



impresa lavoro
Centro Studi

TAXATION IN LITHUANIA

Kaetana Leontjeva, Lithuanian Free Market Institute

Overview of Taxation in Lithuania

Lithuania and the other Baltic states are often regarded as low tax countries. The ratio of tax receipts to GDP in Lithuania is one of the lowest in all of the European Union. Corporate profit tax in Lithuania stands at 15%, and the flat tax on personal income is also 15%. However, the tax burden on labor is much higher – in addition to the personal income tax there are social insurance contributions at a rate of 31%, and healthcare insurance contributions at a rate of 9%.

There are 24 taxes in Lithuania. Revenues from 5 most significant taxes – social insurance contributions, VAT, excise duties, personal income tax and healthcare insurance contributions – account for 90% of total tax revenues in Lithuania.

Since the recession of 2009, when Lithuanian GDP fell by 15%, there have been numerous tax increases in Lithuania. Among the taxes raised were VAT, corporate profit tax, excise duties, land tax, social insurance contributions on self-employed individuals, an introduction of long-term capital gains tax and a real estate tax on “luxury” real estate. Reduced VAT rates on most goods were abolished. Some of the decisions to raise taxes were reversed – for example, corporate profit tax was cut one year after it was raised, but most tax increases remain in place to this day.

There is an outside push for Lithuania to raise taxes: the International Monetary Fund and the European Commission maintain that Lithuania should tax all residential real estate, introduce a tax on automobiles, raise environmental taxes. In addition, Lithuanian politicians have proposed scrapping the successful flat tax on personal income and raising taxes on capital.

In the following sections we will examine the level of taxation in Lithuania, the implicit tax rates, the administrative burden and the degree of fiscal dependence of local governments on transfers from the central government.



Levels of Taxation

This section is devoted to an analysis of the evolution of tax revenues as a share of GDP. It investigates total taxation revenues, including social insurance contributions, and explores receipts from indirect taxes (VAT and excise duties) and income taxes (personal income tax and corporate profit tax). Data is based on the Eurostat's "Main national accounts tax aggregates" database.

Figure 1 shows total tax receipts in the EU-27 and Lithuania in period of 1995 – 2012. The level of tax receipts as a share of GDP has been fluctuating over this period, but is considerably lower than the EU average. In 2009, the Lithuanian GDP contracted by 15%. In order to offset the falling tax revenues, the government has been raising taxes since the end of 2008. One of the unintended consequences of this policy has been a sharp increase of the shadow economy, which rose from 18% in 2008 to 27% in 2012, according to Survey of the Lithuanian Economy by the Lithuanian Free Market Institute. Pervasive tax evasion is one of the reasons why the tax burden appears so low.

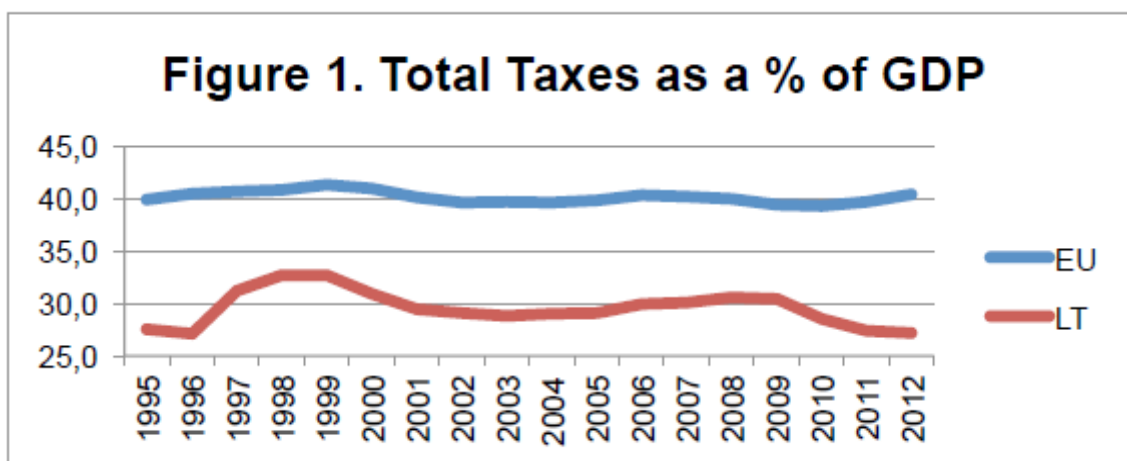




Figure 2 shows VAT receipts in Lithuania and in the EU. Prior to the recent economic recession, Lithuania's VAT rate was stable at 18% but in 2009 it was raised to 21% and most of the reduced VAT rates were abolished. VAT is currently the second most significant tax (after social insurance contributions) in terms of government revenues in Lithuania. VAT revenues have been fluctuating over the past decade, with a significant relative increase in revenues recorded during the economic boom of 2004 – 2008. For the most part of 1995 – 2012, the share of VAT receipts to GDP had been higher in Lithuania than the EU average.

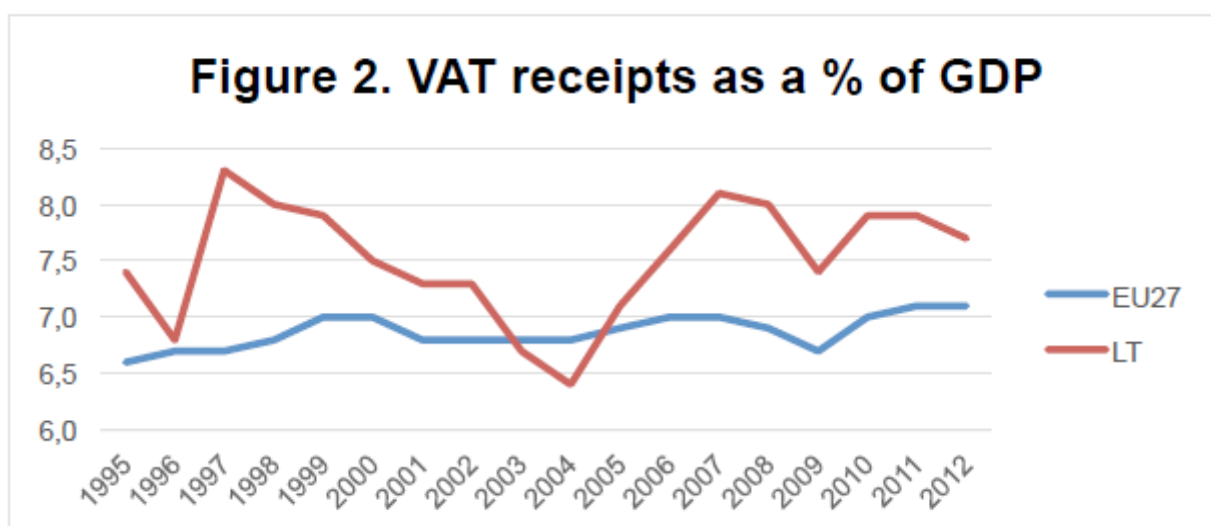


Figure 3 shows total income taxes in Lithuania and in the EU, as well as personal income taxes (dashed) and corporate income taxes (dotted), all as a share of GDP. The level of income taxes is generally lower in Lithuania compared to the EU average. Most of the income tax receipts come from personal income tax receipts, which currently stand at 73% of total income tax receipts. Comparative data on personal and corporate taxation in the EU is not available.

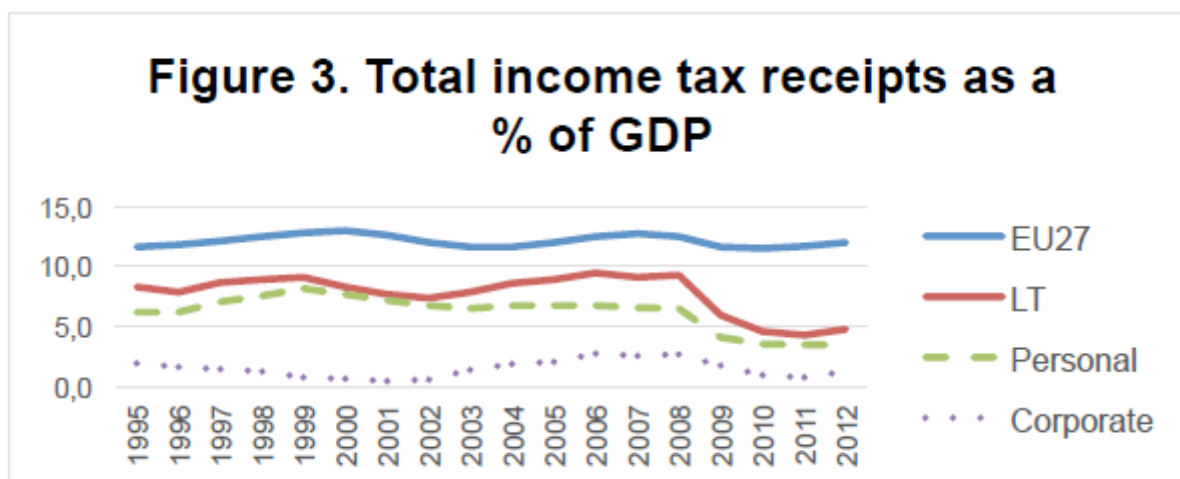
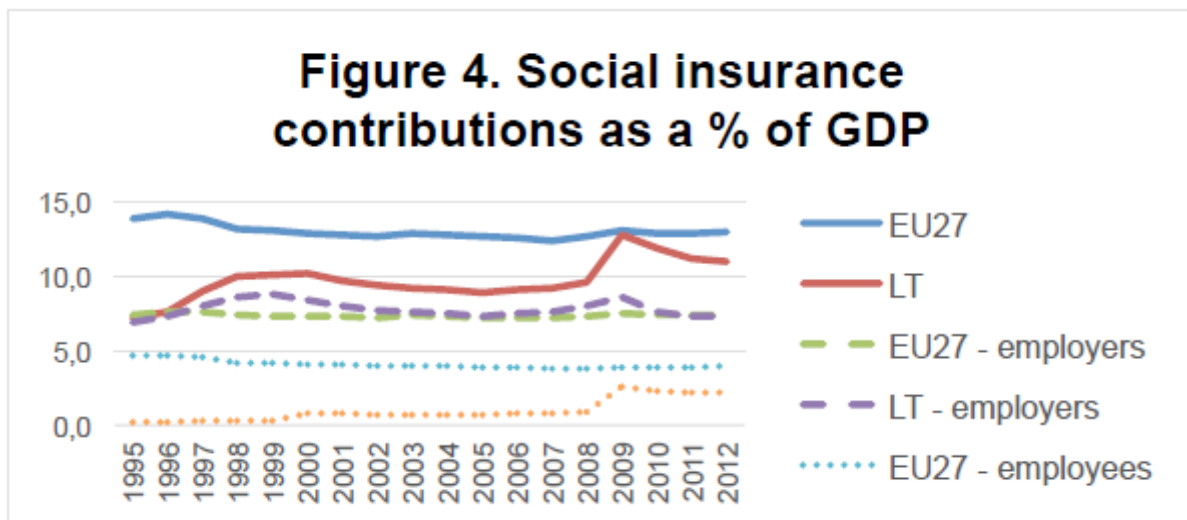




Figure 4 shows social insurance contributions as a share of GDP. These contributions have grown in significance over the past decade and are currently the most significant source of government revenues in Lithuania. Employers' contributions in Lithuania have been slightly higher than the EU average, yet employees' contributions are significantly lower than the EU average.



The comparison of tax receipts as a share of GDP shows that the overall tax burden in Lithuania is lower than the EU average. VAT receipts in Lithuania are higher than the EU average, while total income tax and social insurance contributions are lower than the EU average.

It has already been noted that one of the reasons why Lithuania appears to have a lower tax burden than the EU average is a large shadow economy. In the next section, implicit tax rates will be examined in order to establish whether the tax burden in Lithuania is as low as total tax receipts would imply.



Implicit tax rates

Implicit tax rates (ITR) are calculated as a ratio of total tax revenues to potential tax base for each economic function. In this section, data calculated by the Eurostat is being used to present ITRs for consumption, labor, and capital.

Figures 5 – 7 show the implicit tax rates on consumption, labor, capital and business income, capital of corporations, and capital of households.

Figure 5 shows ITR on consumption. ITR on consumption in Lithuania has been fluctuating over the past decade. It is lower than the EU average, while VAT receipts as a share of GDP in Lithuania are higher than the EU average. The reason for this difference may be the fact that the ITR on consumption includes not only the VAT but also excise duties on energy, tobacco and alcohol, and any other consumption taxes. Older EU members often apply higher excise duty rates than Lithuania, which may explain why Lithuania's ITR on consumption is lower than the EU average.

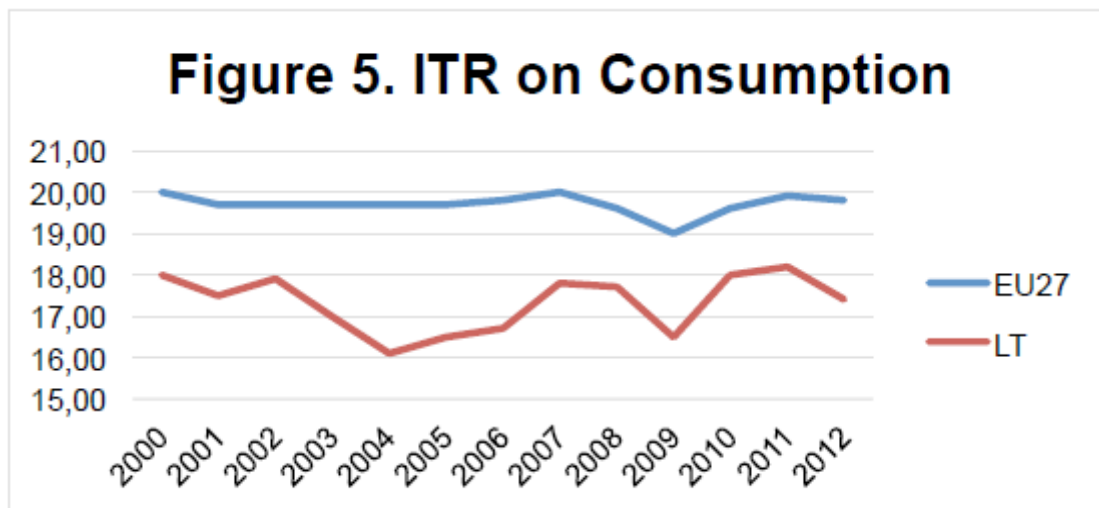




Figure 6 shows ITR on labor. Following significant personal income tax rate cuts over the past decade, the ITR on labor has been falling in Lithuania and is currently lower than the EU average. Three quarters of the ITR on labor consist of social and healthcare insurance contributions, which stand at 40% and are much higher than the personal income tax of 15%. High taxation of labor leads to an expansive shadow economy in the labor market. According to a survey performed by the Lithuanian Free Market Institute in 2014, unreported labor income accounts for 26% of the shadow economy in Lithuania.

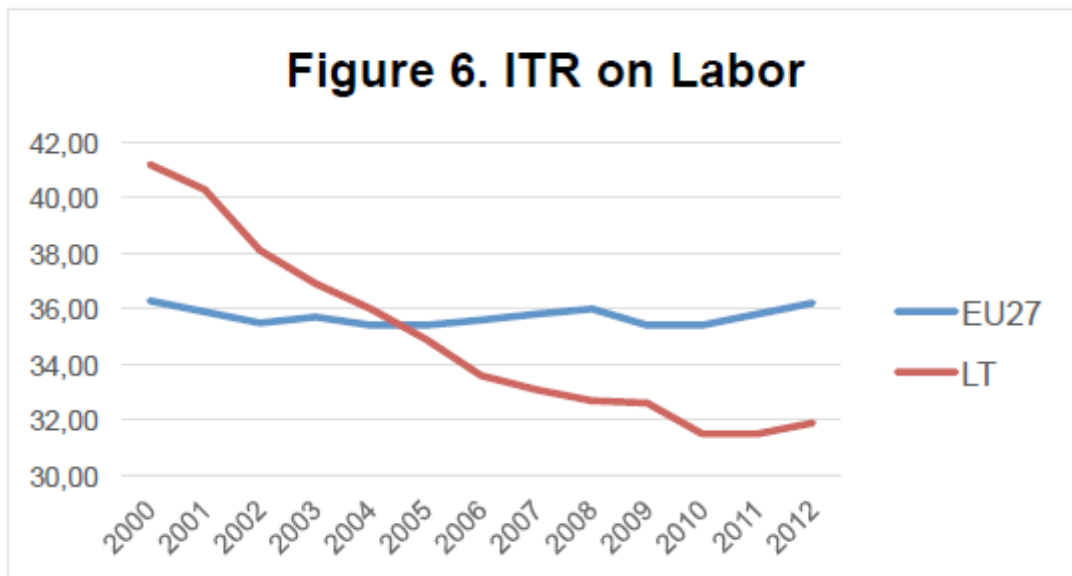
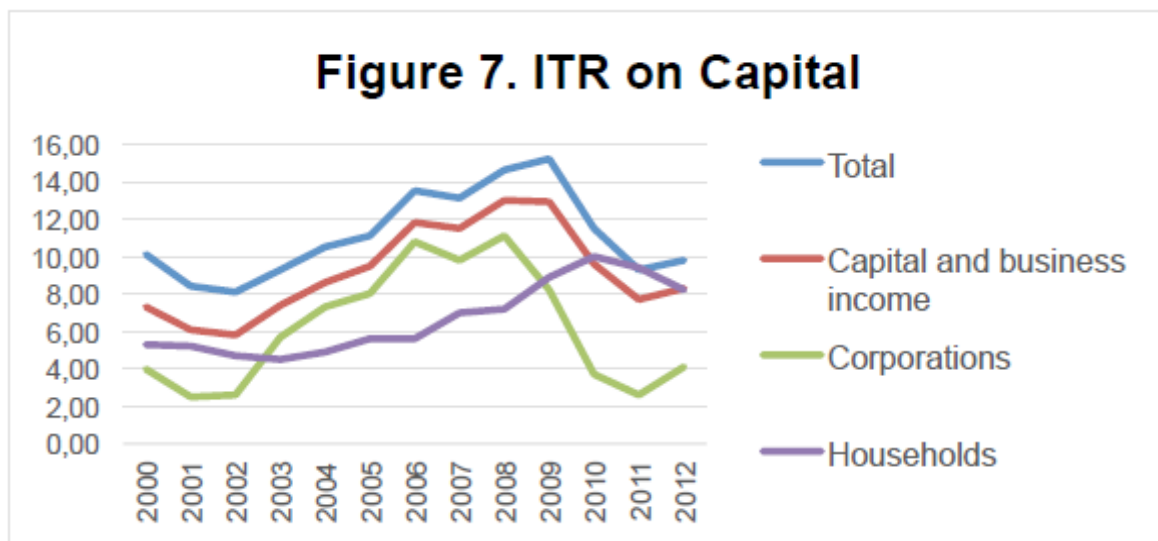




Figure 7 shows ITR on capital in Lithuania, which is considered to be quite low. There are no comparable figures available for the EU average. ITR on capital in Lithuania is lower than in neighbouring Poland, but higher than in Estonia and similar to Latvia. Taxation on households' capital has increased over the past decade, while it has been fluctuating for capital and business income and capital of corporations.



Eurostat data is available up to 2012. As of 2014, Lithuania introduced a tax on long-term capital gains, which would imply that the ITR on capital is currently higher than in 2012.



Administrative burden of fiscal procedures

In addition to the direct tax burden, there is also an indirect tax burden – the costs of administering the taxes, which are borne by the taxpayers as well as the state tax administrators. The total tax administration costs are difficult to measure and usually they are represented by variables such as the number of administrative procedures, and the time and money spent on calculating and filing taxes. The administrative burden is uneven, as it varies depending on the tax and the taxpayers (whether it is a corporation, a self-employed individual, etc.).

Table I shows the World Bank's "Doing Business 2015" index data on Lithuania in the area of "Paying Taxes". This index measures the ease of doing business across different areas (starting a business, paying taxes, etc.) and ranks all the countries according to the same methodology.

Country	Ranking	Number of Payments per Year	Time to Prepare, File and Pay Taxes	Total Tax Rate (% of Profit)
Lithuania	44	11	175	42.6%
OECD	-	11.8	175.4	41.3%

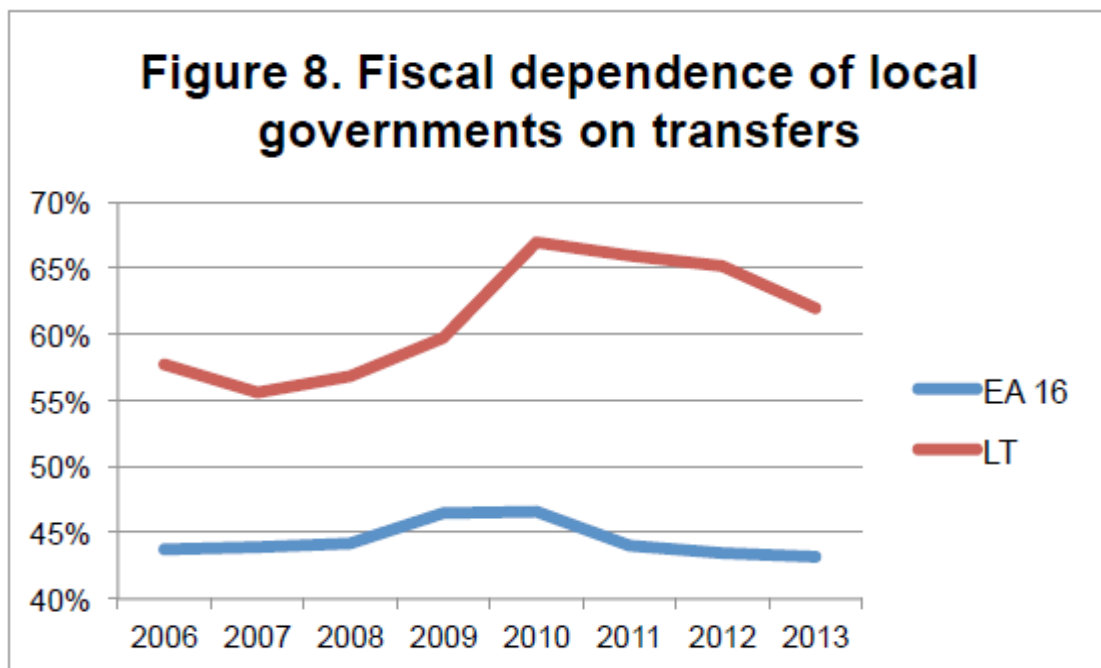
As the table indicates, the burden of tax administration is similar in Lithuania compared to the OECD average, while the share of profit devoted to taxes is higher in Lithuania than on average in the OECD (it should be noted that currently Lithuania is not a member of OECD). Most of the tax is paid in social security contributions (34.95%), with the profit tax standing at 6.1% and real estate tax at 0.8%.



Taxation and federalism

Public administration in Lithuania is divided into two levels: the central government and municipalities. There are 60 municipalities that derive most of their revenue in the form of grants or transfers from the central government. Municipalities receive a share of personal income tax revenues of the individuals registered in that municipality. Also, revenues of the land tax and commercial real estate tax go directly into the municipalities' budgets. All the other taxes go into the state budget or other funds, such as the State Social Insurance Fund.

Eurostat data can be used to measure the fiscal dependence of local governments on transfers. Figure 8 shows the ratio of the sum of capital and current transfers from the central to the local governments and the expenditures of the local governments.



The fiscal dependence of local governments on transfers from the central government is much higher than in the average of 16 Eurozone countries (an average for the whole EU is not available). The fiscal dependence stood at 65% a decade ago, over the past decade it has been fluctuating, peaking at 67% in 2010. This shows that the local governments in Lithuania are very dependent on the central government for revenues and thus lack autonomy.



Conclusion

Lithuanian total tax revenues as a share of GDP are considerably lower than the EU average. VAT receipts are higher in Lithuania than the EU average, social insurance contributions are similar to the EU average, while total income tax receipts are lower than the EU average.

It is important to distinguish that low tax revenues do not necessarily mean a low tax burden. An analysis of ITRs has shown that ITR on labor in Lithuania is significantly high – 32%, just below the EU average of 36%. Social insurance and healthcare insurance contributions account for three quarters of ITR on labor. High taxation of labor creates an incentive to avoid taxes. According to a survey done in 2014, unreported labor income accounts for 26% of the shadow economy in Lithuania. In 2014, total shadow economy accounted for 25% of GDP. Lithuanian politicians acknowledge that labor is taxed too heavily, however, a significant reduction in the tax on labor would have to be accompanied by much-needed reforms in the state social insurance system, which politicians are hesitant to undertake.

Capital taxation in Lithuania is lower than the EU average. However, this fact is not always seen as an advantage for Lithuania, as some politicians campaign to raise taxation of capital closer to the EU level. Long-term capital gains tax was introduced in 2014 and there are more calls even higher taxation of capital.

There are also debates, supported by recommendation from the IMF and the EC to introduce a universal real estate tax and a tax on automobiles. It can be forecast that these taxes would have a minimal impact on total tax receipts, yet they would increase the complexity and administrative burden of the Lithuanian tax system.

Tax administration in Lithuania is as complex and expensive as in most of the developed countries. Revenues from 19 out of 24 taxes in Lithuania account for just 10% of total tax revenues. Many of these taxes bring in little revenue but are difficult and expensive to calculate and administer. A successful attempt to reduce the administrative burden of paying taxes would have to abolish those taxes that are most expensive to administer. However, such a reform appears unlikely, since most of the politicians' time and attention is devoted to raising the tax burden on Lithuania's taxpayers.



impresa lavoro
Centro Studi

References

Eurostat, “Main National Accounts Tax Aggregates”,
http://epp.eurostat.ec.europa.eu/cache/ITY_SDDS/EN/gov_a_tax_ag_esms.htm

Eurostat, “Implicit Tax Rates by Economic Function”,
http://epp.eurostat.ec.europa.eu/cache/ITY_SDDS/EN/gov_a_tax_itr_esms.htm

Eurostat, “Taxation trends in the EU”,
http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-DU-14-001/EN/KS-DU-14-001-EN.PDF

Eurostat, “Government revenue, expenditure and main aggregates”,
http://epp.eurostat.ec.europa.eu/cache/ITY_SDDS/EN/gov_a_main_esms.htm

World Bank, “Doing Business 2015”,
<http://www.doingbusiness.org/data/exploreeconomies/lithuania#paying-taxes>

Lithuanian Free Market Institute, Report on the Lithuanian Shadow Economy,
<http://en.llri.lt/news/economic-policy/shadow-economy/lithuaniashadow-economy-no-3-the-shadow-economy-still-makes-up-a-quarter-of-the-lithuanian-economy/vytautas-zukauskas>