



EVALUATION OF THE FISCAL INCENTIVE SCHEME FOR FILM PRODUCTION IN LITHUANIA

A study commissioned by the Lithuanian Film Centre

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EXECUTIVE SUMMARY

The European audiovisual sector, a key branch of the creative industries, has reached in 2017 an overall market value of around € 28 billion, being expected to continue growing to around €35 billion by 2022 (a 25% increase). In the world, the professional audiovisual industry generated \$178 billion in 2016. Through 2022, it is expected that the global audiovisual revenues will increase 4,7% annually. The industry will create an additional \$52 billion in value by the same year. The audiovisual sector is rapidly evolving due to the digital shift, driving increased consumption and demand of quality content.

Lithuania's film industry is evolving in a small language market (2,8 million) and a tightening labour market. The Lithuanian audiovisual industry has developed at a fast pace in the last years displaying significant growth in the production and exhibition sectors, underpinned by the 2014 introduction of the tax incentive mechanism.

The tax scheme had the following main objectives:

- attract foreign investment in film production
- support the development of a strong local audiovisual industry

The research shows a significant increase in the production activity reflected in the annual turnover of the Lithuanian production companies which has been trending upwards since 2013, evolving from €10,3 million to € 14 million in 2016 (an increase of 36%). Since the implementation of the tax scheme, Lithuania's film industry has shown ability to increase its market share and meet consumers' demand for local stories (21,47% in national market share in 2017). As a result, the national gross box office augmented between 2013 and 2017 from € 10,8 million to € 20,2 million (registering an increase of 87%), with the admissions per capita increasing during the same period from 1,05 to 1,43.

The tax scheme has helped channelling an additional € 24,4 million of foreign investment in Lithuania and helped generating an estimated € 43,5 million in expenditure in Lithuania between 2014-2017. The foreign investment peaked with large productions like War and Peace (2015) or Tokyo Trial (2016) which brought in the investment of producers from countries such as the USA, the UK, Canada or Russia.

The tax scheme alone (via productions that were not supported by state aid, but only by the tax incentive) generated an estimated of 10.583 employment positions (freelance based) in the film production sector and approximately € 6,6 million of personal net income in the 2014-2017 period. The incentive mechanism equally brought significant income for the state, estimated at € 6,8 million of tax revenue (in labour taxes, social security contributions and VAT).

However, given that the tax scheme had a larger application during the analysed period, contributing to productions which were also supported by state funding, the overall economic contribution of the incentive mechanism is reflected in higher numbers. As such, the total number of productions which benefited from the tax scheme created approximately 12.170 freelance positions in the film production sector which generated an estimated € 8,2 million of personal net income in the analysed period. The corresponding production activity brought an estimated of € 10,8 million of tax revenue (in labour taxes, social security

contributions and VAT) from the production sector alone and generated economic activity in other sectors such as hotel and catering, transportation and insurance, for a total spend estimated at € 6,3 million.

The significant development of the local moving image industry enables the country to attract foreign and local investment and for Lithuania 's economy to benefit from the growth of the audiovisual sector worldwide.

The research shows that the local tax scheme is competitive with neighbouring countries but that it requires adaptation to avoid Lithuania being side-lined. It also considers policy measures that should complement the availability of the tax incentive to build on the existing and reinforce the structure of the industry, as well as its talent base.

The report advances three policy objectives to strengthen Lithuania's regional and international competitiveness:

1. The promotion of the Lithuanian culture locally and internationally
2. Strengthen the contribution of the film industry to economic growth and employment
3. Help Lithuania to become an international hub for film production

With a view to achieve the above policy objectives we propose the authorities to:

- Review the functioning of the tax scheme to increase its attractiveness
- Increase the visibility of the scheme to promote its usage both locally and internationally.
- Better articulate the tax scheme with complementary policy measures enabling the development of the local film industry across its value chain.

Each of these propositions is accompanied by a set of policy recommendations:

SPECIFIC OBJECTIVE	RECOMMENDATIONS
<p>Review the functioning of the tax scheme to increase its attractiveness</p>	<ul style="list-style-type: none"> • Address investors' lack of trust in the scheme by switching the delivery of the certificate from the Lithuanian Film Centre (LFC) to Lithuanian Tax Authorities. • Deliver the investment certificate when the contract between the investor and the producer is signed rather than when the funding is delivered. • Increase the intensity of the benefit for producers from 20% to 30%.

<p>Increase the visibility of the scheme to promote its usage both locally and internationally</p>	<ul style="list-style-type: none"> ● Help the emergence of specialised financial intermediaries whose role would be to promote the scheme to potential investors in the business community. ● Organise awareness campaigns for international producers to present the benefits of the scheme at major international film festivals. ● Organise regular events for the business community to meet film producers and tax inspectors to create awareness and trust in the tax benefit. ● Organise marketing campaigns targeting large media companies such as Netflix or Hollywood majors to attract shooting in Lithuania
<p>Better articulate the tax scheme with complementary policy measures enabling the development of the local film industry across its value chain</p>	<ul style="list-style-type: none"> ● Address the risk of labour shortage and skill gaps by developing and implementing training programmes on technical and digital skills. ● Enlarge the scope of the tax scheme to cover video games and other digital AV productions (like AR/VR) to boost excellence in digital creation and skills. ● Implement the amended AVMS Directive in such a way that it encourages distributors and broadcasters to invest in production as well as distribution and make use of the scheme by setting mandatory goals. ● Further improve the ecosystem for the local film industry by lowering the VAT rate in relation to cinema admission in theatres as well as discouraging online piracy. ● Support development of a strong talent base (filmmakers, screenwriters) to foster local creative capacities. ● Improve the availability of data to measure the impact of the scheme and monitor the effect of policy measures across the entire value chain

1. INTRODUCTION

1.1. The assignment

The Lithuanian Film Centre commissioned KEA to carry out a comprehensive study to evaluate the fiscal incentive scheme (hereafter, 'the scheme') for film production in Lithuania. In accordance with the terms of reference, the study aims to provide:

- A comprehensive impact assessment of the Lithuanian tax incentive mechanism on the national economy and audiovisual industry in the period from 2014 to 2017;
- A comparative analysis of the competitiveness of the Lithuanian tax scheme with incentive mechanisms for film production in neighbouring countries;
- Strategic recommendations to improve the efficiency and competitiveness of the Lithuanian tax scheme across the entire audiovisual value chain.

The study aims to demonstrate the economic and social contribution of the Lithuanian film sector and provide policymakers with guidance to make Lithuania a regional centre of excellence in the production of audiovisual content and for the country to benefit from the growth of the digital and creative economy.

1.2. Methodology

In order to carry out this four-months assignment, KEA undertook the following activities:

- an **in-depth desk research** in which the following types of sources were consulted:
 - Academic literature and economic studies on the purpose, functioning and impact of different national incentive mechanisms for audiovisual production in Europe
 - Legal and financial documents on the implementation and functioning of the Lithuanian tax scheme
 - EU audiovisual policy documents
- one **extensive survey** targeting 28 Lithuanian film production companies that benefited from the tax incentive (the questionnaire can be consulted in Annex 1)
- a series of 27 **in-depth interviews** conducted in Lithuania from 7 to 15 March 2018 with film producers, investors, tax experts, film distributors, exhibitors, service providers, representatives of the Lithuanian Ministry of Finance, of Vilnius Film Office as well as the Lithuanian Film Centre (the list of interviewed stakeholders can be consulted in Annex 2).

1.2.1. Framework for the economic impact analysis

Direct impact

In order to assess the impact of the Lithuanian tax incentive, KEA used an input-output economic modelling system which analyses the direct impact of the scheme on the Lithuanian film production. The

direct impact refers to the economic activity and employment generated in the production sector by the film productions which benefitted from the tax scheme. Additionally, KEA analysed the state's expenditure in the scheme and the state's revenues in taxes generated from the production activity (income taxes, social security contributions, VAT). The input-output model for the direct impact is summarised in the table 1 below.

Table 1 – Summary of the input-out economic model

	Input	Output
Film production sector	Budgets of the productions that benefitted from the scheme invested on Lithuanian territory	Increase in: <ul style="list-style-type: none"> • Employment positions • Personal incomes
State's loss/revenues	State's tax expenditure	State's revenues in: <ul style="list-style-type: none"> • Income taxes • Social security contributions • VAT

Induced impact

The employment generated at production level raises the employees' income as the latter earn salaries. This income generates further spending within the Lithuanian economy, which further increases economic activity at the broader national level. The further spending can be estimated by applying an income multiplier to the employees' net income. The income multiplier depends on the marginal propensity to consume which represents the change in consumption associated with the raise in income at a given moment at national level. All the calculations are described in section 4.4 below.

As part of the analytical framework, it is important to show the spillover benefits generated by cinema investment on other sectors such as tourism or in relation to the image of the country abroad reinforcing territorial attractiveness. The present document highlights the potential of such spillover effects based on specific case studies and by showing similar effects in other countries.

1.2.2. Limits of the impact assessment

The activity in the production sector also influences activity on the film's entire value chain, by increasing the distribution of films which generates additional revenues. Moreover, the growth in economic activities in the production sector impacts on the film's supply chain, as a production generally requires additional services in sectors like: hotels and catering, transportation, legal, audit and accountancy, rentals etc. The activity on the supply chain is also reflected in an increase of employment positions and incomes in these additional sectors.

KEA could only estimate the overall expenditures generated in the different sectors on the supply chain by the productions that benefitted from the tax scheme. Moreover, the interviews helped in providing a

more qualitative overview on how the value chain is changing (and could further change) in the light of the implementation of the tax scheme.

As such, the economic impact assessment is limited to the film production sector only, as quantitative data concerning this sector was available partly from the Lithuanian Film Centre, partly from the accounting registers from the production companies which were surveyed. Additional methodological considerations are available in annex 4.

1.3. Short description of the Lithuanian tax incentive mechanism

The tax incentive for film production came into effect in January 2014 for a five-year period. It was approved by the European Commission in 2012, as part of State Aid review.¹ The scheme was designed as a policy measure to boost local and foreign film production in Lithuania and to attract inward investment through a private investment scheme.

The scheme is limited to support the production of feature films, TV dramas, documentaries and animations. It does not extend to other audiovisual productions, such as video games. The support is provided as a donation (which does not exceed 20% of the production budget) by an undertaking and is backed by a tax relief on profits. Thus, the beneficiaries are:

- **Private donors (investors)** (i.e. entities with a Lithuanian corporate tax liability, including foreign entities acting through a permanent office in Lithuania)
- **The film producers** get a financial aid for filmmaking in Lithuania if their production meets the eligibility criteria

The mechanism is deployed in two steps:

- 75% of the donation to the film production can be deducted from the taxable profits to be paid by the investor
- The corporate tax to be paid by the investor can be decreased by the amount of the donated funds

In order for a production to be eligible, at least 80% of all expenses have to be incurred in the Republic of Lithuania and the expenses in Lithuania are at least € 43.000.

In order to be eligible, the film has to meet at least two of the following criteria for cultural content:

- 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, mythological or society personality;
- the film script or the main topic is based on a prominent Lithuanian or European literary creation;

¹ European Commission, SA.35227 (2012/N) – Lithuanian film tax incentive, Brussels, 18.12.2012

- 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 the issue of national and European identity.

The intensity of the benefit for the investor is up to 11,25% according to the Lithuanian Film Centre.² The tax benefit can be exercised by the investor upon receiving the investment certificate for the return period in which the investor receives the certificate. The donation from the private investor can be combined with other state aid, but the cumulated aid amounts are limited to 50% of the production budget of the film, with a couple of exceptions: low budget and difficult films may receive cumulated aid up to 90% of the production budget starting from 2018 (in the 2014-2017 period the maximum intensity for these films was 75%) and co-productions up to 60%.

² <http://www.lkc.lt/en/tax-incentives/film-tax-incentive/>

2. THE LITHUANIAN FILM AND AUDIOVISUAL INDUSTRY

Lithuania's population numbered 2,8 million inhabitants in 2017³. It has been declining since the early 1990s at an average pace of 1,3% annually. The rate of decline is projected to accelerate in the years to come, due to high emigration and negative natural growth⁴. However, Lithuania's economy has continued to grow in the years following the 2009 economic crisis due to strong employment growth and a declining working age population.⁵ Wages continued to grow in the last two years and are projected to continue to do so. However, they remain lower (the average wage reached € 850 in 2017) compared to the average wages in the EU (around €1500 in 2017).⁶ In view of the unfavourable demographics, growth in productivity and capital investment are essential drivers of economic growth in Lithuania.

Lithuania's audiovisual industry which is evolving in a small language market has developed at a fast pace in the last few years. The professionalism and dedication of film professionals, artistic and technical skills combined with a rich cultural experience and a friendly regulatory and tax framework have led to the emergence of one of the most successful film industry in Europe with one of the highest national cinematography market shares (close to 22%). The achievement is considerable in the globalised film market dominated by Hollywood majors and new digital service providers such as Netflix.

The cinema sector is in a stronger position than before the implementation of the tax incentive scheme:

- The Lithuanian Gross Box Office tripled in size between 2005 (€ 3,768 million) and 2007 (€ 10,320 million)⁷. With the introduction of the tax incentive mechanism, the Gross Box Office doubled between 2013 (€ 10,8 million) and 2017 (€ 20,2 million) and the admissions per capita increased between the same period from 1,05 to 1,43.⁸
- In the Top Ten Films in the Lithuanian Box Office in 2016 and 2017, five were national productions supported by the tax incentive scheme.⁹
- The market share of national films reached close to 22% in 2017 (national market share only surpassed in Europe by France and UK (both with 37,4%), Finland (27%), Germany (23,9%), Poland (23,4%) and Czech Republic (22,3%)¹⁰).

With a view to understand the impact of the tax scheme and comment on its future development, it is important to understand the state of the film market in the country.

³ Baltic Countries, Facts & Figures, 2018

⁴ European Commission, Country Report Lithuania 2017

⁵ idem

⁶ OECD data <https://data.oecd.org/earnwage/average-wages.htm>

⁷ KEA, *Study on the impact of European Support Programmes on the State of Lithuanian Audiovisual Industries*, 2009

⁸ Baltic Films Facts & Figures 2013-2018

⁹ idem

¹⁰ European Audiovisual Observatory Yearbook 2017

2.1. Size and structure of the film market in Lithuania

2.1.1. Production capacity

The Lithuanian production sector is highly fragmented, being composed of a rather large number (approx. 59) ¹¹ of small and very small production companies and audiovisual service providers. Companies employ in general not more than 3 permanent employees, the largest reaching at 10-12 employees.¹² However the film industry is very labour intensive with productions creating between 80 to 120 jobs per feature film on average. The majority of companies are developing 1 to 3 projects a year. The industry is not vertically integrated and production companies remain distant from the distribution business in which most profitable margin lie. The main source of funding for production companies are producers' own income and state funding.

The relatively modest production capacity reflects in the average budget of a feature local film which traditionally varies between € 400,000 and € 1 million. Films are usually made for the limited local audience. According to producers, the economy of the film business requires that in order to make a profit on a €250 000 budget film, theatrical audience will need to reach 30 000 admissions. ¹³

International productions are serviced via co-production or by providing technical services without upfront investment in production. The production capacity has increased in the last four years largely due to the additional investment made available by the tax incentive mechanism. The table and graph below show the estimated number of film productions per year between 2014 and 2017, taking into account the number of domestic films (produced with and without the support from the tax mechanism, including co-productions)¹⁴ and the number of foreign productions (data is available only for those supported by the tax scheme)¹⁵.

Year	Domestic productions (including co-productions)	Foreign productions (that benefitted from the tax scheme)	TOTAL
2014	40	1	41
2015	35	7	42
2016	58	10	68
2017	41	7	48

NB: the numbers provided by the Baltic Fact and Figures per year refer to the domestic productions and co-productions that were finished and registered the same year. The Fact & Figures do not include foreign films produced in Lithuania if those films are not released in Lithuanian cinema. As such, the data available for the foreign productions is taken from the Investment Certificates issued by the Lithuanian Film Centre and thus refer exclusively to productions supported by the tax scheme. It is important to note that not all the foreign productions listed in one year are necessarily finished and registered the same year. Some foreign productions were filmed in parts during several years and they received certificates for each year of filming. They are counted for each year they received a certificate, as seen in the table above.

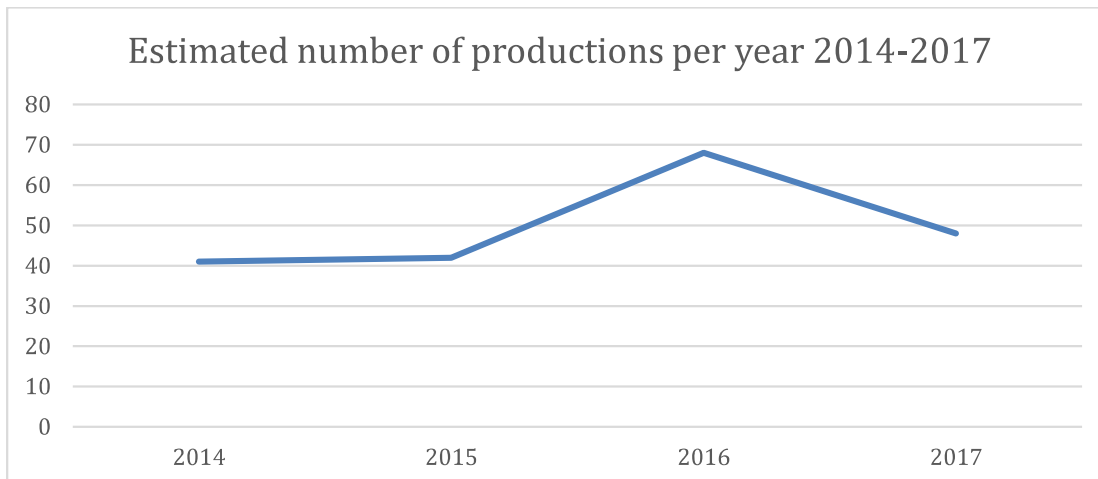
¹¹ www.lkc.lt

¹² Data from the survey targeting the Lithuanian production companies who benefitted from the tax scheme

¹³ interviews

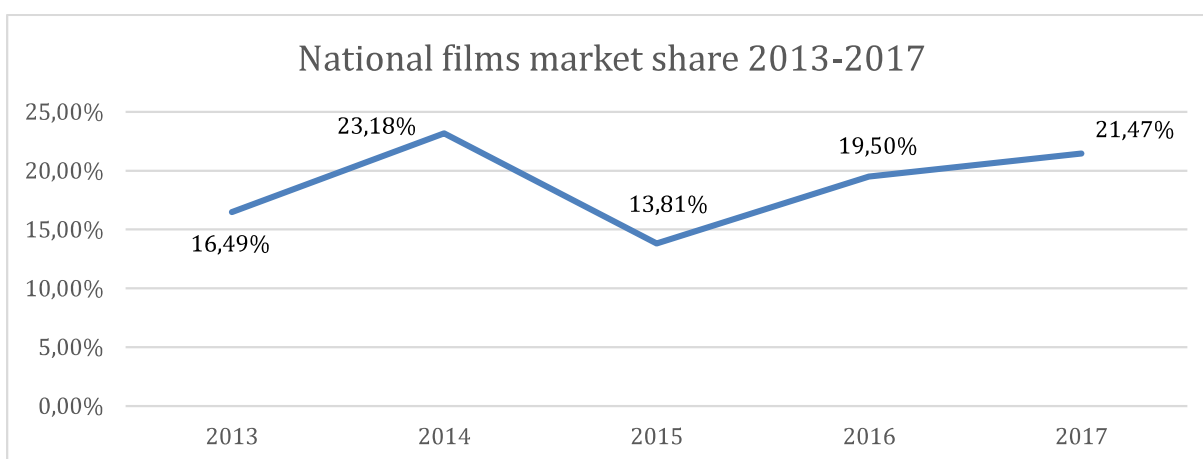
¹⁴ Data from Baltic Films Facts & Figures 2018

¹⁵ Data from the Lithuanian Film Centre



Ever since its late beginnings in the mid-20th century, the Lithuanian film sector has had a rather cultural approach reflected in the development of documentary cinema as a branch of visual art (experimenting with documenting stories, historic events or figures in a poetic way). The poetic documentary tradition emerged in Lithuania in the '60s and continued until today with the work of internationally renowned filmmakers.¹⁶

Lithuania has been producing an increasing number of commercial national films in the last five years, which have recorded increased success in the Lithuanian Box Office. The popularity of national films in Lithuania has peaked in 2014 with 23,18% national market share and in 2017 with 21,47%.



Moreover, the popularity of Lithuanian national films, as well as co-productions, has reached an international dimension in the last years, with several feature films like *Šerkšnas (2017)* or *Stebuklas (2017)* and documentaries like *Nuostabieji lūzeriai. Kita planeta (2017)*, to name a few, selected at major festival such as Cannes, Toronto, Locarno or Karlovy Vari.¹⁷ Lithuanian films' recent international success has been ensured by names like Šarūnas Bartas, Arūnas Matelis, Audrius Stonys, Gytis Lukšas and Kristijonas Vildžiūnas. Moreover, new names are starting to appear alongside these recognised directors,

¹⁶ http://www.lkc.lt/wp-content/uploads/2014/03/Lithuanian-Cultural-Guide_Film.pdf

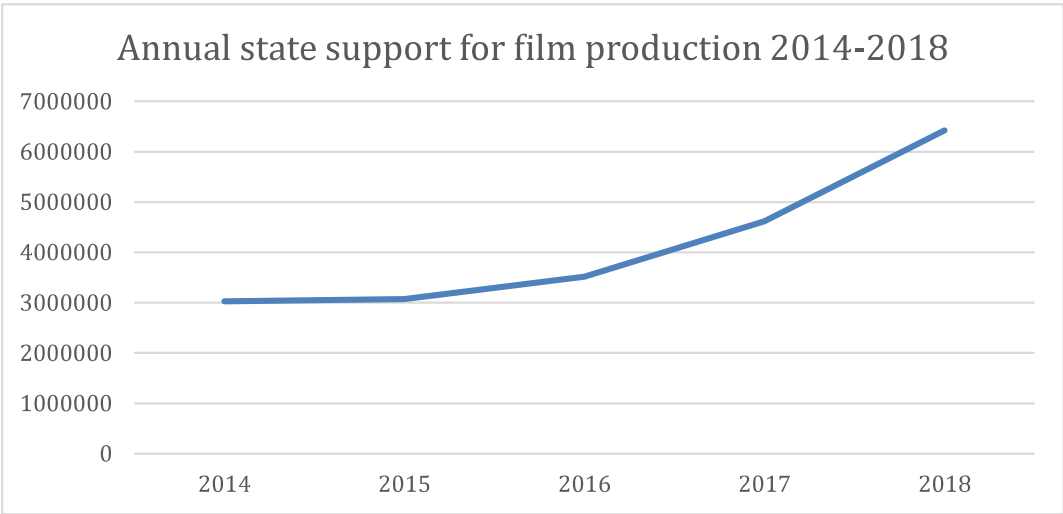
¹⁷ <http://www.filmneweurope.com/countries/lithuania-profile>

such as Kristina Buožytė and Mantas Kvedaravičius, who have had successful premières at the Berlin and the Karlovy Vary international film festivals.¹⁸

2.1.2. Annual state support for film production

The Lithuanian film sector is largely dependent on state support which has been administered by the Lithuanian Film Centre from 2012 and has been growing steadily, as indicated in the graph below. Contrary to more powerful cinematography, the local film production sector lacks investment from players within the value chain (i.e. local TV broadcasting groups and film distributors). These factors, together with the size of the market, explain the relative small size of the sector, the low average budget of a local feature film and the incapacity of production companies to invest in slate of films and catalogues to build valuable intellectual property assets necessary to weather investment risks and establish a stronger industrial infrastructure.

The state budget, mainly intended to support art house movies, did not suffer from the introduction of the tax scheme, on the contrary, as showed in the graph below. Both funding mechanisms are complimentary and seem to address different policy objectives, namely to ensure the production of artistic cinema and to contribute to the emergence of a competitive industry capable of competing for audience with international productions.



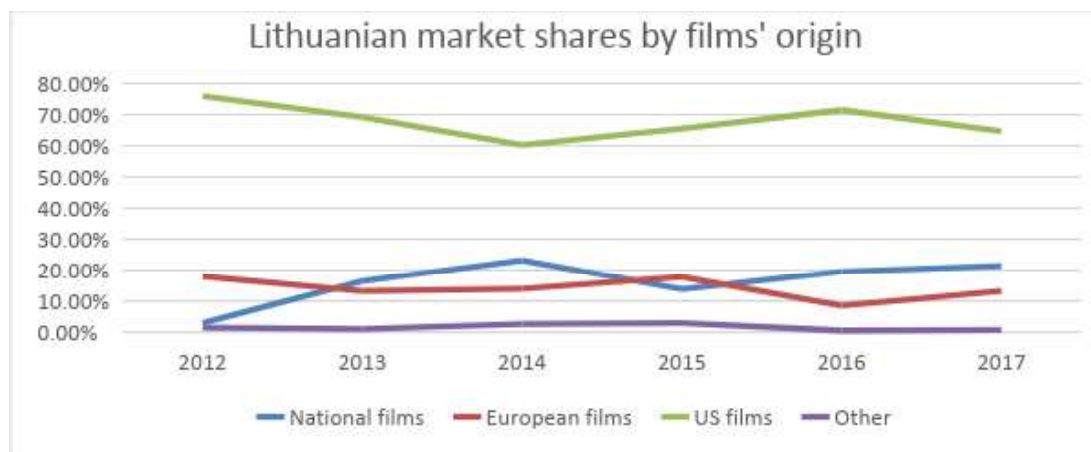
The Lithuanian audiovisual sector also relies on pan-European support initiatives, such as the MEDIA sub-programme of Creative Europe and the Eurimages Fund. Between 2007 and 2015, the Lithuanian audiovisual sector received an overall financial support of € 4 million via the MEDIA programme.¹⁹ Since Lithuania became a member of Eurimages in 2007, 18 co-productions with Lithuanian participation have

¹⁸ http://www.lkc.lt/wp-content/uploads/2014/03/Lithuanian-Cultural-Guide_Film.pdf

¹⁹ Creative Europe MEDIA, Factsheet Lithuania, 2015. Between 2003 and 2015, several programmes and player have been co-financed by MEDIA, such as: The Vilnius International Film Festival (€ 321.000) or ACME Film for the distribution of EU films. Since 2003, 35 Lithuanian films have received support through MEDIA development schemes, as well as from the TV programming scheme.

been supported. The total support that these co-productions received through Eurimages (in the period 2007-2017) amounts to € 2,7 million.²⁰

Like in other European countries, the Lithuanian film market is dominated by Hollywood productions. However, the market share of US films decreased in the last two years, as showed in the graph below.



2.2. Distribution and exhibition capacities

The impact of a tax incentive mechanism for film production goes beyond the production sector, by influencing the activity on the entire film value chain. In the global audiovisual economics, stakeholders involved in distribution and broadcasting are traditional investors in film production. However, this has rarely been the case in Lithuania. Nevertheless, the success of the new Lithuanian tax incentive mechanism might encourage distributors to invest in film production. This is why it is important to consider the distribution sector's capacity in Lithuania for a discussion on its potential involvement in production.

The film distribution sector is highly concentrated with two major players, ACME Film, and Garsų Pasaulio Irašai. ACME Film is the largest distributor in the Baltic states, active in theatrical, TV, DVD and VoD distribution. In 2017 ACME Film had revenues of € 7 million and registered 1,5 million admissions from a total of 72 titles.²¹

The exhibition sector is dominated by the pan-Scandinavian Forum Cinemas, the owner of the largest chain of movie theatres in the country (with a market share of 76% in 2017)²².

Lithuania has a total of 79 cinema screens²³ - a small number, compared to similar size markets. Data indicates a concentration of screens in larger urban areas reflected in the increased number of multiplex cinemas (10 in 2018) in cities such as Vilnius, Kaunas or Klaipėda.²⁴

²⁰ <http://www.lkc.lt/en/2016/03/two-lithuanian-co-productions-receive-eurimages-funding-2/>
<http://www.lkc.lt/en/2015/12/lithuanian-co-production-receive-eurimages-funding/> <http://www.filmneweurope.com/press-releases/item/115376-support-decisions-at-the-148th-eurimages-board-of-management-meeting>

²¹ <http://www.filmneweurope.com/countries/lithuania-profile>

²² idem

²³ Baltic Film Facts & Figures 2018

²⁴ Forum Cinemas owns six multiplexes with 40 screens. Multikino in Vilnius has seven screens with 1673 seats. Baltic Multiplex Ventures which is the owner of the Cinamon multiplex in Kaunas has five screening rooms with over 1000 seats.

Smaller towns and rural areas have an underdeveloped cinema market which makes it difficult for people in these areas to access films. In 2013, 27% of Lithuanians did not have access to cinemas.²⁵

Lithuania has witnessed a successful digital conversion in the cinema sector in the last 6 years: the number of digital screens has increased from 21 in 2012 to 54 in 2017. 3D screens were non-existent until 2016, when 25 were created.²⁶

TV and broadband access

The main channel of distribution of films is television. The television sector is a modest investor in local audiovisual production whilst it contributes to dissemination of local stories and the popularity of talents (actors, cinematographers).

In 2017, the Lithuanian television market was served by a total of 49 operators. Although cable TV remains the leading delivery technology for TV services, its share at the end of 2017 was at 53%, slightly down from 53,7%. On the other hand, IPTV grew from 28% to 31,2% in 2017.²⁷ In 2017, there were 80,5% TV subscribers in Lithuania.

Broadband coverage in Lithuania reached 99% in 2016. Broadband coverage in rural areas remains slightly above the EU average (96% compared to 93%).²⁸ Broadband penetration has increased since 2010 (62,1%), reaching 77,2% at the end of 2016 (a total of 2,1 million Internet users).²⁹ In the broadband market, both subscriber numbers and revenues continue to grow. Revenues in the first three quarters of 2016 increased by 4,4% compared with the same period of 2015.³⁰

These conditions have enabled the Video on Demand service market to grow quite fast in Lithuania. The number of national VoD service increased from 5 at the end of 2014 to 10 in 2017³¹. Lithuanian VoD services are not yet very popular. In 2016, only 11% of internet users consumed Video on Demand services, compared to the 21% average of EU internet users.³² Such VoD services are proposed by larger TV operators (one is owned by the public broadcaster LRT). Currently there are 67 foreign VoD services targeting Lithuania, including large international players such as Netflix, but also Amazon, Google and iTunes. The catalogues of these foreign digital giants offer no domestic audiovisual productions (a report from the European Audiovisual Observatory showed that in 2015 iTunes in Lithuania displayed only 11% of EU works and 0% national³³). Considering the importance taken by digital distribution and its capacity to affect theatrical revenues in the future (today the main source of income of production companies), the regulatory and tax framework needs to consider the contributions of new actors on the value chain to ensure a consistent flow of national production.

²⁵ Attentional et.al., *European Film Study: A Current and Future Profile of European Film Consumers*, 2014

²⁶ Baltic Films Facts & Figures 2012-2018

²⁷ <https://www.broadbandtvnews.com/2018/04/04/lithuanian-pay-tv-the-stats/>

²⁸ European Commission, EU Digital Progress Report 2017

²⁹ <http://www.internetlivestats.com/internet-users/lithuania/>

³⁰ European Commission, EU Digital Progress Report 2017

³¹ European Audiovisual Observatory, MAVISE database

³² Europe's Digital Progress Report (EDPR), Lithuanian Country Profile, 2017

³³ European Audiovisual Observatory, Origin of Films in VOD Catalogues in the EU, 2015

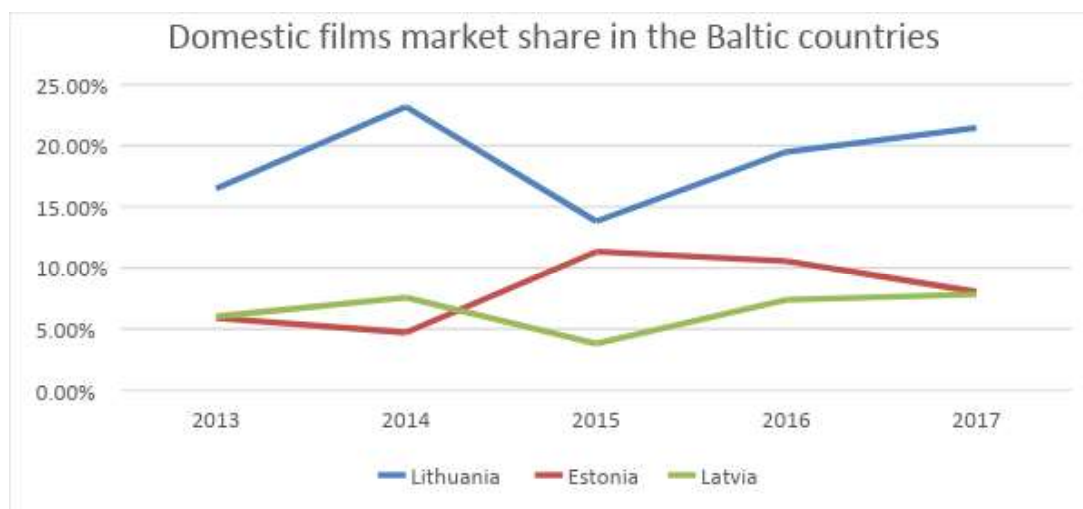
2.3. Lithuania in the Baltics

The Baltic countries – Estonia, Latvia and Lithuania – share common economic and social traits. Estonia stands out as the more advanced of the three, with the smallest population (1,3 million) and the highest GDP per capita of 16.033 in 2017, compared with Latvia (12.722) and with Lithuania (15.231, being also the largest with a population of 2,8 million).³⁴

The Baltics have many traits of an integrated economy. Workers mobility is high, with common outflows, but also cross-border flows in the area.³⁵ At the same time, the Lithuanian workforce is the cheapest, displaying an average monthly income of € 850 in 2017, compared to Estonia (€ 1146) and Latvia (€ 859).³⁶ The correlations of annual GDP growth, private consumption, investment and labour market are significantly higher between the Baltic countries than with any other EU member state or with Russia.³⁷

As an overall integrated economy, the Baltics display similar features in what concerns the audiovisual sector. As such, the Baltic film industry has been growing in the last decade into a dynamic, creative and ambitious market and kept widening its international reach. However, different audiovisual policy measures in the three Baltic countries and different audience dynamics account for slightly different film industries.

As mentioned before, the popularity of national films in Lithuania has rapidly grown, reaching a market share of 21,47% in 2017, as opposed to domestic films in Estonia (8,04%) and in Latvia (7,84%). This is a very important achievement, given the annual state support in Lithuania is the lowest and the number of domestic production in all three countries is very similar.



In the past 5 years, Lithuania has had the lowest state support in the Baltic countries, but the allocated support has been growing steadily³⁸. Latvia and Estonia have had a much larger state support, as shown in the graph below. Incentives for film production complement state support in all three Baltic states, in

³⁴ Baltic Film Facts & Figures 2018

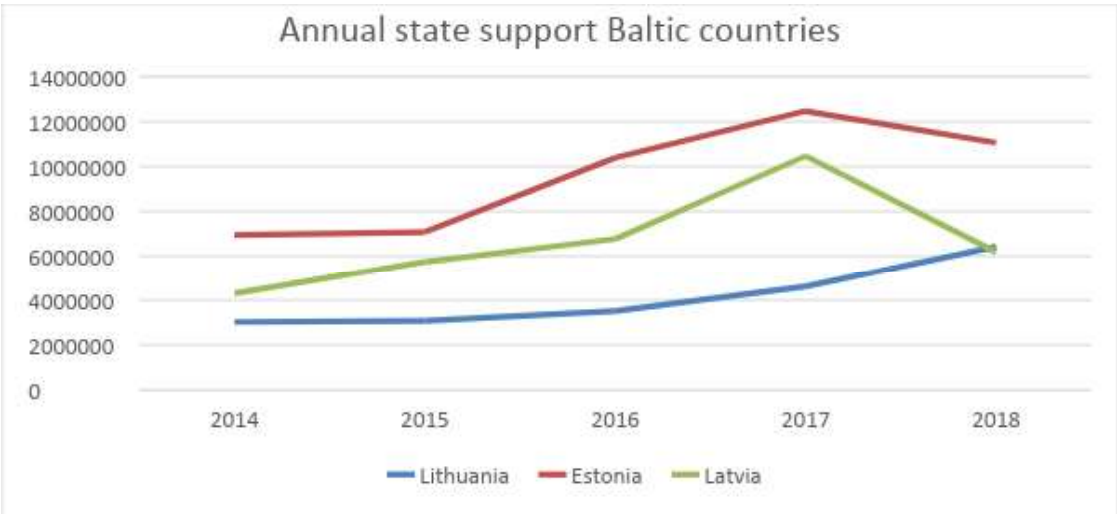
³⁵ European Commission, *Three Baltics: Three Countries, One Economy?*, Economic Brief, April 2017

³⁶ Baltic Films Facts & Figures 2017

³⁷ European Commission, *Three Baltics: Three Countries, One Economy?*, Economic Brief, April 2017

³⁸ Baltic Films Facts & Figures 2014-2018

order to attract foreign investment in the countries and to facilitate film co-productions. These incentives take the form of direct cash rebates for producers or tax rebates for investors in productions (see details in section 5 for the other Baltic incentives).



In relation to production capacities, Lithuania is on a par with Latvia, with 59 production companies³⁹, compared to Estonia (only 36 production companies).⁴⁰ Estonian and Latvian markets are also characterised by fragmentation, and the centralisation of activity in the capitals Tallinn and Riga.

However, Estonia distinguish itself from its neighbours with a strong animation industry which displays highly skilled professionals and world-renowned development and production studios, such as A Film Estonia, Joonisfilm or Nukufilm. Estonia is marching on as one of Europe’s leading creative forces in the industry.⁴¹

Regarding the exhibition sector, there has been a general increase in screening capacity in all three Baltic states. However, even if twice as small in size of population, Estonia has an overall greater screening capacity than Lithuania, which has the lowest value of screens per capita in the Baltics, as seen in table 4. Both Estonia and Latvia have a better digital conversion than Lithuania (74 digital screen and 39 3D screens in Estonia; 60 digital screens and 25 3D in Latvia).⁴²

Nevertheless, the success of national films recorded in recent years and the overall increase in cinema going in Lithuania provide scope for growth in the screening capacity of the country, notably in underserved rural areas.

Table 4 – screening capacity in the Baltics

Country	Population (mil.)	Screens	Digital screens	Screens per capita
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³⁹ <http://www.lkc.lt/en/industry/production> and <http://filmriga.lv/en/guide/producers>

⁴⁰ <http://filmestonia.eu/>

⁴¹ <https://www.screendaily.com/news/tallinn-animation-in-focus/5097169.article>

⁴² Baltic Films Facts & Figures 2018

Lithuania	2,8	79	54 (plus 25 3D screens)	0,000028
Estonia	1,3	97	74 (plus 39 3D screens)	0,000074
Latvia	1,9	61	60 (plus 25 3D screens)	0,000032

2.4. Conclusions

Like most European countries the Lithuanian film industry is rather small and fragmented, relying on state support. It is highly skilled and low-cost, displaying the capacity to attract large international co-productions and projects. In a globalised and very competitive market, the industry has shown incredible resilience achieving a significant market share for national films and a good presence in international festivals.

However, the local distribution sector, including television and digital networks, is playing a negligible part in production risks. The exhibition sector remains underdeveloped. This needs to be addressed to comfort the industry's strategic positioning.

Considering its competitive position in the Baltics, its close relationship with large neighbours such as Russia and Poland but also its proximity with the Nordic countries, Lithuania, by playing its cards well, is in a position to develop as a strong regional hub for audiovisual production, one of the fastest growing economic sectors in the world.

3. GLOBAL TRENDS AND OPPORTUNITIES IN THE AUDIOVISUAL INDUSTRY

Investing in the culture and creative industries (CCIs) drives economic growth. In 2015, the CCIs contributed with € 509 billion in value added to Europe's GDP and accounted for more than 12 million full-time jobs representing 7,5% of Europe's workforce.⁴³ In the UK, for example, the creative industries generated £91.8 billion in gross value added in 2016, which represented year-on-year growth of 7,6%, compared with 3,5% for the UK economy as a whole.⁴⁴

The audiovisual sector is a key branch of the creative industries and enjoys a high degree of policy consideration due to its cultural and economic importance. In 2017, it reached an overall market value of around € 28 billion in Europe, being expected to continue growing to around €35 billion by 2022 (which represents a 25% increase).⁴⁵ In the world, the professional audiovisual industry generated \$178 billion in 2016. Through 2022, it is expected that the global audiovisual revenues will increase 4,7% annually. The industry will create an additional \$52 billion in value by the same year.⁴⁶

Given the above considerations, Lithuania is right to focus on the development of its audiovisual industry. However, the country has to overcome certain challenges in order to develop its competitiveness and attractiveness in the context of major transformations due to the digital shift.

Theatrical revenues continue to expand. The 2016 European box office totalled € 8,4 billion, while the year 2017 saw the highest admission levels of the past decades in Europe, with an estimated record admission of over 1,29 billion sold tickets.⁴⁷ Moreover, the 2017 worldwide box office has hit a record \$40,6 billion, which is up 5% from 2016 and makes 2017 the highest-grossing year in the last decade in global box office history.⁴⁸

However, during the last two decades, the production, distribution and consumption of content has shifted from push to pull, from consumption on a single device to multi-screen / multi-devices.⁴⁹ Newcomers such as OTT services⁵⁰ have been driving these changes, creating new kinds of demand from customers and leading to the emergence of new consumer-driven channels. These changes have brought significant benefits to consumers. There is an increased diversity and highly qualitative content, which can be easily accessed with low costs, thus leading to an increase in consumption (viewing time is expected to reach 60 billion hours in the 5 main EU markets – UK, France, Germany, Italy and Spain - in 2019⁵¹).

⁴³ European Parliament, *Report on a coherent EU policy for CCIs*, 2016

⁴⁴ <https://www.creativeindustriesfederation.com/statistics>

⁴⁵ AVIXA, IHS Markit, *Global AV Industry Outlook and Trends Analysis (IOTA) 2017*

⁴⁶ *idem*

⁴⁷ source: European Audiovisual Observatory 2018

⁴⁸ source: Statista 2018

⁴⁹ Alain Busson *et al.*, 'The European Audiovisual Industry and the Digital Single Market: Trends, Issues and Policies', in *Digiworld Economic Journal*, No 101, 1st Q 2016

⁵⁰ OTT: over-the-top, meaning online delivery of video and audio without the internet service provider being involved in the control or distribution of the content itself.

⁵¹ PwC, *Perspectives from the Global Entertainment and Media Outlook 2017-2021*

As a result, by 2021, Internet video — defined as consumer spending on streaming services, such as Netflix, that do not require a pay-TV subscription — will grow at an 11.6 percent CAGR⁵² to \$36.7 billion. Overall music and SVoD share of total market revenues are growing to reach around 4% by 2020.⁵³

The VoD market alone worth €4,2 billion in 2017 will continue to grow, reaching expected revenues of €6,7 billion in 2020.⁵⁴ In 2016, there were more than 158.139 films on VoD catalogues in Europe.⁵⁵ In 2016, Netflix held an approximate 47% of the total number of SVoD subscribers in the EU and Amazon about 20%.⁵⁶

These new trends are changing revenue patterns and show the growth potential of this industry whilst channels of communication are hungry for audiovisual content. GAFAs⁵⁷ are planning to vastly invest in content production in 2018 and 2019. Several sources mention that Apple is planning around \$1 billion,⁵⁸ while Netflix, Hulu and Amazon Prime Video are expected to triple their combined investments in originals by 2022, spending \$10 billion annually.⁵⁹

Another transformation of the audiovisual sector due to the rapid technologic developments consists in the multiplication of artistic expressions, with the emergence and development of interactive media, such as 3D animation, virtual reality (VR) and augmented reality (AR). The world consumer spending on VR content (including games, interactive experiences and video) reached \$803 million in 2017. IHS forecasts that spending will reach \$2.8 billion by 2021. VR content will also diversify over time, with a shift from premium content to lower entry barriers and the development of independent content productions on VR devices.⁶⁰

The issue is to consider the evolution of tax incentives in consideration of market developments, new market players and increased competition to attract film production. Given its interest in local original content, growing production capacity and skills and accessible labour cost, Lithuania is well positioned to make the most of the above-mentioned trends. In the Recommendations section, we propose measures aimed at leveraging the Lithuanian tax incentive to help the country develop as a digital audiovisual hub.

In parallel to market changes, the regulatory environment is also transforming with a view to support the competitiveness of the AV sector in Europe. The aim of this document is not to be thorough on this matter but to highlight some important developments:

- The Audiovisual Media Services Directive (AVMSD), the only EU legally-binding instrument promoting EU cultural diversity is currently undergoing a reform to take into account the evolution of the sector. The EU legislation provides obligations to Member States to encourage investment in local and European productions as well as to ensure a minimum market access to distribution

⁵² CAGR – Compound Annual Growth Rate is the mean annual growth rate of an investment over a specified period of time longer than one year

⁵³ PwC, *op.cit.*

⁵⁴ ITMedia Consulting, *Video on Demand in Europe: 2017-2020*, 2017

⁵⁵ European Audiovisual Observatory, *How do films circulate on VOD services and in cinemas in the European Union?*, 2016

⁵⁶ European Audiovisual Observatory, *Trends in the EU SVOD market*, 2017

⁵⁷ The four digital giants: Google, Apple, Facebook, Amazon

⁵⁸ <https://techcrunch.com/2018/03/26/apples-original-shows-may-launch-next-march-report-says/>

⁵⁹ <https://www.fiercecable.com/video/amazon-hulu-and-netflix-to-triple-original-content-spend-by-2022-report>

⁶⁰ IHS Markit, *Immersive Computing: Consumer Augmented & Virtual Reality*, 2018

channels. The latest revised text is proposing a minimum amount of European works on VoD catalogues and online offerings.⁶¹

- In 2016 the European Commission has set up a Guarantee Facility mechanism to address the challenge of access to finance in the creative sector.⁶² Managed by the European Investment Fund (EIF) (which channelled €121 million of funding) via the Creative Europe programme, the instrument partially covers financial intermediaries' portfolios of loans to businesses in the creative sector. The possibility of combining the tax incentive with the emergence of local financial institutions providing special loans guaranteed by the EIF should be worth examining to encourage further investment in audiovisual.

The market and regulatory developments call on reviewing the functioning of the tax incentive, in order to make the local audiovisual ecosystem as competitive as possible for local production as well as for foreign investment.

⁶¹ European Commission, *Audiovisual Media Services: Breakthrough in EU negotiations for modern and fairer rules*, press release, Brussels, 26.04.2018 http://europa.eu/rapid/press-release_IP-18-3567_en.htm

⁶² <https://ec.europa.eu/digital-single-market/en/financial-guarantee-facility-culture-creative>

4. IMPACT OF THE LITHUANIAN TAX SCHEME

4.1. Rapid overview of the cinema value chain

The Lithuanian tax scheme functions as an incentive for film production. However, the production stage is inextricably linked to the activity generated in the downstream segments of the film's entire value chain. As such, assessing the impact of the scheme implies not only analysing the production level, but also taking into consideration changes generated along the entire value chain. In order to better visualise the potential overall implications of the tax scheme it is important to consider activities on the film's value chain.

The film value chain is a complex entity currently undergoing a period of change with the emergence of digital technologies questioning the established business model with new market players at distribution level (digital online distribution).

The majority of incentives and subsidy mechanisms in the audiovisual sector in Europe are dedicated to support production.

The production stage is followed by the sales of a film. Distribution companies acquire the economic rights to a film and proceed to plan the release of the film on the national market and abroad, including its marketing and promotion. In Lithuania distributors still rarely invest upfront in local films. As mentioned in section 2, distributors generally tend to be amongst the main investors in productions, together with broadcasters. The tax incentive should encourage distributors to invest in film production in order to contribute to a healthier and more virtuous financial ecosystem.

Most films are released by distributors into the exhibition segment through cinemas. As a result, the cinema exhibition sub-sector is often considered the primary release window. However, due to the digital shift, VoD platforms have become very important actors both in the distribution and exhibition segments.

The TV industry remains a key partner in the value chain as it can be an important buyer of films. Such function is currently not exercised by TV companies in Lithuania. In the context of the new AVMS Directive which also encourages Member States to set up investment obligations for audiovisual production (see details in section 3), Lithuania should consider incentivising broadcasters to invest in production and showcase local cinema. The tax incentive could be key to this objective.

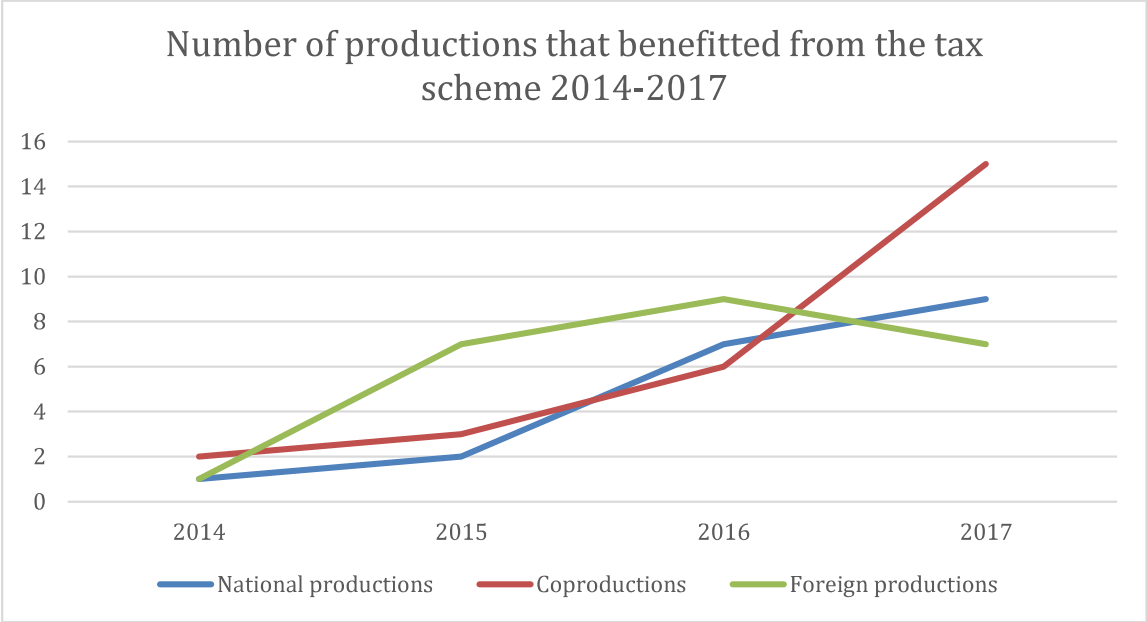
VoD platforms are also tools capable of remedying problems in distribution locally and internationally.⁶³ The strategy would be to attract large international players to develop their European film productions in Lithuania, as well as to ensure that local film productions find their ways on international digital platforms.

4.2. The tax scheme's impact on the growth in film production

The Lithuanian incentive mechanism for film production was implemented in 2014. It had a rather slow start, only one national production, one foreign production and two co-productions having received

⁶³ IDEA and KEA, *Mapping the creative value chains: A study on the economy of culture in the digital age*, 2017

investment certificates in 2014. However, its popularity gradually increased by 2017, when 9 national productions, 15 co-productions and 7 foreign productions benefited from the tax scheme. In total, the tax incentive supported 68 film productions between 2014 and 2017 (22 domestic productions, 23 co-productions and 23 foreign productions)⁶⁴, whilst our research shows that the scheme is still rather unknown to potential beneficiaries.



The tax incentive mechanism enabled an increased number of foreign productions and co-productions to be filmed in Lithuania. The graph above shows an important increase, especially in the number of co-productions. This increase has allowed for a much larger export of audiovisual services by those service companies.

4.3. Capital investment and expenditures

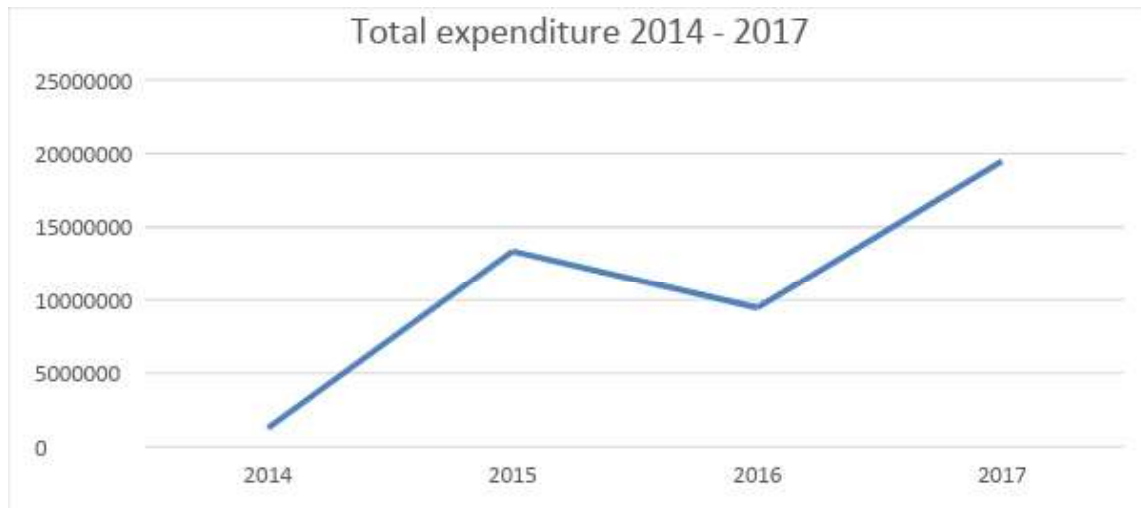
The investments received via the tax scheme totalled € 8.526.871⁶⁵ and went into national, foreign and co-productions as follows:

- National productions: € 956.814 (11,2%)
- Co-productions: € 2.794.585 (32,7%)
- Foreign productions: € 4.775.471 (56%)

The production expenditures incurred in Lithuania (including filming, cast, crew and the supply chain costs) for the films supported by the tax scheme totalled € 43,5 million in the period from 2014 to 2017, growing significantly from year to year, as the graph below shows.⁶⁶

⁶⁴ data from the Lithuanian Film Centre
⁶⁵ Data from the Lithuanian Film Centre
⁶⁶ Data from the Lithuanian Film Centre

It is important to mention that annual data on film production expenditures does not necessarily reflect how budgets were actually spent from year to year, as the data is susceptible to the concentration of spending by fiscal years, for accounting purposes. Conventional accounting practices tend to recognise the entire expenditure for a film before starting the photography. However, the production of a film (and thus actual spending) takes place over several months.



The following figures (relating to foreign investment, employment and generated taxes) are calculated based on the input received from 24 out of 28 production companies that used the tax scheme between 2014 and 2017. The remaining 4 companies did not reply to the survey KEA sent. As a result, our calculations reflect only partially the growth generated in the production sector.

In order to nuance the results and thus the economic contribution of the tax mechanism, our research separates all the productions which benefited from the scheme into productions which received state aid and those which did not. As such, the latter category reflects a clearer economic contribution of the scheme and thus of private investment in film production, as state aid was not involved.

A partial amount of foreign investment in the Lithuanian territory brought by the supported productions (the foreign investment was brought exclusively by productions which did not receive state aid) could be calculated based on data from the Lithuanian Film Centre and input received from the production companies on the investment shares concerning 10 co-productions. As such, by adding the Lithuanian budget of all the foreign productions (without the amount of local investment received via the tax scheme) and the foreign shares spent in Lithuania for the co-productions, KEA estimates an amount of € 24,4 million of foreign investment (which represents a significant 56% of the total expenditure in Lithuania). This is a partial result, considering we could only obtain data concerning 10 co-productions, out of the total of 23 supported by the tax scheme in the analysed period.

The year 2015 witnessed a particular increase in the foreign investment, largely due to a single production, the BBC-Weinstein drama mini-series *War and Peace*, which generated an overall Lithuanian expenditure of € 7.296.770.⁶⁷

⁶⁷ data from the Lithuanian Film Centre

The capital expenditure by the local production companies and audiovisual service providers in relation to the productions which were not supported by state aid has generated in the analysed period an estimated amount of € 3,2 million in VAT revenues for the State, as the survey's results showed. The total number of productions to which the tax scheme contributed (including those supported by state aid) generated an estimated € 4 million in VAT.

An important part of the Lithuanian total expenditure went into the supply chain, in sectors such as hotel and catering, transportation, construction, rentals, insurance, legal services and accountancy. The spending in these sectors for the analysed period was estimated based on the input received from the 24 production companies and is listed in table 5, separated for the productions which did not receive state aid.

Table 5 – Expenditure in other sectors 2014-2017 (Euro)

SECTOR	EXPENDITURE FOR PRODUCTIONS NOT SUPPORTED BY STATE AID	EXPENDITURE FOR ALL PRODUCTIONS WHICH BENEFITTED FROM THE TAX SCHEME
Hotel and catering	1.860.776	2.144.041
Transportation	2.841.468	3.138.511
Legal services	86.145	123.874
Audit & accountancy		160.735
Construction	546.016	546.016
Insurance		8535
Rentals	459.667	506.178
Other	743	8788
TOTAL	5.794.817	6.636.680

4.4. Employment

Film production is a labour-intensive activity. The cast and crew of a film can easily exceed 100 people. According to the data received from the production companies who benefitted from the tax scheme, the number of professionals involved varied from one production to another (i.e. from 15 for smaller productions to a couple of hundreds for larger ones).⁶⁸

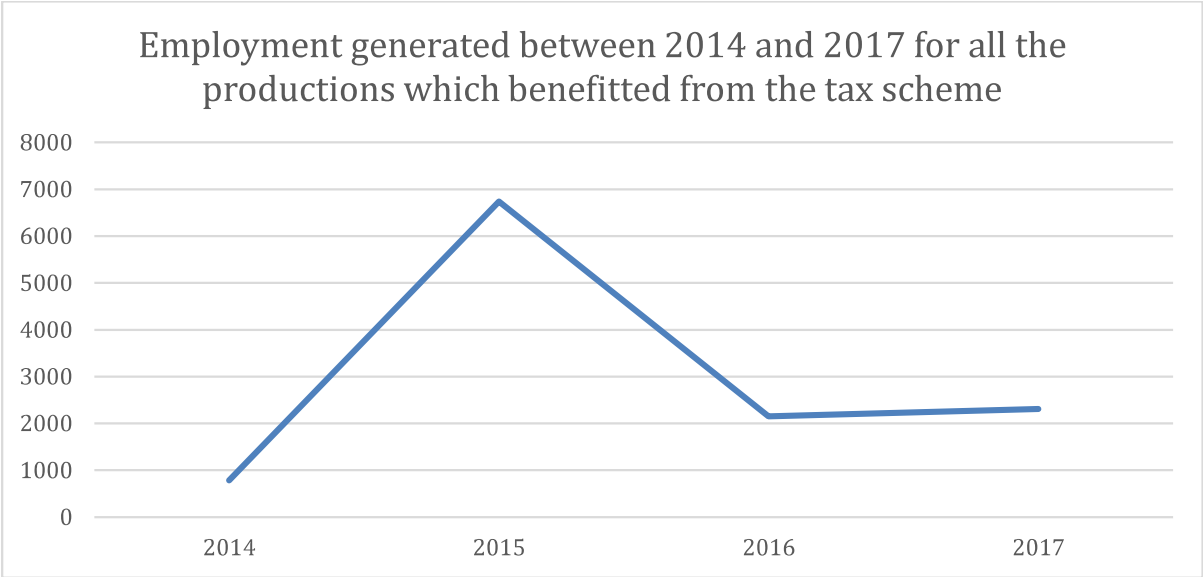
Based on the survey's results, we estimate that the films supported by the tax scheme which did not receive state aid generated an estimated 10.583 freelance jobs in the production sector (i.e. cast, crew, but also a significant number of extras - contracted exclusively for the above-mentioned productions) from 2014 to 2017. The wider application of the tax scheme (being used for the productions which equally benefitted from state support) reflects a wider contribution to the economy. As such, the number of

⁶⁸ survey results

freelance jobs created for all the productions that used the tax scheme in the analysed period (including those which benefited from state aid) reached an estimated total of 12.170.

Company employment in the film production sector in Lithuania is low. The 24 production companies that participated in the survey totalled 56 permanent employees during the analysed period. In this amount we can distinguish 39 permanent positions in the companies which worked exclusively on productions which did not receive state aid between the analysed period. The survey showed that there was not significant variation in the number of permanent positions within the production sector generated by the overall growth in film production. Some of the surveyed companies increased their number of permanent employees from 2 to 3 or from 6 to 10.

Employment is largely provided on freelance and is project-based. Nevertheless, this contributes to the establishment of a stable highly skilled workforce.



The overall increase in activity in the production sector is reflected in an increase of income due to the additional employment created. As such, the productions which did not receive state aid generated an estimated amount of € 9,9 million as gross salaries for both permanent employees and freelancers.⁶⁹ Based on the survey's results and on the income tax rates in Lithuania, we estimate that this gross income generated an overall amount of € 3,6 million in tax revenues (including personal income tax, withholding tax and social security contributions). As a result of the taxation exercise, an estimated personal net income of € 6,6 million was earned by employees and freelancers in the period between 2014 and 2017.

The overall amount in gross salaries generated by all the productions (including those which benefitted from state aid) reached an estimated of € 14,7 million which produced € 6,8 million in tax revenues for the state and € 8,2 million in personal net income.

⁶⁹ survey data

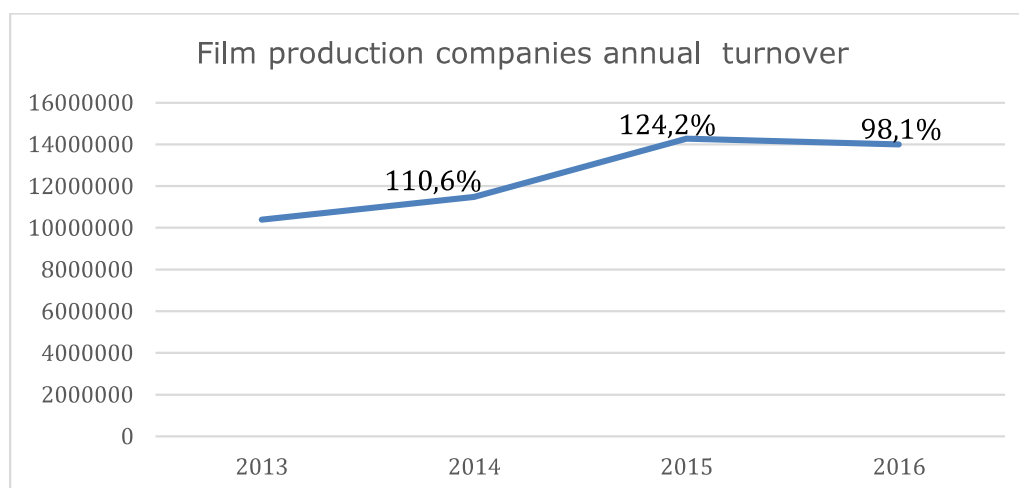
The earned income is also destined to further spending on various goods and services, thus contributing to further growth in the country's economy. The spending depends on the marginal propensity to consume (MPC), which is given by the change in consumption conditioned by the change in income at a given moment. In Lithuania, the 2014-2017 period registered an overall decreased in consumption by 0,2 of the 2014 GDP, according to the European Economic Forecast from 2016.⁷⁰ At the same time, an increase in the country's average income from € 700 to € 850 was recorded in the same period, for an average of 1.355.000 employed persons.⁷¹ This generates an MPC of -0,22 (trending towards saving, rather than spending).

The multiplier (M) resulted from the MPC is 0,81.⁷²

As a result, the induced impact generated by the multiplier effect for the personal net income gained out of the productions which did not benefit from state aid in the 2014-2017 period is an estimated € 5,3 million (the multiplier is applied to the overall personal net income resulted from these productions). The total number of productions which used the tax scheme (including those which received state aid) had an induced impact of € 6,6 million.

4.5. Competitiveness of the cinema sector

The period from 2013 to 2016 has witnessed an important increase in the annual turnover of Lithuanian production companies (as shown in the graph below⁷³), evidence that the audiovisual sector is getting stronger. This ascending trend can be associated with the implementation of the tax scheme, which has enabled production companies to develop more co-productions and foreign projects.



The graph also shows the percentage increase from year to year, as described in the Lithuanian Ministry of Finance accounts.

Lithuania has been producing an increased number of local films (see details in section 2), largely as a result of the implementation of the tax scheme. *Trys milijonai eurų, Kaip susigrąžinti ją per 7 dienas*, or *O*

⁷⁰ European Commission, European Economic Forecast, spring 2016

https://ec.europa.eu/info/sites/info/files/file_import/ip025_en_2.pdf

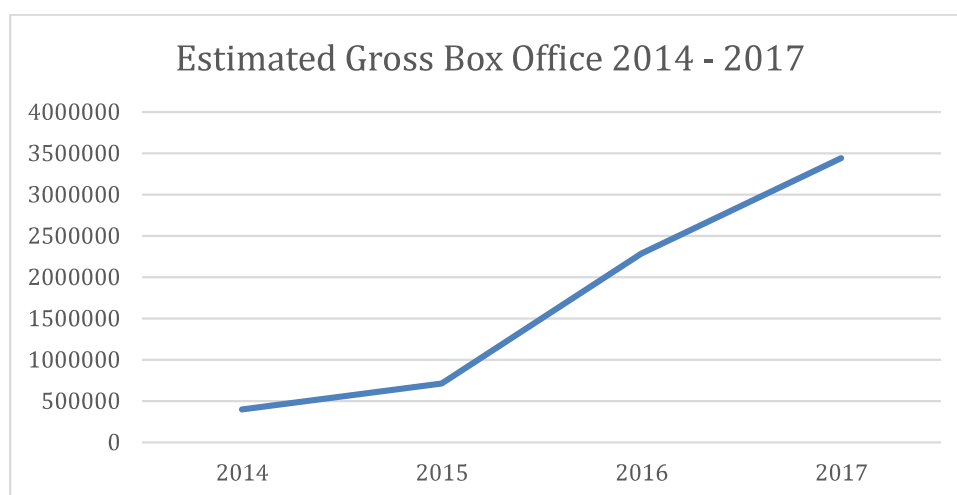
⁷¹ <https://tradingeconomics.com/lithuania/wages>

⁷² The multiplier was calculated using the formula $M=1/1-MPC = 1/1+0,22 = 1/1,22 = 0,81$

⁷³ Data from the Lithuanian Ministry of Finance

ne! O taip! which were in the top ten of the annual box office in Lithuania in 2016 and 2017, scoring €1,3 million, € 465.000 and respectively € 414.000.⁷⁴

The national box office increased from 2014 to 2017, registering a staggering growth every year (in 2017 the revenues had grown with 88% from 2014), as reflected in the graph below⁷⁵, totalling more than € 6,8 million. Eight of the productions supported by the tax scheme were in Yearly Box Office Top Ten in Lithuania (3 in 2015, 2 in 2016, 3 in 2017)⁷⁶ competing with Hollywood blockbusters.



Top Ten Films in Lithuanian Box Office 2017⁷⁷

	Title	Country of origin	GBO Eur
1	<i>Trys milijonai eurų</i>	LT	1.304.887
2	<i>Zero 3</i>	LT	1.008.470
3	Despicable Me 3	US	878.047
4	Emilija is Laisves alejos	LT	577.309
5	Pirates of the Caribbean: Salazar's Revenge	US	597.844
6	Fifty Shades of Grey	US	541.863
7	Boss Baby	US	441.834
8	Fast & Furious 8	US	501.105
9	<i>Kaip susigražinti jį per 7 dienas</i>	LT	465.368
10	Cars 3	US	336.135

In red, domestic productions that benefitted from the tax scheme

⁷⁴ Data from the Lithuanian Film Centre

⁷⁵ Source: www.filmneweurope.com, www.boxofficemojo.com NB : the data is available only for a part of the total film productions supported by the scheme

⁷⁶ Baltic Films Facts & Figures 2015-2018, www.boxofficemojo.com

⁷⁷ Baltic Films Fact and Figures 2018

The increasing interest of national audiences in domestic films and Lithuanian co-productions which has been observed in the last 5 years is clearly related to the usage of the scheme. The popularity of these films is expected to drive people to cinemas even in smaller cities and urban areas which have a notoriously underdeveloped cinema market. As a result, the Head of Forum Cinemas believes that there will be more investment in the future in cinema infrastructure in Lithuania.⁷⁸ These foreseen positive changes are still to be witnessed.

Moreover, the increasing number of co-productions and foreign productions reinforce the credibility of the Lithuanian audiovisual sector, by positioning it as a reliable resource on the international market. It is noteworthy to mention that a diversity of countries participated in the co-productions and foreign productions that benefitted from the tax scheme, such as: The USA, The UK, Russia, Japan, Canada, The Netherlands, France, Italy, Germany, Finland, Sweden, Norway, Spain or the Baltic countries.

Additional spillover impact

Investment in films has an impact beyond the sector's value chain. One of the most notable spillover effects is in the tourism industry and in the positive territorial image associated. *Film-induced tourism* refers to the 'visitation to sites where movies or TV programmes have been filmed, as well as to tours to productions studios, including film-related theme parks'.⁷⁹ In the last two decades, there has been an increasing number of positive examples of how film and television can drive tourism, from feature films like *The Lord of the Rings* trilogy, to TV series like *Downton Abbey* or *Game of Thrones*.

Lord of the Rings is largely credited with a 40% jump in New Zealand tourism between 2000 and 2006.⁸⁰ The very successful HBO TV series *Game of Thrones* is partly responsible for major upticks in tourism in countries like Northern Ireland, or Croatia. A record of 2,1 million worldwide visitors arrived in Northern Ireland in 2016, boosting tourism revenues by 12%, according to Tourism Ireland. At the same time, Belfast Airport had the highest passenger increase of any destination, attracting 388.486 more customers in 2016 compared to 2015.⁸¹ The Croatian city of Dubrovnik has long been a very popular tourist destination in Europe, but it has seen an increase in popularity since the launch of the TV series, which has reportedly been responsible for around half of the 10% annual growth in tourists the city has seen since 2014.⁸²

The Lithuanian tax incentive also attracted large foreign productions which proved to be very successful internationally, such as *War and Peace* (which pulled in 6,3 million British viewers in the launching evening on BBC in 2016 – a 25% share of viewing⁸³) or the largely distributed *Tokyo Trial* (which premiered in 190 countries on Netflix in December 2016 and benefitted from subtitles in 20 languages⁸⁴).

⁷⁸ interviews

⁷⁹ Sue Beeton, *Film-induced tourism*, Channel view publications, Clevedon, 2005

⁸⁰ <https://www.screendaily.com/features/from-lord-of-the-rings-to-game-of-thrones-the-rise-of-film-tourism/5116007.article>

⁸¹ <https://www.telegraph.co.uk/property/uk/game-thrones-effect-hit-tv-show-boosted-northern-irelands-property/>

⁸² <https://qz.com/1054123/game-of-thrones-is-a-blessing-and-a-curse-for-dubrovnik-in-croatia/>

⁸³ <https://www.theguardian.com/media/2016/jan/04/bbc-war-and-peace-countryfile>

⁸⁴ <http://playbackonline.ca/2016/11/18/don-carmody-televisions-tokyo-trials-set-for-netflix-premiere/>

In 2016 the Lithuanian State Department of Tourism (SDT) created three new tourist routes in English language that highlight the various filming locations of War and Peace throughout the country. This marks the first time Lithuania has used a film to promote its local tourism, according to Jurgita Kazlauskienė, former director of the SDT⁸⁵, following the examples of the successful TV series presented above.

It remains difficult to evaluate the impact of War and Peace on national tourism. According to the SDT, 2017 (the year when the War and Peace tour was announced) saw 14% growth in British tourists.⁸⁶ It can be assumed that this registered growth is also due to the newly created tourist route.

4.6. Summary of findings

The large amount of expenditure that was channelled on the Lithuanian territory by all the productions supported by the tax scheme (a total of € 43,4 million out of which more than € 24,4 was foreign investment) generated increased economic activity in the production sector. We summarise below our main findings based on the data from the 24 production companies which answered our survey and the Lithuanian Ministry of Finance's estimation on tax loss.

Employment

The tax scheme alone generated an estimated of 10.583 freelance position in the 2014-2017 period which produced € 6,6 million in net personal income and an additional spending of € 5,3 million (multiplier effect). However, all the productions supported by the scheme (including those which benefitted from state aid) produced an estimated of 12.170 freelance positions, € 8,2 million in net personal income and an additional € 6,6 million in spending (multiplier effect). These overall figures have led to an overall economic contribution of € 14,8 million (referring to the total generated revenues and subsequent spending in the national economy).

Revenues and expenditure on the supply chain and in the exhibition sector

The productions not supported by state aid generated an estimated expenditure of € 5,8 million on the supply chain in sectors like accommodation and catering, accountancy, legal or rental services. The overall expenditure on the supply chain for all the films which benefitted from the tax scheme (including those supported by state aid) was of approximately € 6,6 million. In the exhibition sector, the productions supported by the tax scheme generated an overall gross box office revenue of more than € 6,8 million.

Tax revenues

The productions which did not receive state aid generated tax revenues from the production sector of an estimated € 3,2 million in VAT and € 3,6 million in tax revenues (in income tax, withholding tax and social security contributions), totalling € 6,8 million in revenues for the state. However, if we add the contribution of the films equally supported by the state, the tax revenues for the state amount to € 4 million in VAT and

⁸⁵ <http://www.tourism.lt/en/news/route-visiting-filming-locations-of-bbc-series-war-and-peace-in-lithuaniaspecially-for-cinephiles>

⁸⁶ Data from the Lithuanian State Department of Tourism

€ 6,8 million (in income and social taxes), totalling € 10,8 million. These overall revenues already overcome the state's tax loss as a result of the implementation of the scheme between 2014 and 2017. This tax loss is estimated at between € 9,5 and € 10 in the analysed period.⁸⁷

⁸⁷ estimation based on the figures provided by the Lithuanian Ministry of Finance and on KEA's calculations starting from the functioning mechanism of the scheme

5. COMPETITIVENESS WITH OTHER INCENTIVE MECHANISMS FOR FILM PRODUCTION

Part of the research consisted in investigating other incentive mechanisms for film production in Europe regarding their way of functioning, scope or earmarked budget. Even if incentives in countries like France, Belgium, UK or Hungary are not directly comparable with the Lithuanian one, given that they evolve in much larger economies with much more competitive audiovisual sectors. However, their review helped in understanding how such incentives work and in providing inspiration to make the Lithuanian tax scheme more efficient.

More direct comparisons can be made with incentives existing in the Baltic countries, along the logic of a more integrated Baltic economy and more comparable film sectors. However, the three incentive schemes are not entirely comparable, as the mechanisms have a different time-span of implementation, thus being in different moments of their evolution (the oldest is the Latvian rebate scheme and the newest the Estonian one). Annex 3 provides a comparative overview of the three schemes' beneficiaries, earmarked budget, functioning mechanisms, eligibility criteria and benefits.

It is noteworthy to mention that the Lithuanian tax scheme is based on the model provided by the Hungarian tax incentive system introduced successfully in 2008. While the Hungarian scheme has a very similar functioning mechanism with the Lithuanian one (available through local business companies who receive tax relief after their support of films for an amount of 20% - which was amended in 2014 to 25%)⁸⁸, it is much larger in size, benefitting from a planned tax expenditure of €379 million from 2014 to 2019.⁸⁹

The different types of analysed incentive mechanisms can be primarily distinguished in the way the aid is administered to the beneficiaries. In the case of tax rebates (schemes available in countries like the UK or Belgium), businesses which donate to a film production receive in return a rebate on their corporate tax and/or their profit tax. As such, there are two types of beneficiaries: the 'donor' being the direct beneficiary of the mechanism and the producer, an indirect beneficiary by the donor's motivation to invest. In the case of direct cash rebates, there is only one beneficiary, the producer, who directly receive a disbursement from the state for certain costs incurred in the state's territory. This distinction in the functioning mechanism leads to a series of advantages, but also to some drawbacks for the Lithuanian tax incentive mechanism (and to a certain extent to tax incentives in general. The advantages and drawbacks of the Lithuanian tax incentives are presented below.

5.1. Comparative advantages of the Lithuanian scheme

The Lithuanian tax scheme increases the opportunities for private investment in a film production (as virtually any kind of company can donate to a production). Indeed, cash rebates schemes as operated in Estonia and Latvia limit the opportunities for investment, by only allowing the producer to benefit from a disbursement. The Lithuanian tax scheme minimises the film producers' financial risks and therefore encourages risk taking in the audiovisual sector. Moreover, the scheme triggers more general interest in

⁸⁸ European Commission SA.38425 (2014/N) – Hungary amendment of the Hungarian film support scheme

⁸⁹ European Commission SA.35579 (2013/N) Hungarian film support scheme (prolongation of SA.25613 (N 202/2008))

film making in Lithuania thus contributing to make the economic actors more aware of its economic and social importance.

The Lithuanian tax scheme ensures continuous opportunities for investment, as any company can invest at any time in a production. The applications for direct state's disbursement in the case of a rebate mechanism can only be granted within the limit of the earmarked state budget for the respective year.

From an investment point of view, the implementation of the Lithuanian scheme compensates the lack of investment from financial institutions.

In this respect it should be highlighted that the EU Guarantee Facility (see section 3) could be mobilised in complementarity to the tax incentive to encourage financial institutions to invest in the creative industries. The Lithuanian tax scheme has no significant management cost, as the mechanism is managed by a single person in the Lithuanian Film Centre. The tax administration is not involved in the management of this scheme, unless in the form of control for good reporting by beneficiaries on the tax form.⁹⁰ From this perspective, it is less burdensome than cash rebate systems, which require more in terms of managerial and political resources (as the state budget needs to be approved on a yearly basis).

The Lithuanian scheme is designed not only to attract foreign investment in the country, but also to foster domestic production. During its four years of existence the scheme has supported a total of 68 local, co-productions and foreign productions) providing € 24,4 million in additional foreign investment. In comparison, the Latvian scheme, even if older than the Lithuanian one, supported only 10 productions which brought a total of € 5,2 million in foreign investment between 2013-2016. The Estonian scheme is too new as it supported only two productions in 2016 and 2017, with a total foreign investment of € 1,67 million.⁹¹

The support received via the Lithuanian scheme can be combined with other forms of aid. In most of the cases, the cumulated aid is limited to 50% of the production budget. However, as mentioned before, in case of low budget or difficult films the cumulated support could amount to 75% (since 2018, this limited was raised to 90%). In case of co-productions, the limit is 60%. These caps are very competitive, considering other international support policies for film production. For instance, Estonia sets the same limits (50% limit to the overall amount of state aid, with the possibility of 60% in the case of cross-border productions). In the Hungarian state aid system, the cumulated aid can even increase to 100% in the case of low budget films in Hungarian language.

Generally, a tax rebate mechanism implies that the tax benefit is exercised in a relatively long period of time, depending on when the fiscal years start and end. In the case of the Lithuanian scheme, an investor is able to exercise the tax benefit right upon receiving the investment certificate for the return period in which the certificate was issued. This reflects the rapidity of the mechanism as investors do not have to wait longer to exercise their benefit. The Belgian Tax Shelter provides another positive example in this sense, as temporary tax deduction is issued for the fiscal year when the agreement was signed, within three months after signing it. As such, investors do not have to wait for the definitive tax deduction to exercise the entire benefit (as the definitive tax deduction is agreed upon the issuing of the Tax Shelter

⁹⁰ interviews

⁹¹ <http://filmestonia.eu/index.php/2017/12/01/lati-rahvusliku-filmiauhinna-palvis-ka-eesti-film/>

certificate in maximum four years after the agreement was signed).⁹² Lithuania could follow this example and issue the investment certificate after the agreement is signed between the producer and the investor (currently the certificate is issued after the production comes to an end). This way, the donor would wait less to exercise the tax benefit, as is the case in the Belgian Tax Shelter, when the investor receives a temporary tax deduction after the initial agreement.

It should be added that the Lithuanian scheme reinforces the credibility of the local film sector in the eyes of film professionals worldwide, thus increasing co-production opportunities and exposure of local talents on the international market place. The tax scheme continues to attract large foreign productions, like the new HBO-Sky mini-series project Chernobyl, which started shooting in March 2018.

It should be noted that film producers interviewed welcome the implementation of the Lithuanian tax scheme, highlighting its benefits. No film producer defended another incentive mechanism but called on reform to enable the scheme to remain competitive.

5.2. Comparative drawbacks

The main drawback of the Lithuanian tax scheme is that it limits the amounts of investment in the production to 20% of the production's budget. The Estonian mechanism offers rebates between 20 and 30% of the production costs and an additional 25-30% for eligible staff costs, the Latvian one offers rebates between 20 and 25% of the production costs. This aspect lowers the competitiveness of the Lithuanian scheme as it facilitates a lower intensity of aid for productions and also a lower intensity of benefit for the investors. Moreover, the other Baltic countries are increasing the earmarked budget available for their rebate systems, thus potentially allowing an increased number of productions to benefit. The Latvian budget for cash rebates run by the National Film Centre increased to €1,1 million in 2017⁹³ and the Estonian one reached € 2 million in the same year⁹⁴.

Other tax incentives for film production in Europe also provide a larger intensity of benefit for the producers. Via the Belgian Tax Shelter, the producer may benefit from investments up to 42% of the production's eligible costs⁹⁵, the French tax rebate offers the opportunity for the producer to benefit from investments up to 30% of the eligible costs for national productions and French co-productions (for films in a foreign language, the benefit is however limited to 20%)⁹⁶, while the UK Tax Relief provides an aid of 25% of qualifying film production expenditure.⁹⁷

The Lithuanian scheme is applied on the basis of cultural criteria that the production has to meet in terms of content. These criteria do not exist in the Estonian mechanism, which uses only production criteria (film must have a minimum budget which varies depending on its genre). In Latvia, the cultural criteria have only a partial application (are limited to ensuring the production is filmed in Latvia, or in Riga for a higher

⁹²https://www.belgiumfilm.be/sites/default/files/content/brochure_tax_shelter_2018_angl_a5_new.pdf

⁹³<https://www.calvertjournal.com/news/show/6064/latvia-marks-100th-anniversary-with-increased-film-funding>

⁹⁴<https://investinestonia.com/cash-rebate-a-new-boost-for-estonian-film-industry/>

⁹⁵https://www.belgiumfilm.be/sites/default/files/content/brochure_tax_shelter_2018_angl_a5_new.pdf

⁹⁶<http://www.cnc.fr/web/fr/credit-d-impot-cinema1>

⁹⁷<http://www.bfi.org.uk/film-industry/british-certification-tax-relief/about-tax-relief>

intensity of the benefit). The fact that solely cultural criteria determine the eligibility of a film for the Lithuanian tax limit the opportunities to attract foreign productions to be filmed in the country, especially those with non-European origin (as they will not necessarily focus on a European story or character, as required via the cultural test).

An important challenge for the scheme is that its inner functioning mechanism makes producers dependent on the motivation and capacity of investment displayed by local businesses. As such, the scheme needs sustained promotion activities in order to further connect potential investors with producers and their projects. It is evident from interviews and the usage of the scheme that the latter is not known and therefore underused. This statement is verified as investment triggered by the scheme reached € 8,5 mil from 2014 to 2017 which accounted for around € 9,5 - € 10 million of state expenditure; this represents only half of the state's planned tax expenditure for the scheme for 2014-2017⁹⁸.

Promotion activities following the introduction of the Belgian Tax Shelter can be used as a good example to popularise a tax scheme. Specialist financial intermediaries including banks took the responsibility of promoting the tax mechanism and raising the funds to the benefit of the producers and investors alike.⁹⁹ For instance, the branch of the BNP Paribas Fortis bank responsible with film fundraising aims to position itself as a strategic partner of the bank's clients by seeking to optimise the fiscal situation of the latter. The Tax Shelter product becomes a means to reach the bank's objective, by promoting to the bank's clients only those productions which promise the most interesting return in 'slate' packages which guarantee a risk diversification. A different example is given by a classic Belgian financial intermediary, Casa Kafka, which aims to reinforce the Belgian audiovisual production and creativity by finding a balance between the economic and cultural dimension of the Tax Shelter. To this end, the company promotes a wide diversity of Belgian films (features, animation, shorts, documentaries) via an eclectic catalogue to potential investors, giving the possibility to the latter to choose in which film to invest according to their needs, with no minimum amount required. Only in 2017 Casa Kafka raised more than € 36 million on 154 different films.¹⁰⁰ Scope Invest, another successful intermediary for the Belgian Tax Shelter, raised more than 300 million for around 200 European renowned films, thus helping more than 1800 Belgian enterprises to benefit from the tax incentive.¹⁰¹

The small structure of the Lithuanian industry hinders the emergence of financial intermediaries responsible for the promotion of the scheme. It is important that public authorities, notably the Lithuanian Film Centre, steps up efforts to promote the scheme and play the role of intermediary and broker between the film community and potential investors.

Moreover, in the absence of intermediaries between investors and producers, businesses ready to invest via the Lithuanian tax scheme need to take care of all the administrative paperwork required when making the donation, which imply additional time and financial resources. Moreover, the investors need to be able to trust that the mechanism will not lead to additional bureaucracy and tax audit. It is important to create trust with would-be investors that often fear additional tax control for using the scheme.

⁹⁸ European Commission SA.35227 (2012/N) Lithuanian film tax incentive, Brussels, 18.12.2012

⁹⁹ Aurélie Michiels, *Le Tax Shelter : un incitant fiscal, financier, économique et culturel*, Groupe ICHEC, 2012

¹⁰⁰ <http://www.casakafka.be/>

¹⁰¹ <https://www.scopeinvest.be/expertise-fr>

It is also important to market the tax scheme internationally to help attract large foreign productions. However, considering the size of the production sector (working mainly with shoestring budget) and the capacity or willingness of local businesses to invest in cinema it should be stated that attracting large production is very challenging. Currently the scheme is more adapted to help fund small budget movies than large international productions.

Currently the Lithuanian tax scheme is limited to undistinguishably support the production of feature films, TV dramas, documentaries and animations. However, Europe is witnessing a trend towards adaptation and updating existing incentives to meet the realities of technological development and new consumption patterns (see section 3). For instance, in the UK the incentives have been expanded to new sectors such as video games (since 2014), while France has recently upgraded (in 2015) its tax credit schemes with specific measures related to animation.

The new UK incentive for video games is a tax relief that can be claimed by games production companies in respect of expenditure incurred in the development of British video games for general public, for which at least 25% of the core expenditure is incurred on goods and services provided from the European Economic Area (EEA). The video games company can claim the relief on what is called 'enhanceable expenditure' which is the lower of 80% of the total core expenditure and the actual EEA core expenditure incurred. The tax credit repayable is 25% of the lower of the amount of company's available loss for the accounting period and the enhanceable expenditure for that period.¹⁰² The UK games sector contributes to more than £1 billion a year to the British economy, however, small UK studios face difficulties with securing investment and recruiting talent, so they call on the government for financial support.¹⁰³ For these smaller players, the video games tax incentive comes as a very important tool to develop their capacity.

In France, the tax credit for animation has larger benefits compared to other audiovisual works like films or documentaries, in order to boost the development of this sector. As such, the tax credit for short animation works amounts to 25% of eligible expenses (compared to other short fiction or documentary works for which the intensity is 20%) and to 30% in the case of feature animations (compared to 20% for feature fictions or documentaries). The tax credit for short animation is capped at € 3000 per minute (compared to € 1150 for short documentaries and € 1250 for short fiction).

Finally, the success of the Lithuanian tax scheme combined with the small industrial structure may lead to rapid shortage of skilled labour thus creating bottlenecks. Labour shortage will also result in increased costs as productions will compete for the best crews, talent and technicians with the risk of making Lithuania less attractive.

This review highlights that while the Lithuanian scheme has still some disadvantages which lower its competitiveness at international level, it can be easily improved at flexibility and functioning levels in order to boost its attractiveness. By increasing the intensity of the benefit while dedicating increased promotional

¹⁰² More info at : <https://www.rossmartin.co.uk/companies/running-the-business/1503-video-games-development-relief>

¹⁰³ <https://www.theguardian.com/games/2018/feb/21/british-games-institute-uk-cultural-hub-for-video-games-nottingham>

activity directed to the investors' community at home and abroad, the scheme can easily develop its potential and keep its competitiveness.

6. RECOMMENDATIONS

As observed above the audiovisual market as part of the overall creative economy is a fast-growing economic sector. The sector is worth more than € 180 billion growing at a faster pace than other industries. In the UK, for example, the creative industries generated £91.8 billion in gross value added in 2016, which represented year-on-year growth of 7.6%, compared with 3.5% for the UK economy as a whole, according to the UK's Creative Industries Federation. The cultural and creative industries employed almost 30 million people worldwide in 2015, according to UNESCO. And, unlike other segments of the economy, the creative arts and entertainment also contribute to cultural identity and social cohesion.

Lithuania is right to benefit from the growth of the audiovisual sector a key strategic industry in the creative economy.

Tax incentives to boost audiovisual production and attract foreign investment have grown increasingly popular in the European overly fragmented market, proving to be efficient tools in boosting local economies, providing jobs and strengthening local audiovisual sectors revolution. Countries are competing for the attention of investors in films and TV series to maintain and strengthen the local industrial and creative infrastructures.

Moreover, from a cultural perspective, societies thrive by creating and telling their own stories in an increasingly connected world. The audiovisual sector allows Lithuania to develop and share its story, thus enabling its local culture to exist in a global digitised culture.

6.1. Key findings

The Lithuanian audiovisual industry has developed in the last years displaying significant growth of the local film industry. The implementation of the tax incentive mechanism contributed to this situation.

In its four years of functioning, the tax scheme has significantly contributed to the local economy, by channelling an important amount of foreign investment in the country (approx. € 24,4 million). It enabled to attract large international media groups such as the BBC or HBO. The tax scheme has contributed to the creation in the production sector alone of around 10.583 freelance jobs (through the productions which did not benefit from state aid) and up to 12.170 freelance jobs (through all the productions supported by the tax scheme). These freelance positions generated personal income and stimulated additional spending into the economy (estimated at € 11,9 million from the productions not supported by state aid and at € 14,8 million for all the productions supported by the scheme). The incentive mechanism generated an important revenue for the state (estimated at € 6,8 million in tax revenue from the productions not supported by state aid and at € 10,8 million in tax revenue for the totality of the productions; the latter is an important figure considering that state's investment via the tax scheme amounts to an estimated € 9,5 - € 10 million in the analysed period).

The cultural impact is also significant with national films achieving a market share above 20%, (among the highest in Europe, as shown in section 2 above) and regularly featuring in the top 10 box office hits.

The tax scheme successfully contributed to the internationalisation of the Lithuanian film sector, boosting its attractiveness and credibility. The success of the scheme is creating new challenges and opportunities:

- The need to address the risk of labour and skill shortage in order to increase employment opportunities.
- The requirement to address the structuring of the industry and its consolidation to be able to credibly manage larger international productions.
- Address competition from other states implementing tax incentives to attract film production (only in 2013, film support in the EU was estimated at €3 billion per year, of which €1 billion was provided via tax incentives¹⁰⁴). In this context, it is important to ensure that the scheme remains relevant and competitive.

In order to fulfil its potential, the tax scheme deserves to be better known by potential investors and beneficiaries.

6.2. Policy objectives

The tax scheme is a key instrument to assist Lithuania in building a competitive audiovisual industry and attract further foreign investment in the country bringing skilled jobs, economic and cultural growth, contributing to the country's modern image and territorial' attractiveness as a business and touristic destination. A competitive scheme in complementarity with other policy measures should enable Lithuania to position itself as a regional hub for audiovisual production and, as a result, make the most of the tax break. In this section we propose policy measures aimed at achieving the following objectives:

1. The promotion of Lithuanian culture locally and internationally
2. Strengthen the contribution of the cinema industry to economic growth and employment
3. Help Lithuania to become an international hub for film production.

With a view to achieve the above policy objectives we propose the authorities to:

- Review the functioning of the tax scheme to increase its attractiveness
- Increase the visibility of the scheme to promote its usage both locally and internationally.
- Better articulate the tax scheme with complementary policy measures enabling the development of the local audiovisual industry across its value chain.

For each proposition we created a set of policy measures.

A. Recommendations in relation to the functioning and attractiveness of the tax scheme

1. Address investors' lack of trust in the scheme by switching the delivery of the investment certificates from the Lithuanian Film Centre to Lithuanian Tax Authorities. The Film Centre would

¹⁰⁴ European Commission, *State aid: Commission adopts new film support rules*, press release, Brussels 14 November 2013

still manage the process but the certificate would be delivered by the Finance Ministry, thus giving more authority to the document.

2. Deliver the tax certificate when the contract between the investor and the producer is signed rather than when the funding is delivered. Funding could be made available within six months after the signature of the certificate. This would give investors more visibility on the impact of the transfer and its related tax benefit.
3. Increase the intensity of the benefit for producers via the scheme from 20% to 30% of the production expenses. This would increase the competitiveness of the scheme in face of the other Baltic incentive, by ensuring not only a higher support for the film production, but also a higher tax rebate for the investor (as the taxable profits and corporate tax deduction depend on the donated funds) which would increase the motivation to invest in film production.

B. Recommendations in relation to ensuring more visibility and increase usage of the scheme

1. Help the emergence of specialised financial intermediaries whose role would be to promote the scheme to potential investors in the business community.
2. Organise awareness campaigns for international producers to present the benefits of the scheme at major international film festivals or media conventions.
3. Organise regular events for the business community to meet film producers and tax inspectors to create awareness and trust in the tax benefit, as well as to explain its functioning.
4. Create marketing campaigns targeting large media companies such as Netflix and Hollywood majors to attract shooting in Lithuania.

C. Recommendations to better integrate the tax scheme to the overall audiovisual policies

1. Address the risk of labour shortage and skill gaps by developing and implementing training programmes on technical and digital skills. Seek MEDIA funding to set up a dedicated training programme.
2. Enlarge the scope of the tax scheme to cover video games and other digital AV productions to boost excellence in digital creation and skills.¹⁰⁵
3. Implement the amended AVMS Directive in such a way that it encourages distributors and broadcasters to invest in production, as well as distribution and make use of the scheme by setting mandatory goals.

¹⁰⁵ See UK tax relief mechanism for the production of video games

4. Further improve the regulatory ecosystem for the local film industry by lowering the VAT rate in relation to cinema admission in theatres, as well as discouraging online piracy.
5. Support development of a strong talent base (filmmakers, screenwriters) to foster local creative capacities.
6. Improve availability of data to measure the impact of the scheme and monitor the effect of policy measures across the entire value chain, but also in terms of trade value (export).

7. FINAL CONCLUSIONS

The present report shows a clear positive impact of the tax scheme on the production sector for a minimum cost to Lithuanian tax payers:

- It channelled more than € 24,4 million in foreign investment
- The tax scheme encouraged an increased production of local commercial films that are well received and attended by local audiences. The scheme also contributed to the internationalisation of Lithuanian culture and showcasing of local talents in international festivals
- The scheme contributed to the creation of employment in the production sector which provided an estimated personal net income of € 8,2 million (from all the productions that benefitted from the tax scheme). The increase in production activity also contributes to maintaining a highly skilled workforce
- Overall the scheme played a key role in developing the local audiovisual sector's international attractiveness

The tax scheme enables Lithuania to position itself in the fast growing international audiovisual sectors that is due to expand significantly in the years to come with the explosion of digital distribution platforms and new formats for story telling (notably virtual reality).

The tax scheme needs to be adapted to remain competitive and attractive to would be investors. With a view to reach its full potential as a driver of audiovisual growth complementary policy measures should be adopted with a view to strengthen the local creative ecosystem and for the scheme to impact the entire audiovisual value chain beyond cinema production. Such policy measures include:

- Increase the flexibility of the tax scheme and the intensity of the benefit for producers.
- Increase the international visibility of the scheme and its usage.
- Address the risk of labour shortage and skill gaps in the sector.
- Enlarge the scope of the tax scheme to include other digital audiovisual productions.
- Further improve the regulatory ecosystem for the local film industry by implementing the amended AVMS Directive in a way that it encourages distributors and broadcasters to invest in production, by lowering the VAT rate in relation to cinema admissions, as well as discouraging online piracy.

The authors of this study believe that Lithuania has the potential to become a significant regional hub for audiovisual production and distribution. This should serve the emergence of creative talents and the international distribution of local stories.

8. ANNEXES

8.1. Annex 1: Questionnaire to film producers



22 March 2018

Assessing the impact of the Lithuanian film tax incentive -Questionnaire to film producers-

Introduction

[KEA European Affairs](#) (a research centre specialised in cultural and audiovisual policy based in Brussels) was commissioned by the Lithuanian Film Centre (LFC) to conduct a research in order to assess the impact of the Lithuanian tax scheme for film production on the national economy and film industry from 2014 to 2017. The study will equally provide strategic recommendations to improve the efficiency of the scheme aimed to attract investment in the audiovisual sector.

As producer of a film project supported via the Lithuanian tax incentive, the information you are in position to provide is of crucial importance for the assessment of the effectiveness of the tax scheme.

We would most appreciate your **responses by 13 April at the latest.**

The questions are in relation to each of the productions that received a Certificate of investment during the period 2014 – 2018. Please provide the names of the productions and category (feature, documentary, animation, TV series, etc.) and then provide the following information:

- A. In order to assess the direct impact of the tax scheme on employment and tax collection please provide:**
1. The total number of **permanent jobs** (employees with an employment contract) that your company provided for the production(s)
 2. The total number of **freelance jobs** (professionals hired for a limited time (i.e. for the duration of a film production) without an employment contract) that your company provided for the film production(s)
 3. The **total labour cost (gross salary)** paid by your company as employer for the film production(s) to
 - a. Employees
 - b. Freelancers
 4. The **total labour tax (social security contributions)** paid by your company as employer in relation to jobs provided to
 - a. Employees

- b. Freelancers
5. The **total income tax** paid by the above-mentioned
 - a. Employees
 - b. Freelancers
 6. The **total of social security contributions** paid by the above-mentioned
 - a. Employees
 - b. Freelancers
 7. **The VAT paid by your company** in the acquisition of services for the film production(s).
- B. In order to estimate the impact of the tax scheme on other industries (indirect impact), could you please provide for each production:**
1. The **estimated expenditure on**
 - a. Accommodation
 - b. Catering
 - c. Transportation
 - d. Legal Services
 - e. and on any other relevant sector
- C. Could you please provide information on the **amount of local and foreign investment (if any)** in the film production(s)?

For clarification and information please contact tpletosu@keanet.eu

We thank you for your collaboration.

8.2. Annex 2: List of interviewed stakeholders (7-15 March 2018)

LFC	Rolandas Kvietkauskas – LFC Director r.kvietkauskas@lkc.lt Gerda Leonavičienė – LFC lawyer g.leonaviciene@lkc.lt
Tax specialists, auditors	Aurelija Lauruševičiūtė Justė Tušaitė juste@vak.lt Akvilė Berenė Vaida Ilevičiūtė Dana Tamulevičiūtė dana@dta.lt Monika Mikalauskaitė
State Tax Inspectorate, Ministry of Finance	Alina Gaudutytė – State Tax Inspectorate A.Gaudutyte@vmi.lt Jolite Mazėtienė – State Tax Inspectorate Vytenis Čepė – Ministry of Finance vytenis.cepe@finmin.lt
Service providers (for foreign filmmakers)	Kęstutis Drazdauskas – UAB Artbox kestas@artbox.lt Ramūnas Škikas – UAB Ahil info.ahil@yahoo.com Gabija Siurbytė – UAB Dansu gabija@dansu.eu Lineta Mišeikytė - Baltic Films services lm@bfs.eu.com
Producers (national films/co-productions)	Marija Razgutė – VšĮ Čiobreliai marija@ciobreliai.lt Lukas Trimonis – VšĮ In Script lukas@inscript.lt Uljana Kim – Uljana Kim studio kim@lfc.lt Agnė Adomėnė – Artshot agne@artshot.lt
Producers (commercial Lithuanian productions)	Rokas Vabalas – UAB Vabalo filmai rokasvabalas@gmail.com Povilas Skaisgirys – UAB Singing Fish p.skaisgirys@gmail.com Stasys Baltakis – VšĮ Film Jam stasys@filmjam.eu
Investors	Žaneta Bytautienė – Šiaulių bankas Cinevera Viktorija Juškaitė
Distributors	Asta Martinonytė - ACME Film, distributor Asta.Martinonyte@acmefilm.lt
Exhibitors	Gintaras Plytnikas – Forum Cinemas (representative of the major movie theatre) Gintaras.Plytnikas@forumcinemas.lt
Vilnius Film	Jūratė Pazikaitė – Vilnius Film Office Jurate.Pazikaite@vilnius.lt

8.3. Annex 3: Comparative overview of the Baltic incentives for film production

	Lithuania (2014 – 2018)	Estonia (2016 – 2017)	Latvia
Name of measure	Lithuanian film tax incentive scheme (managed by the Lithuanian Film Centre)	Film Estonia cash rebate project (managed by the Estonian Film Institute)	State support for film production (managed by the Latvian Film Centre)
Type of mechanism	Tax deduction (indirect state aid)	Cash rebate post filming (direct state aid)	Cash rebate (direct state aid)
Objective	To create favourable conditions for cultural film production in Lithuania and attract foreign film producers in Lithuania	To encourage foreign investments in Estonia, develop the Estonian Film Industry, promote Estonia internationally	To encourage foreign investments in Latvia, develop the Latvian Film Industry, promote Latvia internationally
Capped state budget	€ 19.230.000 (in tax expenditure)	€ 1.500.000 (in cash rebates) 2016: € 500.000 2017: € 1.000.000	€ 2.000.000 2016: € 1.000.000 2017: € 1.000.000
Returns	2014 – 2017: 68 film projects (foreign, co-productions and national) € 8.5 million of investments	2016: 2 foreign productions € 1.67 million of foreign investments	2016: 10 film projects € 5.0 million of investments
Types of beneficiaries	Lithuanian or foreign entities registered in Lithuania that has provided a donation to a domestic or foreign film producer for the production of a film in Lithuania	Film or AV works producers registered in Estonia which have entered into a contract with a foreign film or AV works producer with the purpose of producing of a AV work in Estonia	Film or AV works producers registered in Latvia which have entered into a contract with a foreign film or AV works producer with the purpose of producing of a AV work in Latvia
Conditions / Types of films	At least 2 of the following conditions: • The film script is based on the cultural, religious, historical or social life of Lithuania or Europe	Production and post-production of films with the following min overall budgets: Feature film: € 1 million Full-length anim film: € 2 million Short animation film: € 250.000	Production and post-production of films with the following min overall budgets: Feature film: € 710.000 Full-length anim film: € 1.420.000 Short animation film: € 250.000

	<ul style="list-style-type: none"> • The film tells the story of a Lithuanian or EU cultural, historical or religious personality • The film script is based on a Lithuanian or EU literary creation • The film promotes Lithuanian or EU values, or tackles issues of national or EU identity 	<p>Animation series: € 500.000 1 episode of a TV series: € 200.000 Documentary: € 200.000</p> <ul style="list-style-type: none"> • Confirmed financing of at least 50% of the total budget of the film at the moment of application 	<ul style="list-style-type: none"> • Co 50 at
<p>Eligible expenses</p>	<ul style="list-style-type: none"> - Production of feature films, TV dramas, documentaries, animated films - At least 80% of the total eligible expenses must be incurred in Lithuania - Total amount of eligible spend in Lithuania is min € 43.000 <p>Ineligible expenses are equally defined:</p> <ul style="list-style-type: none"> • costs of the preparation of the application • fines, penalties, litigation costs • acquisition of fixed assets, construction, reconstruction if they are unrelated to the production of the film • travel costs when Lithuania is not the place of arrival or departure • development costs • film promotion and marketing expenses • film distribution costs 	<p>Production costs that are incurred in the territory of Estonia</p> <ul style="list-style-type: none"> - Staff cost (remuneration of employees who are tax residents in Estonia) - Rental of shooting equipment, costumes and locations, locations costs, security services - Building materials, props, landscaping - Accommodation, catering, public services - Transport services - Sound and picture post-production, digital visual effects, animation costs - The Scheme shall apply up to 80% of the total cost of the film 	<ul style="list-style-type: none"> - Cos - Latv - after - con - Co - pr - fil - Tra - rel - Ho - pu - Pu - ne - eq - Ar - So - Fe - To - no - of

	<ul style="list-style-type: none"> • payment for actors (if the payment exceeds 4% of the production costs) 		
% of support intensity of the eligible costs	<ul style="list-style-type: none"> • A donation of max 20% of the total production cost is made to a film producer. If several donors – same percentage is maintained. • The total intensity of aids is limited to 50% of the production costs of the film. Exceptions: <ul style="list-style-type: none"> - low budget and difficult films (75% in the 2014-2017 period. Since 2018, the maximum intensity for these films amounts to 90% of the production budget) - co-productions (up to 60% of the production budget) • 75% of the donation can be deducted from the taxable profits of the donor • the corporate tax can be decreased by the amount of the donation • the max intensity of the benefit that can be obtained by the donor is 11,25% of the donation 	<ul style="list-style-type: none"> • 20-30% of the eligible costs of the Estonian production stage – according to the rate of the eligible costs of the Estonian production stage + • 25% of the eligible staff costs - if the Estonian production stage team has hired at least 1 creative employee who is tax resident in Estonia • 30% of the eligible staff costs - if the Estonian production stage team has hired at least 2 creative employees who are tax residents in Estonia • the intensity of the state aid may not exceed 50% of the total eligible costs of the film • the intensity may increase to 60% for the cross-border productions funded by more than one MS • the intensity may increase to 100% for co-productions involving countries from Development Assistance Committee 	<ul style="list-style-type: none"> • 25% • 20% • 25%
Payment	The tax benefit can be exercised upon receiving the investment certificate for the return period in which the investment certificate was received.	Post-filming: <ul style="list-style-type: none"> • The beneficiary will submit a cost report 	Pos <ul style="list-style-type: none"> • Th ap fin

		<ul style="list-style-type: none">• Evaluation of the report within 30 days• Payment will be made no later than 10 days after the date of approval of the final report	<p>em No • Ev a r • Dis the</p>
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8.4. Annex 4: Additional methodological notes

In relation to the tax returns from employment, the tax rate that freelancers have to pay for their professional activities is a variable depending on a series of factors such as the civil status type of insurance or number of current assignments. As such, the majority of the surveyed production companies were not able to provide information on taxes paid by freelancers. KEA could only estimate the total tax revenues generated by freelance jobs in the film production sector based on a flat rate of 52% (which includes the flat personal income tax and the social security contributions free of the constraints mentioned above)¹⁰⁶.

The economic estimations are based on the inputs provided by 24 production companies out of a total of 28 which used the tax scheme. In some cases, the inputs are not complete, due to accountants' difficulties in acquiring information concerning foreign shares of investment or expenditures on the supply chain. As such, the figures reflect only partially the economic impact of the scheme at the production level.

Finally, the scheme is relatively new, being in place for four years only. A longer period of time will show that the scheme has a much larger impact on the economy, as overall economic effects of such mechanism become visible in time. For instance, the returns of supported productions on the entire value chain (box office, TV, VoD or DVD sales) are concretised in at least 2 years since the film is launched and an important number of the concerned productions are still newly launched. As such, a pertinent estimation of their Gross Value Added (GVA) to the film sector cannot be calculated for the moment. Also, the period of time accounts for a general lack of monitoring of the different type of data (such as job increase, personal incomes and tax revenues) in the supply chain or along the entire film's value chain in relation to the tax scheme. However, the present analysis provides a trend for future assessments.

¹⁰⁶ Data from the Lithuanian Tax Law on personal income and social security contribution, which was in place until the end of 2017

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