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Taxes in Lithuania: Benchmarking and Policy Options

Lukas Boer, Tara Iyer, Martin Grote, Tibor Hanappi, and Fayçal Sawadogo

SIP/2025/137

IMF Selected Issues Papers are prepared by IMF staff as background documentation for periodic consultations with member countries. It is based on the information available at the time it was completed on July 29, 2025. This paper is also published separately as IMF Country Report No 25/259.

2025
OCT

 SIP/2025/137

IMF Selected Issues Paper
European Department

Taxes in Lithuania: Benchmarking and Policy Options, Republic of Lithuania
Prepared by Lukas Boer, Tara Iyer, Martin Grote, Tibor Hanappi, and Fayçal Sawadogo*

Authorized for distribution by Kazuko Shirono
October 2025

ABSTRACT: Lithuania faces immediate fiscal challenges from increased defense needs adding to the existing long-term spending pressures. Tackling these requires a multifaceted strategy, including revenue mobilization to ensure fiscal sustainability. This note examines tax policy options, assessing potential changes and their effects. It benchmarks Lithuania's tax system with Baltic and European peers and analyzes revenue mobilization scenarios. Findings suggest that improving VAT efficiency, and adjusting personal income and property taxes, could boost revenues while enhancing progressivity.

RECOMMENDED CITATION: Boer, L., T. Iyer, M. Grote, T. Hanappi and F. Sawadogo, 2025, "Taxes in Lithuania: Benchmarking and Policy Options, Republic of Lithuania." IMF Selected Issues Paper 2025/137.

JEL Classification Numbers:	H11, H20, H24, H25
Keywords:	Tax Policy, Tax Revenue Benchmarking, Revenue Mobilization, Lithuania
Author's E-Mail Address:	LBoer@imf.org, TIyer@imf.org, MGrote@imf.org, THanappi@imf.org, FSawadogo@imf.org

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Taxes in Lithuania: Benchmarking and Policy Options

Republic of Lithuania

Prepared by Lukas Boer, Tara Iyer, Martin Grote, Tibor Hanappi, and Fayçal Sawadogo [1]

[1] The authors would like to thank Kazuko Shirono for helpful guidance. We also thank the Lithuanian authorities, Helge Berger, Vincenzo Guzzo, Irina Bunda, and Sebastian Beer for useful comments, and Sadhna Naik for excellent research assistance.

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REPUBLIC OF LITHUANIA

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CONTENTS

TAXES IN LITHUANIA: BENCHMARKING AND POLICY OPTIONS[1]

Lithuania faces immediate fiscal challenges from increased defense needs adding to the existing long-term spending pressures. Tackling these requires a multifaceted strategy, including revenue mobilization to ensure fiscal sustainability. This note examines tax policy options, assessing potential changes and their effects. It benchmarks Lithuania's tax system with Baltic and European peers and analyzes revenue mobilization scenarios. Findings suggest that improving VAT efficiency, and adjusting personal income and property taxes, could boost revenues while enhancing progressivity.

A. Motivation and Benchmarking

1. Lithuania faces a near-term need to boost defense spending adding to other mounting long-term spending pressures. The long-term pressures are related to the ageing population and investment needs for green transition. Defense spending is expected to increase by an additional 2 percent of GDP relative to previous 2024 projections—and would reach 5 percent annually from 2026-30. While financing could partly come from debt or EU funds—mobilizing tax revenues would be an essential part of a more comprehensive fiscal package ensuring fiscal sustainability, especially given the multi-year scope and permanent component of spending pressures.

2. There have been some recent legislative changes related to national security needs and tax policies. Lithuania's defense fund package adopted in 2024—intended to raise revenues for an increase of defense spending to 3-3.5 percent of GDP—included an increase in the corporate income tax (CIT) from 15 to 16 percent, a faster increase in the CO_2 component for energy products from 2025 to 2030, the inclusion of a security component in excise duty rates for gas and oils intended for agricultural use, an additional increase in excise duty rates for alcoholic beverages and tobacco and an extension of the banks' solidarity contribution through 2025. Subsequently, in July 2025, the Council activated the escape clause for 15 member states, including Lithuania. This clause allows for the exemption of up to 1.5 percent of GDP in defense budgets from deficit calculations, allowing higher defense spending in Lithuania.

3. A draft law approved by the Parliament in June 2025 proposes further tax changes from January 2026 (Table 1). Key features include the following: The PIT would maintain exemptions for lower-income earners and the same phase-out rates but add more tax brackets, while pooling all types of income together (with some exceptions, e.g. dividends) and introducing intermediate tax rate of 25 percent. The standard CIT rate would increase to 17 percent, and the reduced rate would rise to 7 percent. For property taxes, an additional 0.2 percent tax would be implemented on commercial immovable property, with the revenue allocated to the State Defense

[1] Prepared by Lukas Boer and Tara Iyer (all EUR), and Martin Grote, Tibor Hanappi, and Fayçal Sawadogo (all FAD). We thank Kazuko Shirono for helpful guidance. We also thank the Lithuanian authorities, Helge Berger, Vincenzo Guzzo, Irina Bunda, and Sebastian Beer for useful comments, and Sadhna Naik for excellent research assistance. All errors are our own.

Fund, the non-taxable EUR 150,000 threshold for non-commercial immovable property owned by individuals would decrease for non-primary residence and taxation of the property would divide into two "baskets" for the primary residence and for other non-commercial property, with revenues from the latter allocated to the State Defense Fund. The reduced VAT rate would rise from 9 to 12 percent. The proposals additionally include an excise duty on sweetened non-alcoholic beverages as well as concentrates used in preparation of beverages and a 10 percent tax for non-life insurance premiums.

Table 1. Lithuania: Government's Proposed Tax Policy Changes and Expected Revenue Impact

Tax	Existing	Proposal	Revenue impact [i]
PIT	Schedule: 20/32 for thresholds of 0-60 (with non-taxable amount) and >60 average wages	20/25/32 for thresholds of 0-36 (with non-taxable amount), 36-60, and >60 average wages	0.23 percent of GDP
CIT	Rate: 16 percent and 6 percent reduced rate	17 percent rate (also on dividend income) and 7 percent reduced rate, introduction of instant depreciation of certain fixed assets, limitations on the deductions of tax losses	0.05 percent of GDP
Property	EUR 150,000 non-taxable threshold and 0.5-2 percent tax rate for non-commercial immovable property owned by individuals. Revenue from this tax is allocated in the state budget. Other property – 0.5-3 percent rate is set by municipalities. Revenue from this tax is allocated to municipal budgets.	1. Non-commercial property owned by individuals (a) *primary residence* - non-taxable threshold of EUR 450,000) and tax rates ranging from 0.1 to 1 percent would be set by municipalities, with revenues allocated to the municipal budgets. (b) *other property* – EUR 50,000 non-taxable threshold and progressive tax rates ranging from 0.2 to 1 percent would be set by law. Revenues from this tax would be allocated to the State Defense Fund until 2030. 2. Commercial property Additional 0.2 percent tax. Revenue would be allocated for the State Defense Fund.	0.08 percent of GDP (except from primary residence for which the size of impact will depend on decisions taken by the municipalities)
VAT	Reduced rates: 5 and 9 percent	Reduced rates: Increase 9 percent rate to 12, lower rate for books to 5 percent, no VAT relief for heating, hot water and firewood.	0.09 percent of GDP
Sugar tax		Excise duty in EUR/hl differentiating by sugar content per 100 ml.	0.03 percent of GDP
Insurance tax		10 percent tax for all non-life insurance premia	0.12 percent of GDP
Total			**0.6 percent of GDP**

[i] Ministry of Finance estimates. In percent of projected 2026 GDP.

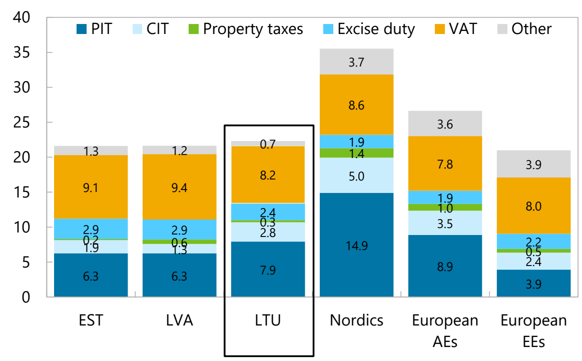
4. Benchmarking Lithuania's tax system indicates potential for raising tax revenues (Figure 1). Compared to other EU countries, Lithuania collects a lower share of tax revenue relative to GDP. Its government revenue levels, similar to Latvia's and Estonia's, align more with EU emerging markets. Lithuania has increased its tax-to-GDP ratio, reaching 22.3 percent in 2023, aided by improved compliance measures, but still remains below the EU average of 26.1 percent. Its tax system relies more on VAT and excise duties while property taxes contribute a smaller share compared to other EU nations.

5. Lithuania's tax structure includes a low-progressivity PIT, low property taxes, high excise taxes, and potential to boost CIT productivity and VAT efficiency (Table 1). The Personal Income Tax (PIT) system is less progressive than in the other Baltic countries, with relatively few employees facing the top PIT rate. Corporate Income Taxes (CIT) have higher productivity than Baltic peers, with an exemption for small entities with less than EUR 300,000 in gross annual revenues. Property taxes are low compared to EU advanced economies, which collect four times more, hinting at room for increases. There is limited scope to increase excise taxes, which are already high relative to AEs. The Value-Added Tax (VAT) system, with a notable efficiency gap compared to Estonia, highlights key areas for reform to enhance revenue.

Figure 1. Benchmarking Tax Revenues

Tax Revenue Level

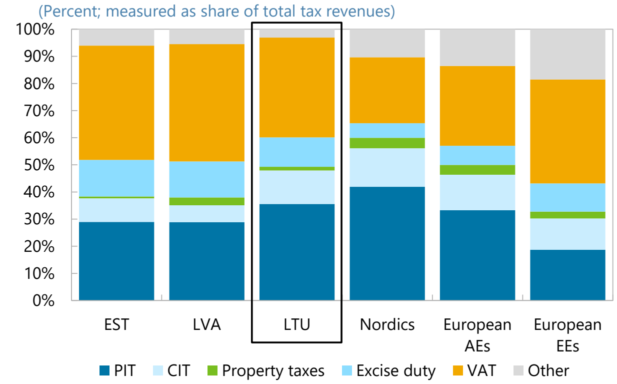
(Percent of GDP)



Source: Government Finance Statistics, IMF; and Eurostat. Notes: 2023 data.

Tax Revenue Composition

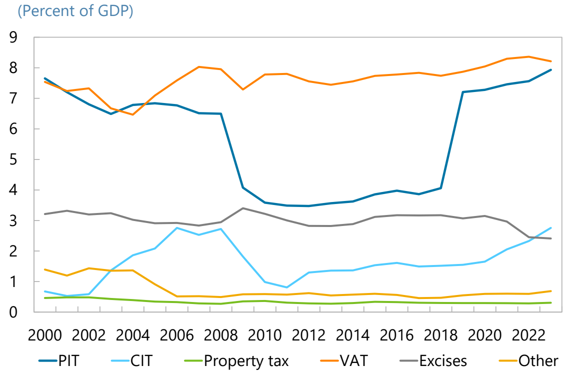
(Percent; measured as share of total tax revenues)



Source: Government Finance Statistics, IMF; and Eurostat. Notes: 2023 data.

Lithuania: Tax Revenues

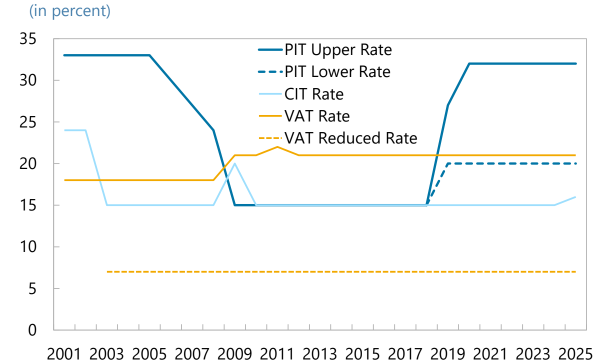
(Percent of GDP)



Sources: Government Finance Statistics, IMF.

Statutory Tax Rates

(in percent)



Sources: OECD. Notes: Reduced VAT rates are 5 and 9 and shown as the average of 9 here. Prior 2019 there was only one PIT rate with a non-taxable amount.

6. Lithuania can boost tax revenue, as current efforts are below potential (Figure 2). Tax capacity is estimated at 30.6 percent of GDP, but collection is only 22.3 percent—similar to Baltic peers yet below European levels, indicating room for growth. Stochastic frontier analysis, used to gauge maximum tax revenue based on structural traits, shows a gap between actual and potential revenue. This gap reflects long-term issues, like the informal sector's size, and short-term inefficiencies, such as tax reform challenges. Lithuania's tax potential, matching Baltic neighbors, lies between European emerging and advanced economies. The 30.6 percent potential underscores the need for structural reforms—including widening the tax base—to enhance revenue collection.

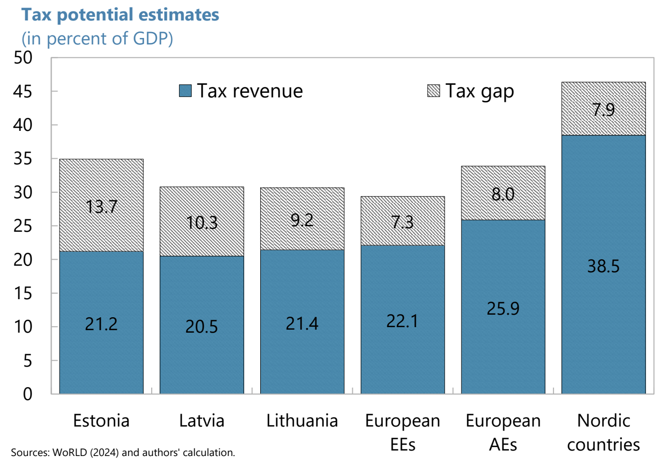
7. This note explores tax reform options for four main taxes: PIT, CIT, property, and VAT. Revenues collected from excise taxes are comparable with other European peers.

Table 2. Lithuania: Benchmarking the Tax System

		Lithuania	Estonia	Latvia	Europe EMEs	Europe AEs	Nordic countries
CIT	Revenue *(in percent of GDP)*	**2.1**	1.5	1.0	2.4	4.0	7.1
	Rate *(in percent)*	**16.0**	20.0	20.0	14.4	22.3	21.2
	Productivity *(in percent)*	**14.0**	7.7	4.9	17.4	19.0	32.9
PIT	Revenue *(in percent of GDP)*	**7.5**	6.9	5.9	3.6	8.3	15.0
	Rates *(in percent)*	**0/15/20/32**	0/20	0/25/33			
	Top rate *(in percent)*	**32.0**	20.0	31.0	17.7	36.0	26.1
VAT	Revenue *(in percent of GDP)*	**8.3**	9.2	9.3	10.1	7.7	8.8
	Rate *(in percent)*	**21.0**	20.0	21.0	20.6	20.8	24.8
	C-efficiency *(in percent)*	**52.6**	67.8	54.2	55.6	52.5	54.0
Property tax	Revenue *(in percent of GDP)*	**0.3**	0.2	0.6	0.6	1.2	1.4
Excise tax	Revenue *(in percent of GDP)*	**3.0**	3.2	2.9	3.7	2.1	2.2

Source: WoRLD (2024), Tax Policy Rates Database, and authors' calculation.
Notes: The values for Estonia and Lithuania refer to 2021 to have details on the full tax revenue composition, while the averages for Nordic countries are based on the latest available year, i.e., 2021 or 2022. Nordic countries include Denmark, Finland, Norway, and Sweden. VAT C-efficiency is defined as the ratio of actual VAT revenue to theoretical VAT revenue, i.e., the product of VAT statutory rate to final consumption.

Figure 2. Tax Potential



Sources: WoRLD (2024) and authors' calculation.
Note: Nordic countries include Denmark, Finland, Norway, and Swedden. The values for Denmark and Sweden used for computing the average values for Nordic countries refer to 2021. The latest year for the other countries refers to 2022.

B. Direct Taxes

8. **Lithuania's personal income tax (PIT) has a complex marginal rate structure with low progressivity, driven by the basic allowance phase-out and varying statutory rates** (Table 2). This leads to sharp marginal tax rate increases at low-to-average income levels, potentially discouraging work for full-time median wage earners. Top marginal tax rates affect only a small fraction of the population. Two thirds of the population's income is below 12 average wages (below EUR 20,000) taxed at a marginal tax rate of 30 percent while only 0.1 percent of the population earns income above 120 average wages subject to the highest tax rate of 32 percent (compare the income distribution in panels 1 and 2 of figure 3). Indeed, Lithuania faces some of the highest income inequality relative to comparator countries. The revised law approved in June aims to make the PIT system more progressive, with incomes below 36 average wages facing a 20 percent rate, a new 25 percent bracket introduced for incomes between 36 and 60 average wages, and a 32 percent rate for income above 60 average wages. This is reflected in the "Government Plan" simulations in Figure 3.

9. **Scenario-based analysis of Lithuania's PIT system highlights potential for increased revenue through a more progressive structure (Figure 3).** Streamlining the marginal rate schedule to prevent higher marginal tax rates for lower-income earners, and add more middle-income tax brackets, could yield up to 0.5 percent of GDP in additional funds ("Progressive 1" scenario). [2] This would require different phase-out rates than the current tax schedules, and the

[2] The graphs are based on output from the IMF's Personal Income Tax Analysis (PITA) tool. The graph on the "Decomposition of Redistributive Capacity" indicates that progressive capacity of a specified PIT system increases as the indifference curves shift toward the upper-east. Progressive capacity on the y-axis measures the Kakwani progressivity index which is the difference between the Gini coefficient of tax liabilities and pre-tax income, a

(continued)

increase in middle-income tax brackets has also been suggested by OECD (2022). An even more progressive tax schedule could raise over 1 percent of GDP ("Progressive 2" scenario).[3] Such progressive reforms would reduce the distortion of labor supply and incentives created by the current tax system for lower-income households, while easing their tax burden. This approach tackles the PIT's implicit complexity and weak effect on income inequality, balancing revenue growth with economic efficiency.

Table 3. Lithuania: Marginal Tax Rates – 2024 System and Alternatives

	Current System		Government Plan		Progressive I		Progressive 2	
	EUR	*%*	*EUR*	*%*	*EUR*	*%*	*EUR*	*%*
Bracket 1	0 – 8,964	0	0 – 8,964	0	0 – 8,964	0	0 – 8,964	0
Bracket 2	8,965 – 11,088	20	8,965 – 11,088	20	8,965 – 11,088	20	8,965- 18,000	20
Bracket 3	11,089 – 26,004	30	11,089 – 26,004	30	11,089 – 26,004	25	14,001 – 20,000	28
Bracket 4	26,005 – 34,371	23.6	26,005 – 34,371	23.6	26,005 – 34,371	28	>20,000	32
Bracket 5	34,372- 114,162	20	34,372- 68,497	20	34,372- 38,147	30		
Bracket 6	>114,162	32	68,498- 114,162	25	38,148- 114,162	31		
Bracket 7	-	-	>114,163	32	>114,162	32	-	-

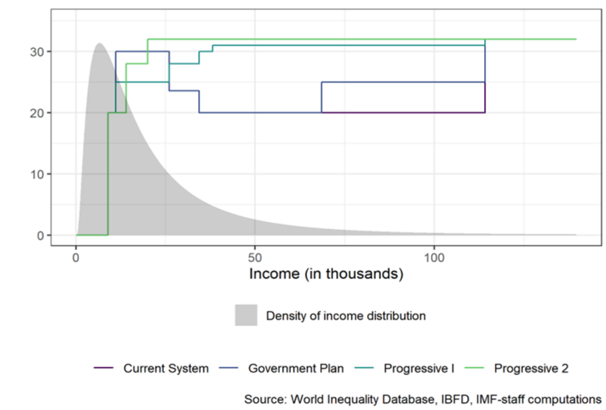
Notes: "Government Plan" is the proposal to be implemented in Jan 2026. Alternative *Progressive I* phases out the basic allowance of 8,964 with different coefficients until an income of 38,147. There is a phase out of 25% for income from 11,089 - 26,004, a phase-out of 40% for income from 26,005 - 34,371 and a phase-out of 50% for income from 34,372 – 38,147. This produces implicit rates of 25, 28 and 30 marginal tax rates. Alternative *Progressive II* removes the phase-out completely and instead sets statutory rates of 20, 28 and 32 at different income levels.

measure of distributive concentration of taxes on higher income.. World Inequality Database (WID) information is based on household surveys and only approximates actual incomes. Results thus need to be interpreted with some caution—e.g., income is frequently underreported at the top of the distribution, especially in developing countries. Moreover, the tool does not include social security contributions, which could affect the tax burden and economic decision.

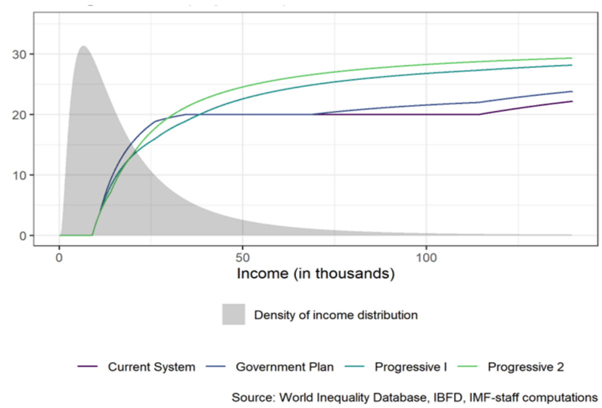
[3] Removing the phase out of the basic allowance completely—thus, smoothing out the marginal rate increases completely—would lower tax revenues by more than 1 percent of GDP.

Figure 3. Personal Income Tax System Characteristics and Scenarios

Marginal Tax Rate (in percent)

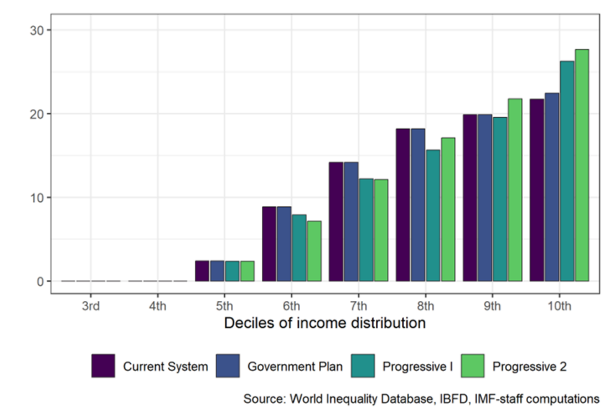


Average Tax Rate (in percent)



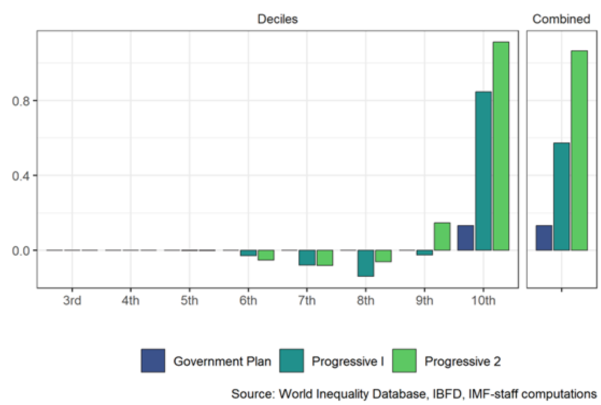
Average Tax Rate (in percent)

Across Income Distribution



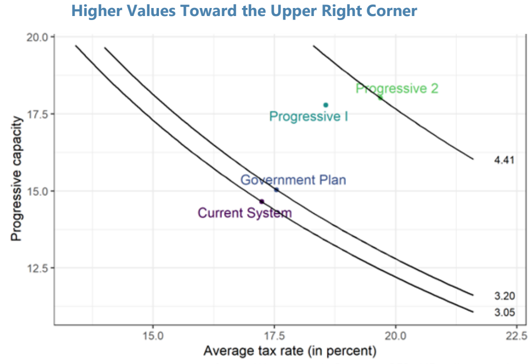
Revenue Change (in percent of GDP)

By Income Group



Decomposition of Redistributive Capacity

Higher Values Toward the Upper Right Corner



Phase-out of Basic Allowance (2024)

Basic Allowance	8,964
Phase-out Range #1	11,088 to 26,004
Phase-out Rate #1	50.00%
Phase-out Range #2	26,004 to 34,371
Phase-out Rate #2	18.00%

Source: Tax parameters have been sourced from IBFD, EY and PwC. Note: Two different phase-out rates apply over two subsequent income range

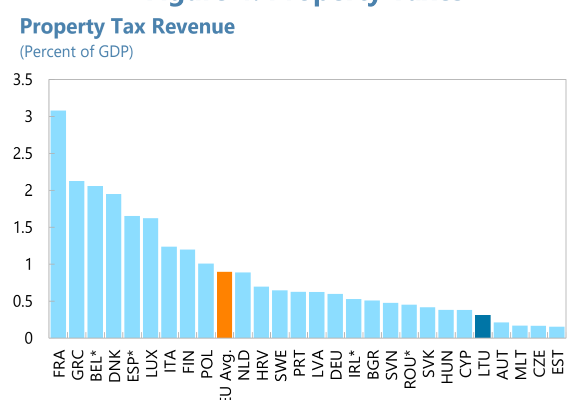
10. **Corporate taxes are subject to competitive pressures in an international context, while their productivity is low due to generous tax exemptions.** The CIT was raised from 15 to 16 percent in January 2025, along with a rise from 5 to 6 percent for the reduced rate. This is projected to generate a modest additional 0.04 percent of GDP in tax revenues, based on revenue changes

linked to previous CIT hikes, and reflecting the lower productivity of the CIT as a revenue source. A recent proposal suggests a further CIT hike of one percentage point, from 16 to 17 percent, which could potentially yield an additional EUR 111.5 million in revenue (when full impact comes into effect, also excluding other CIT related changes) though this depends on stable corporate profits and compliance levels. Lithuania currently raises more CIT revenue than its Baltic counterparts—which tax only distributed (not retained) profits at a 20 percent rate—yet its 16 percent rate is competitive in an international context and remains below the 21-22 percent averages in EU advanced economies and Nordic countries like Finland and Sweden.

11. While there is limited scope to raise substantial revenues through CIT hikes – exemptions can be addressed. Given the Baltic region's inclination to maintain competitive corporate tax rates to attract investment—there is limited scope for substantial CIT increases. Moreover, the low CIT productivity in Lithuania raises the issue about the economic and political costs of such increases. Consequently, the focus should shift towards addressing exemptions that erode revenue, particularly the EUR 300,000 turnover threshold, below which small businesses qualify for the reduced 7 percent rate, as this shift from 7 to 17 percent for growing businesses creates a steep tax cliff that discourages firm growth (see Garriga and Scot, 2023) and reduces overall CIT efficiency. This could be done potentially through a graduated rate or lowering the threshold to capture more firms under the standard rate.

12. Lithuania's property tax revenues are relatively low (Figure 4), and administrative powers are decentralized. There are currently two property taxes: the land tax ranges from 0.01 percent to 4 percent of assessed value, and the immovable property tax ranges from 0.5 percent to 3 percent for real estate over EUR 150,000, targeting thus only high-value buildings. The two legislations include various exemptions with discretionary decision making at the municipal level—municipalities administer property taxes and grant exemptions—which results in inadequate incentives, potential tax competition at the local level, and meagre revenues for local budgets that are already fairly balanced.

Figure 4. Property Taxes



Source: Government Finance Statistics, IMF.
Notes: 2023 data. *Latest available data is for 2022.

13. The tax policy change in 2026 aims would only partially broaden the tax base and leave revenues far below international benchmarks. The change would include distinct provisions for residential and commercial properties. For primary residences, municipalities would set a non-taxable threshold of EUR 450,000 and apply tax rates ranging from 0.1 percent to 1 percent, with revenue directed to municipal budgets. For other properties, a lower EUR 50,000 non-taxable threshold would apply, with progressive tax rates from 0.2 percent to 1 percent set by law, and revenue allocated to the State Defense Fund until the end of 2030. Commercial properties would face an additional 0.2 percent tax, with the revenue also allocated to the State Defense Fund. A reasonable target range for property tax revenues is between 1 and 2 percent of GDP—significantly higher than the current 0.3 percent in Lithuania. To address equality concerns, an ideal property tax should be levied according to the benefits principle as property owners benefit from public goods like infrastructure. Tax relief ideally should be individualized and based on means testing individual applications for relief. It would include access to a tax deferral regime that taxes the most vulnerable parts of the population only when assets change ownership and thus prevent permanent revenue loss.[4]

C. Indirect Taxes

14. Lithuania's VAT has a standard rate of 21 percent, with exemptions and reduced rates (Figure 4). The compliance gap[5] improved to 14.6 percent from 24.0 percent in 2018. The 2022 policy gap was EUR 3,281 million (33.2 percent of potential revenue), including a 22.7 percent non-actionable exemption gap, a 6.0 percent actionable exemption gap, and a 4.5 percent rate gap (EUR 446 million), mainly from accommodation, restaurant, and pharmaceutical sectors. A proposed law would raise the reduced rate from 9 percent to 12 percent for essentials like accommodation, transport, and cultural events, aiming to simplify the system and align it with the 21 percent rate, adding EUR 80 million in annual revenue.

15. VAT efficiency has significant scope to improve. The VAT C-efficiency in Lithuania was 52.6 percent in 2022, lower than Latvia and significantly below Estonia, but comparable to European AEs. Improving this efficiency to the level of European EMs (55.6 percent) could potentially yield an additional 0.5 percent of GDP in revenue.[6] Improving it to the average of Latvia and Estonia (61 percent) would yield an additional 1.3 percent. Several targeted strategies can be applied.

- *Strengthening digitalization* by expanding the State Tax Inspectorate's i.MAS system with real-time e-invoicing and AI analytics can reduce fraud, building on its 2016 launch and proven EU successes. The i.MAS system is a digital platform that integrates tax data, allowing authorities to monitor transactions and VAT filings more effectively.
- *Reducing carousel fraud* would help mitigate the VAT gap. Carousel fraud occurs when goods are traded across borders in a circular pattern to exploit VAT-free intra-EU transactions, leading to significant revenue losses, and can be reduced through regional cooperation and promoting digital payments to shrink the informal economy.
- *Simplifying compliance,* especially for small businesses, including by further raising the VAT registration threshold below which firms with annual sales under are exempted from VAT obligations (which is currently set at EUR 45,000) —and offering pre-filled returns, as seen in Estonia, would ease burdens on small businesses.

[4] See IMF (2024): How to Design and Implement Property Tax Reforms.

[5] This is an estimate of overall non-compliance, a proxy for VAT revenues lost due to VAT fraud, evasion and avoidance, non-fraudulent bankruptcies and financial insolvencies, or miscalculations, among other drivers.

[6] The additional revenue projections have been approximated as (8.3*55.6)/52.6-8.3.

- *Strengthening oversight of cross-border trade* with stricter controls and Baltic collaboration can curb tax evasion.
- *Targeting VAT evasion hotspots* through sector-specific audits in agriculture and fuel, alongside piloting Poland's split payment model, where buyers pay VAT directly to a tax authority account rather than the seller, preventing the seller from potentially pocketing it.

D. Conclusion

16. **This study suggests that changes to the PIT, VAT, and property taxes would have sizeable revenue impacts while also having other economic benefits** (Table 4). The note benchmarks the Lithuanian tax system against Baltic and other European peers and explores different revenue mobilization scenarios. Changes to the PIT and property tax systems could mobilize more revenue while also making the tax system more progressive – addressing the high societal inequality – and providing more fiscal autonomy to municipalities. Furthermore, improving VAT efficiency through methods including strengthening digitalization, reducing carousel fraud, and simplifying compliance would bring in greater tax revenues. Changes to these three taxes should be prioritized, while CIT reform should focus more on addressing exemptions.

Table 4. Lithuania: Staff Proposal for Tax Policy Change Options and Expected Revenue Impact

Tax	Existing	Proposal	Revenue impact
PIT	Schedule: 0/15/20/32	Increase progressivity by eliminating the current system of phase-out and lower income brackets.	0.2 – 1 percent
CIT	Rate: 16 percent	Limit large CIT rate increases beyond 18 percent, and address exemptions.	0 – 0.1 percent
Property	Revenues: 0.3 percent GDP	Broaden property tax base and limit exemptions. Use means-testing.	0.5 – 1.5 percent
VAT	Rate: 21 percent	Increase efficiency through digitalization, improving compliance, reducing carousel fraud.	0.5 – 1.3 percent

Note: Revenue impact of PIT reforms estimated using the IMF Personal Income Analysis (PITA) revenue mobilization tool, and of CIT reforms using government revenue estimates from historical CIT changes. Staff estimates and benchmarking are used to assess the revenue impact of property tax and VAT reforms.

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