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REPORT

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

Lithuania's new corporate income tax for companies implementing large projects (LT009)

I. Background

Lithuania has notified a tax measure (LT009) adopted in June 2020 for investments in large projects in order to foster economic growth and job creation across the country.

The Commission services' table hereafter a summary conclusion on the Lithuanian measure.

II. Amendments to the Law on Corporate Income Tax

a. Tax relief from CIT for investments in large projects

In Lithuania, the standard CIT rate is 15% from 1 January 2010. A reduced corporate income tax rate of 5% applies to certain small businesses, and significant tax incentives apply to businesses in Free Economic Zones.

The tax measure amending the Corporate Income Tax ("CIT") Law is an exemption from CIT for investments in large projects and is open to businesses engaged in large investment projects in the fields of **data processing, web server services (hosting) and related activities, or from manufacturing**[1]**.** Such exemption is available to domestic and foreign undertakings that make the qualifying investments in Lithuania for up to 20 years from the date of entry into force of the investment contract for the major project.

The tax measure is in place from 1 January 2021 to 31 December 2025.

If a large project is carried out in the territory of a Free Economic Zone, this project may only benefit from the CIT advantage/s available therein or the CIT exemption for major projects above. Businesses cannot cumulate the two (or more) tax benefits.

b. Qualifying conditions for the CIT exemption

The CIT exemption applies if the following conditions are cumulatively met:

- The undertaking must implement a large investment project under a large investment project agreement with the government of the Republic of Lithuania;
- The average number of employees involved in the implementation of a large project in Lithuania during the tax year should not be less than 150 (200 if the business is established in the district of Vilnius). New employees must be exclusively tasked to perform the activities set in the agreement on the large investment project;
- Capital investment of the undertaking should not be less than EUR 20 million (EUR 30 million if the business is established in the district of Vilnius), and an auditor's confirmation of the actual amount of capital invested is required;
- At least 75% of the undertaking's income in the tax year should consist of revenue from data processing, internet server services (hosting) and related activities, or manufacturing. If a large investment project involves the two kind of activities (i.e., manufacturing included), income from both the activities cannot be less than 75% of the undertaking's income.
  The remaining income (up to 25%) can arise from activities other than data processing, web server services (hosting) and related activities, or manufacturing, but yet related to implementation of the agreement on the large investment project[2]. The exemption only applies to the income of the undertaking generated by the large investment project.

[1] 'Data processing, web server services (hosting) and related activities' include the following: provision of infrastructure for hosting, data processing services and related activities; specialised hosting activities such as web hosting, streaming services, application hosting; application service provisioning; general time-share provision of mainframe facilities to clients; data processing activities: complete processing of data supplied by clients, generation of specialised reports from data supplied by clients; provision of data entry services. Class of activities above do not include those where the supplier uses the computers only as a tool (such activities are classified according to the nature of the services rendered).

[2] Passive income like royalty payments from IP assets can also benefit from CIT exemption for large investment projects if: (i) they can be considered as non-operating (incidental) income; (ii)

Concerning the employment and capital investments' requirements, the undertaking investing in a large project is obliged, within a period of five years from the date of entry into force of the investment agreement, to:

1) create at least 150 new jobs (full-time) in the Republic of Lithuania and, in the case of investment in the district of Vilnius, at least 200 new jobs (full-time), and maintain each job for at least five years from the date on which the employee was first recruited; and
2) invest at least EUR 20 million in the Republic of Lithuania or, in the case of investments in the district of Vilnius, at least EUR 30 million.

The CIT exemption starts applying from the tax period in which the thresholds above are complied with, and the exemption is suspended for the tax period/s in which the amount of capital investment or the average number of employees have fallen below the thresholds set. The exemption is renewed for the tax period/s in which the required thresholds are reached again. Maximum duration of the CIT exemption (20 years) include all tax years during which the two thresholds are not reached.

III. Summary conclusion

Taxpayers investing in large investment projects in the fields of data processing, web server services (hosting) and related activities, and/or in manufacturing activities, can benefit from a CIT exemption for 20 years if the qualifying conditions above are met.

Those companies can benefit from a significantly lower level of taxation than that generally applied to others (15%), resulting actually in no CIT taxation for the long period in which the tax benefit is applicable. This can affect the location of business activities in the EU in a significant way.

There is no de-jure ring-fencing, the exemption is available to domestic and foreign undertakings that make the qualifying investments in Lithuania.

Concerning economic substance, it appears prima facie that the tax relief is granted for manufacturing or other production activities. However, highly mobile assets, such as software and other IP components, may be included as qualifying investment costs. The LT authorities confirmed that at most 25% income can arise from activities other than data processing, web server services (hosting) and related activities, or manufacturing. Those (capped) activities must however be carried out to implement the agreement on the large investment project.

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they do not exceed 25% of total income of the undertaking implementing the large project; and (iii) at least 75% income arise from data processing, internet server services (hosting) or related activities, or manufacturing.

As for substantial economic presence, legal requirements and safeguards concerning new jobs (minimum number of newly created jobs and their minimum 5 years holding period from recruitment) and the other qualifying expenses (minimum capital investments required) relating to large projects are present.

Additionally, the fact that at least 75% of the undertaking's income should derive from manufacturing or data processing, internet server services (hosting) and related activities (the income generating activities), and that the CIT exemption only applies to those income generating activities should also reassure in terms of nexus.

Follow-up

It is the Commission services' view that the measure falls within the scope of the Code of Conduct and should be treated as follows:

- There is no need to assess the measure that appears to be overall compliant with the Code's criteria;
- However, given the duration of the tax exemption, the measure should be closely monitored in the future, particularly in respect to highly mobile assets and the 25% threshold for the large investment project's generating income from royalties.

IV. Follow-up

The Group agreed that LT009 measure does not need to be assessed, but future application should be monitored as specified above.