

TAXATION OF LITHUANIAN HOLDING COMPANIES

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Holding companies in Lithuania are taxed same way as any other joint stock company. However Lithuanian tax legislation provides certain advantages that may bring Lithuanian jurisdiction into consideration for establishment of the holding company:

- Competitive income tax rate of 15 per cent;
- Exemption of distributed dividends under certain conditions;
- Thin capitalization debt to equity ratio 4:1;
- Deductibility of interest paid for the loans;
- Possibility to transfer tax losses among group members;
- Non taxation of capital gains from the sale of shares in certain instances.

Corporate Income Tax in General

The standard corporate income tax for all the income of the Lithuanian companies is chargeable at the rate of 15 per cent. However, under certain circumstances Lithuanian company could be subject to the reduced corporate income tax rate of 5 per cent. Tax rate of 5 per cent shall apply to the companies, which: [a] have not more than 10 employees and [b] their taxable income during the taxable year is less than LTL 1'000'000 (EUR 289'620) and [c] their shareholders (individually or in group) do not hold more than 50% shares in that or any other legal entity.

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Dividends

i. Received dividends

Dividends paid out to the Lithuanian entity by its Lithuanian subsidiaries are subject to a standard corporate income tax rate of 15 per cent. The same rate applies for the dividends received by the Lithuanian entity from its foreign subsidiaries.

Dividends received by Lithuanian entity from its Lithuanian subsidiaries are not subject to the corporate income tax if the recipient has held at least 10 per cent of voting shares (ownership interests) for a continuous period of at least 12 successive months including the moment of distribution.

Dividends received by Lithuanian entity from its foreign subsidiaries are exempt from corporate income tax if besides holding 10% of stock for 12 months it additionally satisfies the requirement that subsidiary's income was subject to the corporate income tax or an equivalent tax and which was not registered or otherwise organised in a target territory.

Subject to the provisions of the Law on Corporate Income Tax the target territory is a foreign state or zone included in the List of Target Territories established by the Minister of Finance (Black list) and meets at least two of the criteria set out below:

- the equivalent tax rate in that territory accounts for less than 11.25 %;
- different rules for equivalent taxation are applied in that territory, depending on the state in which the controlling person is registered or otherwise organised;
- different rules for equivalent taxation are applied in that territory, depending on the state in which activities are pursued;
- the controlled taxable entity has concluded an agreement with the tax administrator of that state concerning the tax rate or base;
- there is no effective exchange of information in that territory;
- there is no financial and administrative transparency in that territory: the rules for tax administration are not entirely clear and the procedure for the application of these rules is not presented to the tax administrators of other states.

According to the Law on Personal Income Tax, dividends received by the natural person (Lithuanian resident) are subject to the personal income tax at the rate of 20

per cent. However, in this case the received dividends shall not be subject to any additional taxation (social security, mandatory health insurance etc.). The rates of taxation in respect to the dividends distributed to the non-residents are established under the double tax treaties. Lithuania currently has entered into 50 double taxation treaties:

Ireland	Armenia	Austria	Azerbaijan
Belarus	Belgium	Bulgaria	Czech Republic
Denmark	The United Kingdom of Great Britain and Northern Ireland		
Estonia	Greece	Georgia	Iceland
Italy	Israel	the USA	Canada
Kazakhstan	China	Korea	Croatia
Latvia	Poland	Luxemburg	Macedonia
Malta	Moldova	Norway	the Netherlands
Portugal	France	Romania	Russia
Serbia	Singapore	Slovakia	Slovenia
Finland	Sweden	Switzerland	Turkey
Ukraine	Uzbekistan	Hungary	Germany
Spain	India	Mexico	

A treaty with Kyrgyzstan and Mexico is signed but not yet in force.

ii. Paid dividends

As a general rule dividends received by foreign parent companies for the shares, portion of capital or other rights held in a Lithuanian subsidiary shall be subject to a withholding tax at a rate of 15%. In such cases the corporate income tax shall be paid by the Lithuanian entity distributing the profit. Such foreign shareholders could apply for the refunding of the corporate income tax in their country of domicile.

However, dividends paid to a foreign parent company shall be exempt from withholding tax if: [a] a parent company has held at least 10% of subsidiary's shares for at least 12 months and [b] a foreign parent company is not registered or otherwise organized in a target jurisdiction.

Financing of Lithuanian holding companies

i. Thin capitalisation

Under the Lithuanian tax legislation thin capitalisation rules apply in respect to borrowings from related parties, as well as borrowings guaranteed by related parties. The debt to equity ratio is 4:1 in such cases. The above regulations are not applicable in cases when Lithuanian entity has sufficient proof that the same loan under the same conditions would have been granted by non-related entity. It should also be pointed out that under the Lithuanian legislation in any case the interest rate on shareholders' loans cannot exceed the average bank interest rate at the country of lender's business.

ii. Interest

All the interest paid on loans and other debts related to the business activities of the Lithuanian entity is generally deductible. However, the penalty interest for the delayed payment of taxes and other public payments owed to the state is not deductible for corporate income tax purposes.

According to the Law on Personal Income Tax, interest on loans (if the repayment of the loan commences no earlier than 366 days after its issuance) granted by the Lithuanian residents and non-residents are exempted from personal income tax.

Capital gains

In general transfer of Lithuanian entity shares by non-resident is not taxable in Lithuania. The income received by the Lithuanian resident is included into the general income and is subject to general tax rates. In certain cases Lithuanian residents (individuals) may be exempted from the taxation in respect to sale of shareholdings. Such privilege is applicable in following cases:

- Lithuanian resident receives income from disposal of the shares acquired before 1 January 1999;
- Lithuanian resident receives income from selling the shares not earlier than 366 days after they have been acquired and such individual has not owned more than 10 per cent of the shares of that entity during the 3 years before the end of the taxation period when the shares have been sold. However this incentive shall not apply in case the shares have been transferred to the company that issued the shares being sold.

Gains derived by non-resident individuals from the transfer of shares in Lithuanian companies are not taxable in Lithuania.

Capital gains of the corporate shareholder shall be exempted from the corporate income tax if:

- Gains have been derived from the transfer of shares of the entity registered with an EEA Member State or a state which has an effective tax treaty; and
- Such entity is subject to corporate income tax or an equivalent tax; and
- The transferring entity has held more than 25 per cent of the shares in that entity for an uninterrupted period of at least 2 years (3 years in case of reorganization).

The above exemptions are also applicable in cases when the shares are not transferred to the issuer.

Reorganization

The Law on Corporate Income Tax defines three transactions that qualify as mergers for tax purposes:

- (a) reorganization transactions where one or two entities (acquired entities) are merged into an existing entity (acquiring entity) without going into liquidation;
- (b) reorganization transactions where two or more entities (acquired entities) are merged into a new entity (acquiring entity) without going into liquidation; and
- (c) when an entity transfers all its assets, rights and obligations to another entity which is a 100 per cent holder of its subscribed capital (or 100 per cent of shares representing the capital) without going into liquidation.

In (a) and (b) cases, the transaction must satisfy certain conditions³ in order to qualify for the tax relief foreseen by the Merger Directive. In case (c), the

3 These conditions are: (i) all assets, rights and obligations of the acquired entities are transferred to the acquiring entity; (ii) the participants of the acquired entities receive the shares of the acquiring entity in proportion to the assets of the acquired entity which have been transferred to the acquiring entity; and (iii) when the shares of the acquired entity are exchanged for the shares of the acquiring entity and in accordance with reorganization conditions, the difference in price can be paid up in cash; the payment must not exceed 10% of the nominal value of shares or, in the absence of a nominal value, the balance value of the shares.

transaction must satisfy the following conditions in order to qualify for the tax relief foreseen by the Merger Directive: all the assets, rights and obligations of the entity are being acquired; and the entity which acquires all the assets, rights and obligations must be in possession of 100 per cent of the authorized capital of the acquired entity, i.e. it must be a parent company.

Anti-Avoidance

i. General anti-avoidance

The abuse of law doctrine is the same for civil law and tax law in Lithuania and acts as GAAR in the tax field. The concept is quite broad and entails any taxpayer's contract, transaction or chain of transactions concluded with an aim to receive tax benefits, e.g. reduce or defer the amount of payable taxes, increasing the amount of tax credits, misrepresenting or non-disclosing circumstances necessary for the proper tax assessment. If a taxpayer's transaction is undertaken with a main business purpose and tax benefits are only ancillary such transactions will not be considered to be abusive.

If however an abuse of law is determined, tax authorities may disregard legal form of a transaction chosen by a taxpayer and re-characterize it and assess taxes according to the real circumstances. The doctrine of abuse of law hasn't been thoroughly tested in Lithuanian courts yet. Specific anti-avoidance measures include various rules implementing additional requirements or withdrawing tax benefits for transactions with black listed jurisdictions, e.g. expenses incurred by payments to listed tax havens are not deductible unless the taxpayer seeking a deduction proves *inter alia* that a recipient has actual capability to provide services or sell goods which were bought by Lithuanian entity.

ii. Transfer pricing

All related party transaction must be executed at arm's length. The tax authorities are entitled to make adjustments to the respective transaction prices if they do not conform with market prices. The Lithuanian rules refer to the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations established by Organisation of Economic Cooperation and Development (OECD) to the extent that they do not contradict with domestic rules.

According to the Lithuanian transfer pricing regulations, companies may apply the following methods, although traditional methods should be given preference: (i) comparable uncontrolled price method; (ii) resale price method; (iii) "cost plus" method; (iv) profit split method; (v) transactional net margin method.

All entities with annual revenue exceeding 10 million LTL, as well as all banks, insurance companies and credit institutions are required to prepare transfer pricing documentation in a specifically prescribed form. The documentation may be in a foreign language, but upon request has to be translated into Lithuanian.

Controlled Foreign Company

Pursuant to the provisions of the Law on Corporate Income Tax the Controlled Foreign Company (CFC) is defined as a foreign company in which another company (or individual):

- Directly or indirectly holds more than 50 % of stock or rights in respect of dividends; or
- Together with related parties, holds more than 50 % of stock or rights in respect of dividends and the controlling company's holding is 10 % or more.

The (positive) income of CFC is attributed to a Lithuanian controlling party in proportion to its holding. This income does not include 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 so attributed.

A Lithuanian entity has a right to reduce corporate income tax on the positive income by the amount of corporate income tax on the positive income which was paid in a state or zone where the CFC is registered or otherwise organised, proportionately to the number of shares (interests, member shares), votes or rights to the profit of the CFC held by the Lithuanian entity. Where the tax paid in the said state or zone exceeds the amount provided for in the laws of that state or zone, the Lithuanian entity shall have a right to reduce corporate income tax on the positive income only by the amount of tax on the positive income of CFC, which had to be paid in the state or zone wherein CFC is registered or otherwise organised. The regime does not apply if CFC's income comprises only of dividends from the Lithuanian controlling company or constitutes less than 5 per cent of the Lithuanian controlling company's income.

The positive income is attributed to the Lithuanian controlling party only if:

- the CFC is not registered or otherwise organised in the states or zones included in the list approved by the Minister of Finance (white list);
- the CFC complies with any of the forms of business organisation of a foreign entity included in the list approved by the Minister of Finance i. e.

(i) business organisation in states included in the above list where special corporate income tax incentives are granted; and (ii) business forms organized in other countries not included into the above list or list of tax havens which are subject to the corporate income tax with the rate less than 11.25 per cent.

The above listed states approved by the Minister of Finance (white list) include: Armenia, Austria, Belgium, Bulgaria, Canada, China, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Iceland, Ireland, Israel, Italy, Kazakhstan, Korea, Latvia, Luxembourg, Malta, Moldova, the Netherlands, Norway, Poland, Portugal, Romania, Russia, Singapore, the Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom and the United States.

Group taxation

There are no group taxation regulations under the Lithuanian tax legislation. However, the Law on Corporate Income tax allows transfer of the losses between the entities within the group of companies. Respective entity is entitled to transfer the tax losses incurred in the tax year of 2010 or later to another company of the same group which has the right to reduce the taxable profit of the same tax period. The above transfer is possible only subject to the following conditions:

- on the day of transfer of the tax losses, the parent entity in the group of entities holds, directly or indirectly, at least 2/3 of shares (interests, member shares) or other rights to distributable profits of each of the subsidiaries taking part in the transfer of the tax losses, and
- tax losses are transferred between the entities within a group of entities which have been part of that group for an uninterrupted period of at least two years calculating until the day of transfer of the tax losses, or
- tax losses are transferred or taken over by the entity (entities) of the group of entities which have been part of the group since the date of the entity's (entities') registration and will be part of the group of entities for an uninterrupted period of at least two years calculating from the date of the entity's (entities') registration.

A foreign entity may transfer tax losses (or a part thereof) to a Lithuanian entity only if:

- the foreign entity is a resident of the EU Member States for tax purposes, and it takes on one of the forms of business organisation listed in Annex to

Council Directive 90/434/EEC and which is subject to tax specified in Article 3(c) of Directive 90/434/EC, and

- tax losses transferred by the foreign entity may not be carried forward to the following fiscal year (or deducted from its income (profit)) under the requirements of legal acts of the EU Member State a resident of which the transferring foreign entity for tax purposes is, and
- tax losses transferred by the foreign entity have been calculated (recalculated) in accordance with the provisions of this Law.

Where, in accordance with the procedure laid down in this Article, tax losses (or a part thereof) are transferred for remuneration, the remuneration received for such transfer shall not be treated as income of the Lithuanian entity which received it, and losses incurred shall not be treated as allowable deductions of the Lithuanian entity which incurred them.

An entity which has any overdue and unpaid taxes may not transfer tax losses to another entity in accordance to the above provisions. Also an entity may not transfer tax losses, where in the case of calculation of taxable profits for that tax period the entity would not pay corporate income tax or equivalent tax due to tax reliefs applicable to it (taxable profits would have been taxed at a tax rate of 0% or the entity would have been exempt from paying tax).