



CHAMBERS
Global Practice Guides

Corporate Tax

Law and Practice – Bulgaria

Contributed by
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2018

BULGARIA

LAW AND PRACTICE:

p.3

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The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

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BULGARIA LAW AND PRACTICE

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Georgiev, Todorov & Co. was founded in 1991 as one of the first Bulgarian law firms. Currently, it is one of the largest business law firms in the country, consisting of seven partners and 52 lawyers. Based in Sofia, it provides both domestic and international clients with a high level of ex-

perience, especially in the areas of corporate and commercial law, tax law and major business transactions, as well as in the field of appealing procedures. Additionally, the firm has significant experience across the telecommunications, IT and litigation sectors.

Author



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1. Types of Business Entity, Residence and Tax Treatment

1.1 Corporate Structures and Tax Treatment

Businesses in Bulgaria generally adopt a corporate form. There are five different types of corporate structures in accordance with the Commercial Act:

- Unlimited Partnership;
- Limited Partnership;
- Limited Liability Company;
- Joint Stock Company; and
- Limited Partnership with Shares.

The key differences relate to the number of members and the kind of liability of the members. For instance, Unlimited Partnerships require the personal participation of their members. Limited Partnerships require the personal participation only of their unlimitedly liable members. The members of Limited Liability Companies and Joint Stock Companies participate and are liable only to the extent of their capital participation. All entities listed above are taxed as separate legal entities.

1.2 Transparent Entities

Bulgarian law does not envisage the existence of transparent entities, ie, where the income is considered to be the income of its members. One specific entity is the consortium, because of the contribution of its members and the distribution of the profit, which is mostly used for public procurements, but it is not a classic transparent entity.

1.3 Determining Residence

Under the Bulgarian Corporate Income Tax Act, the following are considered local legal entities:

- legal entities established under Bulgarian law;
- companies established under Regulation (EC) No. 2157/2001 of the Council; and
- co-operative societies established under Regulation (EC) No. 1435/2003 of the Council, which have their registered office within the country and are entered in a Bulgarian register.

Under the definitions of the double taxation treaties, the tests for determining the residence of incorporated businesses could be the place of effective management or the place of incorporation.

1.4 Tax Rates

There is no difference in tax rates depending on the type of members. Incorporated businesses are subject to a flat corporate tax rate of 10%. Certain exemptions apply to some collective investment schemes or special investment vehicles. There are also special tax regimes regarding taxation of commercial maritime shipping companies and gambling businesses.

2. Key Features of the Tax Regime

2.1 Calculation of Taxable Profits

The tax base is the accounting profit pursuant to the commercial accounts and subject to adjustments. The taxable profit is the accounting profit adjusted for tax purposes.

Tax adjustments include the following:

- non-business related or not duly documented expenses;
- hidden profit distribution expenses;
- interest restricted under the thin capitalisation rules;
- expenses for impairment of assets; and

- dividends received from local or EU-based companies.

According to tax depreciation rules, maximum annual tax depreciation rates are between 4% and 50%, depending on the type of asset. In general, profits are taxed on an accrual basis.

2.2 Special Incentives for Technology Investments

Tax depreciation expenses are allowed for tangible and intangible assets.

2.3 Other Special Incentives

Part of the corporate tax due shall not be paid by the social and health insurance funds under certain conditions related to their basic activities.

The corporate tax on tax profit may be remised at up to 100% if the company carries out production activities only in municipalities where the unemployment rate is higher than the country's average unemployment rate compared to the previous year, and if some other conditions are met.

Special incentives apply to companies that hire disabled or unemployed people under certain conditions.

2.4 Basic Rules on Loss Relief

The losses from a current year can be carried forward for the next five years.

2.5 Limits on Deduction of Interest

Under the "thin capitalisation" rules, if the debt-to-equity ratio of the company exceeds 3:1, (some of) the interest expenses may not be tax deductible in the current year.

2.6 Basic Rules on Consolidated Tax Grouping

There are no rules on consolidated tax grouping in Bulgaria. Each company is taxed separately as an independent trader, including regarding company losses.

2.7 Capital Gains Taxation

Capital gains are included in the taxable profit of the company, ie they are considered as income from a company's regular business activity, and are subject to adjustments in accordance with the applicable fiscal and accounting rules. The applicable tax rate is the standard corporate rate of 10 %.

Some capital gains are exempt, ie capital gains on publicly traded shares on the Bulgarian Stock Exchange or on a stock exchange under Directive 2004/39/EC.

2.8 Other Taxes on Transactions

VAT and excise duties may be payable by an incorporated business on a transaction. Sales of real estates are subject to transfer tax.

2.9 Other Notable Taxes

There is a one-off tax on the following expenses:

- "representative" expenses;
- "social" expenses provided in kind to employees (eg, fringe benefits), except for food vouchers and voluntary insurance contributions (social, health and life insurance) up to BGN60 per employee per month; and
- expenses related to the use of vehicles for management purposes.

The tax rate is 10% on the accrued expenses. Both the respective expense and the one-off tax applicable to it are deductible for corporate income tax purposes.

Social Security and Health Insurance

The insurance base is the gross remuneration less statutory deductions, in some cases, and is capped at BGN2,600 (approximately EUR1,300) monthly.

Social security treaties: foreigners may be exempt from social security contributions in Bulgaria, or the contributions they make may be recognised in their home country under an applicable bilateral or multilateral social security agreement (as the scheme applicable for EU citizens).

Environmental fees: the producers or importers of products (or the entity performing an intra-community acquisition) whose usage incurs large amounts of waste have to pay a product fee based on the type of waste.

They can avoid paying the product fee if they collect or recycle certain amounts of the waste produced by their products, either on their own or through a licensed collective waste management organisation.

Real estate tax is between 0.01% and 0.45% annually, charged on the higher of the gross book value and the tax value of the immovable property. The exact rate is determined by the municipality in which the real estate is situated.

Garbage collection fees are determined by each municipality, and are generally levied on the gross book value of the real estate. Alternatively, the fee may be determined on the basis of the number and volume of waste containers used.

Vehicle tax depends on the type and characteristics of the vehicle, and applies to cars, ships and airplanes. The tax rate is determined by each municipality within ranges stipulated in the law.

Donation tax ranges between 3.3% and 6.6% of the value of the donation, with the exact rate determined by each municipality.

3. Division of Tax Base Between Corporations and Non-Corporate Business

3.1 Closely Held Local Businesses

Businesses usually operate in corporate form, with Limited Liability Companies and Joint Stock Companies being preferred.

3.2 Corporate Rates and Individual Rates

The corporate tax rate and the personal income tax rate applicable to individual professionals are the same (10%). The difference is that a business's accounting profit is adjusted for tax purposes, while 25% legally granted expenses apply for individual professionals.

3.3 Accumulation Earnings for Investment Purposes

There are no rules to prevent closely held corporations from accumulating earnings for investment purposes.

3.4 Sales of Shares in Closely Held Corporations

Dividends are subject to 5% withholding tax when distributed to individuals, irrespective of whether they are paid to resident or non-resident individuals. The tax base is the gross amount of the dividends received. The withholding tax rate may be reduced under an applicable tax treaty.

For non-residents, the income originating from transactions in financial assets/shares issued by local legal entities shall be considered as income from a source within the country, and is subject to withholding tax. The regular withholding tax rate is 10%. The tax base is determined as a result of the sales price minus the acquisition expenses. The withholding tax rate may be reduced under an applicable tax treaty.

For residents, the gain on the sale of shares is subject to a standard flat rate of 10%.

3.5 Sales of Shares in Publicly Traded Corporations

Both resident and non-resident individuals are taxed in the same way when receiving dividends from closely held corporations.

The same applies to taxation on the sale of shares. As previously noted, some capital gains are exempt, ie, capital gains on publicly traded shares on the Bulgarian Stock Exchange or on a stock exchange under Directive 2004/39/EC.

4. Key Features of Taxation of Inbound Investments

4.1 Withholding Taxes

Dividends are subject to 5% withholding tax when distributed to non-residents (except for EU/EEA entities). Dividends distributed to EU and EEA resident entities are exempt, in compliance with the Parent-Subsidiary Directive.

Royalties and interest are subject to 10% withholding tax when distributed to non-residents.

Royalties and interest accrued to EU and EEA resident entities are exempt under certain conditions, in compliance with the Interest and Royalties Directive.

There are also some reliefs related to interest on bonds and some debt instruments issued by a local company, the state or a municipality that are traded on a regulated stock exchange in an EU or EEA Member State.

4.2 Primary Tax Treaty Countries

Although there is no statistical data or research on this issue, there are suggestions that the primary tax treaty countries that foreign investors use to make investments in local corporate stock or debt are the Netherlands, Cyprus and the United Kingdom.

4.3 Use of Treaty Country Entities by Non-Treaty Country Residents

The Bulgarian tax authorities quite often challenge the use of treaty country entities by non-treaty country residents.

In order to prove its eligibility for treaty relief under the DTT, the foreign entity should demonstrate the following to the Bulgarian tax authorities:

- that it is the beneficial owner of the income that originates from Bulgaria;
- that it has no permanent establishment in Bulgaria which is related to the income;
- that it is a tax resident of the other contracting state for the purposes of the DTT; and
- that all other specific conditions laid down by the DTT are met, if any.

The Bulgarian tax authorities usually strictly examine who is the beneficial owner of the income.

4.4 Transfer Pricing Issues

When performing an audit, the Bulgarian tax authorities check all tax issues within the scope of said audit.

4.5 Related Party Limited Risks Distribution Arrangements

If the contracts for the sale of goods or the provision of services are signed at arm's length prices/market value, the Bulgarian tax authorities will not challenge the use of related party limited risk distribution arrangements.

4.6 Variation from OECD Standards

Bulgarian transfer pricing rules conform with the OECD standards.

5. Key Features of Taxation of Non-Local Corporations

5.1 Taxation of Non-Local Corporation Versus Local Subsidiaries

There is no difference between the taxation of local branches of non-local corporations and local subsidiaries of non-local corporations: both are subject to the same tax treatment as local companies.

5.2 Capital Gains of Non-Residents

Non-residents' capital gains on the sale of stock in local corporations are subject to 10% withholding tax. The tax base is the direct gain, ie, the difference between the selling price and the acquisition price. The tax does not apply where the gain is on the shares of a non-local holding company that owns the stock of a local corporation directly, because it is not considered to be income that originates from Bulgaria.

The withholding tax rates may be reduced under an applicable tax treaty. According to the Bulgarian Constitution, any international instruments that have been ratified by the constitutionally established procedure, then promulgated and entered into force with respect to the Republic of Bulgaria, shall be considered part of the domestic legislation of the country. They shall have priority over any domestic legislation stipulating otherwise.

5.3 Change of Control Provisions

There are no such provisions regarding change of control.

5.4 Determining the Income of Foreign-Owned Local Affiliates

No formulas are used to determine the income of foreign-owned local affiliates selling goods or providing services. The basic requirement is that the contracts should be signed at arm's length prices/market value.

5.5 Deductions for Payments by Local Affiliates

The same standard is applied as to the deduction of any other expenses. In general, the expenses should be related to the company's business, should be at arm's length price, and should be actually rendered.

5.6 Constraints on Related Party Borrowing

Withholding tax is due on interest payments, as explained above. There is a reporting obligation for statistical purposes if the payment exceeds BGN50,000: such payments must be reported to the Bulgarian National Bank.

6. Key Features of Taxation of Foreign Income of Local Corporations

6.1 Foreign Income of Local Corporations

The foreign income of local corporations is not exempt from corporate tax: local corporations are taxed under the domestic law on their profit and income from all sources within the Republic of Bulgaria and abroad. Any foreign income is considered to be part of the company's profit and is subject to taxation as the local income.

In cases where the provisions of an international treaty do not apply, the taxable persons shall be entitled to recognition of tax input in accordance with certain conditions. When determining the local corporate tax or the alternative taxes, the taxable persons shall be entitled to recognition of tax input regarding any tax that is similar to the corporate one, or that has been levied instead of it and has been paid abroad.

6.2 Non-Deductible Local Expenses

Not applicable, please see the point above.

6.3 Taxation on Dividends from Foreign Subsidiaries

Dividends from foreign subsidiaries of local corporations are taxed as regular income. However, dividends from foreign subsidiaries established in an EU or EEA Member State are exempt, pursuant to the rules of the Parent-Subsidiary Directive that are transposed in the Bulgarian law.

6.4 Use of Tangibles

No local corporate tax is due from non-local subsidiaries for the use of intangibles developed by local corporations. The non-local subsidiaries should pay an arm's-length fee to the local corporations.

6.5 Taxation of Income of Non-Local Subsidiaries Under CFC-Type Rules

CFC-type rules are not adopted in Bulgarian legislation, so local corporations are not taxed on the income of their non-local subsidiaries.

The position is different regarding non-local branches of local corporations, because legally the branch is part of the corporation and is not considered an independent legal entity. This means that the income of non-local branches of local corporations will be treated as the income of the local corporations. Nevertheless, the tax may be reduced under an

applicable Double Tax Treaty with the jurisdiction where the branch is established.

If there is no such DTT in force, when determining the corporate tax or the alternative taxes, the local corporations shall be entitled to recognition of tax input regarding any tax that is similar to the corporate one, or that has been levied instead of it and has been paid abroad.

The local corporations shall be entitled to recognition of tax input for the tax levied abroad on the gross amount of dividends, interest, royalties, remuneration for technical services and rent.

6.6 Rules Related to the Substances of Non-Local Affiliates

There are no rules related to the substance of non-local affiliates in Bulgarian legislation. According to the tax administration practice, tax authorities examine if the non-local affiliate is the real beneficial owner of the income and whether the transaction is actually performed.

6.7 Taxation on Gain on the Sale of Shares in Non-Local Affiliates

The gain on the sale of shares in non-local affiliates is taxed as regular income of local corporations. Nevertheless, the tax may be reduced under an applicable Double Tax Treaty with the jurisdiction where the non-local affiliate is established.

If there is no such DTT in force, when determining the corporate tax, the local corporations shall be entitled to the recognition of tax input regarding any tax that is similar to the corporate one, or that has been levied instead of it and has been paid abroad.

7. Anti-Avoidance

7.1 Overarching Anti-Avoidance Provisions

Where one or more transactions, including those between unrelated persons, have been effected under conditions that

lead to tax evasion, the tax base shall be determined without taking into consideration the said transactions, or certain conditions thereof, or the legal form thereof, and what is taken into consideration shall be the tax base that would have been achieved if a customary transaction of the respective type had taken place at arm's length prices and sought to achieve the same economic result, without leading to tax evasion.

8. Other

8.1 Regular Routine Audit Cycle

The tax administration implements tax insurance control through audits and checks.

The audit is a combination of tax inspector activities, aiming to establish obligations for taxes and obligatory social security contributions. An audit may be assigned only with a special order for assignment of the audit. As the result of an audit, a tax assessment act may be issued, which may impose tax liabilities. The tax assessment act is subject to appeal in three stages:

- the tax assessment act is subject to administrative appeal before a special competent body that is part of the tax administration;
- the tax assessment act is subject to appeal before the first court instance which is the regional administrative court;
- the judgment of the regional administrative court could be appealed before the Supreme Administrative Court.

The check is a combination tax inspectors' observation of the tax and social security contributions legislation. Such checks may establish definite facts and circumstances that are significant for the obligations for taxes and obligatory social security contributions. A check shall not establish tax liabilities. A check may be implemented by the tax inspectors, without an explicit written assignment being necessary.

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