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Subject: State aid – SA.45764 (2016/N) – Lithuania – State aid in favour of maritime transport. Prolongation and modification of the tonnage tax scheme

Sir,

1. PROCEDURE

- (1) By electronic notification of 29 June 2016, the Lithuanian authorities notified the Commission, in accordance with Article 108(3) of the Treaty on the Functioning of the European Union ("*TFEU*"), of their intention to both prolong by 10 years and amend the existing tonnage tax scheme ("*the existing scheme*"). The Commission had approved the existing scheme by decision of 19 July 2006¹.
- (2) The Commission regarded the notification as incomplete and therefore requested additional information by letter of 23 August 2016. The Lithuanian authorities replied by letter dated 23 September 2016.
- (3) The Commission requested further information by letter dated 22 November 2016. The Lithuanian authorities provided additional information by letter of 28 December 2016.

¹ Commission decision of 19.7.2006 in State aid N 330/2005 – Lietuva, *Pagalba laivybos bendrovėms – Tonažo mokesčio schema*, OJ C 90 of 25.4.2007, p.10.

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2. DESCRIPTION OF THE EXISTING SCHEME

2.1. Objectives of the scheme and fundamentals of operation

- (4) The objective of the Lithuanian tonnage tax scheme is to preserve the shipping sector in Lithuania, to make maritime transport safer, more efficient, more secure and environmentally friendly, and to protect and promote employment for EU/EEA seafarers. The scheme aims to encourage ship-owners to repatriate ships sailing under flags of convenience and to maintain or develop maritime activities in Lithuania.
- (5) The scheme provides for an alternative method of corporate taxation in Lithuania. Undertakings which are liable to taxation in Lithuania and which are engaged in international transportation by ship, or an activity directly assimilated thereto, may opt to be taxed on the basis of the net tonnage of their fleet ("*tonnage tax*"), instead of being taxed on the basis of actual profits of their maritime transport activities. The tonnage tax covers tax-adjusted commercial profits and losses generated by eligible shipping activities as well as chargeable gains and losses on eligible assets. Other profits of a shipping company are subject to standard taxation.

2.2. Eligible beneficiaries

- (6) Eligible for tonnage tax under the scheme are Lithuanian taxable entities or foreign taxable entities registered or otherwise organized in a Member State of the EU and conducting their activity in the Republic of Lithuania:
 - tax residents in Lithuania,
 - engaged in international transportation by seagoing ships or an activity directly related thereto, and
 - managing the seagoing ships by the right of ownership or a lease (financial lease) agreement providing for the transfer of ownership, or according to a purchase and sales agreement providing for the transfer of ownership upon the payment by the entity of the entire value of the assets, or lease on the basis of the bareboat charter, and
 - in the case of a ship-management company the company must manage by ownership not less than 25 % of the total net tons of seagoing ships managed by it, and
 - providing in Lithuania strategic, commercial and technical management services to seagoing ships used for international transportation.
- (7) As regards the requirement to carry out strategic, commercial and management activities in Lithuania, the Lithuanian authorities explained that any EU/EEA shipping company can provide shipping services in Lithuania and manage it through a subsidiary established in Lithuania. Such establishment is necessary in order to guarantee responsibility and accountability. The Lithuanian authorities further pointed to the fact that in order to be taxable in Lithuania, which is a requirement to benefit from the tonnage tax, foreign companies have to register a permanent establishment in Lithuania, meaning sufficient human and/or technical

resources to perform a particular activity. The Lithuanian authorities stressed that the tonnage tax scheme does not require beneficiaries to perform strategic, commercial and technical management only in Lithuania.

2.3. Eligible vessels and activities

- (8) Eligible for tonnage taxation are seagoing ships (namely cargo ships, container ships, tankers, ‘Roll-on/roll-off’ (‘ro-ro’) ships, ‘Roll-on/roll-off’ passenger ships (‘Ro-pax’), passenger ships, cruise ships) of above 100 net tons, which:
- are registered with the Register of Seagoing Ships of the Republic of Lithuania or the seagoing ships’ register of any other EU/EEA Member State, and
 - meet the safety standards set forth by the legal acts of the Republic of Lithuania and those of the European Union, and
 - comply with the standards set by the International Labour Organisation (ILO) and the International Maritime Organisation (IMO), as ratified by Lithuania as a member of these organisations.
- (9) Qualifying vessels must be engaged in international carriage of freight and passengers by sea-going vessels and other activities directly related thereto. Only the following related activities (“ancillary activities”) qualify for tonnage taxation:
- ship management and administration services directly connected with the carriage of passengers and/or goods by seagoing ship (e.g. purchase of fuel, hire of crew, cargo and passenger reservations, etc.);
 - insurance services directly connected with the carriage of passengers and/or cargo by seagoing ship;
 - passenger embarkation/disembarkation services;
 - cargo loading/unloading services, including trans-shipment or packing/unpacking before loading or immediately after unloading;
 - leasing to a client, of containers needed for the carriage of goods on a seagoing ship, or other form of delivery to customers;
 - sale, during an international passenger voyage, of services required on board a seagoing ship and performed on board the ship itself, and goods needed for use or used on board a ship, except for the sale of luxury services (casinos, betting, gaming table operations, excursions for passengers², etc.) and luxury goods (jewellery, souvenirs, etc.);

² Land-based services, such as local excursions or road-port transportation which are typically included in the overall service package are bought-in either from unrelated companies or at arm's length price from the same group's entities, which are subject to usual income taxation.

- salvage services and other assistance at sea, when provided at sea by a seagoing ship;³
 - lease of a seagoing ship under a freight contract, as provided for in Article 2 of the Lithuanian Merchant Shipping Act, where the entity engaged in international transport by ship and operating the ship retains the running of the ship and control of the crew;
 - short-term investments from working capital, if consistent with the entity's income from permitted types of activity;
 - advertising and marketing services, where such activity is connected with the sale of advertising space on board seagoing ships;
 - shipping company agency and ship brokering services for own seagoing ships;
 - transfer of operated assets, if such assets are assigned to maritime transport.
- (10) Revenues from ancillary activities are only eligible for tonnage tax if they account for less than 50% of total tonnage taxed revenues of the respective vessel during a given taxable year.
- (11) The following vessels are excluded from the benefit of tonnage taxation: fishing vessels, warships, yachts, harbour and river ferries, offshore vessels, dredgers, cable-laying vessels, salvage and rescue vessels, tugboats, inland water vessels.
- (12) The net tons of eligible vessels managed by the shipping company by right of ownership cannot be less than 25% of the total net tonnage of sea-going vessels managed by the shipping company.
- (13) Shareholder dividends, any remuneration of managers and directors of shipping companies as well as bonuses for such managers and directors are excluded from tonnage taxation. Such payments are subject to regular Lithuanian corporate respectively income taxation.

2.4. Flag-link

- (14) As was described above, eligible ships must be either registered in Lithuania or in any other EU/EEA Member State.
- (15) The Lithuanian authorities confirmed that this means that all eligible ships must fly the Lithuanian or an EU/EEA Member State flag. The Lithuanian authorities further confirmed that all revenue generated by a shipping entity using non EU/EEA-flagged ships is treated as ineligible for tonnage taxation.

³ This only includes incidental rescue and other such operations in which an eligible sea-going ship is involved, and which do not constitute the core activity of the ship. Rescue and salvage vessels are excluded from the scheme.

2.5. Legal basis, implementing provisions

- (16) Lithuania introduced the scheme on 1 January 2007, on the basis of the Law N° IX-675 of the Republic of Lithuania on Profit Tax.

2.6. Budget

- (17) Estimated foregone annual profit tax revenues under the existing scheme amounted to LTL 2.1 million (EUR 0.6 million).⁴

2.7. Duration of the scheme

- (18) The approved duration of the existing scheme was 10 years as from 1 January 2007.⁵

2.8. Ring-fencing

2.8.1. Separate accounting

- (19) An entity whose income is taxed under the tonnage tax rate must, for each tax period, submit separate income tax declarations for income derived from activities subject to the tonnage tax and income derived from other activities subject to the general provisions on the calculation of tax. In addition, the Lithuanian Taxation of Profits Act stipulates that taxpayers' books are to be kept in such a way as to provide sufficient information for the calculation of tax on profits.

2.8.2. Arm's length principle

- (20) Under the general provisions of the Lithuanian Taxation of Profits Act, the arm's-length principle applies to transactions effected between related or associated entities which are entitled to avail of the tonnage tax and other entities. Similarly standard provisions for the prevention of tax evasion (e.g. the substance-over-form principle) will also be applied to the tonnage tax regime

2.8.3. Groups of companies

- (21) The tonnage tax system does not provide for differentiated taxation for groups of entities. The currently applicable law on Corporate Income Tax of the Republic of Lithuania establishes that each entity (irrespective of its affiliation to a group of entities) which is liable to pay tax in the Republic of Lithuania has to keep separate accounts. This is also the case in respect of the tonnage tax. The objective of this provision is to exclude the situation whereby a controlled or a controlling entity could place profitable vessels of the controlling or a controlled entity within a tonnage tax regime and loss-making ships under the general rate of corporate income tax.

⁴ Recital (8) of the Decision in N 330/2005.

⁵ Recital (10) read in combination with recital (5) of the Decision in N 330/2005.

2.8.4. *Opting in/out of the favourable tax treatment*

- (22) An entity which is entitled to opt for the tonnage tax must meet all the requirements for the application of the tonnage tax throughout the period (up to 10 years), and, if it no longer meets them, it loses the right to apply the fixed rate of tonnage taxation and cannot opt for that fixed rate for a period of ten years following the loss of such a right.
- (23) If an entity which is entitled to, and has opted to, pay tonnage tax loses the right to pay the tax (because it no longer meets the eligibility criteria), then, starting from the taxation period in which this right was lost, the entity's revenue will be subject to the general provisions for the calculation of corporate income tax. Moreover, such an entity is no longer entitled to opt for the tonnage tax for the remaining taxation periods within the 10 years starting from the taxation period in which the entity was first entitled to pay the tonnage tax.
- (24) If an entity is entitled to and has opted to pay the tonnage tax and then loses the right to pay the tonnage tax, the calculation of the depreciation or amortisation of assets subject thereafter to normal corporation tax is to be based on the acquisition price of the assets, deducting the amount of depreciation or amortisation which would have been calculated if the entity had been subject to normal corporation tax all the time.
- (25) However, if an entity which is entitled to and has opted to pay the tonnage tax loses the right to pay the tonnage tax as a result of *force majeure*, i.e. circumstances beyond its control (e.g. a vessel owned by the entity is lost in a storm), the entity shall not lose the right to benefit from the tonnage tax scheme.
- (26) If an entity, which has opted for the tonnage tax, abuses the system, the general provisions of tax administration of the Republic of Lithuania shall apply. These provisions provide for the payment of outstanding amounts and for the imposition of fines.

2.9. Tonnage tax base and tonnage tax calculation

- (27) The amount of tax is established on the basis of the net tonnage of eligible vessels. The relevant taxable period is the time during which the vessel is registered with the Register of Seagoing ships of the Republic of Lithuania or the seagoing ships' register of another EU/EEA Member State.
- (28) Qualifying companies are taxed on the basis of a fixed profit calculated as a lump sum on the basis of the net tonnage of the qualifying vessels as follows, per 100 net tons (NT) and per 24-hour period started, irrespective of whether the vessel is operational or not:

<i>Net capacity of vessel</i>	<i>Calculation of flat-rate revenue</i>
<i>Up to 1000 NT</i>	<i>LTL 3.2 (EUR 0.93) per day per 100 NT</i>
<i>From 1001 to 10 000 NT</i>	<i>LTL 2.3 (EUR 0.67) per day per 100 NT</i>
<i>From 10 001 to 25 000 NT</i>	<i>LTL 1.5 (EUR 0.43) per day per 100 NT</i>
<i>More than 25 000 NT</i>	<i>LTL 0.92 (EUR 0.27) per day per 100 NT</i>

3. AMENDMENTS TO THE EXISTING SCHEME

3.1. Reasons for the amendments

- (29) The Lithuanian authorities explained that the shipping industry found the existing scheme not sufficiently attractive and flexible. While the introduction of the scheme in 2007 first had a significant impact on the sector, the number of shipping companies under the Lithuanian tonnage tax scheme has decreased from five to four.
- (30) The Lithuanian authorities evaluated the positions of interested parties. According to the Lithuanian authorities, major shipping companies whose ships are flying the flag of Lithuania pleaded for a prolongation of the scheme and explained that otherwise they rather see their business development in other operating environments, i.e. in countries applying more attractive and flexible taxation schemes.
- (31) The Lithuanian authorities expect that the absence of State aid to maritime transport would weaken the Lithuanian shipping industry and might even result in the loss of the Lithuanian fleet. The Lithuanian authorities concluded that in order to both ensure tax revenues and encourage shipping companies to fly under the national, an EU or EEA flag, Lithuania should adopt some of the more favourable provisions that are already applied in the tonnage tax schemes of other EEA countries.

3.2. The amendments

- (32) Lithuania proposes amendments to the scheme as set out in the draft Law on the amendment of Articles 2, 38(1) and 38(2) of the Law No. IX-675 of the Republic of Lithuania on Profit Tax.
- (33) According to the Lithuanian authorities, the draft law aims to clarify the definitions of the terms “shipping unit“, “international carriage of sea-going vessels directly related activities” and “international carriage by seagoing vessels”. Moreover, new provisions would enable an entity to include operating incomes received from chartering-in activities, as well as, under certain conditions, from bareboat-out activities for a three years period. Apart from the amendments outlined in subsections 3.2.1 to 3.2.5 below, no other changes will be made to the Lithuanian tonnage tax scheme.

3.2.1. *Duration and budget*

- (34) The Lithuanian authorities intend to prolong the scheme until 31 December 2027.
- (35) Since the scheme is a fiscal measure, the Lithuanian government did not have to adopt any budget. According to the Lithuanian authorities, estimated annual foregone tax revenue will amount to 0.3 million EUR.

3.2.2. *Rules applicable to revenues from chartering in with crew (time/voyage chartering)*

- (36) As described in recital (12) above, the existing scheme requires that a beneficiary company must own at least 25% of the ships it manages.
- (37) That mandatory ownership floor rate will be reduced to 10%. At the same time, a new provision will stipulate that the net tons of time or voyage chartered-in vessels used by the shipping entity do not exceed 75% of all net tons of all vessels managed by the shipping entity.

3.2.3. *Rules on revenue from bare-boat chartering out*

- (38) In addition to the amendment described in recital (37) above, new limitations on eligible bare-boat chartering-out activities are introduced:
- The net tons of sea-going vessels leased according to bareboat charter-out contracts must not exceed 30% of all net tons of all the vessels managed by the shipping entity;
 - income under charter-out contracts is received for no longer than three years.

3.2.4. *Financing of acquisitions*

- (39) Under the present scheme the acquisition of the sea-going vessel including the financing of acquisition through the subsidiary of the shipping entity, for the purpose of carrying out international shipping by sea and directly related activities is eligible for tonnage tax.

3.2.5. *Benefit from the contract of financing of the acquisition of sea-going vessels*

- (40) Under the present scheme benefits from the contract of financing of the acquisition of the sea-going vessel on international shipping by sea or international shipping by sea and directly related activities are eligible for tonnage tax.

4. ASSESSMENT OF THE AID

4.1. Existence of aid under Article 107(1) TFEU

- (41) The Commission maintains the reasoning set out in its previous decision on the existing scheme, which concluded that the measure constitutes State aid within

the meaning of Article 107 (1) TFEU.⁶ There is no element in the new scheme which would alter this assessment.

4.2. Basis for compatibility assessment – Guidelines on State aid to maritime transport

- (42) The existing scheme was approved on the basis of the Guidelines on State aid to maritime transport⁷ ("*the Maritime Guidelines*"). The objective of the scheme, as described in recital (4) above and as approved by the Commission remains unchanged.
- (43) The Maritime Guidelines are still in force. Hence, the compatibility of the new scheme with the internal market has to be assessed on the basis of the Maritime Guidelines.
- (44) In respect of the scheme's provisions that continue to apply unaltered, the previous assessment of the compatibility of the existing scheme with the internal market, see in particular recitals 37 to 40 and recitals 51 and 52 of Decision in N 330/2005, remains unaltered.
- (45) As regards the amendments to the existing scheme, the Commission has in its case practice developed criteria that ensure that only activities that are in line with the objectives and eligibility conditions of the Maritime Guidelines are covered by tonnage tax schemes, and that the total support level of the shipping companies does not exceed the limit imposed in Section 11 of the Maritime Guidelines.
- (46) Therefore, the Commission has to assess whether the prolonged and amended scheme contributes to objectives in the common interest, has an incentive effect on beneficiaries and does not distort competition contrary to the common interest. Moreover, the Commission has to assess whether the scheme's amended rules contains appropriate ring-fencing rules applicable to prevent abuse and exceedance of the aid limit.

4.3. Objective in the common interest

- (47) Section 2.2, 1st paragraph, of the Maritime Guidelines provides for specific objectives in the Community maritime interest that may be supported with aid schemes.
- (48) Based on information provided by the Lithuanian authorities, the Commission finds that the scheme contributes to the following objectives in accordance with the Maritime Guidelines:
 - The eligibility criteria described in recital (8) last alinea help improving a safe, efficient, secure and environment-friendly maritime transport. The Lithuanian authorities confirmed that Lithuania is a member of the International Labour Organisation (ILO) and the International Maritime Organisation (IMO) and therefore must follow all ratified instruments adopted within these organisations;

⁶ Recital (29) of Decision in N 330/2005.

⁷ OJ C 13, 17.1.2004, p. 3.

- The eligibility criteria described in recital (8) first alinea encourage the flagging or re-flagging to Member States' registers. The Lithuanian authorities confirmed that the obligation that vessels are EU/EEA-registered applies to the entire fleet of a beneficiary, see recital (15).

(49) In conclusion, the scheme continues to contribute to objectives in the common interest.

4.4. Competition with flags of convenience; improvement of the fiscal climate for shipping companies

- (50) Section 3.1, 1st paragraph, of the Maritime Guidelines suggests that the creation of conditions allowing fairer competition with flags of convenience seems the best way forward to avert the flagging out of vessels and also corporate relocation due to the low-tax environment in third countries.
- (51) As described above in recitals (29) and (30), the number of companies operating under the tonnage tax scheme has declined and in the absence of any tonnage tax scheme in Lithuania industry would tend to relocate to countries with a more favourable tax climate.
- (52) Given the mobility of the maritime industry, the Commission finds that aid through the prolonged scheme is needed to bring about a material improvement which the market in all probability would not deliver itself.
- (53) Section 3.1, 1st paragraph, of the Maritime Guidelines suggests that the fiscal climate in many third countries is considerably milder than within Member States, which has resulted in there being an incentive for companies not only to flag out their vessels but also to consider corporate relocation.
- (54) Given that the scheme in question is a special measure to improve the fiscal climate for ship-owning companies in Lithuania, the Commission has no doubts that the scheme is the appropriate policy instrument.

4.5. Provision of fiscal incentives to stimulate competitiveness

- (55) Section 3.1, 5th paragraph, of the Maritime Guidelines provides that a system of replacing the normal corporate tax system by a tonnage tax is an incentive to stimulate the competitiveness of the EU shipping industry which can generally be endorsed. Moreover, recent expertise confirms the incentive effect of such tax relief. For example a study from 2015 by the University of Antwerp found that tonnage taxation has been the main incentive that contributed to the re-flagging status into EU flags⁸.
- (56) The Commission, therefore, has no doubts that the scheme will have an incentive effect on beneficiaries to pursue activities in the common interest.

⁸ University of Antwerp *et al.*, Study on the Analysis and Evolution of International and EU Shipping Final report, September 2015, p. iii, 44-48, <http://ec.europa.eu/transport/modes/maritime/studies/doc/2015-sept-study-internat-eu-shipping-final.pdf>.

4.6. Eligible vessels and activities

- (57) Pursuant to Section 2 last subparagraph of the Maritime Guidelines, the Guidelines are applicable to "maritime transport" activities as defined in Regulation (EEC) No 4055/86⁹ and in Regulation (EEC) No 3577/92¹⁰, that is to say, to the transport of goods and persons by sea between ports but also between a port and an off-shore installation/structure. As regards tonnage tax aid, the Maritime Guidelines also relate to towage and dredging under the conditions specified in Point 3.1 of the Guidelines.
- (58) As was described above in recital (9), eligible vessels must be engaged in international carriage of freight and passengers by sea-going vessels and other activities directly related thereto.
- (59) The scheme's overall eligibility criterion "international carriage of freight and passengers by sea-going vessels" remains unchanged and hence complies with the concept of "maritime transport" as specified in the Maritime Guidelines and as acknowledged in respect of the existing scheme.¹¹
- (60) The scheme's legal text provides for an exhaustive list of eligible activities, comprising:
- Activities specified under the existing scheme, as described in recital (9) and as acknowledged in respect of the existing scheme¹²;
 - Activities introduced by way of amendment to the scheme.
- (61) The Lithuanian authorities explained that in order to be eligible for tonnage tax aid, all activities as specified in the exhaustive list of activities directly related to international carriage by sea-going vessels must be an integral part of international carriage by sea-going vessels performed by the eligible shipping unit. The Lithuanian authorities declared that companies who pursue only these other activities without actually pursuing international carriage by sea-going vessels are ineligible for tonnage taxation.
- (62) In the following, the Commission will assess whether the amended provisions on eligible activities fall within the concept of eligible maritime transport.
- 4.6.1. *Amendment – Rules applicable to revenues from chartering in with crew (time/voyage chartering)*
- (63) As described in recital (12), the existing scheme required that a beneficiary company must own at least 25% of the ships it manages.
- (64) That mandatory ownership floor rate will be reduced to 10% whilst at the same time the net tons of time or voyage chartered-in vessels used by the shipping entity may not exceed 75% of all net tons of all vessels managed by the shipping entity.

⁹ Regulation (EEC) No 4055/86 of 22.12.1986 applying the principle of freedom to provide services to maritime transport between Member States and between Member States and third countries, OJ L 378, 31.12.1986, p. 1.

¹⁰ Regulation (EEC) No 3577/92 of 7.12.1992 applying the principle of freedom to provide services to maritime transport within Member States (maritime cabotage), OJ L 364 of 12.12.1992, p.7.

¹¹ Recital (29) of Decision in N 330/2005.

¹² Recital (29) of the Decision in N 330/2005.

(65) The Commission has accepted in the past that limiting the share of time/voyage chartered fleet to 75% of the beneficiary's total fleet ensures that the beneficiary contributes to an objective of the Maritime Guidelines, notably the flagging or re-flagging to Member States' registers or maintaining and improving EU maritime know-how.¹³ Hence, the amendment as regards chartering-in is in line with the Maritime Guidelines.

(66) Therefore, the amendment as regards chartering-in is in line with the Maritime Guidelines.

4.6.2. *Amendment – Rules on revenue from bare-boat chartering out*

(67) As set out in recital 38 the net tons under a bare-boat charter-out contract may not exceed 30% of all net tons of all vessels managed by the shipping entity and income under bare-boat charter-out contracts is received for no longer than three years.

(68) The Commission considers that mere ship lessors cannot be deemed to provide maritime transport services in the sense of the Maritime Guidelines, and therefore cannot benefit from a tonnage tax regime. The Commission, however, allows - limited - flexibility in favour of genuine shipping companies which charter out their vessels on a bare-boat basis in the context of temporary over-capacity.¹⁴

(69) In line with case practice the Commission accepts the 30% ceiling for bare-boat chartering-out.¹⁵

(70) The Commission notes that the amendment will tighten the rules in so far as it limits bare-boat chartering-out to three years. Such temporary bare-boat chartering is in line with the Maritime Guidelines.¹⁶

(71) Moreover, the Lithuanian authorities committed to allow tonnage taxation of bare-boat chartering out only if such activity is related to a beneficiary's temporary excess capacity. Excess capacity that was specially acquired for chartering-out purposes is ineligible for tonnage taxation. The Lithuanian authorities will issue a commentary to the scheme's legal text, in order to explain these criteria in detail.

(72) Consequently, the scheme's chartering-out rule is in line with the Maritime Guidelines.

¹³ Decision of 1.4.2015 in case SA.37912 (2013/N) – Croatia, *Introduction of a tonnage tax scheme in favour of international maritime transport*, OJ C 142, 22.4.2016, p.1.

¹⁴ Decision of 20.12.2011 in case SA.30515 (N 448/2010) – Finland, *Amendments to the tonnage taxation aid scheme*, OJ C 220 of 25.7.2012, p.1.

¹⁵ Accepted maximum rates are within a 20%-50% range; 20%: Decision of 1.4.2015 in case SA.37912 (2013/N) – Croatia, *Introduction of a tonnage tax scheme in favour of international maritime transport*, OJ C 142, 22.4.2016, p.1; 50%: Appropriate measures decision of 18.12.2015 in case SA.33828 (2012/E, 2011/CP) – Greece, *Tonnage tax scheme and other tax relieves provided in Law No 27 of 19 April 1975 as amended*.

¹⁶ Decision of 1.4.2015 in case SA.37912 (2013/N) – Croatia, *Introduction of a tonnage tax scheme in favour of international maritime transport*, OJ C 142, 22.4.2016, p.1

4.6.3. *Amendment – Financing of the acquisition of the sea-going vessel including the financing of acquisition through the subsidiary of the shipping entity, for the purpose of carrying out international shipping by sea and directly related activities (Tonnage taxation of interest income)*

- (73) In principle, the financing of a beneficiary’s vessel, in particular interest income, can be subject to tonnage taxation provided that the liabilities concerned are directly linked to eligible vessels that carry out maritime transport.
- (74) In that respect, the Commission notes that, firstly, such activities must be an integral part of a beneficiary’s maritime transport activities. Secondly, such activities must be usual in shipping practice. Thirdly, the financing must only be for the acquisition of sea-going vessels. These three criteria combined ensure that financing not directly connected with eligible activities will not come under tonnage taxation.
- (75) As regards the eligibility of subsidiaries, the Commission notes that the incorporation of subsidiaries, e.g. in certain jurisdictions abroad and on the request of creditors, is indeed practiced in the shipping industry.¹⁷
- (76) The inclusion of the financing of the acquisition of eligible vessels is therefore in line with the overall concept of ‘maritime transport’, as such activity can only benefit from the advantage of tonnage taxation if it is an integral part of a beneficiary’s eligible maritime transport activities.

4.6.4. *Amendment – Obtaining of benefit from the contract of financing of the acquisition of the sea-going vessel on international shipping by sea or international shipping by sea and directly related activities.*

- (77) The Commission notes the legal definition specified in the scheme’s legal text, which stipulates that “*benefit from the contract on financing the purchase or acquisition of the sea-going vessel is the income of the shipping entity received upon abandonment by the credit institution financing the acquisition of a sea-going vessel of all or part of the requirement arising from the credit contract, including interest and other payments provided for in this contract, or upon abandonment of the entity transferring the seagoing vessel of all or part of the requirements arising from the contract governing the transfer of the seagoing vessel.*”
- (78) In essence, that definition catches situations where book-profits arise e.g. from the cancellation, restructuring or refinancing of loans, or from cancellations of contracts on the transfer of a vessel.
- (79) The definition provides sufficient safeguard for the connection of such benefit to eligible maritime transport. The eligibility of such benefit for tonnage taxation under the scheme is therefore in line with the Maritime Guidelines’ overall concept of ‘maritime transport’, as such activity can only benefit from the

¹⁷ See recitals (30), (31) and (97) of Commission decision of 1.4.2015 in case SA.37912 (2013/N) – Croatia, *Introduction of a tonnage tax scheme in favour of international maritime transport*, OJ C 142 of 22.4.2016, p.1.

advantage of tonnage taxation if it is an integral part of a beneficiary's eligible maritime transport activities.

4.7. Ring-fencing

- (80) The Commission assessed whether the prolonged scheme will continue to provide for sufficient safeguards against abuse.
- (81) First of all, the Commission notes that ring-fencing measures as approved under the existing scheme remain unchanged.

Opting in – out of the favourable tax treatment

- (82) The Lithuanian authorities will introduce an 'all-or-nothing rule' in the sense that all eligible sea-going ships of a tonnage-taxed undertaking and its group must be covered by the scheme. According to the Lithuanian authorities each of the present beneficiaries has brought all its eligible ships under the scheme.

Compliance control

- (83) The Lithuanian authorities explained that pursuant to the scheme's legal text, beneficiaries shall submit both annual and advance fixed-income tax returns/declarations. On the basis of an Order of the Head of the Tax Administration of Lithuania, such declarations must include the following information:
 - The ship's place of registration;
 - The ship's name and IMO-number;
 - The type of use: ownership, financial-lease, bare-boat charter in;
 - Number of days the ship is in use;
 - Taxable base.

- (84) Said Order will be amended to include in the mandatory information the code of the foreign country where the ship is registered, in cases of bare-boat chartering 'in' or 'out'.
- (85) Moreover, the Lithuanian authorities will provide updated explanations when the amended scheme is enforced, in a 'Commentary on the provisions of the Law on Lithuanian Tonnage Tax'.

Prevention of over-capitalization of tonnage-taxed activities ('thick capitalization')

- (86) Under tonnage tax schemes, no tax deductions are possible with respect to interest cost. Hence, it cannot be excluded that beneficiaries disproportionately allocate equity financing to tonnage-taxed activities, and debt financing to activities that are subject to regular taxation. In recent decisional practice, the Commission has

positively noted the existence of rules that avoid any such disproportionate advantage.¹⁸

- (87) The Lithuanian authorities declared that national legislation provides for sufficient measures to ensure that beneficiaries cannot obtain undue tax benefits from over/under capitalization. In particular, the Lithuanian Corporate Income Tax Law sets a basis for thin-capitalization treatment and Decree N° 1575 of the Lithuanian Government establishes the applicable rules. In essence, these rules specify that only expenses which are required to earn a tax payer's revenue and/or achieve economic benefit will be acknowledged as eligible deduction. Overheads which cannot be attributed to a specific activity must be attributed to corresponding activities proportionally, or according to any other reasonable allocation key. According to the Lithuanian authorities, this prevents tax payers from shifting their expenses between activities in such a way that they could allocate profits to non-taxable activities and losses to taxable ones.
- (88) The Lithuanian authorities declared that an identical principle applies to the tonnage taxation scheme.
- (89) Moreover, the Lithuanian tax authority applies anti-avoidance regulations set forth in the Lithuanian Law on Tax Administration. For example, the tax authority has the right to apply a 'substance-over-form' principle in cases where it considers that the tax payer intends to obtain an undue tax advantage.

Transitional rules between the corporate income taxation and tonnage tax scheme

- (90) As established in recent Commission decisions¹⁹, capital gains related to previously over-depreciated ships entering the tonnage tax system cannot be covered by the tonnage tax system and should be considered as a separate State aid measure.
- (91) Therefore, whenever a ship is brought into the tonnage taxation, any related tax liability²⁰ (so-called 'hidden tax liability') should be established and any relief measures with respect to this tax liability must remain within the aid ceiling pursuant to Section 11 of the Maritime Guidelines.
- (92) The Lithuanian authorities will apply the following approach:
- Calculation of hidden tax liabilities as a difference between the accounting value of a ship at the moment of entry into tonnage taxation and its tax value;
 - Writing-off of hidden tax liabilities within the aid ceiling;
 - Any remaining hidden tax liabilities are subject to standard corporate tax when a ship with such liabilities is sold;

¹⁸ Under the previous Maritime Guidelines: Decision of 13.5.2003 in State aid N 737/2002 – France, *Régime d'imposition forfaitaire sur la base du tonnage en faveur de compagnies de transport maritime*, OJ C 38 of 12.2.2004, p. 5. Under the 2004 Maritime Guidelines: Decision of 18.8.2016 in State aid SA.43642 (2015/N) – Sweden – *Tonnage tax scheme*, OJ C 341, 16.9.2016, p.8.

¹⁹ Decision of 20.12.2011 in State aid SA.30515 – N 448/2010 – Finland, *Amendments to the tonnage taxation aid scheme*, OJ C 220 of 25.7.2012, p.1; decision of 13.4.2015 in State aid – SA.38085 (2013/N) – Italy – Prolongation of the tonnage tax scheme, OJ C 406 of 4.11.2016, p.1.

²⁰ Difference between the market value and the tax value as at the entry into the tonnage taxation.

- If the ship is sold in view of being replaced with a new one, taxation of the remaining liability may be postponed up to three years. The new ship would then be assigned the remaining hidden tax liability as established for the sold ship.

- (93) In that respect, the Lithuanian authorities informed the Commission that all beneficiaries had entered the scheme when it was introduced in 2007 and since have remained in the scheme. The Lithuanian authorities therefore expect that the sale of ships, if any, during the extended duration of the scheme would fall within the aid ceiling. Therefore, the only part of the capital gains subject to standard corporate taxation should be the one exceeding the aid ceiling.
- (94) The Commission finds that these rules provide sufficient safeguard against any undue aid through the favourable taxation of tax liabilities arising from previous over-depreciation under regular corporate tax rules.

Conclusion on ring-fencing measures

- (95) The amended scheme's ring-fencing measures as well as measures that ensure that the aid ceiling is not exceeded will remain in line with the Maritime Guidelines.

4.8. Distortions of competition

- (96) Pursuant to Section 2, 2nd paragraph, of the Maritime Guidelines, aid schemes should not be conducted at the expense of other Member States' economies and must be shown not to risk distortion of competition between Member States to an extent contrary to the common interest.
- (97) In that respect, the Commission assessed whether the fixed-profit rates applicable under the scheme are more favourable than the rate levels currently in force in other Member States that also grant State aid through tonnage tax schemes.
- (98) Firstly, the Commission notes that the fixed-profit rates described in recital (28), which were approved for the existing scheme, continue to apply.
- (99) Secondly, the Commission notes that these rates do not deviate significantly from the rates that the Commission has approved for other Member States' tonnage tax schemes.²¹
- (100) Lastly, available information does not suggest that the scheme encourages either the flagging out or corporate relocation from other Member States to Lithuania.
- (101) Therefore, in conclusion, the assessment of the Commission under the previous scheme remains unaltered and the Commission finds that aid under the prolonged and amended scheme does not threaten to distort competition contrary to the common interest.

²¹ Decision of 18.8.2016 in State aid SA.43642 (2015/N) – Sweden – *Tonnage tax scheme*, OJ C 341, 16.9.2016, p.8; decision of 13.4.2015 in State aid – SA.38085 (2013/N) – Italy – *Prolongation of the tonnage tax scheme*, OJ C 406 of 4.11.2016, p.1.

5. CONCLUSION

(102) Having regard to the analysis set out above, the Commission concludes that the scheme under examination is in line with the Maritime Guidelines.

6. DECISION

(103) The Commission has decided, on the basis of the foregoing assessment, not to raise objections to the notified aid scheme on the grounds that it is compatible with the internal market pursuant to Article 107(3)(c) of the TFEU.

(104) The Commission reminds the Republic of Lithuania to submit annual reports on the application of the scheme.

(105) The Commission further reminds the Republic of Lithuania to inform the Commission pursuant to Article 108(3) of the TFEU on all plans to alter this aid scheme with the exception of the amendments committed by the Lithuanian authorities, enumerated above.

If any parts of this letter are covered by the obligation of professional secrecy according to the Commission communication on professional secrecy and should not be published, please inform the Commission within fifteen working days of notification of this letter. If the Commission does not receive a reasoned request by that deadline, the Republic of Lithuania will be deemed to agree to the publication of the full text of this letter. If the Republic of Lithuania wishes certain information to be covered by the obligation of professional secrecy, please indicate the relevant parts and provide a justification in respect of each part for which non-disclosure is requested.

Your request should be sent electronically in accordance with Article 3(4) of Commission Regulation (EC) No 794/2004, to the following address:

European Commission
Directorate-General for Competition
State Aid Registry
B-1049 Brussels
Fax (32-2) 296 12 42
Stateaidgreffe@ec.europa.eu

Yours faithfully,
For the Commission

Margrethe Vestager
Member of the Commission