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> Changes in taxation of salary in Lithuania – legal and tax aspects the business has to know

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In brief:

- > Gross salary for each employee has to be recalculated by multiplying the current gross salary by the coefficient of 1,289.
- > Such change of salary has to be formalized by amending the employment agreement with each employee.
- > The costs of the employer remains the same, whereas the salary of the employee slightly increases.
- > Employment agreements shall be amended until year 2019.
- > Amended rates of personal income tax and social security contributions will come into force as from 1 January 2019.

Below please find a brief overview of the taxation of labor as well as our explanations with respect to most problematic issues that the businesses are facing.

As it is explained by the officials of the Government of the Republic of Lithuania, these changes should support the position of Lithuania as more business friendly country by shifting the greater part of social security contributions from the employer to the employee. In order that the salary of the employees would not decrease due to the change of social security contributions rate, the employer **must recalculate** the gross salary of the employee and increase it by multiplying current gross salary by the coefficient of 1,289 without any consent of the employee.

By shifting the burden of social security contributions from the employer to the employee, the Government had a difficult task – ensure that the net salary earned by the employees would not be negatively affected by the changes in tax system. However, although the salary of the employees will even slightly increase, it seems that the administration and salary calculation will become more tricky and negatively affect the payroll compliance.

Changing of employment agreement

Changing of valid employment agreements

According to Article 9 of the Law on Change of Articles 2, 4, 7, 8, 10, 23, 25 and 32 of the Law on the State Social Security (hereinafter – the Law changing the Law on the State Social Security), when changing employees' gross remuneration in employment agreements according to newly introduced rules for calculating the salary, an employer must amend employment agreements before 1 January 2019 without prior consent of an employee.

However, in order to assure legitimate interests of employees regarding the right for the same size remuneration after the Law changing the Law on the State Social Security comes into force, it is recommendable to inform employees about amendments to employment agreements as it is envisaged in Article 44 of the Lithuanian Labour Code.

Getting employees well acquainted with the changes

In order to ease the administrative burden in relation to amending each and single employment agreement, the simplest way to amend them is for the manager of a legal entity to:

1. prepare a decree, by virtue of which all employment agreements are amended automatically;
2. to prepare an annex to employment agreement to each employee, whereby new remuneration is stipulated;
3. to attach informational notice to such an annex, whereby an employee would be informed about

reasons of remuneration change, as well as new rules on salary calculation.

It is important to note, that if there is an agreement with employees regarding exchange of information via e-mail in the context of employment relation, such aforementioned informational notice can be sent to employees via e-mail.

Indicating the salary in the employment agreement

We would like to point out that recalculation should apply to the **gross salary** (salary before taxes). Therefore, gross salary should be indicated in both the current or the new employment agreements concluded by the legal entity.

Otherwise, in case the employment agreement only contains the provisions regarding the **net salary**, there is a risk, that in case of a tax dispute the taxes paid by the employer for its employee may be considered as non-allowable deductions from corporate income tax perspective. The reasoning behind this is that if only the net salary is agreed in the employment agreement, the taxes paid for the employee will be considered as the benefit of the employee (not as a remuneration), and thus not related to the earning of taxable income of an entity.

In order to avoid such misunderstanding, we would highly recommend indicating a **gross salary** in the employment agreement only.

Conversion of variable part of the remuneration

Quite often there are situations, when employment agreement, in addition to fixed remuneration, also contains variable part of the remuneration, i.e. so called commissions (which may be indicated in percentages or as a fixed amount). In case of commissions, the same principle of amending employment agreements with respect to remuneration as described above shall be applied (including informing employees about the changes as regards remuneration). So in this case, if commissions are indicated in percentages, the percentage shall be simply multiplied by 1,289.

For example, if indicated commission is 10%, it should be multiplied by coefficient of 1.289:
 $10\% * 1,289 = 12,89\%$

Of course, from the practical point of view, the percentage can be rounded to employee's benefit, so the calculation of commission is simplified.

In the event the commission is indicated as fixed amount, the same rules apply, i.e. commission is multiplied by coefficient of 1,289.

The deadline for the change of employment agreements

As already mentioned, employment agreements must be changed by 1 January 2019, i.e. before legislative changes comes into force. For this reason, when changing employment agreements, it is necessary to prescribe that amendments to employment agreement come into force as of 1 January 2019 and only in the event that the Law changing the Law on the State Social Security comes into force on the same conditions and scope as it was adopted on 28 June 2018.

Signing of the new employment agreements before 2019

New employment agreements that are concluded before 1 January 2019, may also contain provisions that stipulate remuneration according to new rules on salary calculation. However, such provisions shall also prescribe that new salary calculation method comes into force as of 1 January 2019 and only in the event that the Law changing the Law on the State Social Security comes into force on the same conditions and scope as it was adopted. Together with newly concluded employment agreement, the employee shall receive informational notice, whereby the salary calculation method is described (both salary calculation method during the moment of conclusion of the employment agreement and after the Law changing the Law on the State Social Security comes into force).

Changes in personal income tax and social security contributions related to the calculation of salary

Personal income tax changes

Based on the Law No. Nr. XIII-1335 of 28 June 2018 changing the Law on Personal Income Tax of the Republic of Lithuania, the rate of Personal income tax (hereinafter – PIT) shall be increased.

Please find a brief overview of the changes affecting the calculation of salary. The rates are calculated based on the average monthly salary (hereinafter – AMS):

Income	PIT rate
Labour related income, that is lower than:	
<ul style="list-style-type: none"> ▪ 120 AMS (in 2019) (based on the data available in 2018, 120 AMS is ~106,560 EUR) ▪ 84 AMS (in 2020) (based on the data available in 2018, 84 AMS is ~74,592 EUR) ▪ 60 AMS (in 2021) (based on the data available in 2018, 60 AMS is ~53,280 EUR) 	20 %
Labour related income, that is over than:	27 %

<ul style="list-style-type: none"> ▪ 120 AMS (in 2019) (based on the data available in 2018, 120 AMS is ~106,560 EUR) ▪ 84 AMS (in 2020) (based on the data available in 2018, 84 AMS is ~74,592 EUR) ▪ 60 AMS (in 2021) (based on the data available in 2018, 60 AMS is ~53,280 EUR) 	
Labour related income earned and calculated in 2018 and paid off in 2019 or later.	15 %

According to the new legislation, in case the labour related income of the person reach the threshold indicated above, the additional amount of PIT has to be paid until 1st of May, when the PIT return (the new version of it should be available shortly) has to be submitted.

Changes of the calculation of personal allowance (untaxable income)

From 2019 the maximum untaxable income amount applicable to the employees (except of employees with limited working capacity) will be 300 EUR and will be applied to the employees receiving a minimum wage that will be applicable from 2019. From 2020 the maximum untaxable income will reach 400 EUR, from 2021 – 500 EUR.

The personal untaxable income of other all other employees will be calculated according to the following formula:

$$\text{Monthly untaxable income} = 300 - 0,15 \times (\text{labour related income} - \text{the amount of minimum wage})$$

It is expected that the amount of the minimum wage will also increase respectively.

Please be noted, that from 2019 the employees of limited working capacity as well seniors will be entitled to a untaxable income allowance higher than the maximum untaxable income amount indicated above.

The calculation of social security contributions is subject to change

The main changes regarding the social security contribution are:

- > changes in the „employee’s“ and the „employer’s“ tax rates;
- > implementation of social security contribution cap.

The rates of social security contributions, health insurance, contributions to the guarantee fund and long-term employee benefit fund payments

According the changes of the Law changing the Law on the State Social Security, the following changes may be applicable as from 1 January 2019:

„Employee’s taxes“ are taxes which are deducted from the salary indicated in the employment agreement:

- > 19,50% social security contributions, including the health insurance contributions of 6,98%;

„Employer’s taxes“ are taxes which are calculated on top of the gross salary:

- > 1,47% social security contributions;
- > 0,32% guarantee fund and long-term unemployment fund.

In case of limited term contract, the social security contributions of the employer shall be increased by 0,55%.

Please be noted that the above mentioned rates does not include the payments to pension funds (calculated only if the employee chooses to transfer).

The cap of social security contributions and its calculation

The salary of the employee should not be subject to social security contributions provided that the salary exceed:

- > 120 AMS (in 2019) (based on the data available in 2018, 120 AMS is ~106,560 EUR)
- > 84 AMS (in 2020) (based on the data available in 2018, 84 AMS is ~74,592 EUR)
- > 60 AMS (in 2021) (based on the data available in 2018, 60 AMS is ~53,280 EUR)

Note:

In order to calculate the social security contributions correctly after reaching the cap, please be aware of the following rules:

- > PIT rate on salary, that exceeds the set threshold (the rate increases from 20% to 27%) taking into account all the income of the person in all the work places. However, in terms of the cap of social security contributions, the cap applies only to the income received from one employer. Therefore, if a person has earned more than 120 AMS, however with 2 different employers, the cap will not be applicable.

Moreover, the cap of social security contributions is not applicable with respect to health insurance contributions 6,98% that has to be paid on all income.

The amounts that has been overpaid by the employee shall be refunded by 31st of May of the following year.

Changes of the employer's costs and employee's salary

Based on our calculations, due to the changes in tax system the labour costs of the employee might slightly increase by 0,02%:

Increase of costs of the employer

Salary before taxes	Labor costs		Increase	
	2018	2019	EUR	%
1.000,00	1.311,80	1.312,07	0,27	0,02%
100.000,00	131.180,00	131.207,31	27,31	0,02%

Taking this into account the employer shall foresee the slightly increased salary budget for 2019.

estimation of an employee earning 1.000 EUR before taxes.

The employees may benefit from the reform by earning a bit more than before. Please find below a salary

Year	Salary gross	PIT	Social insurance contributions	Transfer to pension fund	Total	Salary net	Employer's taxes	Costs of labor	Tax exempt income	Benefit to employee
2018	1000	138	90,00 (PSD+VSD=9%)	20,00 (2%)	248	752	311,80 (31,18%)	1312	80	
2019	1289	221	251,36 (VSD+PSD =19,5%)	38,67 (3%)	511,02	777,99	23,07 (1,79%)	1312	184,05	25,98

Other insights

Application of new regulations in practice

Recently we have received a number of questions from our clients regarding the application of the new taxation system. Therefore we will provide few insights below:

- > New regulation applies to the employment income that was earned after 1st of January 2019. Therefore, the salary that will be paid in 2019 for the work completed in 2018 shall be subject to currently applicable rules.
- > Unused vacation of the employees shall be converted on 31 December 2018 by multiplying monetary value of unused vacation by the coefficient of 1,289.
- > The bonus payments paid in 2019 for the good results completed in 2018 shall be subject to the taxation applicable at the moment when the bonus payments are calculated, i.e. in 2019.

According to the above mentioned changes we would highly suggest to pay the salaries for December 2018 by the end of the year and thus to avoid the likely failures in the accounting system of the entity.

Taxation of presents to the employees

Some companies motivate their employees by giving them a bonus on some special occasions such as birthday or a wedding. Provided that the value a bonus to one employee does not exceed 200 EUR for one employee in a year, such bonus shall be exempt from PIT. However, the bonus shall be still subject to social security contributions.

Before the above listed changes come into force, the greater part of taxes is falling on the employer, thus, in case of a 200 EUR bonus the employee receives around 160 EUR to his account. However, as from 2019 in case of the same bonus the employee would only receive over 120 EUR. Therefore, in case of such bonuses the employee will benefit less.

It should be noted that in case the presents to the employees of the Company are provided in a form of a gift card or a voucher (not cash) and does not exceed 200 EUR, it shall not subject to taxes at all.

Questions

Should you have any questions, we are ready and pleased to assist you with amending employment agreements and with optimizing taxes with respect to new changes.

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