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**Subject: SA.35227 (2012/N) — Lithuania
Lithuanian film tax incentive**

Dear Sir,

1. SUMMARY

- (1) I am pleased to inform you that the European Commission has approved the Lithuanian film tax incentive scheme until 31 December 2018 on the basis that the Lithuanian authorities have undertaken to modify the scheme if required by a change in the relevant State aid rules¹ during this period.

¹ Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on certain legal aspects relating to cinematographic and other audiovisual works (COM(2001)534 final, 26.9.01, OJ C 43 pp. 6-17, 16.2.02); prolonged in 2004 (OJ C 123 pp.1-7, 30.4.04), 2007 (OJ C 134 p. 5, 16.6.07) and 2009 (OJ C 31 p. 1, 7.2.09) until 31 December 2012, at the latest.

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LIETUVOS RESPUBLIKA

2. PROCEDURE

- (2) On 1st August 2012, pursuant to Article 108 (3) of TFEU, the authorities of Lithuania notified to the Commission the above mentioned scheme. The Commission requested additional information on 20 September 2012 and on 26 November 2012, which the Lithuanian authorities provided on 9 October 2012, 4 December 2012 and 5 December 2012.
- (3) The Lithuanian authorities have confirmed that no aid will be paid under the scheme until approval of this scheme by the European Commission.

3. DESCRIPTION OF THE MEASURE

- (4) The legal basis for the scheme is the following: Republic of Lithuania Law Amending the Law on Cinema (2011, NR. XI-1897), Decision of the Government of the Republic of Lithuania d. d. June 13, 2012, No 697 On the Republic of Lithuania draft law No XIP-4091 on amendments of the Republic of Lithuania law on taxes on profit, Article 2, and addition of articles 172 and 462 to the law.
- (5) The objective of the scheme is culture, in particular by creating favourable conditions for cultural film production in Lithuania and attracting film producers to produce their films in Lithuania.
- (6) The mechanism consists in a donation made by an undertaking to the cinema sector and backed by a tax relief on profits. The tax relief will be granted to a Lithuanian or foreign entity acting through a permanent office² that has provided a donation to a film producer for the production of a film or a part of a film in the Republic of Lithuania. This pure agency requirement only applies to the film producer at the moment when the producer receives the donation. The direct beneficiaries are:
- entities with a Lithuanian corporate tax liability, including foreign entities or citizens acting through a permanent office or a permanent base in Lithuania;
 - individuals with an income tax liability in Lithuania;
- (7) The film must comply with the criteria for the cultural content assessment established by the Lithuanian authorities. A commission of experts will assess the cultural content of the films on the basis of the script. The commission will function under a national film centre responsible for administering the film tax incentive.
- (8) The films have to meet at least two of the following criteria:
- the film script or the main topic is based on the cultural, historical, religious, mythological or social life events of Lithuania or Europe;
 - the film tells the story of a famous Lithuanian or European cultural, historical, religious, society or mythological personality;

² A Lithuanian entity is a legal person that is registered in accordance with the legal acts of the Republic of Lithuania. A foreign entity is a legal person of a foreign country or an organisation with an office in a foreign country and which are established or otherwise organised according to legal acts of the foreign country, including any other taxable entity established, founded or otherwise organised abroad, and acting through a permanent office in the Republic of Lithuania.

- the film script or the main topic is based on a prominent Lithuanian or European literary creation;
- the film promotes important Lithuanian and European values: cultural and religious diversity, human rights and public spirit, democracy and solidarity, minority rights and tolerance, respect for cultural and family traditions;
- the film tackles issues of national and European identity.

(9) The mechanism of aid deploys in two steps: i) 75% of the donations for the production of the film can be deducted from the taxable profits or income to be paid by the Lithuanian or foreign entity and ii) the corporate tax to be paid by the Lithuanian or foreign entity can be decreased by the amount of the donated funds.

(10) The mechanism is possible under the following conditions:

- at least 80% of all the expenses for the film or its part are incurred in the Republic of Lithuania³ and the expenses incurred in the Republic of Lithuania are at least LTL 150 000;
- the aggregate maximum amount of the donation funds provided does not exceed 20% of the production costs of the film or its part. The cap of 20% applies also when there are several donations for the same production. If this amount is exceeded, the permissible tax relief will be computed only on the 20% share of the donation funds.

The Lithuanian authorities indicated that this provision will be understood in the sense that the maximum eligible donation will be 20% of the lower of (1) 125% of Lithuanian expenditure or (2) the entire film production budget.

- the film or its part is produced in the Republic of Lithuania by a Lithuanian film producer. A Lithuanian film producer is considered a natural person, a permanent resident of Lithuania or a citizen of the European Economic Area (EEA), acting through a permanent base in Lithuania, also a Lithuanian entity or an entity of the EEA, acting through a permanent office in Lithuania, who is engaged in film production and is responsible for the creative, organizational and financial process of film production.

(11) The corporation tax will be decreased by the amount of the donated funds for the tax period for which a note attesting that the donated funds comply with the defined requirements is received (called "Investment Note"). The Investment Note entitles the taxpayer to obtain the benefits from the tax incentive.

(12) The corporate tax payable during the taxation period can be decreased by not more than 75%. If the amount of the donated funds exceeded 75% of the payable tax for the taxation period, the amount in excess could be deducted from the corporate tax payable for the next two taxation periods. However, the corporate tax amount computed for each subsequent period cannot be decreased by more than 75%.

(13) The following example illustrates how the aid operates:

A film production company (producer) produces a film with total production budget of LTL 13 million. LTL 10 million of this is Lithuanian expenditure [L] and LTL 3 million is non-Lithuanian expenditure [E]. A company with taxable profit of LTL 25 million and which is

³ It means that 80% of the production activity should take place in Lithuania, regardless of the origin of the goods or services purchased.

liable to Lithuanian corporate tax (Corporate tax rate in Lithuania = 15 %) contributes with 20 % of the lower of (1) 125% of Lithuanian expenditure or (2) the entire film production budget [D]. In this case, the eligible donation is 20% of 125% of Lithuanian expenditure.

Financial position of the producer:

Lithuanian production costs [L]	10 000 000 LTL
Total production budget [L+E]	13 000 000 LTL
Budget to which aid applies (125% x L)	12 500 000 LTL
Maximum donation eligible (20 % x 125% x L ([D]))	2 500 000 LTL
Remaining finance to be found by the producer	10 500 000 LTL

Financial position of the company:

Profit before the donation [P]	25 000 000 LTL
- 75 % of the donation amount [D x 0.75]	- 1 875 000 LTL
Profit before taxes [PBT]	23 125 000 LTL
Reduced tax liability [RT] (PBT x 15%)	3 468 750 LTL
- Tax deduction for donation [D]	- 2 500 000 LTL
Tax payable [T]	968 750 LTL

The net gain for the company is LTL 281 250 (since the tax payable before the donation would have been 15% x LTL 25 000 000, ie, LTL 3 750 000).

- (14) The scheme will run until 31 December 2018. Only donations made until 31 December 2018 are eligible for the benefits from tax incentive. The budget for the 6 years (2013-2018) is LTL 66 400 000 (EUR 19 230 000). The annual budget may vary.
- (15) The Lithuanian authorities declared that the maximum intensity of the benefit which can be obtained by the donor company or by all donors if the film attracts several donors is 11.25% of the donated funds. In the above example, this intensity is:

$$281\,250 \text{ (net gain for the company)} \div 2\,500\,000 \text{ (amount donated)} \times 100\% = 11.25 \%$$

- (16) The loss of fiscal revenues resulting from the tax incentive is 111.25% of the financial contribution to the film production. However, the Lithuanian authorities consider that the tax deduction available to film donors should be considered as a general measure because any company can be a donor. The tax benefit covers additional risks as well as transaction and administrative costs incurred by the donor companies (such as searching for the film

production company, checking its financial standing, drafting and signing donation agreements, applying for the relevant certificate from the authorities).

- (17) The potential tax benefit can only be exercised as of 30 September in the year following the financial period in which the donation was granted. The delay in using the potential tax benefit further increases the financial costs of the donor company. The potential tax benefit will not materialize if the donor company ends the fiscal year with a loss. Furthermore, the form of contribution chose for this scheme is not a liquid form of investment and cannot be converted into cash in short term basis.
- (18) The contribution to the film production made by the donor will represent a free transfer. The Lithuanian authorities showed that the donor company will not obtain any other economic advantage out of the film production except the tax deduction.
- (19) As concerns the film producer, the aid from the notified scheme can be combined with other aid, but the cumulated aid amounts are, in any event, limited to 50% of the production budget of the film. The Lithuanian authorities will register the information on the films produced, on the producers and the distribution of films as well as the aid awarded. The information system will allow verification of the overall aid received.

4. ASSESSMENT OF THE MEASURE

4.1. Existence of aid within the meaning of Article 107(1) of the TFEU

- (20) According to Article 107(1) TFEU, "save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."
- (21) The funds used to provide the support under this scheme are derived from the fact that the State foregoes tax revenues. Therefore, the scheme involves a transfer of State resources.
- (22) As for the notions of advantage and selectivity, the existence of aid in the case of the tax incentive has to be assessed in the case of both the film donor (direct beneficiary) and the film production company which receives a donation as a result of the tax incentive scheme (indirect beneficiary).

Tax deduction available to the film donor

- (23) From the side of the donors, the scheme is open for any undertaking operating in any sector that is subject to Lithuanian corporate tax. The donor is provided by the state authority responsible for supervising this scheme with an Investment Note which will be the supporting document for exercising the tax incentive.
- (24) As described in paragraphs 16 and 17, the scheme is designed merely as a compensation for the financial costs involved in the donation. The Lithuanian authorities showed that additional risk premium under the present scheme is justified.
- (25) The Lithuanian authorities explained in addition that a direct financing by the government would mean higher additional administration costs and financial costs. The

minimum spending costs of such an administrative organisation would not depend on the number of the film productions being the same in case of no film eligible under the scheme. The contribution to the film should be made by the state at least 9 months earlier than currently. Therefore it can be more expensive to administer the amounts of money involved in the form of grants for a limited number of films which could benefit from this measure each year (especially considering relatively very small Lithuanian film industry).

- (26) Consequently, the tax benefit given to donor companies to incentivise their participation in the scheme does not appear as disproportionate if factors like inflation, cost of the capital, additional risks and the time value of the donation are taken into account. In the light of the Commission's practice⁴, as the measure does not provide a selective advantage to any undertaking, the scheme shall be considered as a general measure not subject to state aid assessment.
- (27) Therefore, the Commission can conclude that the tax deduction available to the film donor does not constitute state aid.

Contribution to the film producer from the tax incentive

- (28) As regards the contribution to the film producer, the measure confers an advantage on film producers as without the tax incentive they are unlikely to benefit from donations at a similar scale.
- (29) Furthermore, it is observed that, in order to benefit from the tax deduction, the donor must contribute to a film production with specific conditions on the entity receiving the donation. The Commission notes that although the film production company receiving the donation is not a direct beneficiary of State resources, there is a clear selectivity in the objective of the tax incentive⁵.
- (30) Accordingly, the support from the State strengthens the position of a selected number of beneficiaries in relation to their competitors in the EU and therefore this aspect of the measure has the potential of distorting competition. Since film productions are subject to trade between Member States, the financial advantage granted to film productions through the tax incentive is likely to affect trade.
- (31) Consequently, the contribution to the film producer from the tax incentive is considered to constitute state aid within the meaning of Article 107(1) TFEU. The compatibility of this aid therefore has to be assessed.

4.2. Compatibility of the aid

- (32) The Commission will assess the compatibility of the notified measure with the internal market in the light of the Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on certain legal aspects relating to cinematographic and other audiovisual works⁶ (referred to as "the Cinema Communication") which contains a detailed interpretation of Article 107 (3) (d) of the TFEU in this area of state aid law. The aid can be justified if the aid scheme complies with the general legality principle and the four specific compatibility

⁴ See Commission decisions in cases N202/2008 Hungarian film support schemes, JOCE C/273/2008 of 28 October 2008 and N464/2009 Indirect state aid for the performing arts organizations, JOCE C/313/2009.

⁵ See the decision N202/2008, point 124.

⁶ For reference, see footnote 1.

criteria regarding cultural content, territorial conditions, aid intensity and aid supplements, as set out in the Cinema Communication.

A. General legality principle

- (33) According to point 2.3 (a) of the Cinema Communication, the aid scheme needs to respect the “general legality” principle, i.e., the Commission must verify that the scheme does not contain clauses that would be contrary to TFEU provisions in fields other than state aid. In particular, the Commission must ensure that the TFEU principles prohibiting discrimination on the grounds of nationality and freedom of establishment have been respected.
- (34) The Lithuanian authorities confirmed that the scheme does not contain any restrictions or discrimination on the ground of nationality or residence.
- (35) To be in line with the freedom of establishment provisions of the Treaty, the Cinema Communication requires that beneficiaries need not have a permanent branch or agency in the territory before the aid is paid. With regard to the Lithuanian film producer, the Lithuanian authorities confirmed that the agency requirement only applies to the film producer at the moment when the producer receives the donation.
- (36) It is observed that the legislation at stake does not provide for the obligation of registration before the aid is paid. Consequently, on the basis of the information provided by Lithuanian authorities, the notified scheme does not raise any issue in respect of the general legality principle.

B. Cultural product

- (37) According to point 2.3 (b) 1 of the Cinema Communication, the aid must be directed towards a cultural product. Each Member State must ensure that the content of a production which benefits from aid is cultural according to verifiable national criteria.
- (38) The Commission notes that the system of tax relief does not provide direct aid to film producers. However, the tax incentive is linked to the film production as the donor company receives aid only if the film to which it had contributed complies with cultural criteria established by the Lithuanian authorities. In the absence of this mechanism, it can be assumed that fewer companies would make donations in favour of film production. Therefore, the film producers can be considered as indirect beneficiaries of the incentive tax.
- (39) Criteria included in the analysed measure (see point 8 of this decision) are directly related to the cultural content of the films and the Commission's assessment is therefore based on these criteria.
- (40) The promotion of culture and of the diversity of its expressions is supported both by Article 167 of TFEU, and the UNESCO Convention on the Promotion and the Protection of the Diversity of Cultural Expressions, which was approved by the Council on behalf of the Community by means of Decision 2006/515/EC⁷.

⁷ Council Decision of 18 May 2006 on the conclusion of the Convention on the Protection and Promotion of the Diversity of Cultural Expressions, OJ L 201 , 25.07.2006 p. 15 – 30

(41) The Commission notes that the cultural content of the films is assessed by an evaluation commission composed of film experts according to the criteria set out in the Lithuanian legislation. These criteria, as assessed by experts, ensure the cultural content of the films thus financed through the mechanism of the tax incentive. The Commission considers that the Lithuanian authorities have established verifiable national criteria within the meaning of point 2.3(b) 1 of the Cinema Communication. Consequently, the Commission considers that the aid is directed towards a cultural product.

C. Territorial conditions

(42) According to point 2.3(b) 2 of the Cinema Communication, the producer must be free to spend at least 20% of the film budget in other Member States without suffering any reduction in the aid provided for under the scheme. In other words, the Commission accepted as an eligibility criteria territorialisation in terms of expenditure of up to 80% of the production budget of an aided film or TV work.

(43) In the case at hand, it is observed that the film producers remain free to spend up to 20% of the production budget outside Lithuania without any reduction in the amount of aid taking place according to the rules described in paragraph 10 of this decision, as required by the Cinema Communication.

(44) Consequently, the territorial criterion of the Cinema Communication is fulfilled.

D. Aid intensity

(45) According to point 2.3 (b) 3 of the Cinema Communication, the aid intensity must be limited to 50% of the production budget, with the possible exception of difficult and low budget films. In the scheme under assessment, the maximum intensity of the aid obtained by the film producer is 20% of the production budget. If there are several donors for the same production, the same maximum intensity is maintained.

(46) Therefore, the Commission concludes that the scheme complies with the aid intensity rules of the Cinema Communication.

E. Aid supplements

(47) According with 2.3(b) 4 of the Cinema Communication, aid supplements for specific filmmaking activities (e.g. post-production) are not allowed in order to ensure that the aid has a neutral incentive effect and consequently that the protection/attraction of those specific activities in/to the Member State granting the aid is avoided.

(48) The current scheme does not provide for such aid supplements.

5. CONCLUSION

(49) In the view of above, the Commission finds that the aid granted on the basis of the measure in question is compatible with the internal market in accordance with 107(3)(d) TFEU and has accordingly decided not to raise objections to the notified measure.

(50) The Lithuanian authorities are reminded that, pursuant to Article 108(3) TFEU, they are obliged to inform the Commission of any plan to extend or amend the measure.

(51) The scheme has been approved until 31 December 2018 on the basis that the Lithuanian authorities have committed to amend the scheme if required by a change in the relevant state aid rules during the lifetime of the scheme.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site:

<http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President