

Favourable legal environment and stable taxation policy

Harmonisation of legal acts with those of the European Union and the reform of the administrative system in Lithuania has contributed to the protection of ownership, legal occupancy and investments. The real estate market in Lithuania is regulated following generally accepted principles of ownership immunity and protection of rights of a just acquirer (possessor). Also, the principles of equal treatment and equal protection are the main principles of the investment law, meaning that both Lithuanian and foreign investors are subject to equal business conditions and their rights and lawful interests are equally protected by law.

Direct Real Estate Acquisition

Principally, there are no severe limitations to the acquisition of buildings and land for development by foreigners. Foreign investors have the right to buy or lease buildings for their commercial activities as well as lease or purchase land plots for the construction of buildings.

As for buildings, there are no substantial restrictions imposed by Lithuanian law related to the acquisition of these types of real estate by Lithuanians or foreigners. There are no particular restrictions imposed on the construction activities of foreign enterprises either.

The main requirement for foreigners wishing to acquire land in Lithuania is meeting the criteria of origin – citizenship, permanent residency or establishment in a European Union member-state or a state that entered into the Europe Agreement (Association Agreement) with the European Communities and the Member States thereof, or a member state of the Organisation for Economic Cooperation and Development (OECD) or of the North Atlantic Treaty Organisation (NATO), or a state which is a party to the European Economic Area Agreement. Foreigners that do not comply with the established criteria may lease land plots or use them based on other contracts.

For protection of owner interests, sale

- purchase real estate agreements have to be certified by a notary public. Following the general principles of law, Lithuanian law is always applied to international transactions concerning real estate located in Lithuania. The transfer of real estate has to be documented by a statement of transfer-acceptance that is signed by the buyer and the seller.

A notarised sale - purchase real estate agreement is binding on the seller and the buyer. However, the sale and purchase of real estate may be invoked on third parties only upon proper registration of such agreements with the Real Property Register.

The Real Property Register contains all actual information on buildings and land plots, rights to real estate and encumbrances thereof. One can receive information from the Real Property Register on changes in real estate, mortgages on buildings or land plots including pledges of land lease rights, imposed attachments, civil cases brought to the court regarding real estate as well as registered agreements or decisions made regarding the legal status of real estate, such as concluded lease agreements and equivalent.

Information on real estate mortgages in the Real Property Register comes from the Register of Mortgages. Divisions of Mortgages at the local courts are in charge of the registration of mortgages that come into effect upon registration in the Register of Mortgages. Real estate mortgages are common collateral on loans issued by Lithuanian banks for the acquisition and development of real estate.

It is noteworthy that borrowing in Lithuania is rather inexpensive. The Bank of Lithuania provided the following statistics on average loan interest rates proposed by major Lithuanian banks in the year 2003, decreasing throughout the year:

| Loan duration | 6-12 months | | 1-5 years | | over 5 years | |
|----------------------|-------------|-------|-----------|-------|--------------|-------|
| | LTL | EUR | LTL | EUR | LTL | EUR |
| Annual interest rate | 5.86% | 4.85% | 6.55% | 4.26% | 5.02% | 4.13% |

Source: the Bank of Lithuania

Indirect Real Estate Acquisition

There are no restrictions for foreigners on the acquisition and sale of interest in companies for the purpose of acquiring real estate indirectly. Companies established in Lithuania notwithstanding who has their effective control are entitled to acquire land plots without any restrictions. Corporations of limited liability are the common legal form in Lithuania. "Closed" stock corporations with a minimum capital of approx. € 2,900 and up to 250 stockholders and so called "open" stock corporations with a minimum capital of approx. € 43,443 are the two alternatives for corporations. Lithuanian law, designated to satisfy private interests, has established a number of other legal forms for private ownership and the use of real estate: a personal enterprise, a general partnership and a limited partnership. With the exception of limited partners in a limited partnership, personal enterprises and partnerships are regarded as enterprises with unlimited responsibility.

All registration differences of enterprises of so called "local" capital and of "foreign" capital have been eliminated. A new integrated Register of Legal Persons has been recently established for the purpose of accumulating, protecting and providing information on all Lithuanian legal persons. An enterprise is considered to be established only when this enterprise is registered in the Register of Legal Persons. Consequently, any changes of incorporation documents and data of the enterprise are effective only after they are registered in the Register of Legal Persons.

Real Estate Lease

Both Lithuanian enterprises and foreigners may lease land and buildings, either from the state or from private owners. Any agreement for the leasing of real estate is to be concluded in written form. Such agreement may also be invoked in respect to third parties only upon registration thereof with the Real Property Register. With the exception of certain lease conditions specified by law, provisions of the



LITHUANIAN LAW EQUALLY PROTECTS LOCAL AND FOREIGN INVESTOR RIGHTS

lease of real estate are negotiable. One of the lease conditions regulated by law is that terms of state-owned land leases may not exceed 99 years and other real estate may not exceed 100 years.

Commercial real estate leases typically have terms of three or more years. A lessee that has duly performed under the terms of a lease agreement shall be entitled to a pre-emptive right to renew the lease agreement and is entitled to restitution if the lessor has failed to comply. A lease agreement may be terminated under certain circumstances as established by law and the contract.



LITHUANIAN LEGAL ENVIRONMENT IS FAVOURABLE FOR ACQUISITION OF REAL ESTATE

Tax Framework

Tax rates in Lithuania are in general lower than those in Latvia and Estonia:

| Tax | Lithuania | Latvia | Estonia |
|------------------------------|-----------|---------|-----------------|
| Corporate income tax | 15% | 15% | 0% ¹ |
| Income tax | 33%; 15% | 25% | 26% |
| Withholding tax on dividends | 0%; 15% | 0%; 10% | 0%; 26% |
| Withholding tax on interest | 10% | 10% | 26% |
| VAT | 18% | 18% | 18% |
| Tax on land | 1.5% | 1.5% | 0.5-2% |
| Real estate tax on buildings | 1% | 1.5% | 0% |

¹ Reinvested profits are tax exempt but if distributed, profits are subject to income tax at the rate 26/74

Tax on Direct Acquisition of Real Estate

The acquisition of real estate in Lithuania is not subject to real estate transfer tax. Only registration fees of a maximum of approx. € 2,900 are incurred.

Real estate transfers are generally exempt from VAT but VAT may be opted for under certain circumstances. VAT is only incurred if the real estate comprises buildings and the land they are built on and is being transferred within two years of completion. No VAT is payable for the transfer of land unless the land plot is designated for the construction of buildings.

A non-resident enterprise selling real estate in Lithuania would be liable for corporate income tax at a rate of 10%. The tax is levied on income without taking expenses into account. Afterwards a non-resident enterprise may apply to the Lithuanian Tax Authority for recalculation of tax on capital gain taking into account the acquisition value of the real estate.

Non-resident individuals selling real estate are liable for income tax at a rate of 15% on the capital gain. Lithuanian enterprises and permanent establishments of foreign companies are subject to a standard corporate income tax of 15% or 13% for gains on the sale of real estate, and may thus offset expenses relating to the sale in order to reduce profits.

Current Taxation

Income tax at a rate of 15% or corporate income tax at a rate of 10% is also payable on rent and lease payments to individuals or companies not resident in Lithuania. As with current income, rent and lease payments (less expenses) to

permanent Lithuanian establishments of foreign companies are subject to the standard 15% or 13% corporate income tax.

The renting and leasing of real estate is generally VAT exempt. However, VAT is payable on residential real estate if it is rented out for less than two months, and on financial leases on new buildings. Furthermore, entrepreneurs and companies may opt for VAT (18%) if the real estate is rented to a VAT-registered payer (another entrepreneur or company).

Real estate tax on land payable by the land owners amounts to 1.5% annually of the registered value of the land.

Real estate tax on buildings is also incurred, but only by legal persons; it is 1% annually of the value of the building for tax purposes and is payable by the owner.

Tax on Indirect Acquisition of Real Estate

In terms of taxation, there is no difference between investments into partnerships and corporations because Lithuanian partnerships are not transparent for tax purposes and, like corporations, are liable for corporate income tax.

The transfer of interest in Lithuanian property enterprises is not subject to real estate transfer tax or VAT (with certain exceptions).

Current taxation

Under Lithuanian tax law, both partnerships and corporations are taxable enterprises and thus subject to corporate income tax. The standard tax rate is 15% and drops to 13% for small enterprises with an annual income of less than approx. € 783,000 and less than 10 employees on average.

The tax base is the net income in the commercial balance sheet adjusted for tax provisions, i.e. for a rental property it is rental income less tax-deductible operating expenses.

In particular, depreciation on buildings counts as a tax-deductible expense. The straight-line depreciation method should be applied when calculating the depreciation of residential and other buildings. Residential buildings should be depreciated during a period which should not be shorter than 20 years and for other buildings, 15 years. New buildings are written off over a period of 8 years or longer, either on the straight-line basis or using the declining balance method.

Losses may only be claimed as tax deductible for Lithuanian corporate income tax. It is thus possible for Lithuanian enterprises and permanent establishments of foreign investors to carry forward losses for five years. The only exception to this rule is losses from the sale of securities and derivatives, which may only be carried forward for three years and only be netted against capital gains on the sale of securities and derivatives. It is not possible to carry back losses in Lithuania.

Lithuania levies a 15% withholding tax on dividend distributions to foreign shareholders and withdrawals from Lithuanian partnerships by foreign partners. Withholding tax on dividend distributions does not apply if the foreign corporation holds an investment of more than 10% in the Lithuanian partnership or corporation for at least twelve consecutive months and the profit distributed is taxed at the standard rate of corporate income tax.

There are no thin capitalisation rules under Lithuanian tax law.

With the exception of the fact that Lithuanian law will continue to be brought in line with EU directives, and the implementation of the EU Parent/Subsidiary Directive, no other changes in tax legislation are planned at present.

Lithuania is eagerly awaiting its forthcoming accession to the EU. Numerous changes in important areas for commercial real estate investment such as tax frameworks, accounting and real estate law have to some extent already been made or are planned for the near future. Now is the time to plan investment structures and models in light of the planned new regulations, and to determine strategies for the future. However, your attorney and tax advisor should always be consulted about the risks and effects of whatever steps you decide on.

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