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MEETING DOCUMENT

From:	General Secretariat of the Council
To:	Code of Conduct Group (Business Taxation)
Subject:	(Draft) Progress Report by the Code of Conduct Group (Business Taxation) to the ECOFIN Council of December 2018 - Annex: Lithuania's Extension of the corporate income taxation regime to special tax zones (LT006)

Delegations will find attached a document in view of the meeting of the Code of Conduct Group (Business Taxation) on 15 November 2018.

Lithuania's Extension of the corporate income taxation regime to special tax zones (LT006)

I/ AGREED DESCRIPTION

The following description was agreed by the Code of Conduct Group (business taxation) on 24 July 2018:

By Act of 12 December 2017, Lithuania amended its existing Corporate Income Tax Regime for Special Tax Zones by extending the scope and tax benefits available to taxpayers in the zones. The law entered into force as of 1 January 2018.

Background – previous work of the Group on the Lithuania CIT regime for special tax zones

Under the 2017 standstill notification exercise, Lithuania notified to the Code Group changes brought to the special tax zones regime in 2016 by allowing additional qualifying activities[1]. At the same time, the FHTP raised concerns on potential IP aspects of the existing regime, in particular with respect to computer related activities.

At the 8 June 2017 meeting, the Group decided that, based on the description, there was no need to assess the changes to qualifying activities but the Group would return to the possible IP aspects of the measure once information on this is provided by Lithuania.

After further discussions with Lithuania, and considering the fact that no taxpayer was exclusively deriving income from computer related activities, the Group endorsed the solution that the regime should not be further reviewed, provided that no adverse economic effects are at stake and that the Commission should monitor this. Lithuania committed to report annually the relevant and objective data.

Under the 2018 standstill notification exercise, Lithuania has now notified new amendments to its CIT regime for special tax zones.

The modifications to the regime

The standard CIT rate in Lithuania is 15%.

1 Additional qualifying activities for tax relief notified in 2017:
- accounting, bookkeeping and consultancy activities (except for audit, evidence of invoice expertise and veracity),
- office administrative and support activities,
- human resource activities,
- architectural, engineering and related technical consultancy activities (except for construction work control and aerial photography).

Until the end of 2017, under the CIT regime for special tax zones, a company established therein was:

- exempt from the CIT for 6 tax periods, and
- subject to a 50% reduced CIT rate for the subsequent 10 tax periods.

As of 1 January 2018, a company which has been established since 1st of January, 2018 in a special tax zone is:

- exempt from the CIT for 10 tax periods, and
- subject to a 50% reduced CIT rate for the subsequent 6 tax periods.

Until the end of 2017, the activities allowed in the special tax zones were limited to some specific qualifying activities[2] as well as those added in 2016[3].

As of 1 January 2018, the CIT regime for special tax zones is available to all types of activities, except for trading activities and activities excluded under Commission Regulation (EU) No 651/2014 (insurance, credit institution activities, head office and business and other management consultancy activities).

The other conditions applicable to the regime remain unchanged. Especially, the substance requirements are still:

- a capital investment of minimum EUR 1 million (or, in the case of services, of minimum EUR 100.000 and an average number of employees of at least 20) ; and
- at least 75% of the income of the tax year must be generated only from activities provided particularly on the territory of the zone.

The amendments to the special tax zone regime are not specifically providing a preferential treatment for income from IP related activities. However, IP income may benefit from the regime, as it is not specifically excluded.

Investment in intangibles are limited, as they shall meet the limitations of state aid regulations:

a) they must be used exclusively in the establishment receiving the aid;
b) they must be amortisable;
c) they must be purchased under market conditions from third parties unrelated to the buyer; and
d) they must be included in the assets of the undertaking receiving the aid and must remain associated with the project for which the aid is granted for at least five years or three years in the case of SMEs.

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[2] Manufacture, treatment, processing and storage of goods, manufacture of aircraft and spacecraft as well as related equipment, repairs and technical maintenance of aircraft and spacecraft, activities related to the technical maintenance and repairs of aircraft (repairs of electronic and optical equipment, technical testing and analysis), computer programming activities, computer consultancy activities, computer hardware management, other information technology and computer services, data processing, hosting and related activities, activities of call centres, wholesale trade in goods stored within the zone, and/or services provided in the zone and related to the aforementioned activities carried out within the zone (transportation and servicing of the goods manufactured, treated, processed or stored within the zone and of the goods required for manufacturing, treatment or processing within the zone, the territory of the construction zone, as well as other services relating to the aforementioned activities).

[3] accounting, bookkeeping and consultancy activities (except for audit, evidence of invoice expertise and veracity), office administrative and support activities, human resource activities, architectural, engineering and related technical consultancy activities (except for construction work control and aerial photography).

Those conditions do not match the conditions agreed by Member States through the modified nexus approach. In particular, the CIT regime is not conditional upon a link between R&D activities and IP income.

When examining the previous IP component of the special tax zone regime, that was limited to computer related activities, the Group endorsed the solution that there was no need to further review the regime on condition that no adverse economic effects are at stake. This decision was linked to a commitment by Lithuania to provide, on a yearly basis, relevant data on the use of this regime.

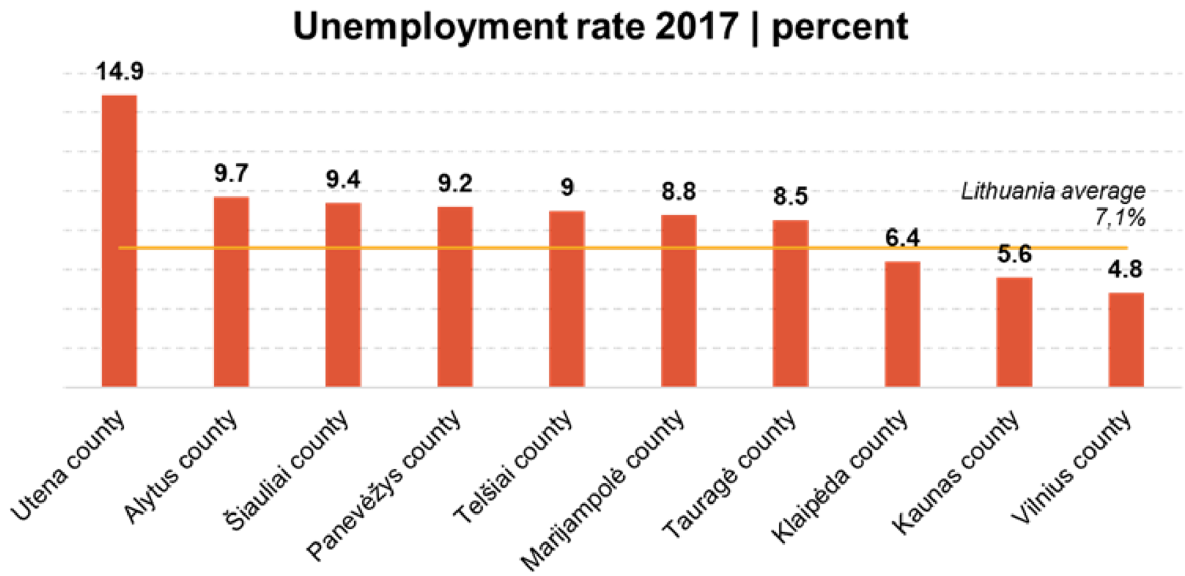
Subject to above mentioned conditions and limitations the new amendments to the CIT regime for special tax zones offer a longer CIT exemption (10 years instead of 6 years) that is available to all IP activities and no longer to computer related activities only.

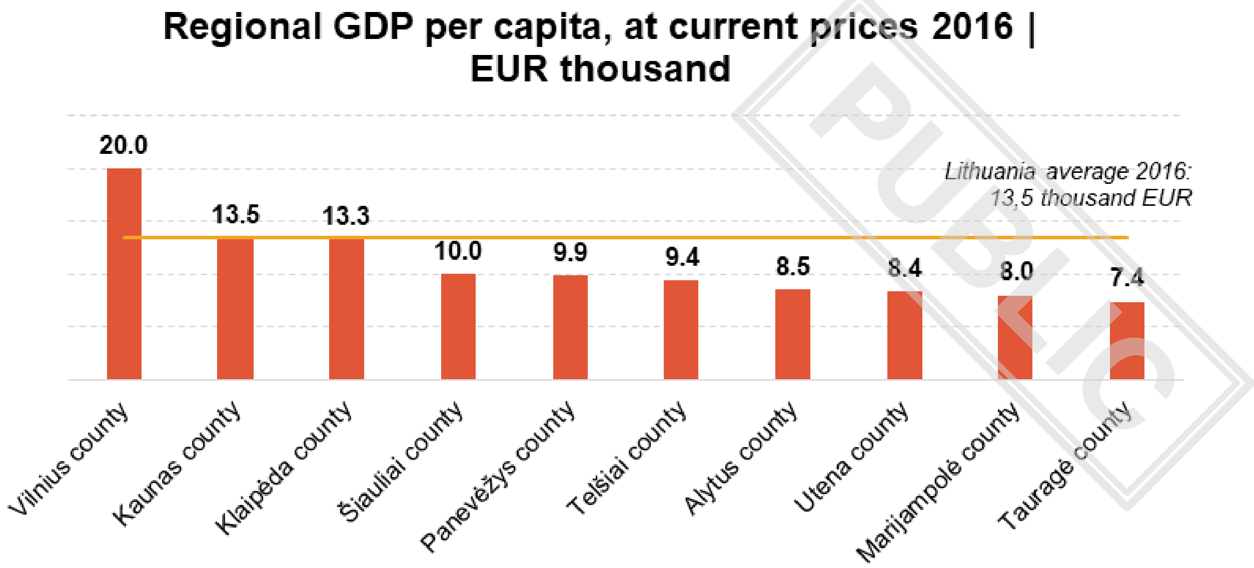
The BEPS risk could be more significant and have adverse economic effects.

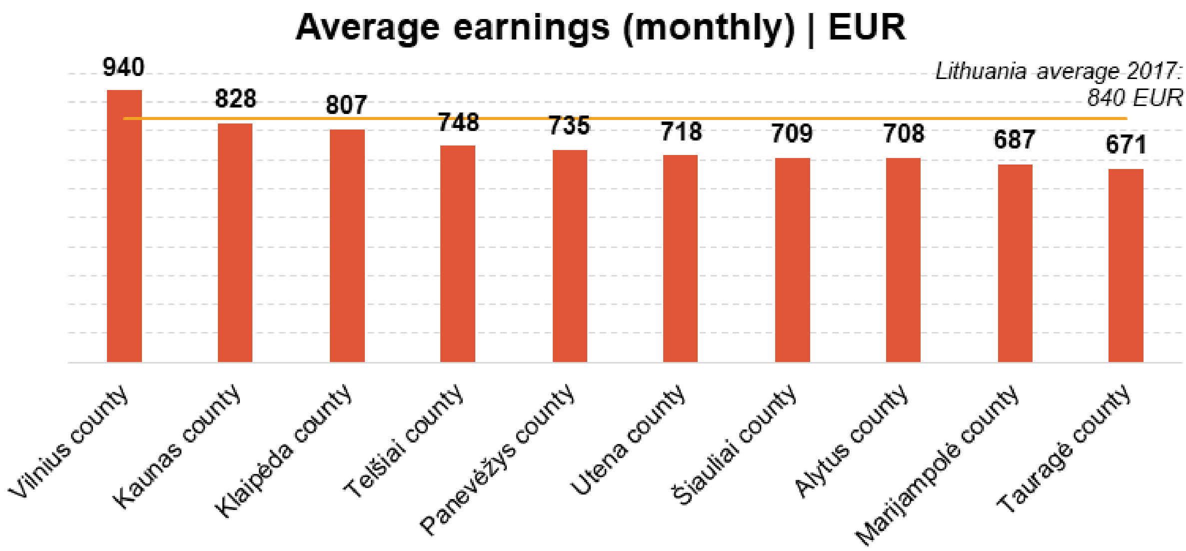
Policy rational

The CIT regime for special tax zones was designed to create new jobs and to attract capital investments in certain undeveloped regions of Lithuania. The preferential tax treatment is only applicable to a small area – special tax zones occupy 14.2 km2 as compared to the 65.3 thousands km2 of the Lithuania territory. The location of the zone was selected by reference to the low level of economic development in these regions (including high rate of unemployment).

Lithuania provided the following information: "*As the data suggests, the majority of free economic zones have been established in Lithuanian counties where the economic development (in terms of GDP per capita, unemployment rate and average wages) is currently lower than the country's average. This is not the case with Kaunas and Klaipeda counties, however free economic zones in these counties were established in 1996 when economic and social development across the whole country was low*".







Statistics

After the 2016 amendments to the legislation, Lithuania had provided data reflecting the situation before the 2017 extension of the scope. It appeared from this data that 51% of SEZ companies were domestic-owned while 49% were foreign-owned[4].

Following the extension of the scope in 2017, Lithuania shared relevant data (see annex to this room document). It appears that the 2017 amendments to the CIT regime for Special Economic Zones did not create adverse economic effects since:

- There are actually less companies benefiting from the regime than in 2016: 30 companies in 2017 as compared to 32 companies in 2016. Out of these 30 companies, 8 are directly or indirectly foreign-owned;

[4] Room document for the 8 June 2017 Code of Conduct Group meeting, WK 6177/2017

- The amount of tax benefit declined in 2017: 5 522 000 EUR in 2017 compared to 7 327 000 EUR in 2016;
- Only one company out of 30 performs an activity that could be related to IP activities.

Concerning the extension of the scope in 2018, Lithuania indicated that 8 new FEZ companies have been established since 1 January 2018.

FEZ name	Number of new FEZ companies
Panevėžys FEZ	2
Kėdainiai FEZ	1
Šiauliai FEZ	2
Klaipėda FEZ	2
Kaunas FEZ	1
Akmenė FEZ	0
Marijampolė FEZ	0

Lithuania does not however have information on the amount of capital invested, as it will be accounted at the end of the tax period. Therefore, it is not yet possible to determine whether these companies will meet the minimum investment criterion to benefit from the CIT regime for Special Tax Zones.

In **conclusion**, for now there is no evidence of potential adverse economic effects. However, there are already eight new companies established in the first 6 months of the new version of the regime for Special Tax Zones as compared to the 30 existing companies, which shows an increase in the use of the Special Tax Zones. The regime does not need to be assessed but its potential adverse economic effects should be monitored by the COCG.

Annex: Monitoring the effects – relevant 2017 data

At the 20 July 2017 Code of Conduct Group meeting, the Group agreed that the IP component of the corporate income tax regime for Special Tax Zones should not be further reviewed provided that no adverse economic effects were at stake and that the Commission should monitor these effects. In this respect, Lithuania committed to report annually relevant and objective data on the use of the CIT regime for Special Tax Zones.

The Commission services requested such data from Lithuania that shared the following information.

1/ How many taxpayers benefited from the regime?

In 2017, the FEZ relief (0% or 7,5% CIT rates[5]) was applied by 30 taxpayers.

Data of taxpayers (legal entities) who benefited from the FEZ regime

	2016	2017
Number of taxpayers *of which:*	**32**	**30**
applied 0 % CIT rate	*16*	*15*
applied 7.5 % CIT rate	*16*	*15*
Declared taxable profit, *thousand euros*	**54 339**	**52 200**
Budget revenue losses due to the SEZ relief, *thousand euros*	**7 327**	**5 522**

2/ Amongst the beneficiaries, how many are directly or indirectly foreign owned companies, of PEs of foreign companies and of Lithuania owned companies?

In 2017, amongst the beneficiaries, 8 legal entities were directly or indirectly foreign owned companies (managed more than 50 % of the shares) and 22 of Lithuania owned companies (managed more than 50 % of the shares).

3/ What is the total amount of tax benefit granted in the zones? If possible specify the proportion of income benefiting from the regime that is IP related income.

The total amount of declared taxable profit in 2017 - 52 200 thousand euros and the total amount of the budget revenue losses – 5 522 thousand euros.

It is not possible to specify IP related income, however, please find below relevant data for sector(s) of activity that benefitted from the regime by NACE Rev. 2

[5] 100% CIT exemption or 50% CIT exemption

	Sector(s) of activity that benefitted from regime by NACE Rev. 2	Description	Number of entities in each sector that benefitted from regime
2017	C	Manufacturing	16
	D	Electricity, gas, steam and air conditioning supply	1
	F	Construction	2
	G	Wholesale and retail trade; repair of motor vehicles and motorcycles	2
	H	Transportation and storage	4
	L	Real estate activities	4
	M	Professional, scientific and technical activities	1
	Total		**30**

4/ Amongst the total tax benefits granted in the zones, how much is attributable to domestic owned / foreign owned companies?

In 2017 amongst the total benefits granted in the zones (5 522 thousand euros), amount of 1 905 thousand euros (34,5%) is attributable to foreign owned companies and amount of 3 617 thousand euros (65,5%) is attributable to domestic owned companies.