Council of the
European Union

Brussels, 27 May 2019
(OR. en)

9652/19
ADD 3

FISC 274
ECOFIN 515

REPORT

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	Code of Conduct Group (Business Taxation) – Report to the Council = Endorsement

Lithuania's patent box (LT007)

I/ AGREED DESCRIPTION

The following description was agreed by the Code of Conduct Group on 27 February 2019:

Country			LITHUANIA
1. Please provide below the basic information about your regime	a. Name of the regime		Reduced corporate income tax rate for taxable profits earned from IP developed through R&D activities
	b. Year of introduction/relevant legislation	Year	The amendments to the Republic of Lithuania Law on Corporate Income Tax were adopted on 12 December 2017 and on 6 December 2018. These provisions are applicable to the calculation of the corporate income tax for 2018 and subsequent tax periods.

Country			LITHUANIA
		Please attach to this template (or provide a link to) the legislation which introduces your new IP regime (if in a language other than English or French, please provide a translation).)	The most recent version of the legislation is available at: https://www.e-tar.lt/portal/lt/legalAct/TAR.A5ACBDA529A9/gvLQvtmxhq For the English translation of the legislation, please see the Annex 1.
	c. Benefits under your regime (e.g. a reduced rate or a deduction, an exception, or some other reduction in the taxable base)		A reduced rate Besides the reduced tax rate, the Lithuanian CIT also allows taxpayers a triple deduction (300%) of eligible R&D expenditures. Taxpayers can benefit from both the deduction (front-end regime) and the lower tax rate (back-end regime).
	d. Effective tax rate under your regime		5 %
	e. Statutory rate in your jurisdiction that would apply in the absence of the regime		The general corporate income tax rate is 15 %.
	f. Stated purpose of your regime		To boost technical innovation by stimulating the development of new patents, copyrighted software developed through R&D activity undertaken by the taxpayer itself.
2. Please describe the scope of qualifying taxpayers under your regime.			According to the provisions of the Law on Corporate Income Tax, qualifying taxpayers include resident taxpayers, foreign PEs of resident companies and domestic PEs of foreign companies that are subject to the corporate income tax to the extent they developed the qualifying IP.
3. What types of IP assets can qualify for benefits under your regime?			Computer programmes protected by copyright, qualifying patents including supplementary protection certificates which are the result of R&D, exclusive

Country			LITHUANIA
			licence to exploit aforementioned IP items may qualify for benefit. Qualifying patents mean any patent which meets the patentability criteria (novelty, inventive step, industrial applicability) protected by the European Patent Office, patents or supplementary protection certificates issued in the EEA country or in the country with which a convention for the avoidance of double taxation has been concluded. Existing copyrights and patents that already have been issued are included as qualifying assets. These assets can only benefit from the tax benefits if the taxpayer can track these expenses and documentary evidence shall be provided. In addition, pending patents are included as qualifying assets. Should the patent be ultimately reversed, the corporate income tax paid from the taxable profits from the use, sale or any other transfer into ownership of qualifying IP assets is recalculated for all tax periods when the tax relief has been applied. Also company's annual returns should be specified accordingly including to pay back provided benefits. Qualifying IP assets do not cover utility models (short term patents, petty patents, etc.), plant breeders' rights and orphan drug designation. Marketing– related IP assets such as trademarks never qualify for the tax benefit.
4. Third	a. Are you	Yes/no	No

Country			LITHUANIA
category of IP assets	planning on allowing the third category of IP assets described in paragraph 37 of the Action 5 Report to qualify for benefits?	(i) Please describe how you will limit the taxpayers benefiting from the third category.	NA
		(ii) Please describe what IP assets will qualify under this category, and the reason why they will fit with the specific requirements in paragraph 37 of the Action 5 Report.	NA
		(iii) Please describe the transparent certification process (undertaken by a competent government agency that is independent from the tax administration) under your regime.	NA
		(iv) Please describe the procedures you have	NA

<table>
<tr><th colspan="3">Country</th><th>LITHUANIA</th></tr>
<tr><td></td><td></td><td>implemented to ensure annual reporting to the FHTP and spontaneous exchange of information.</td><td></td></tr>
<tr><td colspan="3">5. What income will qualify for benefits? Please describe how you are ensuring that the amount of income is not equal to the gross income from IP assets.</td><td>The profits which qualify for the benefits are calculated as the overall income from the qualifying IP asset produced in R&D activities less all expenses incurred in earning that income.

The overall income may include royalties, exclusive license payments in respect of the use of the qualifying asset, compensations for IP right infringement and other income from the use or transfer of the qualifying IP.

It does not include embedded IP income.</td></tr>
<tr><td rowspan="2">6. Embedded IP income</td><td>a. Does your regime allow embedded IP income to qualify for benefits?</td><td>Yes/No</td><td>No</td></tr>
<tr><td colspan="2">b. If yes, please describe how you are ensuring that non-IP income (e.g. marketing and manufacturing returns) does not also qualify for benefits.</td><td>NA</td></tr>
<tr><td>7. Tracking and tracing</td><td>a. Have you designed tracking and tracing requirements to ensure that</td><td>Yes/No</td><td>Yes</td></tr>
</table>

Country			LITHUANIA
	income that is not from qualifying IP assets or that is not qualifying IP income does not qualify for benefits?		
	b. If yes, please describe your regime's tracking and tracing requirements.		The tax benefits from IP regime shall be applied if: - the nexus is ensured between expenditures, each qualifying IP asset and taxable profit and - the taxpayer maintains the documentary evidences which enable to track and demonstrate this link. If the taxpayer can prove that calculation of taxable profit from the use of qualifying IP asset per qualifying IP asset IP is not feasible for practical reasons (as it is engaged in a sufficiently complex IP related business) it is allowed to use the product-based approach. In this case the taxable profit is calculated and tracked either per asset (a product) or the group of assets (products) whereas these assets include IP qualifying asset. The documentary evidences are required.
8. Please explain how losses associated with the IP income will be treated under your regime. The explanation should include how your regime ensures that the requirement under footnote 14 to paragraph 47 of the Action 5 Report is met.			The treatment of losses associated with the IP income corresponds to the separate loss method (outlined in FHTP paper CTPA/CFA/FHP/NOE2 (2016)6) which prevents IP losses to be set off against the general tax rate. IP losses cannot be used against ordinary income, but they may be carried forward to be used against future IP income.

Country			LITHUANIA
9. If you are not a Member State of the European Union, have you designed your regime to be consistent with footnotes 16 and 19 on page 42 of the Action 5 Report?			NA
10. Related-party outsourcing	a. Does your regime limit benefits based on outsourcing to related parties?	Yes/No	Yes
	b. If yes, please explain how your regime limits benefits based on outsourcing to related parties.		This limitation is ensured by the nexus ratio approach envisaged in the legislation (in line with the BEPS Action 5 Report). According to this approach, related party outsourcing expenditures are explicitly excluded from the qualifying expenditures and will be put in the denominator as overall expenditures (and not in the numerator as qualifying expenditures). Qualifying R&D expenditures must have been incurred by a qualifying taxpayer itself or outsourced to unrelated-party (they are also subject to a 30 % “up-lift” to the extent that the increased amount of qualifying expenditures does not exceed the taxpayer’s overall expenditures).
11. Acquisitions of an IP asset	a. Does your regime limit benefits based on acquisitions?	Yes/No	Yes
	b. If yes, please explain how your regime limits benefits based on		This limitation is ensured by the nexus ratio approach envisaged in the legislation (in line with the

Country		LITHUANIA
	acquisitions. Following this question, please proceed to Question 13.	BEPS Action 5 Report). According to this approach, the acquisition of an IP asset will be put in the denominator as overall expenditures (and not in the numerator as qualifying expenditure). Qualifying expenditures – costs incurred in creating assets through scientific research and experimental development activities, attributable to the costs of scientific research and experimental development which according to CIT provisions may be deducted from income three times, excluding those which are incurred due to activities of associated persons and acquisition costs of qualifying IP assets. Costs which may be deducted from income three times are explicitly defined by the Resolution On the Approval of the Description of Procedure for Allocation of Costs to Costs of Research and Experimental Development Works" (approved by the Government of the Republic of Lithuania No. 1183, 19 November 2008). The list includes the following costs: • wage costs and costs of compulsory health insurance contributions and state social insurance contributions deducted from wages of the employees directly involved in R&D works; • costs of secondments directly related to R&D works and necessary for performance of R&D works; • costs of raw materials and/or materials, other current assets used in performing R&D works; • costs incurred in purchase of services (scientific consultancy services, lease of premises and/or equipment, public utilities, maintenance, storage, telecommunication and other services) directly related to R&D works and necessary for performance of R&D works; • costs incurred in purchase of constituent works of R&D works from other taxable entity or natural person, if such purchased works are performed in the country of the European Economic Area or in the country which is outside the European Economic Area, but with which the Republic of Lithuania has concluded the double taxation convention and applies its provisions; • amounts of the value added tax on purchase

Country			LITHUANIA
			and import duties deducted from the costs specified in this section which are not deductible according to the provisions of the Republic of Lithuania Law on Value Added Tax (OJ, No. 35-1271, 2002). The list does not include IP acquisition costs.
12. Related-party outsourcing and acquisition of an IP asset in line with footnotes 16 and 19 on page 42 of the Action 5 report	a. Does your regime limit benefits based on the location of the R&D activities in the case of related-party outsourcing and acquisitions?	Yes/No	No
	b. If yes, please explain how your regime limits benefits based on the location of R&D activities.		NA
13. Rebuttable presumption	a. Does your regime treat the nexus ratio as a rebuttable presumption?	Yes/No	No
	b. If yes, please answer to the following questions (i) through (iii)	(i) Please describe how departures from the application of the nexus ratio will be limited to the exceptional circumstances described in paragraph 48 of the Action 5 Report.	NA

Country			LITHUANIA
		(ii) Please provide examples of situations where your jurisdiction expects taxpayers to rebut the presumption.	NA
		(iii) Please describe the procedures you have implemented to ensure annual reporting to the FHTP and spontaneous exchange of information.	NA

Additional information

The amendments are incorporated into the Corporate Income Tax Law implementing other anti- BEPS measures included in ATAD Directive (please find below the reference to e- register of the legal acts and also unofficial translation of the amendments in respect of the IP regime):
https://e-seimas.lrs.lt/portal/legalAct/lt/TAD/45c8e820fd4711e89b04a534c5aaf5ce?positionInSearchResults=11&searchModelUUID=15d4e79c-9138-4412-ab14-626b209e9738

The additional legislation implements the respective nexus requirements explicitly and includes the introduction of the separate loss method, explicit requirements for the tracking and tracing system, the recalculation of the tax in case of the reversion of patent, some slight specifications on qualifying expenditures and overall expenditures. The amendments are applied in calculation and declaration of the corporate income tax for 2018 and later tax periods.

LAW ON AMENDMENT

TO ARTICLES 2, 4, 5, 11, 17, 30, 39, 55 AND SUPPLEMENT WITH ARTICLE 30[1]

OF

REPUBLIC OF LITHUANIA LAW

ON CORPORATE INCOME TAX NO. IX-675

2018 No. Nr. XIII-1697

Vilnius

Article 3. Amendment to Article 5

1. To amend paragraph 7 of Article 5 and to set it forth to read as follows:

“7. The part of taxable profits from the use, sale or any other transfer into ownership of assets of a Lithuanian entity, permanent establishments calculated according to the formula set out in paragraph 9 of this Article shall be taxed at a rate of 5% where:

1) income from the aforementioned use, sale or any other transfer into ownership of assets is received only by the Lithuanian entity or permanent establishment that created the assets and only they incur all the expenditure due to such income generation, and

2) the assets are a copyrighted computer (software) programme or an invention complying with the criteria of patentability (novelty, inventive step and industrial applicability) protected by patents or supplementary protection certificates granted by the European Patent Office in a state of the European Economic Area or in a state with which a treaty for the avoidance of double taxation has been concluded and brought into effect.

2. To supplement Article 5 with paragraph 8:

“8. The provisions of paragraph 7 of this Article shall also apply in case where the assets created by the Lithuanian entity or permanent establishment are used by them under an exclusive licence. The relief shall be applied when the computer (software) programme is already protected by the copyright, patent application has been filed, patent has been granted, the supplementary protection certificate has entered into force or the exclusive licence has been granted. When the relief is applied from the date of the submission of the patent application, and the patent has not been granted or the patent is recognised as invalid, also the supplementary protection certificate is recognised as invalid or the exclusive licence is invalid, the corporate income tax paid from the taxable profits from the use, sale or any other transfer into ownership of assets calculated according

to the formula specified in paragraph 9 of this Article must be recalculated for all tax periods when the relief has been applied following the provisions of Article 68 of the Law on Tax Administration. "

3. To supplement Article 5 with paragraph 9:

"9. The part of taxable profits from the use, sale or any other transfer into ownership of assets shall be calculated according to the following formula:

$$\frac{\text{Eligible expenditure}}{\text{Total expenditure}} \times \text{Profits from the use of assets, where:}$$

eligible expenditure – costs incurred in creating assets through scientific research and experimental development activities, attributable to the costs of scientific research and experimental development which following the provisions of Article 17[1] may be deducted from income three times, excluding those which incurred due to activities of associated persons, and acquisition costs of assets specified in subparagraph 2 of paragraph 7 of this Article. The amount of the calculated eligible expenditure incorporated into the formula shall be increased by 30%; however, such an increased amount may not exceed the total amount of expenditure calculated;

total expenditure – eligible expenditure, acquisition costs of assets specified in subparagraph 2 of paragraph 7 of this Article and other costs attributable to allowable deductions or limited allowable deductions incurred in creating assets through scientific research and experimental development activities, including those which have been incurred due to activities of associated persons, excluding interest and depreciation costs of buildings;

profits from the use of assets – taxable profits calculated on the basis of income received from the use, sale or any other transfer into ownership of assets created by the entity itself through scientific research and experimental development activities (including royalties and compensations for violated intellectual property rights), after deducting the allowable deductions or limited allowable deductions with respect to this income."

4. To supplement Article 5 with paragraph 10:

“10. The formula specified in paragraph 9 of this Article used for the calculation of the part of taxable profits from the use, sale or any other transfer into ownership of assets shall be applied individually for each assets specified in subparagraph 2 of paragraph 7 of this Article, or for assets (a product) or the group of assets (products), when these assets (a product) or the group of assets (products) is created by using several items of assets indicated in subparagraph 2 of paragraph 7 of this Article, and the entity may prove that the formula for practical reasons may not be applied individually for each assets specified in subparagraph 2 of paragraph 7 of this Article. In all cases, the entity shall maintain the documentary evidences proving the link between eligible expenditure, total expenditure, the assets specified in subparagraph 2 of paragraph 7 of this Article, or assets (a product) or the group of assets (products), and the profit from the use of the assets.”

Article 6. Amendment to Article 30

1. To amend paragraph 1 of Article 30 and to set it forth to read as follows:

“1. Where losses for the tax period are calculated by deducting non-taxable income, allowable deductions and limited allowable deductions from income during the fiscal year, the amount of such losses shall be carried forward to the following fiscal year, except for losses incurred from the transfer of securities and/or financial derivatives and losses from the use, sale or any other transfer into ownership of assets calculated according to the formula specified in paragraph 9 of Article 5 of this Law.

2. To supplement Article 30 with paragraph 2^1:

“2^1. Losses from the use, sale or any other transfer into ownership of assets calculated according to the formula specified in paragraph 9 of Article 5 of this Law shall be carried forward to the following fiscal year, however shall be covered only from taxable profits calculated according to the formula specified in paragraph 9 of Article 5 of this Law.”

Article 11. Entry into Force, Implementation and Application of the Law

1. This Law, excluding Articles 3 and 6 as well as paragraph 4 of this Article, shall enter into force as of 1 January 2019.

2. The provisions of this Law, excluding Articles 3 and 6 of this Law, shall apply in calculation and declaration of the corporate income tax for 2019 and later tax periods. The provisions of Articles 3 and 6 shall apply in calculation and declaration of the corporate income tax for 2018 and later tax periods.

3. If the copyright of assets specified in subparagraph 2 of paragraph 7 of Article 5 amended by paragraph 1 of Article 3 of this Law arose, patent has been granted or the supplementary

protection certificate has entered into force, or the exclusive licence has been granted before 31 December 2017, the provisions of paragraphs 7-10 of Article 5 amended by Article 3 of the Law on Corporate Income Tax shall apply only in case, when there are documentary evidences proving the proper application of paragraph 10 of Article 5 supplemented by paragraph 4 of Article 3 of the Law on Corporate Income Tax.

II / FINAL ASSESSMENT

The following assessment was agreed by the Code of Conduct Group on 11 April 2019:

	1a	**1b**	**2a**	**2b**	**3**	**4**	**5**	**OA**
LT – Reduced CIT rate for taxable profits earned from IP assets (LT007)	X	?	X	?	X	X	X	X

In accordance with the 24 November 2016 report of the Code of Conduct Group to the Council, the following assessment has been prepared with regard to paragraphs 1 to 5 of the Code, based on the OECD description (hereafter referred to as "agreed description"[1]) provided by the Lithuanian authorities in February 2019. The measure was assessed against all Code criteria and on the basis of the modified nexus approach.

Explanation

Significantly lower level of taxation:

"Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code"

The Reduced CIT Rate for taxable profits earned from IP assets ("IP regime") applies for the calculation of the CIT from 2018 onwards. It provides for a lower tax rate for income and gains derived from certain IP rights.

A corporation tax rate of **5%** on relevant profits (royalties and proceeds from the alienation of IP assets) is applied compared to the current Lithuanian company tax rate of **15**%.

This rate is significantly lower than the rate generally applying. **It is therefore potentially harmful within the meaning of paragraph A of the Code.**

Criterion 1:

[1] For this particular exercise, the Member State's reply to the OECD questionnaire for FHTP.

“whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a concerns the *de jure* application of the measure.

Both Lithuanian resident companies and Lithuanian permanent establishments (PEs) of non-resident companies subject to Lithuanian corporate income tax which carry out R&D activities and derive IP income from such activities can benefit from the IP regime. There seem to be no provisions restricting the benefits to transactions with non-residents.

1b) Criterion 1b is used to complement the assessment under criterion 1a which only looks at the literal interpretation of the measure. It takes account of the *de facto* effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b.

In light of the recent introduction of the IP regime, it is unlikely that statistical or impact data is either available at this stage, or representative enough to reflect the comprehensive effects of the newly IP regime. Moreover, the agreed description in the format used lacks such data.

This is a horizontal issue for almost all assessments. To the extent that our draft assessment is based on currently available information [or lack of] on statistics, we suggest that the group reserves the possibility of a potentially different outcome of a future assessment based on more complete information.

Criterion 2:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

As regards criterion 2 the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. *de jure* interpretation and *de facto* analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a) What has been written under criterion 1a applies analogously to criterion 2a.

There are no rules preventing domestic taxpayers from benefiting from the IP regime or to exclude domestic transactions.

2b) On the basis of the explanations provided above and the marking under criterion 1b, the evaluation of criterion 2b follows the same reasoning.

In light of the recent introduction of the IP regime, it is unlikely that statistical or impact data is either available at this stage, or representative enough to reflect the comprehensive

effects of the newly IP regime. Moreover, the agreed description in the format used lacks such data.

This is a horizontal issue for almost all assessments. To the extent that our draft assessment is based on currently available information [or lack of] on statistics, we suggest that the group reserves the possibility of a potentially different outcome of a future assessment based on more complete information.

Criterion 3:

"whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages"

In November 2014 the Group agreed, in co-ordination with developments at the OECD, on the modified nexus approach as the appropriate method to ensure that patent boxes require sufficient substance. Therefore, under this agreed approach, criterion 3 for the Code is to be interpreted in line with the modified nexus approach. The key elements of the modified nexus approach are: Scope (qualifying IP assets), Nexus ratio, Tracking and tracing, Rebuttable presumption and Treatment of losses.

1. Scope:

Qualifying IP assets: Income benefiting from an IP regime has to come from a qualifying asset, comprised in one of the three categories 1) patents and functionally equivalent assets including utility models, protection granted to plants and genetic material, orphan drug designations and extensions of patent protection; 2) copyrighted software, and 3) assets that share the features of patents and are substantially similar to the two previous categories and are certified as such by a competent government agency in the State[2].

The Lithuanian IP regime benefits to: 1° Computer programmes protected by copyright, 2° qualifying patents, 3° supplementary protection certificates which are the result of R&D, and 4° exclusive licence to exploit aforementioned IP items.

Qualifying patents mean any patent which meets the patentability criteria (novelty, inventive step, industrial applicability) protected by the European Patent Office, patents or supplementary protection certificates issued in the EEA country or in the country with which a convention for the avoidance of double taxation has been concluded. Existing copyrights and patents that already have been issued are included as qualifying assets. These assets can only benefit from the tax benefits if the taxpayer can track these expenses and documentary evidence shall be provided.

Pending patents are also included as qualifying assets. If the patent is ultimately reversed, the CIT paid from the taxable profits is recalculated for all tax periods when the tax relief has been applied. Also company's annual returns should be specified accordingly including to pay back provided benefits.

Qualifying IP assets do not cover utility models (short-term patents, petty patents, etc.), plant breeders' rights and orphan drug designation. Marketing-related IP assets such as trademarks

[2] Category limited to companies which are not part of a group with more than €50m turnover and gross revenues of €7.5m from all IP assets.

are excluded.

The LT IP regime does not cover the third category of IP assets for small and medium size enterprises[3]. Thus, no annual reporting obligation to FHTP, nor a spontaneous exchange of information necessary.

The agreed description indicates that royalties from licensing an IP right, exclusive license payments, compensations for IP right infringement and other income from the use or transfer of the qualifying IP right (capital gains) can benefit. Embedded royalties are excluded.

2. Nexus ratio:

The tax advantage granted under the LT IP regime is a reduced tax rate.

Such reduced rate applies on the relevant qualifying net[4] IP income. The portion of income qualified for the reduced rate is calculated under the modified nexus formula: [QE (+30% uplift) / OE x OI]:

- QE being qualifying expenditure excluding outsourcing to related parties and acquisition costs;

- OE being overall expenditure, including outsourcing to related parties and acquisition costs;

- OI being overall income calculated as a net income and including royalties and capital gains (with a transfer pricing method).

3. Tracking and tracing:

MS must require companies to track expenditure, IP assets and income. When such tracking would be unrealistic and require arbitrary judgements, MS may allow the application of the nexus approach so that the nexus may be between expenditure, products arising from IP assets and income (product-based approach). It requires tracking of all QE and OE at the level of the product.

The LT law sets specific provisions regarding the tracking and tracing requirements under the IP regime. The entity shall keep any documentary evidence needed to determine direct and indirect income and expenses related to the IP assets involved, so tracking and tracing is ensured. The product-based approach is also allowed.

4. Rebuttable presumption[5]:

Under the LT IP regime, the nexus ratio is not treated as a rebuttable presumption.

[3] Given that such inventions are substantially similar to the IP assets in the first two categories, they should be certified in a transparent certification process by a competent government agency that is independent from the tax administration.

[4]The profits which qualify for the benefits are calculated as the overall income from the qualifying IP asset produced in R&D activities less all expenses incurred in earning that income.

[5] Jurisdictions could treat the nexus ratio as a rebuttable presumption but would need to limit to exceptional situations where the ratio could be rebutted to those that meet at minimum the following requirements: the taxpayer should first use the nexus ratio to establish the presumed amount of income that could qualify for benefits; the nexus ratio (excluding the up-lift) should equal or exceed 25%; the taxpayer should demonstrate that because of exceptional circumstances, the application of the nexus ratio would result in an outcome inconsistent with the nexus approach (burden of proof on the taxpayer).

5. Treatment of losses[6]:

The treatment of losses associated with the IP income corresponds to the separate loss method which prevents IP losses to be set off against the general tax rate. IP losses cannot be used against ordinary income, but they may be carried forward to be used only against future IP income.

Criterion 4:

"whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD"

- General transfer pricing rules:

Lithuania applies the arm's length principle and its regulations make reference to the OECD Transfer Pricing Guidelines.

The arm's length principle is relevant to the following features of a patent box: the reduction of the tax base by a fixed percentage, if any; the calculation of royalty profits; the application of safe harbour rules; the asymmetrical treatment of losses (if any).

- Reduction of the tax base by a fixed percentage: *in principle, reducing a company's arm's length profits by a fixed amount means that the final result does not reflect the arm's length principle. This is a question about the circumstances in which fixed reductions of the tax are acceptable and is therefore part of the overall assessment that the Group need to make.*

The tax benefit under the Lithuanian IP regime is granted through a reduced tax rate and not a reduction in the tax base. Therefore, the amount of the basis of income is not modified in the IP regime in a way that would not reflect the arm's length principle.

- Calculation of royalty profit (embedded royalties): *where transfer pricing rules exist, the profits that go into a patent box will reflect the arm's length principle because they are just a part of the company's total profit. In principle this applies both to royalties and embedded royalties. If the IP regime covers also the latter category, its identification within the sale price of a product should rely on transfer pricing principles.*

Embedded royalties are excluded from the Lithuanian IP regime.

- Safe harbour rules: *adoption of safe harbours is not in accordance with internationally agreed principles; safe harbours are not recommended in the Transfer Pricing Guidelines.*[7]

[6] Note 14 to Action 5 Report: Jurisdictions should also use any tax losses associated with the IP income in a manner that is consistent with domestic legislation and that does not allow the diversion of those losses against income that is taxed at the ordinary rate.
[7] *Transfer Pricing Guidelines*, p167.

The Lithuanian IP Regime does not seem to provide for such safe harbour rules.

- Asymmetrical treatment of losses: *where the profits from particular IP assets are taxed at a lower rate in a patent box then the losses should be treated in the same way and not deducted outside the box at a higher rate.*

What has been written under criterion 3 above on losses applies analogously to criterion 4.

Criterion 5:

"whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way"

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations *etc*. before a measure can be considered transparent.

The nexus approach contains commitments to additional transparency in three areas. These concern the third category of qualifying assets, new entrants to existing IP regimes after 6 February 2015 and the rebuttable presumption rule. Commitments regarding new entrants to pre-existing regimes are not subject to the present assessment and are part of a separate monitoring process. The commitments in the 2015 Report cover both the report of certain information to the Forum on Harmful Tax Practices and the spontaneous exchange of information between competent authorities.

Third category of qualifying assets

Not applicable, as third category of IP assets is not covered by the Lithuanian IP regime.

New entrants

Not applicable, as the regime came into force in 2018.

Rebuttable presumption rule

Not applicable, as nexus ratio is not treated as a rebuttable presumption.

Overall assessment:

In light of the assessment made under all Code criteria, the Lithuanian IP regime is considered as **not harmful** from a CoC point of view.

Overall the LT IP regime is in line with the modified nexus approach. Similar to other recently introduced or amended measures, question marks remain in the grids in relation to criteria 1b and 2b.

In summary, the Group's overall assessment is that this measure is **not harmful**.