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RESEARCH AND POLICY ANALYSIS BY THINK TANKS IN CEE IN RESPONSE TO EU LEGISLATIVE INITIATIVES AND PROPOSALS

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About the publication

This publication is result of cooperation between independent think tanks in Central and Eastern Europe (CEE). The purpose of this cooperation is to increase awareness of upcoming legislative initiatives in the CEE countries, and to increase the presence of liberal opinions from the CEE countries in the EU decision making.

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Position on the System of Own Resources of the European Union

The European Commission (EC) has presented a new proposal on the System of Own Resources of the European Union. The aim of this proposal is to modernise existing Own Resources by:

- decreasing to 10% the percentage of the customs duties the Member States retain as "collection costs";
- decreasing the share of the Own Resource based on Gross National Income, and keeping it as the balancing resource;
- simplifying the Value Added Tax based Own Resource and increasing its share in the overall Own Resources;
- introducing a basket of new Own Resources, that will cover approximately 12 % of the budget, consisting of: a share of the relaunched Common Consolidated Corporate Tax Base; a share of the auctioning revenue of the European Emissions Trading System; a national contribution calculated on the amount of non-recycled plastic packaging waste;
- establishing the principle that future revenues arising directly from EU policies should flow to the EU budget;
- phasing out corrections;
- increase the Own Resources ceiling.

If agreed on, the provisions of this proposal shall apply from the 1st of January 2021 (except the provisions regarding the CCCTB which will apply from the second year following the date of application of national provisions).

Proponents of this proposal claim that:

- the present level of 20 % collection costs for customs duties can be considered as higher than what would actually be needed as an appropriate incentive for diligent collection of custom duties by national authorities on behalf of the Union;
- recent economic developments are creating a challenge for national authorities when it comes to measuring Gross National Income precisely, therefore new revenue components will allow to keep the GNI based Own Resource as a balancing component and reduce its weight;
- current VAT-based Own Resource requires numerous corrections and compensations as well as the cumbersome computation of a weighted average rate thus it can be reformed by focussing on the standard rated supplies; streamlining the procedure to calculate the Value Added Tax base and; applying a uniform call rate on the standard rated base;
- the 'basket' of new Own Resources which are linked to key EU policies, specifically climate change, environmental policy, plastics strategy, the circular economy and the Single Market, will provide fresh money to the EU budget.

There are multiple reasons to suggest though that the proposed reform of the System of Own Resources of the EU may not only prevent the achievement of its goals, but may also be harmful to the companies and taxpayers of the EU and to the Single Market as general.

The reform proposal ignores the core problem of the EU Finances - EU budget cannot satisfy the ever growing appetites for financing a broad range of different programmes and projects and proposed reforms do not provide a systematic change but an opportunity to extract extra revenue from taxpayers

The EU budget has been a result of political negotiations and trade-offs between member states rather than a well-grounded financing scheme of generally agreed pan-European goals. The politicized use of EU funds distorts the motivation of market participants, harms free competition, impairs an effective allocation of limited resources, incentivizes corruption, contributes to higher inflation in recipient countries and brings benefits primarily to particular interest groups rather than to all EU citizens. Failing to cooperate on mutual goals and seeking to maximize their own benefits, member states end up in a situation where funds are used inefficiently.

Policies that are funded from the EU budget are too demanding, too ambitious and therefore unrealistic. Policies are incoherent and contradictory; some of them erode European competitiveness, so the aims of every policy and their consistency need profound re-examination.

As stated in the proposal itself, the basket of new Own Resources will provide fresh funds to the EU budget and can help manage the impact arising from the withdrawal of United Kingdom - a significant net contributor to the EU budget. Therefore, the reform of new Own Resources in addition to the reform of existing ones, can be seen as an EU 'way out' of the financial hardship, that was created by the withdrawal of the UK.

Frankly, the main aim of this proposal has nothing to do with the reform of existing Own Resources. Although the withdrawal of net-contributor should mean a decrease in the overall EU budget, the aim of current proposal is to ensure, that the EU Budget revenues will increase over time.

This can be clearly seen from the estimated evolution of the structure of EU financing provided in the proposal. Although share of existing Own Resources will diminish in 2021-2027 compared to 2018, the nominal amount will grow from 120 bln EUR to 128. Total budget revenue will grow from 145 in 2018 to 178 bln EUR in 2021-2027 - more than 22 %.[1]

The fact that the reform of the Own Resources is based on artificial grounds is illustrated by the proposal to decrease the percentage of the customs duties the Member States retain as "collection costs" by half - from 20 % to 10 %. The authors of the proposal claim, that the present level of 20 % collection costs for customs duties can be considered as higher than what would actually be needed. They present facts that only 2.1 % of imported items were subject to controls during customs clearance in 2016 but this rate varies widely among Member States. Besides, the application of simplified procedures and automation contribute to improving the cost-effectiveness

[1] https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7886

of controls. They also claim that the amounts retained by Member States as collection costs do not always directly support customs activities and recent developments show that fewer human resources are available in national administrations for performing controls. Although these claims may be correct they do not substantiate the proposed cut of the collection costs. Put it simply, various Member States may have different level of collection costs, the actual level of collection costs may be lower than 20 %, but there is no data shown to support the proposal to bring the level of collection costs to 10 %. For example, national administrations may employ fewer human resources for performing controls, but they may use intelligent and expensive IT systems to support customs activities.

The calculation of the New Own Resources will face the same obstacles as does the calculation of existing national contributions

The authors of the proposal state that the need to diminish share of the existing Own Resources comes from the complexity of calculation of existing shares of Own Resources. For example, digitalisation, globalisation and other economic developments are posing challenging for national statistical authorities. Therefore larger and more frequent revisions of the 'Gross National Income' data to adequately reflect the national income of the different economies are to be expected. But GNI-based Own Resource will continue to account for a major part - 58 % of total revenue of estimated average EU budget in 2021-2027. Thus, the need to calculate GNI will still be present.

The harmonization of corporate tax base which is needed to introduce the CCCTB-based Own Resource will also incur costs of conforming to the new rules at business and state tax administrator level. Thus more complicated calculations will be performed not on the EU but at the state or company level.

Same applies to the naive belief that current proposal will allow to phase out corrections and create a simple and transparent system. As the EU budget is a result of political negotiations and trade-offs between member states rather than a well-grounded financing scheme of generally agreed pan-European goals, corrections may still be added to the proposed system in the future.

Also, Corporate tax base is far less stable than the VAT and GNI. The EU budget should not rely on unpredictable and unstable basis.

The statement that present proposal does not create any new tax for EU citizens is misleading and deceptive

Although, the EU does not have the direct power to levy taxes, certain provision of the proposal may lead to the increase of tax burden of the EU citizens and companies. Imposing of the CCCTB would create considerable compliance costs, prevent companies from exploiting the advantages of different tariffs in different Member States, disproportionately and artificially expand the CIT base in some Member States, thus increasing the tax burden. Also, 3 % call rate for the EU may lead to a direct increase of CIT as Member Stated may try to keep their net CIT revenue at the same level.

The same applies to the proposed 20 % contribution from the EU Emissions Trading System to the Union Budget and EUR 0.8/kg call rate on the non-recycled plastic packaging waste reported each year to Eurostat. In order to keep their net budgetary revenues at the same level, Member States may transpose the contribution as tax to the producers of non-recycled packaging waste. Thus increasing the risk of tax fraud, misreporting and increase in actual plastic pollution.

Also, CO2 emissions and states' recycling capacity are closely related to the "development" of the economy. New EU member states are less efficient, thus their contributions will not be spread "equally" or fairly.

The EU budget revenue reform is inseparable from the EU budget spending reform

The balancing power of the GNI based own resource ensures that not only the general budget of the EU is always balanced at the stage of adoption - it also determines the constant growth of the expenditure side of the general budget of the EU.

Policies that are funded from the EU budget are too demanding, too ambitious and therefore unrealistic. Policies are incoherent and contradictory; some of them erode European competitiveness, so the aims of every policy and their consistency need profound re-examination.

Given that the single market and economic freedoms bring real and tangible benefits to all EU citizens and to all member states, and that this was the major aspiration for founding the EU, the EU budget should be strictly in line with the goal of implementing and strengthening the common market. And vice versa, no funding is justified if it hampers the free movement of capital, technology, goods, services and people. The current situation of the budget is a result of a gradual departure away from the original values of the Common Market behind the EU's foundation.

Cohesion can only be achieved by the removal of regulatory barriers to flexibility and free movement of factors of production within the common market, as well as the improvement of the physical conditions to free movement; thus, EU funds should only focus on infrastructure that links member states together, i.e. pan-European transportation links, and only if they truly create increased functioning of the single market.

Competitiveness policy should create market conditions conducive to free competition. Any public "competition" projects or publicly subsidized private (profit-seeking) projects are not acceptable. Competitiveness Policy includes some programs, such as the implementation of pan-European transport projects that improve market conditions; therefore these programs should be included in the future finances.

There is hardly any social and economic justification for the Common Agricultural Policy and rural development programs. The investment into creating a "good" CAP (which makes up 37% of 2014-2020 budget) is a waste of time and other limited resources because it is in all aspects unjustifiable: the member states have different problems, however the common policy applies the same mechanisms of subsidies to all states; the system itself is rigid and cannot respond to changing global conditions; it does not bring mutual benefits, yet leads to mutual problems and costs. Therefore all efforts should focus on the creation of a sound exit mechanism from this destructive use of public resources.

Conclusions

- There are multiple reasons to suggest though that the proposed reform of the System of Own Resources of the EU may not only prevent the achievement of its intrinsic goals, but may also be harmful to the companies and taxpayers of the EU and to the Single Market as general.
- Proposed reforms do not provide a systematic change but an opportunity to maintain the increasing level of EU budget revenues, although a significant net contributor is withdrawing from the Union.
- The calculation of the New Own Resources will face the same obstacles as does the calculation of existing national contributions.
- The introduction of new Own Resources may lead to an increase of tax burden for EU taxpayers.

Recommendations

We agree, that the present EU budget revenue system is too complex and the use of multiple revenue streams is inefficient and unjustified. The VAT and GNI-based revenue streams overlap, causing double taxation of the value added component.

The EU budget revenue sources must be reformed and built on the following maxims: national contributions to ensure democracy; proportionality to encourage fairness and neutrality; simplicity and transparency to create accountability; and a low administrative burden to increase the effectiveness of payments.

The employment of these maxims dictates the following changes on the revenue side:

- to eliminate the VAT-based revenue stream;
- to rely on member states' contributions based on equal proportions of GNI;
- to diminish the financial role of the traditional “own” resources, leaving them as a temporary regulatory tool and to move towards deeper liberalisation of trade;
- to abstain from creating new sources of revenue;
- to eliminate "corrections of payments" or rebates.

We believe, that it is time to reform the notion that the EU budget is driven by the expenditure side rather than determined by the availability of revenue. Adjusting the revenue side of the budget is mostly automatically depending on the expenditure level, creates constant pressure to raise taxes for the EU taxpayers.

EU budget spending must go in line with the following maxims: EU funds for EU goals; goals, not interests of particular groups, ensure efficiency; financing may bring desired results, yet redistribution is a result in itself. The application of these principles implies an essential reform (and perhaps the abolition of some) of the current policies.

On the EU budget expenditure side there is a crucial need for the following actions:

- to create a sound exit mechanism from CAP and rural development policies and annually reduce contributions to the EU budget by the amount previously allocated to these policies;

- to redesign the Cohesion Policy, focusing it on removal of barriers to flexibility of the markets and free movement of factors of production inside the EU market and improvement of infrastructure linking member states;
- to abstain from financing highly uncertain goals, such as climate change control and mitigation, Galileo, etc.;
- to rely on the private financing of innovation, research and development and not to increase present EU budget funding for these purposes;
- to supplement the Union's external actions with the promotion of free market reforms in non-EU countries;
- to avoid the financing of profit-seeking private companies regardless of their region, economic activity or project;
- to avoid unrealistic and potentially harmful large scale investment programs such as the Juncker's Investment Plan.

To conclude, only a fundamental budget reform, not a reform of the budget's structure, may change Europe. Accordingly, the EU budget must be reduced if an agreement on common needs or attainable goals is not reached.

Position on the Proposal for a Council Recommendation on Access to Social Protection for Workers and the Self-Employed

As part of the implementation of the European Pillar of Social Rights, the European Commission (EC) has adopted a Proposal for a Council Recommendation on Access to Social Protection for Workers and the Self-Employed. The objective is to support people in non-standard forms of employment and self-employment who, due to their employment status, are not sufficiently covered by social security schemes and thus are exposed to higher economic uncertainty. Principle 12 of the Pillar states that "regardless of the type and duration of their employment relationship, workers, and, under comparable conditions, the self-employed have the right to adequate social protection."

Through a proposal for a Council Recommendation, the Commission aims to encourage EU countries to:

- allow non-standard workers and the self-employed to adhere to social security schemes (closing formal coverage gaps);
- take measures allowing them to build up and take up adequate social benefits as members of a scheme (adequate effective coverage) and facilitating the transfer of social security benefits between schemes;
- increase transparency regarding social security systems and rights.

Europeans are already lagging behind others in terms of willingness to start their own business and increased tax contributions could make the situation worse. Only 37% of Europeans said that they would like to be self-employed, compared to 56% respondents in China, 63% in Brazil or even 82% in Turkey.[2] Only 9% of the EU respondents said that the reason they would choose to be employees rather than self-employed is to be covered by social welfare/insurance.

While increased transparency of social security systems and rights should undoubtedly improve the functioning of social security systems across Europe, the other two priorities aimed at expanding social security benefits to non-standard workers and the self-employed could face implementation challenges and bring negative results for the following reasons:

- Harmonizing access to social protection inevitably would result in bigger welfare state and possibly increased social security contributions for non-standard or self-employed people therefore hurting European competitiveness. Emerging new forms of work (e.g. platform workers), technological changes, worsening demographic trends and tough competition that the EU and Member States face from beyond the Single Market require a clear understanding and agreement that the EU should strive for innovation and flexibility in

[2] http://europa.eu/rapid/press-release_MEMO-13-7_en.htm

terms of regulatory principles and measures, including in the field of employment and social policies. Strict labour regulation and extended social policies are the trend of yesterday. It ignores the future economic and business (workplace) trends and involves a burden for employment and entrepreneurship, threatening competitiveness and investment attractiveness of Member States.

- Worsening demographic situation in the Union urges Member States to reform their social security systems. It is projected that the old-age dependency ratio (people aged 65 and above relative to those aged 15 to 64) in the EU will increase by 21.6 percentage points, from 29.6% in 2016 to 51.2% in 2070.3 Harmonization of social policies would hinder solutions that the Member States could develop independently in trying to reform their social systems, adjust to emerging demographic and economic changes.
- The intended harmonization of social security systems in a very diverse European context would face many obstacles and could result in discontent across the Member States. Various political traditions, tax systems and different capabilities of public finances have produced very different types of welfare-state models across the continent (e.g. Anglo-Saxon or Scandinavian models). As a result, EU measures to reorganize social security systems (or change the principles of access to social protection) would most likely not only face resistance in EU member-states. Some measures would simply face budgetary constraints and fall short of implementation because of disparities in social security capabilities. Despite a slow downward trend the debt-to-GDP ratio in the Union remains very high. It is projected at 81.6 % across the EU in 2018 and vary significantly between Member States.4
- Traditionally, the implementation of social policy measures did not fall with EU competency. Harmonization of access to social protection at the EU level would seriously undermine subsidiarity and proportionality principles, which are at the very core of the EU policy as defined in the Treaty on the EU. Even though Article 2 (3) TEU establishes a socio-economic union, it does not imply that reaching the EU goals requires a rigid protectionist regulation of labour and welfare systems. ‘A highly competitive social market economy’ can be achieved by market instruments and by removing existing regulatory burdens (including the ones created by the older EU Directives). The Charter of Fundamental Rights provides substantial legislative grounds for social rights, while Member States have judicial systems in place for individuals to claim or defend those rights. Social policy measures among the EU members are usually implemented via the method of open coordination, which enables sharing best practises and benchmarking. Article 151 of Lisbon Treaty states that social policy shall be implemented by taking into account ‘diverse forms of national practices, in particular in the field of contractual relations, and the need to maintain the competitiveness of the Union economy’.

Arguably technological, demographic and economic challenges should shift social security systems towards transparency and flexibility. However an attempt to harmonize access to social protection in the Union would reduce the likelihood of finding the best answers suited to different economic situations in the Member States. It would create a burden for employment and entrepreneurship, threatening competitiveness and investment attractiveness. Moreover, it would face significant implementation challenges since the scope of social protection generally is very diverse in the

[3] http://www.silvereco.org/en/wp-content/uploads/2018/06/the-2018-ageing-report.pdf

[4] https://ec.europa.eu/info/sites/info/files/economy-finance/ip069_en.pdf, p.15

Member States. These are the main reasons why EU should embrace the improvement of social policies using method of open coordination, benchmarking and exchange of best practices between the Member States.

Position on the Energy Taxation Directive

Energy Taxation Directive is redundant and harmful

In helping to achieve the objectives of Energy Taxation Directive (ETD), namely: internal market, energy efficiency, climate change and jobs and growth, ETD has been of little use or even harmful.

In terms of *internal market*, Energy Taxation Directive ETD is redundant. Legal mechanisms to safeguard single market operated regardless of harmonized taxation. Goods flows across borders, regardless of differences in VAT rates or VAT exemptions.

It is quite likely that a period of high oil prices had an overwhelming effect on incentives to invest in *energy efficiency.* The effects of high oil prices and CO2 emissions trading are likely to have dwarfed the effects of ETD.

ETD has not led *to jobs and growth.* In anything taxation has led to less jobs and less growth by increasing costs to industry and by reducing disposable incomes of consumers. Taxation of energy has added to the tax burden of EU citizens rather than shift it. Despite the rhetoric that energy taxes would replace certain taxes, energy taxes added more taxes. Despite extra income received from energy taxes governments are reluctant to reduce other taxes.

ETD should protect European citizens from excessive taxation of energy

Just as ETD sets *minimum* levels of taxation on EU level, the discussion of setting *maximum* tax levels on EU level is long overdue. From the economic point of view maximum levels of taxes on energy would protect the consumers from incompetent national governments, who finance their failed economic policies by taxing productive businesses and consumers. On political level it would prevent national governments from using EU and single market as a scapegoat for high taxes, the benefits of which are reaped by national governments.

Tax competition is good

Tax competition should not be discouraged. Different level of taxation does not impedes on smooth functioning of the Single Market. Moreover, there are ample safeguards and authority to deal with national governments who would want to disrupt free movement of energy products across borders of member-states.

It is true that minimum levels of taxation limit "race to the bottom", but this is tax competition, which should be allowed among member-states. If anything it should be encouraged, just as competition by productive efficiency or natural differences of economies is encouraged; just because Spain receives extra warmth and sunlight, there is no tax on Spanish tomatoes vis-à-vis tomatoes grown in Finland.

ETD does not even the playing field in the EU, hurts EU companies globally

Regarding level playing field, even in terms of energy prices, the field is uneven. Due to different pricing policies, market situation, size, scale and multitude of other factors energy prices (e.g. electric energy, natural gas) for industry already differ by the factor of 2 or 3 across EU on average. If we are talking about energy as an industrial input, minimum levels of taxation play a negligible role in leveling playing field across EU. ETD distorts level playing field when it comes to EU companies competing in a *global* market.

Taxation of energy creates additional cost to industry, reducing the competitiveness of EU companies. Ability to use reduced rates allows energy-intensive industries escape taxation and restore some of the competitiveness in the global market. Therefore, exemptions are useful but only to an extent that they allow industry (or consumers) to bypass the ETD.

The Directive's consultation seems offline with other legislative initiatives, on Renewable Energy Directive (RED) in particular: RED current amendment, aiming at eliminating clean bio diesel ingredients like palm oil (demand for which was boosted by the adoption on this very Directive in 2009), is discriminating against global suppliers of such and, thus, violate at least three of the WTO founding principles (on non-discrimination, predictability and negotiation) and threaten a "trade war" palm oil producing jurisdictions, like Malaysia and Indonesia. At the same time, producers of non-palm-oil additives to the so called "EU crop based biofuels" from our countries petitioned (twice, only in May this year) the Commission, the Council and the EP for more subsidies.[5] In fact, taking taxes via ETD and allocating them through RED is further damaging the playing field policy principle, within EU and globally and opens the door for additional logrolling within EU institutions. The process is superfluously complicated by other, nice sounding Commission initiatives, like, especially, "the Clean Energy for All Europeans – unlocking Europe's growth potential" of November 2016.

The end result, we think, ca be no other than more public discontent with the EU, and additional centrifugal tendencies in the public opinion.

Minimum energy taxes create additional problems for member-states with low incomes

Countries of Central and Eastern Europe suffer from minimum level of excise tax on transportation fuels. First, due to low disposable incomes and minimum EU excise tax, transportation fuel is relatively more expensive for general population in CEE countries than in old member-states. Of course, even in minimum EU-excise rates did not exist, this problem would still exist because prices of products tend to converge in a single market. However, minimum taxation aggravates this problem. This creates ethical problems (e.g. is it ethical to impose high taxes on people with low incomes) as well as reduces living conditions for population.

Second, many CEE member-states have borders with non-EU members (e.g. Russia, Belarus) which have lower taxation for transportation fuel. This creates ample opportunities to supply illegal contraband fuel, or semi-legal cross-border trade. Research of LFMI[6] indicates that in 2012 the

[5] See, e.g.: With a bad RED II policy we will not invest: V4+Sustainable Biofuel Alliance, EuroActiv, May 22, 2018.

[6] For more on the grey economy, see LFMI's research at https://www.llri.lt/wp-content/uploads/2015/11/Shadow-Economies-in-a-Baltic-Sea-Region.pdf

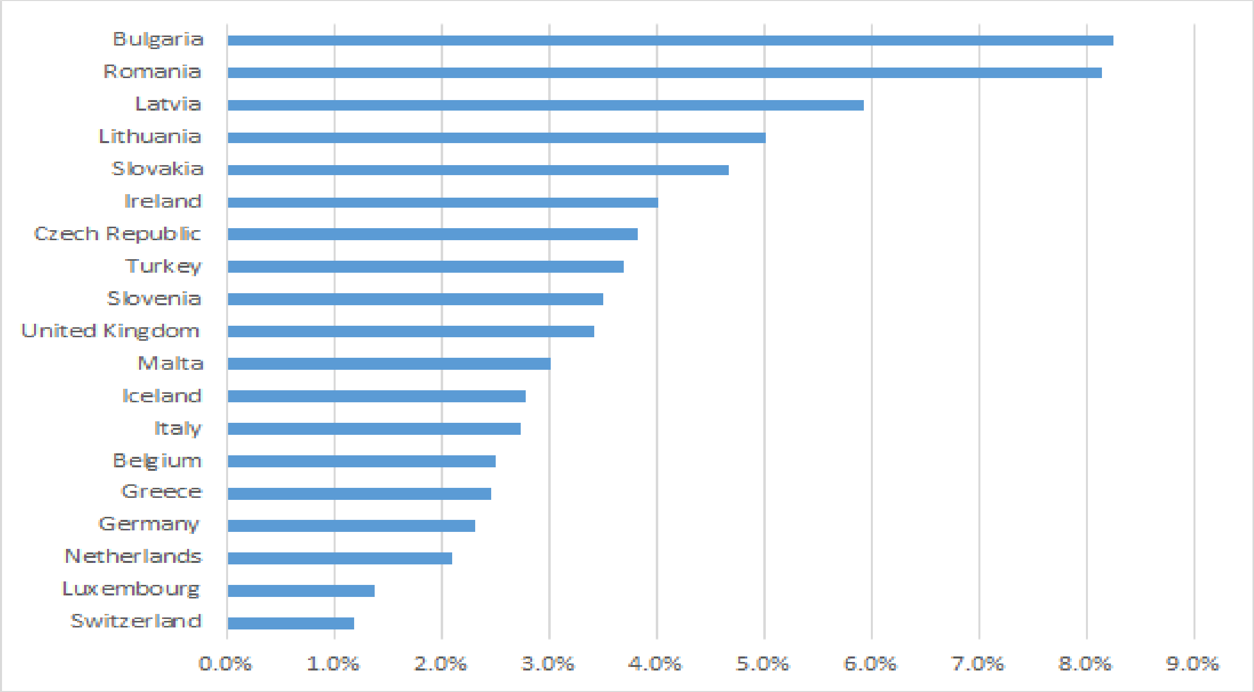
grey or shadow market for fuel composed nearly 20% of the market for transportation fuel. This costs lost tax revenue, hurts local retailers and encourages illegal activities.

Position on the Effects of Tobacco Taxation

Taxation of tobacco products raises severe economic and social concerns which should be taken into account when formulating further tobacco taxation policies, including on novel tobacco products. We argue that increased education rather than higher excise duties should be the main policy in reducing the incidence of smoking.

Taxation of tobacco products creates a disproportionately high burden for citizens in countries that have lower income levels. Although nominal tobacco tax rates in the Baltic States are not lower, the affordability of tobacco products is among the lowest due to a relatively low income level (Picture 1). It can be seen that cigarette consumption in Lithuania makes up 5 percent of annual net average earnings, while in Luxembourg it accounts for only 1.4 percent. The low affordability leads people to turn to the informal and illegal tobacco market.

Picture 1. Cigarette consumption as a percentage of total average annual net earnings (2012, Eurostat).[7]

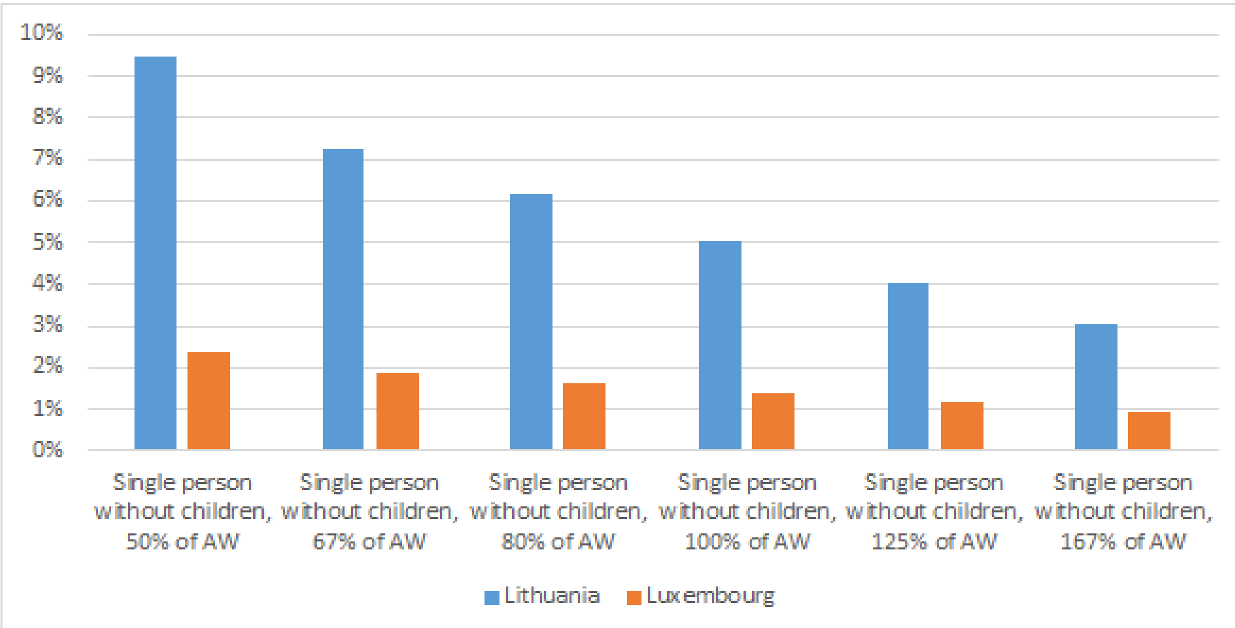


Tobacco products constitute a much higher proportion of the consumer basket for lowest-income earners. This makes tobacco taxation regressive. Furthermore, its financial burden for the most vulnerable segments of society is particularly large because of low price elasticity in European

[7] We assume that a smoking person buys on average a pack of 20 cigarettes once every three days.

Union countries, which is estimated to be −0.4 (Picture 2).[8] These population segments tend to rely on the informal sector and their tobacco consumption rarely decreases. To add, due to the regressive nature of excise taxes, higher tax rates do not provide sufficient incentives for wealthier people to stop smoking either.

Picture 2. Percentage spent on cigarette consumption from total net earnings for different income levels (2012, Eurostat)[9]



As mentioned, high taxation of tobacco products coupled with geographical proximity with third countries incentivizes illegal tobacco trade in Lithuania and other countries. It is estimated that illicit tobacco accounted for 19.6 percent of the whole tobacco market in Lithuania in the last quarter of 2017 (*Shadow tendencies in Lithuania, 2017*). During the economic crisis, when people's income fell, it was as high as 42.8 percent. These data suggest that the informal tobacco market is flexible and may expand substantially as affordability of tobacco products falls.

To conclude, while increasing public health and reducing the incidence of smoking should be a priority, we believe that taxation of traditional and novel tobacco products is not the right way to accomplish these goals. Due to entrenched shadow economies in poorer EU countries, positive effects of lower tobacco usage from higher excise duties are reverted. High excise duties do not work well in Eastern European countries which are close to EU borders. We believe that the correct policy on reducing smoking incidence is consistent education about the harm caused by tobacco consumption.

[8] S Gallus, A Schiaffino, C La Vecchia, J Townsend, E Fernandez. *Price and cigarette consumption in Europe*.

[9] We assume that a smoking individual buys on average 365/3 cigarette packs per year (which corresponds to buying a pack of 20 cigarettes once every three days).

Position on the Review of the SME Definition

SME definition is an important issue, regarding not only a number of European policies that have been set up to ensure these SMEs benefit from financial support, fee reduction, reduced administrative burden, etc., what has been mentioned in the introduction of this survey. SME definition, with some changes made, is usually transposed to national laws, regarding business taxation. For example, Lithuanian Law on Corporate Income Tax states that taxable profits of entities (except for non-profit entities) whose average number of employees on the staff list does not exceed 10 and whose income during the tax period does not exceed EUR 300 000 shall be taxed at a rate of 5%, instead of standard 15 % rate. Even more favourable regime exists for such entities during their 1st year of operation. They are entitled to pay 0 % CIT. Therefore, we can clearly see that part of the criteria (headcount) is taken from the current SME definition of micro-sized enterprise. Sadly, financial criteria are lowered, thus preventing a larger number of businesses from taking advantage of this favourable tax regime. Member States should be encouraged to apply SME criteria thoroughly and in favour of business.

On the contrary, Lithuanian Law on Small and Medium-Sized Business Development uses the exact same criteria, provided by the = EU. According to this Law, the following forms of State aid may be applied to small and medium-sized business entities:

- tax relieves (if provided by law), relieves on charges;
- financial support: granting of loans on favourable terms, partial or full payment of interest, provision of guarantees, credit insurance, investment of risk capital in small and medium-sized enterprises, reimbursement of certain expenses (expenses related to fees on registration, research, guarantee fees, credit insurance premiums, acquisition of quality certificates, and other expenses), subsidies for job creation;
- advisory, training, skills improvement or re-qualification services offered to enterprise owners, members of enterprise bodies and enterprise employees on favourable terms;
- establishment of business incubators, business centres, technology parks and services provided by them;
- other forms of assistance established by the Government, county governors or local authorities.

We believe, that in case of Lithuania, micro-sized enterprise headcount threshold of 10 employees very often forbids business from possibility to use the advantage of favourable tax regime & other forms of assistance. It is especially evident in situations where companies employ more than 10 employees (some of them may even work part-time) and their annual income does not exceed 300,000 or 2 million Euros.

Therefore, we believe that headcount threshold should be increased, especially in cases of micro-sized and small-sized enterprises.

Also, a part of a criteria of definition of SMEs is usually used when introducing business-friendly VAT cash-accounting systems around the Member States. Member States applying this accounting scheme set a threshold for taxable persons based on their annual turnover that may not exceed the maximum of EUR 2,000,000 or the equivalent in national currency, after consulting the VAT Committee.

Member States should be encouraged to apply business-friendly VAT cash-accounting systems for micro-sized and small-sized business, though this instrument helps to balance the cash-flow and mitigates the need to use expensive credit alternatives.

Also, it is very important to mention, that SME status is created to diminish the administrative burden on business. Treating enterprises in which a public authority controls 25% (or less) of the capital as SMEs, puts entirely privately owned companies into competitive disadvantage.

Therefore, SME status should not be given to companies, that are partially owned by the state, or the threshold should be lowered.

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