities, members of partnerships or sole proprietors will have to pay CHI contributions at the rate of 9%.

Other income received by Lithuanian tax residents which is subject to PIT as provided in the PIT Law (e.g. dividends, income from sale of property or shares, etc.) shall also be subject to 6% CHI contributions.

The following income shall be subject to SSS and CHI contributions:

- Income derived from sports activities, performers' activities or under copyright agreements received not from the employer (for the insurers - SSS contributions at 30,98%; for the insured – SSS contributions at 3% and CHI contributions at 6%);

- Income derived under copyright agreements received not from the employer (for the insurers - SSS contributions at 29,7%; for the insured - SSS contributions at 3% and CHI contributions at 6%);
- Income derived from sports activities and performers' activities received not from the employer (for the insurers - SSS contributions at 28,5%; for the insured – SSS contributions at 3% and CHI contributions at 6%);
- Income received from individual activities, except from income derived under business certificates (for the insurers – SSS contributions at 28,5%; for the insured – CHI contributions at 9%);
- Income received from individual activities derived under business certificates (for the insurers – contributions for base pension amounting to 50% of state base pension amount; for the insured – CHI contributions at 9%);
- Farmers (for the insurers – SSS contributions at 28,5%; for the insured – CHI contributions at 9%);
- Lawyers, notaries, bailiffs (individual activities) (for the insurer – SSS contributions at 26,3%: capped at the monthly insured income amount of two current years); for the insured – CHI contributions at 9%).

The following reduced rates of SSS and CHI contributions shall apply in 2009:

- Income derived from sports activities, performers' activities or under copyright agreements received not from the employer (for the insurers – SSS contributions at 7% and CHI contributions at 3%; for the insured – SSS contributions at 1% and CHI contributions at 6%);
- Income derived from sports activities, performers' activities or under copyright agreements received not from the employer (for the insurers – SSS contributions at 7% and CHI contributions at 3%; for the insured – SSS contributions at 1% and CHI contributions at 6%);
- Farmers (SSS contributions at 8% and CHI contributions at 3%).

2010 shall also be treated as a transitional period for the above mentioned income, the amount of SSS contributions shall be twice as large as the one established for 2009.

The rate of state social security pension amount that the insured persons participating in the accumulation of pensions transfer to pension accumulation companies is reduced from 5.5% to 3%.

Amendments to the CIT Law

On 30 December 2008 the following main amendments to the CIT Law were introduced:

1) Increase in CIT rates

The standard CIT rate was increased from 15% to 20%. The increased rate *inter alia* is applicable to dividends and income from transfer or rent of real estate, performers' or sports activities and payments (tantiems) to the Members of the Supervisory Board received by foreign entities not through a permanent establishment.

Please note that interest, royalties and compensations for violation of copyright or related rights derived by foreign entities not through permanent establishments will continue being subject to CIT at a rate of 10%.

2) Relief applicable to investment projects

Entities involved in investment projects will be able to reduce their taxable profits up to 50% by the acquisition costs of fixed assets meeting certain requirements. The costs exceeding the aforementioned limit can be carried forward for 4 years. Taxable profit can be reduced by costs incurred in 2009 – 2013 tax periods only.

3) Relief for credit unions and the Central Credit Union was abolished

The relief applicable to credit unions and the Central Credit Union being exempt from CIT during the first three tax periods from the date of their registration, and paying CIT reduced by 70% starting from the forth tax period was abolished. Following the provisions of the amended CIT Law, credit unions and the Central Credit Union shall pay CIT according to the standard rules.

4) Certain requirements related to reorganisation in the form of shares-for-shares transactions were amended and requirements related to non-taxable transfer of shares in case of reorganisation were restricted

In order reorganisation related to exchange in shares (shares-for-shares) to be treated as neutral for CIT purposes, the qualifying number of voting shares was reduced from 2/3 to 1/2. Following the provisions of the new order, when an entity, seeking to hold shares in another entity conferring more than 1/2 of voting rights, or holding shares in another entity conferring more than 1/2 of voting rights and seeking to acquire a further holding, transfers its new share issue in exchange for the aforementioned shares in another entity, such reorganisation shall be considered as tax neutral for CIT purposes.

The holding period for shares was increased from two to three years in order the capital gain on disposal of shares transferred upon the reorganisation to be treated as non-taxable for CIT purposes. Following the provisions of the new order, capital gain on disposal of shares transferred upon the reorganisation shall be treated as non-taxable, if the entity transferring shares holds more than 25% of voting shares for a continuous period of at least 3 years.

5) The dividend "participation exemption" rule became more strict and certain cases were established when profits distributed to individuals are subject to CIT

The dividend "participation exemption" rule received by Lithuanian or foreign entities was restricted (dividends are not subject to CIT if not less than 10% of voting shares are held for a continuous period of at least 12 months). Following the provisions of the new order, the "participation exemption" rule shall not apply (i.e. dividends will be subject to CIT) to dividends proportionally distributed from profits that were subject to 0% CIT or non-taxable profits resulting from following reliefs:

- Tax relief applied with regard to investment companies for their non-taxable investment income;
- Tax relief on transfer of shares, if an entity transferring shares holds more than 25% of voting shares of the entity being transferred for a continuous period of at least 2 years (in case of reorganisation – for a continuous period of 3 years);
- Tax relief applied to insurance companies regarding life insurance premiums and insurance investment income being non-taxable;
- Relief applied on taxable profits due to participation in an investment project (see above).

The above mentioned rules are not applied to entities acting in free economic zones.

If an amount of CIT is deducted from dividends due to above mentioned tax reliefs, the same amount will not be deducted from the taxable profits of the entity receiving dividends.

Besides, "participation exemption" rule will not be applied on dividends received from foreign entities, if such dividends were proportionally distributed from profits that were not subject to CIT or subject to 0% CIT in those countries.

Profits distributed to individuals are subject to 20% CIT, if proportionally distributed from profits that were subject to 0% CIT or due to the above mentioned reliefs were not subject to CIT. These provisions do not apply to the taxable profits of entities acting in free economic zones and cooperative societies, where the reduced rate of 0% was applied on such profits.

In our opinion, the amended taxation of dividends does not correspond to the provisions of the European Council Parent/Subsidiary Directive.

6) Other amendments

The amendments to the CIT Law also provide for a new relief for non-profit organisations. However, certain reliefs for entities engaged in agricultural activities and cooperative societies are abolished or amended.

All the above mentioned amendments, except for Point 5 above, came into effect as of 1 January 2009. The amendments mentioned in Point 5 came into effect as from 30 December 2008.

Amendments to the VAT Law

On 30 December 2008, amendments to the Lithuanian VAT Law that came into force on 1 January 2009 were passed. Main amendments are:

- The standard VAT rate of 18% is increased to 19%;
- This reduced VAT rate was increased from 5% to 9% and is applicable only to books and non-periodical publications by 30 June 2009;
- The reduced VAT rate of 5% was abolished for all other goods and services;
- The reduced VAT rate of 9% applicable to services of construction, renovation and insulation of residential houses (financed by the State and municipalities) is abolished (please refer below for transitional provisions);
- The compensation relief for supply of heating of residential premises and the supply of heating water is abolished (please refer below for transitional provisions).

Transitional provisions:

- 18% VAT rate shall be applicable to cigarettes and other manufactured tobacco which were marked with excise duty stickers by 31 December 2008, and where the excise duty thereon is paid by 31 January 2009. The 18% VAT rate will apply to the supply of these goods by 1 March 2009;
- Reimbursed pharmaceuticals and medicinal devices will be subject to 5% VAT by 30 June 2009;
- The 5% VAT rate will apply to subscriptions of periodicals if agreements were signed by 31 December 2008;
- The 5% VAT rate will apply to hotel and similar accommodation services if rooms were booked by 31 December 2008;
- The 5% VAT rate will apply to tickets to cultural and sports events if these were paid for by 31 December 2008;
- The reduced VAT rate of 9%, by 31 December 2008 applicable to services of construction, renovation and insulation of residential houses (financed by the State or municipalities), will continue to apply in 2009 only in cases where the agreements on these services were signed by 31 December 2008;
- Supply of heating of residential premises and the supply of heating water, will be taxed at 5% by 31 August 2009 (the 14% difference will be compensated by the State).

Amendments to the Law on Excise Duties

On 30 December 2008, amendments to the Lithuanian Law on Excise Duties that came into force on 1 January 2009 were passed. Main amendments are:

- Excise duty levied on beer, wine made of fresh grapes and on other fermented beverages, intermediate products and ethyl alcohol is increased;
- 50% reduced excise rate previously applied for small beer producing companies is abolished;
- Excise duty on leaded and unleaded petrol, kerosene, gas oils, petroleum gas and gaseous hydrocarbons (except for natural gas) is increased.

Starting from 1 March 2009, excise duty on cigarettes shall be levied at the following rate:

  - Specific element - LTL 95 (currently LTL 79);
  - *Ad valorem* element – 25% (currently 20%).

Starting from 1 September 2009 the aforementioned rates will be increased to LTL 132 and 25% respectively.