



Fall | 18



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ESTABLISHING A BUSINESS ENTITY IN LITHUANIA

ILN CORPORATE GROUP



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ESTABLISHING A BUSINESS ENTITY IN LITHUANIA



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1. Types of business entities

Investors may choose from the following types of business entities:

- Private limited liability company
- Public limited liability company
- Individual enterprise
- Limited partnership
- General partnership
- Small business
- Cooperative
- Agricultural company
- Branch or Representative office

The most common types of business for foreign investors in Lithuania are public and private limited liability companies and branch or representative office.

1.1 Public and Private limited company

Public limited liability company (“akcine bendrove” or “AB”) and private limited liability company (“uzdaroji akcine bendrove” or “UAB”) are the most common types of companies in Lithuania. After the first quarter of 2018, there were 123,969 UAB and over 374 AB registered in the Register of Legal entities.

The main differences between UAB and AB:

- capital requirements: the minimum share capital requirement for UAB is only EUR 2,500, whereas for AB it is EUR 25,000;
- auditing: AB must always have an auditor for the carrying out of the audit of its annual financial statements. An UAB must have an auditor when it is established in its articles of association or if required by law. For example, the applicable law foresees that the annual financial statements of UAB shall be audited, if at least two of the following three criteria are met: net sales revenue during the reporting financial year exceeds EUR 3.5 m., asset balance value exceeds EUR 1.8 m., average annual number of employees exceeds 50. The auditor is elected, and his remuneration is set by the shareholders of the company;
- bodies of the company: the head of the company shall always be elected in UAB and AB. The board (collegiate management body) is not a mandatory body in UAB, whereas in AB at least one collegiate body shall be formed, taking into account, that in case a supervisory board is not formed and some of the functions of it are delegated to the board of the company and members of it must meet several independent requirements;
- public trade of shares and bonds: AB can be listed in a stock exchange and sell its securities publicly, whereas UAB cannot be listed.

A licence / permit may be required for certain regulated areas of activities. For



instance, companies engaged in businesses such as insurance, banking, pharmacy, construction, transportation, etc. must obtain licences/permits. In certain cases, those licences/permits are either issued before the establishment of a company (i.e. its registration in the Register of Legal Entities) or before the actual commencement of activities. Also, permits / consents may be required upon carrying of certain corporate actions of the licensed companies, for example, upon increase of the capital, initiation of merger, transfer of shares, etc.

1.2 Branch or Representative Office

A branch and Representative Office, although it can be registered in the Republic of Lithuania, are not considered as distinct legal entities from the parent company. A branch is a structural subdivision of the legal entity, having its own registered office and performing all or part of the functions of legal entity. A Representative Office is a subdivision of a legal entity, having its own registered office and having a right to perform some actions on behalf of the legal entity. Legal entity assumes all obligations of branch or representative office.

A branch and Representative Office perform their activities under the regulations approved by the legal entity.

A branch or Representative Office is established upon the decision of the founder (legal entity) to establish a branch or a representative office. Also, statutes of a branch or representative office shall be prepared.

There is no requirement under Lithuanian law regarding a branch's or representative office's registered capital.

2. Steps and Timing to Establish

Generally, a company is established in two steps: (i) adopting foundation documents and (ii) registering the company in the Register of Legal Entities.

Considering only the most common corporate structures for foreign investors (AB and UAB), the following main steps to establish a company are:

- making an interim name reservation (if so decided);
- signing of an Act of Incorporation (or Agreement of Incorporation, in case there are several founders). The Act of Incorporation of UAB may also incorporate information about the founder, the decision of the founder(s) regarding election of management bodies;
- obtaining a consent of the owner for premises wherein the company shall be domiciled;
- opening of an accumulation account at a bank;
- transferring of initial contributions to the accumulation account (always not less than EUR 2,500 in case UAB is being established and not less than EUR 25,000 when AB is being established);
- signing of the Articles of Association;
- drafting of a Report on Establishment of a Company (only in case of AB);
- convening of a Founders' Meeting; electing of the management bodies (always in case of AB and with respect to UAB – If such decision is not taken upon signature of an Act of Incorporation or Agreement);



- preparing data of shareholders' list for Legal Entities Information System (JADIS) (in case of UAB);
- notarizing the establishment documents at the notary;
- registration of documents with the Register of Legal Entities.

Please note that in case the founder of a company is a foreigner, in all cases documents of the founder should be submitted to the notary (extract from the foreign register, in which the date of the legal entity is stored and copy of articles of association of the legal entity). Such documents must be officially certified and either apostilled or legalized and translated into Lithuanian language.

To establish a branch or representative office in Lithuania, the following main steps must be taken:

- making an interim name reservation (if so decided);
- adoption of a decision by a competent body of the founder to establish a branch or representative office in Lithuania, to appoint a manager of a branch or representative office;
- obtaining consent of the owner for premises wherein a branch or representative office shall be domiciled;
- preparation and approval of regulations of the branch or representative office by a competent body of a founder;
- notarizing the establishment documents at the notary;
- registration of documents with the Register of Legal Entities.

In addition to the above-mentioned documents of the foreign founder, the annual financial statements for the last financial year must be

submitted to the Register of Legal Entities in case of establishment of a branch or representative office by a foreign company (officially certified and either apostilled or legalized and translated into Lithuanian language).

The registration of a company or a branch takes up to 3 business days as of submission of all documents to the Register of Legal Entities.

As of lately, the law provides a possibility to register UAB on-line. However, there are certain requirements that must be met: only the natural person may be the founder, the founder must have a qualified e-signature, the articles of association and the act of incorporation of UAB are to be of the form approved by the Government, the name of UAB must be reserved and not include a word "Lithuania" in it, there must be a sole founder, the premises whereat UAB shall be registered must be solely owned by the founder and not arrested and the authorized capital (in case of UAB) must be paid by monetary contributions.

3. Governance, Regulation and Ongoing Maintenance

3.1 Corporate Governance

Members of the management board must be natural persons and members of supervisory board may be natural or legal entities. However, there are more restrictions related to independence that apply to members of supervisory board (and even more requirements if company is listed). The members of the management board must act in good faith and reasonable manner in respect of the company and members of other bodies of it. Furthermore, they must be loyal to the company and maintain confidentiality. Every candidate to the position of the management board or supervisory board member must inform the electing body where and what position he



holds, how his other activities are connected to the company and to other legal entities related to the company.

The manager of the company shall be a single-person management body of the company. The manager must be a natural person. Every candidate for the office of the manager of the company must also inform the electing body where and what position he/she holds, how the other activities are connected to the company and to other legal entities related to the company.

The company is represented by the manager of it. However, there may be a rule of quantitative representation established in the articles of association the company, whereas the company may be represented by more than one person, acting together.

According to it, the manager of the company must in all cases act on behalf of the company together with the member(s) of the management board.

The management board member and the manager of the company who fails to perform or performs improperly his duties set in laws or incorporation documents (e.g. duty of confidentiality, care) must redress all damage incurred on the company. The member of the management body of the company who has concluded the contract overstepping his authority shall also take on subsidiary liability where a company fails to satisfy fully the claim of a third person, arising of such a contract.

3.2 Reporting requirements

The set of annual financial statements of a company together with the annual report of the company and the auditor's report (if compulsory) must be submitted to the Register of Legal Entities not later than within 30 days after the annual general meeting of

shareholders of the company (it must be held within 4 months from the close of the financial year of the company).

3.3 Requirements for local shareholding / directors

For shareholders, there are no specific requirements. In respect of their nationality, they may be either Lithuanian or a foreign individual or company.

The applicable law does not provide for any specific educational requirements for the director and members of the board, except for the requirement that they must be natural persons.

Regarding employment of the Manager from foreign countries please refer to Article 4.4.

3.4 Protection of minority shareholders

The legislation of the Republic of Lithuania does not provide any exceptional rights for minority shareholders. The rights of shareholders depend on the number of shares owned by the shareholder.

Legal acts grant several rights for protection of minority shareholders, such as:

- the right to take an action for declaring the decisions of a company's bodies invalid, within 30 days of the day when the plaintiff found out or should have found out about the contested decision;
- company must, at a shareholder's written request and not later than within seven days from the receipt of the request, grant access to and (or) submit to him copies of particular documents related to company (such as articles of association of the company, annual and interim financial statements, minutes of the general meetings of shareholders, etc.). The



Company may refuse to grant the shareholder access to such information and/or documents if they are related to confidential information or commercial (industrial) secrets, unless the shareholder provides a written pledge not to disclose the commercial (industrial) secrets or confidential information. The Company must grant access to the shareholder to other information of the Company and/or provide copies of the documents if such information and documents, including information and documents, related to confidential information and commercial (industrial) secret of the Company, are necessary to the shareholder to fulfill the requirements set by legal acts.

- shareholder or a group of shareholders owning not less than 1/10 of the company's shares has a right to initiate investigation of company's activity. Shareholders shall enjoy the right to request the court to appoint experts who must investigate whether a legal entity or legal entity's managing bodies or their members acted in a proper way;
- shareholder or a group of shareholders owning not less than 1/3 of the company's shares has a right to force sale of shares of a legal entity's member whose actions contradict the goals of legal entity's activities and where there are no grounds to expect any changes in the said actions;
- shareholders owning not less than 1/10 of the company's shares have a right to initiate the convocation of general meeting of shareholders (Articles of Association of the company may establish a smaller number of shares);
- shareholders owning not less than 1/20 of the company's shares have a right to propose a supplement to the agenda for the general meeting of shareholders;

Please note that shareholders of a legal entity may conclude a shareholders' agreement, regulating relationships of shareholders of the company, including, but not limited to, the agreement on voting in the general meeting of shareholders. Such an agreement of shareholders may include various provisions beneficial for minority shareholders.

There is also a possibility to establish a protection for minority shareholders in the establishment documents of the company as well as in the agreements of shareholders.

4. Foreign Investment, Thin Capitalization, Residency and Material Visa Restrictions

4.1 Taxation

4.1.1. Thin Capitalization rule

Thin capitalization ratio is 1:4. Interest and currency exchange loss on the capital borrowed from the controlling creditor, which exceeds the equity of the company more than 4 times, are non-deductible for corporate income tax purposes.

The controlling creditor is the one who:

- directly or indirectly holds more than 50% of shares or rights (options) to dividends; or
- together with related parties, holds more than 50% of shares or rights (options) to dividends, and the holding of that creditor is not less than 10%.



4.1.2. Related-parties' transactions

Transfer pricing (TP) rules apply to transactions between a Lithuanian resident company and a person associated with the resident company (a controlled transaction). If the price of a controlled transaction differs from the market value of the above transaction (arm's length transaction), corporate income tax (CIT) shall be imposed on the amount which the Lithuanian resident company would have received as income or the amount which the Lithuanian resident company would not have incurred as expenses if the transfer price had conformed to the market value of the transaction.

The Lithuanian company (or a permanent establishment of a foreign company) must prepare and have the transfer pricing documentation when its annual sales exceed EUR 2,896,200.

The Lithuanian tax authorities apply the transfer pricing methods which basically follow the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. These are:

- Comparable Uncontrolled Price (CUP) method - compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction. If there is any difference in prices, this may mean that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.
- Resale price method - the resale price margin (i.e. the gross margin) that the reseller earns from the controlled transaction is compared with the

gross margin from comparable uncontrolled transactions.

- Cost plus method - the mark-up on costs that the manufacturer or service provider earns from the controlled transaction is compared with the mark-up on costs from comparable uncontrolled transactions.
- The transactional net margin method - compares the net profit arising from controlled and uncontrolled transactions (after relevant operating expenses have been deducted) instead of comparing a gross profit on resale or gross mark up on costs.
- The transactional profit split method - splits the combined profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated between independent enterprises.
- Combination of the above methods.

4.1.3. Permanent establishment

A permanent establishment of a foreign entity in Lithuania is subject to CIT at 15% rate.

A foreign entity is deemed as operating through its permanent establishment in Lithuania if its activities comply with the following two criteria:

- its activities are not temporary;
- a commercial cycle of operations has been finished.

Activities of a foreign entity are considered temporary in the Republic of Lithuania if they last up to six months.



A completed cycle of commercial operations consists of three stages of operations carried by a foreign entity:

- stage one covers one or several of the following operations: marketing, including market analysis, distribution, advertising, design, and exploration works and other essentially similar operations;
- stage two covers one or several of the following operations: warehousing, consulting, acceptance of orders, scientific research, experimental, development and technological work, production, provision of services and other essentially similar operations;
- stage three several of the following operations: selling, supply, delivery, payment (remuneration) and other essentially similar operations.

If the activity of a foreign entity is not temporary, the cycle of commercial operations has not been completed but the stage of performed activity is considered as an independent activity of a foreign entity (or its part), such a foreign entity may also be deemed having a permanent establishment in Lithuania.

The second condition, based on which it is established whether or not a foreign entity performs its activities in Lithuania through its permanent establishment, is a representative/ agent through which the activity is performed, i.e. a foreign entity is considered to be performing activities through its permanent establishment if it performs its activities in Lithuania through a dependent agent/representative.

The third condition, based on which it is established whether or not a foreign entity

performs its activities in Lithuania through its permanent establishment, is a construction site, a construction, assembly, or equipment facility used by a foreign entity in Lithuania.

The fourth condition, on the basis of which it is established whether or not a foreign entity performs its activities in Lithuania through its permanent establishment, is the use of equipment or structures for prospecting or extraction of natural resources in Lithuania, i.e. a foreign entity is deemed to perform activities through its permanent establishment in Lithuania if it uses equipment or structures for prospecting or extraction of natural resources, including the wells or vessels used for that purpose.

4.1.4. Withholding taxes

Dividends

15% withholding tax is applied on dividends paid by a Lithuanian company to a foreign company.

Full participation exemption applies dividends if the recipient foreign company has held at least 10% of the voting shares in the distributing Lithuanian company continuously for at least 12 months. The participation exemption does not apply to dividends paid to foreign companies registered or organized in listed tax havens; also, it does not apply to dividends which are being paid to foreign companies if their main goal or the main object is to get tax benefit, which conflicts with the Council Directive 2011/96/EU.

Interest

Interest paid to foreign companies is generally subject to a 10% withholding tax.



No withholding tax is applied on interest paid to companies resident in EEA countries or countries having a tax treaty with Lithuania.

Other exemptions include interest on government securities issued in the international markets, deposit interest and interest on subordinated loans meeting the criteria prescribed by the Bank of Lithuania.

Royalties

Royalties paid to foreign companies are subject to a 10% withholding tax.

No withholding tax is applied on royalties' payments if the recipient is an associated company of the paying company and is resident in another EU Member State. Two companies are "associated companies" if (i) one of them holds directly at least 25% of the capital of the other or (ii) a third EU company holds directly at least 25% of the capital of the two companies. A minimum holding period is 2 years.

Other income

Income from sale or lease of immovable property located in Lithuania is subject to a withholding tax at a rate of 15%. Reassessment on a net basis is available upon request.

15% withholding tax applies to income paid to non-residents (including companies) for entertainment and sports activities performed in Lithuania, as well as to payments to the members of the supervisory council. Reassessment on a net basis is available upon request for entertainment and sports activities.

Capital gains received by foreign entities other than through its permanent establishment are not subject to withholding tax in Lithuania.

4.1.5. Corporate Income Tax

Resident companies and permanent establishments of the foreign entities (including branches) in Lithuania are subject to corporate income tax on the worldwide income.

Permanent establishments of non-resident companies are subject to corporate income tax principally on the same grounds as resident companies.

The general corporate income tax is 15%.

A small company is subject to a reduced corporate income tax rate of 5% if its average number of employees does not exceed ten persons, and its taxable income during the taxable period is less than EUR 300,000, and the company is subject to a corporate income tax rate of 0% for the first reporting period.

Ordinary losses of up to 70% of taxable income of the taxable period may be carried forward indefinitely. Capital losses may be carried forward for 5 years to be offset against future capital gains.

Tax losses can be also transferred from one company to another within the same group of companies and within the same tax period, if certain conditions are met.

4.1.6. Further corporate tax exemptions

For the corporate taxpayers who have been implementing the investment projects (e.g. acquisition of fixed assets such as machinery and equipment, trucks and trailers, computer hardware and software, communication equipment and acquired rights) the taxable profit may be reduced up to 100%.

R&D costs may be deducted in a triple amount in the taxable period when they are incurred.



Companies established in the free economic zones with capital investments of not less than EUR 1,000,000 and which meet certain other conditions are exempt from corporate income tax for the first 10 years following the date of the capital investments and they are subject to a 50% reduction in CIT rate for 6 subsequent years.

Also, Companies established in the free economic zones with capital investments of not less than EUR 100,000, whose average number of employees is not less than 20 in financial years, and which meet other certain other conditions are exempt from corporate income tax for the first 10 years following the date of the capital investments and they are subject to a 50% reduction in CIT rate for 6 subsequent years.

4.2 Taxation of Non-Residents

The income tax base of non-resident individuals is worldwide income derived through a fixed base maintained in Lithuania, if any, and the following types of income from the Lithuanian sources:

- employment income;
- distributed profits, including dividends;
- any payments made to members of the management board or the supervisory council;
- interest;
- royalties;
- income from leasing of immovable property located in Lithuania;
- income from the disposal of immovable property located in Lithuania or movable property that is subject to mandatory registration in Lithuania;

- income from sports and entertainment activities; and
- compensation for violation of copyright or similar rights.

The general flat rate of personal income tax is 15%.

4.3 Harmonization with EU tax legislation

The Lithuanian tax system is harmonized with EU tax legislation.

4.4 Residency and visas

Lithuania is a member of the European Union and it is a Schengen country. The basic rules regarding EU and non-EU nationals are as follows:

4.4.1 Citizens of the European Union

A citizen of the EU and his family members may enter and stay in the Republic of Lithuania upon a valid travel or identity document for a period of three months starting from the first day of entry. A citizen of the EU arriving in Lithuania for a period exceeding three months within a half a year and meeting at least one of the grounds specified in the Law on the Legal Status of Foreigners (e.g. to work) shall be issued a certificate of the form established by the Minister of the Interior. The certificate shall be valid for a period of five years (or a shorter period requested by the foreigner). The family members of the EU citizens who are not EU citizens shall be issued EU residence permits valid for the period of the EU citizen's certificate but in any case, for no longer than five years.

A citizen of the EU who has been lawfully residing in the Republic of Lithuania for the last five years shall acquire the right of permanent residence in the Republic of Lithuania. Absence from Lithuania for more than six months within a year may



constitute grounds for refusing the right of permanent residence, except in cases where absence is caused due to serious reasons (due to pregnancy, childbirth, acute illness, studies, professional training or assignment to another EU Member State or a third state). The acquired right of permanent residence in the Republic of Lithuania shall be lost upon departure from the country for a period exceeding two consecutive years.

The same rights and requirements are vested to the citizens of the European Free Trade Association (EFTA) Member States (Iceland, Norway, Switzerland, and Liechtenstein).

4.4.2 Visa Requirements

Citizens of certain countries may enter Lithuania without a visa. A list of these countries may be found at www.migracija.lt or the website of the Ministry of Foreign Affairs www.urm.lt.

Visa types are a Schengen visa and a national visa. Schengen visas may be single-entry, dual-entry and multiple-entry visas. National visas shall be single-entry (issued to an alien who has been granted a temporary or permanent residence permit to formalize the permit) and multiple-entry visas (issued, for example, to students, artists, sportsmen, employees, etc.).

Documents for the issuance of a visa are to be submitted to a diplomatic mission or a consular post of the Republic of Lithuania abroad or in certain cases to a diplomatic mission or a consular post of another Schengen State representing the Republic of Lithuania abroad.

4.4.3 Residence Permits

In the Republic of Lithuania, a foreigner could get a temporary or permanent

residence permit to live in the Republic of Lithuania. The temporary and permanent residence permit is issued to a foreigner who is a citizen of a non-EU Member State.

The temporary residence permit to live in the Republic of Lithuania may be issued for a period of one to three years, depending on the grounds of issuance of the temporary residence permit, among them employment, owning a business, studying and family reunification.

The permanent residence permit may be issued among other grounds after living for 5 years in the Republic of Lithuania with the temporary residence permit, subject to passing the Lithuanian language exam and the exam of the basics of the Lithuanian Constitution. The permanent residence permit is valid for a maximum period of 5 years. After this period, the permit shall be replaced.

In general, a foreigner of a non-EU Member State must also obtain a work permit to be issued under a separate procedure when applying for the temporary residence permit to live in the Republic of Lithuania on the grounds of employment. The work permit is not necessary in certain cases including those when such foreigner establishes a company, becomes a co-owner of it and becomes a Manager, Board member or Supervisory Board member or has not less than 1/3 of the shares of the company. The company should meet the special requirements: (i) the company must operate at least six months; (ii) the company has at least 3 employees who are citizens of the Republic of Lithuania or has permanent residence permit to live in the Republic of Lithuania; (iii) owned capital of the company must be not less than EUR 28,000 and the foreigner's invested part should be not less than EUR 14,000.



An application for the issuance of an initial temporary residence permit must be submitted to a diplomatic mission or a consular post of the Republic of Lithuania abroad, and a foreigner who is legally staying in the Republic of Lithuania must submit the application to a migration office of a territorial police agency in the territory of which he intends to reside. The lodging of such application is not entitling a foreigner to stay in the territory of the Republic of Lithuania before the application is examined and a decision is taken. The same applies when lodging an application for the replacement of a temporary residence permit.

The application for the issuance of the first temporary residence permit must be considered not later than within four months from the lodging of the application with a relevant institution (exceptions are applied for high qualified employees, startup founders or shareholder who invested not less than EUR 260,000), whereas an application for the replacement of a temporary residence permit – not later than within two months from the lodging of the application, with abovementioned exceptions.

The decision to issue a temporary residence permit is valid for three months, accordingly, after adoption of a particular decision it is necessary to apply to the territorial police agency personally to formalise a temporary residence permit.