

A COMPARATIVE ANALYSIS OF INDIVIDUAL BUSINESS ACTIVITIES AND EMPLOYMENT RELATIONSHIPS IN THE CONTEXT OF A LAW PRACTICE: ISSUES AND SOLUTIONS

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Abstract. *This article provides a critical analysis of the proposed reform of the Republic of Lithuania Law on Personal Income Tax (PIT), with a focus on its negative impact on persons engaged in individual business activities, in particular, lawyers and assistant lawyers as well as representatives of other free professions. The PIT reform is assessed through a comparison between individual business activities and employment relationships, with the main consequences of the reform identified as follows: the proposed combining of passive income (from property sale or lease) and active income (from work, i. e. earnings) and equalised taxation of income irrespective of differences in origin, intensity of effort, and risks will undoubtedly damage economic justice; capital gains under a project would be taxed by up to 36 %, whereas in Latvia or Poland the tax rate is 19–20 % and in Sweden it is 30 %, which means that taxation in Lithuania would be disproportionately high; equal taxation could encourage highly-qualified specialists to relocate to jurisdictions that are more favourable in terms of taxation. Thus, the reform would increase both emigration rates and the size of the shadow economy.*

The current tax regime is deemed to be a balanced one. At present, different PIT rates are applied depending on the type of activities: 5–15 % to individual business activities, 20–32 % to income from employment, and 15 % to dividends. It is obvious that the proposed PIT reform is unfounded both legally and economically as it violates the principles of proportionality, fairness and legal certainty. It is recommended that a targeted, proportionate and gradual solution should be implemented having regard to the types of activities as well as risks.

Keywords: *personal income tax, individual business activities, employment relationships.*

Introduction

Determining a person's residence for tax purposes forms a fundamental and integral part of the taxation system of any state. Based on such determination, the person is subject to either unlimited (resident) taxation or limited (non-resident) taxation. In Lithuania, taxation of personal income is based on residents' categorisation as permanent/non-permanent residents, which determines whether a taxpayer is taxed on total income derived worldwide or just on the income received in Lithuania (Law on Personal Income Tax, 2002). In accordance with Article 4 of the Law on Personal Income Tax (LPIT), a natural person is considered as a permanent resident of Lithuania if the person meets at least one of the criteria listed in the said Article: has a place of residence in Lithuania; the centre of their main personal, social or economic interests is in the territory of Lithuania; they stay in Lithuania for more than 183 days in any calendar year; or the person is a Lithuanian citizen who receives income from Lithuanian sources (LPIT, 2002). Such legal position is in line with the rules for avoiding double taxation in which priority is given to the criterion of place of residence (Organisation for Economic Co-operation and Development, 2017). Therefore, determination of the status of a permanent resident is the first and key element in the application of the personal income tax system, ensuring compatibility of international taxation rules. A person is started to be classified as a permanent resident and their income is taxed in Lithuania upon meeting at least one of the criteria set in Article 4 of

LPIT. In some cases, non-permanent residents can be taxed in Lithuania, however, only income the source of which is in Lithuania will be considered as taxable income. This means that acquiring the permanent resident status in Lithuania is essential in determining which income will be taxed with PIT and what tax rates will apply. Lately, a PIT system reform aimed at equal taxation of individual business activities and income from employment has been increasingly discussed in this country. According to proponents of such reform, the purpose is to create a fairer and more neutral taxation environment. A thorough analysis, however, raises doubts over whether this principle of equalisation is proportionate, legally justified and socially balanced. Both research and assessments made by professionals' communities point out to potential long-term adverse consequences of such reform, in particular for self-employed persons and highly-qualified professionals.

Research problem. The proposed changes to the personal income tax and the aim to equalise tax rates for persons working under employment contracts and persons engaged in individual business activities may contradict key principles such as proportionality, legal clarity and tax neutrality. According to Moore, K. B., research has shown that a tax reform that is carried out while disregarding professional aspects and risks inherent in different business activities can lead to an increase in economic activities outside formal regulatory frameworks and reduce motivation for individual business activities (Moore, 2004). Furthermore, the law doctrine suggests that a lack of legal certainty in tax law makes planning of activities difficult and diminishes public trust in the authorities – this is particularly relevant to persons engaged in individual business activities (Gorodilov, 2022; Demin, 2020).

Purpose of research. The purpose of this work is to examine differences between tax and legal regulation of individual business activities and employment relationships in terms of the proposed personal income tax reform.

Tasks. (1) To identify the importance of the personal income tax within taxation system of the Republic of Lithuania; (2) To examine the current legal regulation of individual business activities and employment relationships in Lithuania and to identify existing differences in terms of personal income tax; (3) To assess the impact of the personal income tax reform upon individual business activities and to identify the gap between the reform and the economic and legal substance of an employment relationship; and (4) To identify potential consequences of the reform for both behaviour and work volumes of persons engaged in individual business activities.

Methodology. Corporative method, analysis of scientific literature, and methods of summarisation and systematisation.

Importance of the personal income tax

Every state has the purpose of collecting maximum amounts of funds in its budget for the financing of certain state-controlled areas. According to E. Puzinskaitė (Puzinskaitė, 2011), there is a close correlation between the budget available to the state and certain functions performed by it, and the higher the efficiency of the tax system, the higher the state budget revenues. Efficiency of tax systems of different states is measured according to the following criteria: tax administration within the state; proper implementation of taxation principles; proper resolution of taxation-related issues; management of the tax system etc. Therefore, in order to ensure that its budget is properly funded, each state seeks to put in place and implement a fair tax system, to manage taxation gaps and to improve taxation principles (Kuodis, 2008). Revenues from personal income tax account for a large part of total state budget revenues. Therefore, this tax is central to the tax system of the state.

An overview of tax systems of the European Union's Member States reveals their diversity including differences in the application of PIT. There is a trend for making taxation principles more uniform, however, the process of harmonising PIT in the EU is difficult as the Member States differ in terms of economic and social development. Therefore, having regard to specific economic situation, geopolitical factors etc., each country applies a different taxation system and individual tax exemptions and reliefs.

According to I. Szarowka (2014), PIT is important within the taxation system not just as one of the main taxes feeding the state's revenues but also as a tax that has an impact on other economic factors such as the functioning of the labour market, emigration, relocation of legal entities to other countries etc. This tax affects the economy in its entirety. On examining taxation of residents' income within the overall tax structure, the author of this article has concluded that unreasonable changes in taxation lead to a disarray among residents and businesses. A number of tax reforms were carried out in Lithuania during the period of over 30 years of independence, and now the governing party is proposing a new PIT reform, which obviously promotes instability and uncertainty among taxpayers. The analysis provided by I. Szarowka aimed to determine the share of PIT in tax revenues by applying a certain tax rate. It has been established that PIT is a highly significant tax. An increase by one percentage point (i. e. the PIT share as part of the entire tax structure) would mean raising the PIT rate up to 0.57 p. p. I. Szarowka has pointed out that a proportionate PIT rate can reduce current progressiveness of the model in a short term.

To sum up, one may conclude that the importance of PIT manifests itself through the revenues received by the state budget. As four tax reforms have already been proposed in Lithuania during 20 years, and now the fifth one is on the table, a change in the PIT determination methods will make it difficult to collect requisite funds to the state budget. Therefore, introduction of a progressive model in the long term is being discussed. One may agree that the current taxation model does not always meets the state's expectations for the collection of tax revenues, however, the necessity and efficiency of such radical changes is doubtful. Practices in other countries must be taken into consideration, and an analysis of Lithuania's economic situation including an examination of various segments and identification of all possible threats and consequences is required.

Current regulation of personal income tax and issues pertaining to the planned tax reform

Personal income tax in Lithuania is governed by the Republic of Lithuania Law on Personal Income Tax (LPIT) that lays down rules for its imposition and application. It should be pointed out that Article 4 of the LPIT details the notion of a permanent resident as PIT is levied on permanent residents of Lithuania who have received income and non-permanent residents that are liable to pay PIT on their income received in Lithuania. Article 5 of LPIT deals with the object of this tax; to put it short, it covers all income of a permanent resident the sources of which are in and outside Lithuania. It should also be stressed that PIT is imposed on non-residents' income as well. Income from individual business activities received through a permanent base in Lithuania and income earned abroad but linked to such base are classified as income taxable in Lithuania if such income is received by a non-permanent resident. Non-permanent resident's income that is not related to the permanent base but the source of which is in Lithuania is also subject to taxation in Lithuania save for exceptions stated in the LPIT.

An overview of PIT rates levied on different types of activities is necessary in order to properly describe the essence and faults of the PIT reform (data source: State Tax Inspectorate, 2025):

Table 1. Tax rates (State Tax Inspectorate, 2025)

| | |
|--|---|
| 20 % | <p>Tax allowance ceiling for annual income earned from employment or equivalent relationships, based on average wage (AW):</p> <ul style="list-style-type: none"> In 2021-2024 – a 20 % PIT rate was applied to the share of income that does not exceed 60 AW; above this ceiling, 32 % PIT rate was applied;. In 2020, the ceiling was higher: 84 AW; In 2019, the ceiling was even higher: 120 AW. |
| 32 % - in and after 2020; 27 % - in 2019 15 % | <p>A higher (32 %) PIT rate applies to the share of annual income earned from employment or equivalent relationships that exceeds the set AW ceiling. The ceiling was:</p> <ul style="list-style-type: none"> In 2024, 2023, 2022 and 2021 – 60 AW, In 2020 – 84 AW, In 2019 – 120 AW. <p>Income that had been calculated in 2018 or earlier and paid in 2019 or later were taxed without having regard to the total annual income, i. e. a non-progressive (standard) PIT rate was applied to it.</p> |
| 15 % | Sickness, maternity, paternity, childcare and long-term service record benefits including benefits paid at the employer's expense. They are not subject to the annual PIT rate ceilings. Therefore, their taxation depends on their specific character rather than total annual income. |
| 15 % | Income derived from distributable profits (dividends) are not linked to the annual income ceiling. Therefore, its taxation is not dependent on total annual income. |
| 15 % (less tax credit) | Income from individual business activities. |
| 5 % | A share of income from business activities other than individual business activities, received from waste sold or otherwise transferred into ownership, that does not exceed 120 AW; applicable since 2019. |
| 20 % | A share of income from business activities other than individual business activities, received from waste sold or disposed otherwise, that does not exceed 120 AW; applicable since 2019. |
| 20 % | <p>Annual income not linked to employment relationships or equivalent relationships the share of which does not exceed set AW ceilings: 60 AW (2021–2024), 84 AW (2020) and 120 AW (2019). The following types of income are included:</p> <ul style="list-style-type: none"> tantiemes or other remuneration for work in a supervisory council, board or loan committee, paid instead of tantiemes or together with them; author's fees received from persons related to the resident's employment relationships or equivalent relationships; income received for management of small partnerships under a civil (service) agreement by managers of small partnerships who are not members. |
| 32% - from 2020; 27% - 2019 | <p>Annual income not linked to employment relationships or equivalent relationships the share of which exceeds set AW ceilings – 60 AW (2021–2024), 84 AW (2020) and 120 AW (2019). The following types of income are included:</p> <ul style="list-style-type: none"> tantiemes or other remuneration for work in a supervisory council, board or loan committee, paid instead of tantiemes or together with them; author's fees received from persons related to the resident's employment relationships or equivalent relationships; |

| | |
|------------|--|
| | <ul style="list-style-type: none"> income received for management of small partnerships under a civil (service) agreement by managers of small partnerships who are not members. |
| 15 % | <p>The share of income not linked to employment relationships or equivalent relationships that does not exceed 120 AW from 2019. The following types of income are included (except income from individual business activities, distributed profit, tantiemes, remuneration for work in a board/supervisory council/loan committee, income under authorship agreements received from one's employer, and income received under service agreements by managers of small partnerships who are not members):</p> <ul style="list-style-type: none"> interest; proceeds from sale or other disposal of property; author's fees received from persons other than one's employer; income from lease of property; winnings in gaming; royalties; prizes received from a source other than one's employer, gifts etc. |
| 20 % | <p>The share of income not linked to employment relationships or equivalent relationships that exceeds 120 AW from 2019. The following types of income are included (except income from individual business activities, distributed profit, tantiemes, remuneration for work in a board/supervisory council/loan committee, income under authorship agreements received from one's employer, and income received under service agreements by managers of small partnerships who are not members):</p> <ul style="list-style-type: none"> interest; proceeds from sale or other disposal of property; income from business activities other than individual business activities received for waste sold or otherwise transferred into ownership; winnings in gaming; author's fees received from persons other than one's employer; income from lease of property; royalties; prizes received from a source other than one's employer, gifts etc. |
| Fixed rate | Applied to income on which a fee is paid at acquisition of a business licence. |

The Law on Personal Income Tax provides for tax reliefs such as tax allowances under Article 17 of the LPIT, amount of tax allowance applied only to the income from employment relationships or equivalent relationships (Article 20 of the LPIT), and tax deductions (Article 21 of the LPIT).

Therefore, one may state that the current income taxation system functions perfectly and ensures consistent and growing collection of tax revenues. The proposed changes of the reform would impose substantial restrictions on freedom of economic activities that is enshrined in the Constitution. A proposal that is subjected to strongest criticism is combining all the resident's income (except income from profit distribution) and equal taxation irrespective of the origin, i. e. both active income (e. g. wages, provision of services, trading) and passive income (e. g. lease, sale of property, capital gain). The proposed PIT reform provides for a uniform PIT rate starting from an EUR 35,000 threshold. This gives rise to questions as to how the market would be affected and how would taxation of employment relationships and individual business activities change; also, whether such solution is reasonable and whether it poses a risk to the very existence of individual activities as a form of business, which currently play an important

role in Lithuania. According to official statistics, as of 1 January 2024, 238,924 legal entities were registered in Lithuania, and as of October 2024, there were approx. 1.46 million employees; in 2024, 263,929 persons were engaged in individual business activities (VĮ Registrų centras (Centre of Registers, a public entity)). The latter figure shows that this form of conducting business is important for the national economy (Duomenų galia, 2024).

A significant impact of the proposed PIT reform is seen at an annual income level of EUR 35,000 (which is equivalent to EUR 2,917 per month gross or EUR 1,968 per month net). The PIT payable by a person engaged in individual business activities becomes equal to that payable by an employee. It is difficult to say whether these two forms of activities can be equalised and how this would affect the market, however, it is likely that individual activity will remain a suitable choice only for persons who earn up to EUR 29,000 per year (\approx EUR 2,416 per month gross or EUR 1,727 per month net). It should be stressed that for some professions, such as notaries, lawyers or bailiffs, changing the form of activities is impossible, the more so – changing the place of residence, therefore, it is presumed that such persons would be put in a risky position in the market, and it is them, earning over EUR 35,000, who will be burdened by the proposed taxation. In the meanwhile, other market participants will be encouraged to form legal entities and to receive income through dividends. It is probable that persons engaged in individual business activities with annual income exceeding EUR 29,000 will change the country of residence or enter the employment market; the size of shadow economy may increase as it is likely that part of such persons will not declare their income; or, as mentioned above, they will change the form of business into a legal entity in order to derive income from dividends.

In view of the foregoing, it is probable that the proposed changes will reduce the number of persons engaged in individual business activities and income of such persons, along with reduction in consumption and tax revenues from value added tax and income tax. On the other hand, in order to maintain the same level of income, such persons will raise their service rates, which will cause harm to consumers whose ability-to-pay is already doubtful.

Issues of taxation of lawyer's activities in the context of the personal income tax reform

It should be pointed out that an analysis of potential changes in PIT shows that the reform would make the position of lawyers engaged in individual business activities significantly more difficult. Solicitors and assistant solicitors, in particular, would be disproportionately affected by the proposed legal changes. The most important aspects are discussed below.

Firstly, combining all the resident's income (except income received from distribution of profit) and equalising it for tax purposes is a completely unfounded and economically incorrect solution, which is also doubtful in terms of compliance with the Constitution. The summing up of income while disregarding the origin of income, relevant experience of European countries close to Lithuania and taxation context is unacceptable and unfair for the following reasons:

1. Equalised taxation of individual business activities, employment relationships and passive income is deemed to be unjustified both legally and economically as these types of income differ not only by their origin but also the type of efforts and risks assumed by the person. To earn active income, a resident invests their time and work, often encountering business risks, whereas passive income – such as lease or capital gain – are often related to asset management or investment decisions with a different types of risks and input. Constitutional principles of equality of taxpayers, good faith and fairness would be violated in the event of such equalisation.

2. The draft proposal for the new LPIT does not consider a probability that a resident may receive passive income of accidental nature – e. g. from sale of real estate that they have held for a long time. In such a case the person would fall within the brackets of a much higher PIT rate. Notably, the value of real estate increases in the long term, and such growth is determined by actions of the owner (proper maintenance and repairs) and inflation rather than by actions of the state. Under the proposed income summing-up model, the whole amount would be taxed as income received in one year because, in case of a proportional distribution over the property ownership period and upon combining it with other income of the same period, the resident may be not subject to the progressive tax rate at all. Such taxation scheme distorts the real nature of the resident's income and violates the principle of proportionality.

3. The proposed reform would mean summing up of all income of a resident (except dividends) irrespective of the type of income. This would result in an unrealistically high taxation of capital gains: the PIT rate could be up to 36 %. Fixed tax rates levied on capital gains in neighbouring countries (such as Latvia or Poland) are usually lower; furthermore, this income is not combined with income from activities. For example, in Latvia capital gains are taxed at 20%, whereas other income up to 31%; in Poland 19% and 32%, respectively. Such disproportion shows that the proposed change in the Lithuanian PIT framework stands out in the region as a one unfavourable for capital investments. In addition, such decisions damage competitiveness of the country's taxation system.

4. Finally, implementation of the proposed model that combines active and passive income would not give an incentive to residents to stay in Lithuania, set up a business and develop economic activities. On the contrary, they would be motivated to seek a more favourable tax environment in the neighbouring countries such as Poland or Latvia where administrative burden is lighter and tax rates are more competitive.

Still, if a decision to carry out the PIT reform and to increase tax rates is taken, it will be critically important to exclude income that is different by substance – in order to retain entrepreneurs that create value added in Lithuania and to attract highly-qualified specialists from abroad. The existing system in which residents income is classified by origin and taxed with different progressive tax rates ensures certain taxation fairness and promotes economic activity.

According to current legal regulation (Personal Income Tax, 2025):

a) income that is deemed to be equivalent to income from employment, tantiemes and remuneration for work in supervisory councils/boards is taxed at 20%–32%,

b) income from individual business activities (also activities related to art and sports) is taxed 5%–15%, and

c) any other income is taxed at 15%-20% except individual business activities, income from dividends and income from employment which are taxed at 15%.

Such system enables to maintain separate income taxation regimes that reflect differences in terms of income type, intensity of efforts and risks. The current income taxation system is most balanced as it takes account of different character of activities and ensures freedom of choice of activities. Whereas the income equalisation model proposed in this reform is considered as its essential flaw as it ignores differences between individual business activities, employment relationships and passive income.

It should be stressed that employment relationships provide guarantees: the employee enjoys social security according to the law and receive fixed pay on a monthly basis. Income from an individual business activity is also considered as active income, however, the person engaged in it has no employer and their income depends on personal initiative, market conditions, geopolitical situation, and the status of the country's economy. On the contrary,

passive income – such as proceeds from property sale or investments – is derive from one-off transactions or capital gains and, in substance, are not related to protection inherent in an employment relationship. For the reasons stated above, equalisation of taxation of all these types of income violates the principle of proportionality and does not ensure fairness of taxation.

Another important point is related to essential differences between individual business activities and employment relationships that must be taken into consideration in the formulation of tax policies. A person engaged in individual business activities initiates their professional activities independently, creates their workplace, finances relevant expenses, and assumes full responsibility for continuity and lawfulness of their activities. In LPIT, a special term is used to denote such realisation of the resident's right: permanent base. Furthermore, such person does not receive social security guarantees that are provided to employees. A resident engaged in individual business activities can freely choose the place of business including abroad. Such mobility legally defined as a *permanent base* signifies a more flexible model of organising business activities as compared with conventional employment relationships.

Ability to maintain and attract knowledge and highly-qualified human resources is the key strength of a state in terms of economic competitiveness. In modern global market, competitive advantage is determined also by movement of talents, innovation and knowledge – not just by investments or capital flows. Current Lithuania's taxation policy is favourable for legal entities: the Law on Corporate Income Tax provides for tax reliefs to investments and innovation as well as for start-ups. However, similar strategic approach to taxation of personal income is not obvious in the proposed PIT reform. Many highly-qualified professionals operate independently, register individual business activities, and provide services to customers in both Lithuania and foreign countries. Such persons work independently, are not subordinate to anyone, and create their own workplaces. Their purpose is to provide knowledge-based services focussed on the customer's needs, with the specificity of their activities enabling them to be flexible in selecting the country of operation. Whereas proponents of the PIT reform intend to equalise taxation of such professionals with that of employees without having regard to risks, substance of activities, and differences in terms of responsibility. Such equalisation could be considered as a destruction of the model of individual business activities and would mean a significant restriction on the freedom of operation.

A comparison of individual business activities and employment relationships is provided below. The obvious differences shown by this analysis lead to a conclusion that equal taxation of these activities is not only legally unjustified but is also unreasonable from the economic point of view.

Table 2. A comparison of individual business activities and employment relationships.

| | Individual business activities | Employment contract |
|-----|--|---|
| 1. | Individual business activities do not guarantee income (daily, monthly, annual). No income is guaranteed. The person is responsible for obtaining a business permit/licence independently. | Irrespective of performance results, the person working under an employment contract (the employee) is guaranteed a fixed and stable wage. The employer pays and is responsible for business licences and permits. |
| 2. | The person engaged in individual business activities assumes all risks including the risks related to continuity of business and stability of income; there is a bankruptcy risk; they do not enjoy social security (e. g. in the event of an accident). | The employee receives stable income and is not responsible for continuity of the entity's business activities; the employer and the employee agree only on performance of certain work functions and the employee enjoys social security in the event of an accident at work. |
| 3. | Individual business activities are based on independence that manifests itself through conclusion of a service agreement. | The employee performs set functions for the employer, and such functions form part of the entity's business. The employee is dependent on and subordinate to the employer. |
| 4. | Individual business activities do not involve any incentive mechanisms. | The employee may be incentivised depending on the quality of performance of their work functions. |
| 5. | The person engaged in individual business activities creates a workplace for themselves and there are no restrictions in terms of working time. Creation of a workplace, however, gives rise to additional expenses for rent and means of work. | The employee is provided by a workplace and incurs no additional costs or risks related thereto; maximum length of a working week is 40 hours. |
| 6. | The person engaged in individual business activities is not paid for days-off and holidays (or paid at different rates) or overtime. | The employee receives pay irrespective of how many working days coincide with holidays. Work on holidays is paid at a double rate, and work on days-off at a rate increased 1.5 times. Extra payment for overtime is guaranteed. |
| 7. | The person engaged in individual business activities must earn money for their annual holiday, i. e. there is no leave pay and the money has to be earned in advance. | The employee is granted a set number of leave days and payment for the leave is guaranteed. |
| 8. | No time is granted for childcare, and childcare time is not paid for. There is no preservation of business during maternity leave and childcare leave, and the person has to restart work with their customers and develop their business anew. | An employee with two or more children receives additional paid days-off every month. The employee's job is retained during maternity and childcare leave, and they can return to their previous workplace. |
| 9. | Individual business activities involve full financial liability (i. e. the person is liable to the full extent of their family assets). | The employee's material liability is limited to an amount equal to the average monthly wage multiplied by 3 to 6. |
| 10. | The person engaged in individual business activities has to make arrangements for their skills improvement independently. | The employer pays for the employee's skills improvement. |
| 11. | In case of sickness, the person engaged in individual business activities receives a minimal benefit of EUR 31.62 per day. This means that no sickness benefit is provided for. | Sickness benefits received by the employee depends on the employee's pay (70 % of pay). |

| | | |
|-----|--|--|
| 12. | Should annual income from individual business activities exceed EUR 45,000, the person is liable to pay VAT. | Employees do not pay VAT. |
| 13. | Banks apply terms and conditions that are different from usual ones to loans granted to persons engaged in individual business activities. | Banks treat persons working under employment contracts as more reliable ones and grant loans on more favourable terms. |
| 14. | The person engaged in individual business activities is obliged to keep accounts or hire an accountant. | Responsibility for keeping the entity's accounts rests with the employer. |
| 15. | The lawyers' right to engage in other activities or to work under an employment contract is restricted (except academic activities and authorship agreements). | A person working under an employment contract has the right to be employed by other employers as well. |

An analysis of the differences between individual business activities and employment relationships shows that, even if a decision is taken to change the framework for taxation of personal income and implement a different tax regime for persons engaged in individual business activities, it is important to retain the principles of good faith and fairness in the taxation system. It should be stressed once again that income from such activities cannot be equalised with income from employment, not least due to the different nature of these two types of activities and different inherent risks. In particular, it is unreasonable to combine income from individual activities with the resident's other income received during the same year in order to apply a common system of progressive taxation. Such practice would distort tax neutrality and violate the principle of proportionality.

In the event of rejection, considering the geopolitical situation, of all the above arguments against the application of the new model to individual business activities, a higher tax rate on such activities could only be considered if the increase in the tax rate is gradual and not radical (a few percentage points only), and the whole increase is earmarked for the Defence Fund.

Having regard to geopolitical factors and in order to reinforce the financial base of the national defence, a targeted PIT reform model could be considered, i. e. levying of an additional tax rate on higher income from individual business activities. In such a case, an introduction of a new 17% or 20% PIT rate for income exceeding 60x AW per calendar year, irrespective of the size of the excess, could be considered. The said rate would be levied on the excess amount only. Such solutions would ensure clarity of the use of the funds, which would result in the public trust in the taxation system and people would be motivated to contribute to the national security.

Research has shown that increased tax rates reduce returns from individual business activities and may result in exit from such activities or rising prices, which is finally borne by consumers (Bruce, 2002); (Fölster, 2002); (Ferede, 2013).

Considering the risks identified above, it is proposed that income from individual business activities is taxed at a 17% or 20% PIT rate levied on the income exceeding the amount equal to 60x AW during a tax period. Such taxation should be implemented gradually, at the rate of a percentage point per year. This model would enable persons engaged in individual business activities to adapt to the change gradually, ensure stability and reduce risks; consumers would be enabled to adapt to changed conditions.

Conclusions

Personal income tax is deemed to be a key and essential part of the state's fiscal policy, has a significant impact on the collection of state budget revenues, and fosters economic stability and social equality. It should be stressed that changes in the PIT model contribute to mistrust in the taxation system on the part of the public and businesses, and lead to tax uncertainty, therefore, a clear and consistent taxation model based on the principles of fairness, good faith and proportionality should be maintained in the long term.

One may assert, based on provisions of the Republic of Lithuania Law on Personal Income Tax and tax rates currently levied on residents' income, that the present PIT framework ensures sufficient stability of tax revenues for the state budget. Proposed PIT changes, in particular those related to equalised taxation of income of different types, pose a threat to the very survival of individual business activities, may promote development of the shadow economy, and may slow down the growth in tax revenues. Therefore, a thorough impact assessment must be made prior to carrying out such reform, having regard to different forms of activities, social aspects, and structure of the national economy.

On completion of an overview of differences between individual business activities and employment relationships, one must point out, in particular in the context of a law practice, that even if a decision is taken to change the framework for taxation of personal income and to implement a different tax regime for persons engaged in individual business activities, it is important to retain the principles of good faith and fairness in the taxation system. Income from individual business activities cannot be treated as income equivalent to income from employment. The proposed equalisation of income of all types (active and passive) by imposing the same tax rate is economically unjustified and legally dubious as it disregards different origin of income and different levels of effort required and risks involved; it also violates constitutional principles of good faith, equality and proportionality.

The proposed PIT reform that is being publicised would reduce tax competitiveness of Lithuania. A comparison of taxation of capital gains in Lithuania, Latvia and Poland shows that the proposed change in Lithuania would increase the tax rate up to 36 %, which would result in the reduced competitiveness of the country's taxation system in the region. Furthermore, a steep increase in tax rates poses risks to both businesses and consumers. Research shows that a sudden rise in PIT for individual business activities can reduce economic activeness, encourage exiting this type of activities, or increase service prices for consumers.

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