

Bulgaria

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1 General: Treaties

1.1 How many income tax treaties are currently in force in your jurisdiction?

Bulgaria has a relatively wide tax treaty network, including around 60 effective treaties as of June 1, 2005.

1.2 Do they generally follow the OECD or another model?

Yes, they generally follow the OECD model.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

In order to take domestic effect (including having priority over contradicting rules of domestic tax law), treaties need to be incorporated into domestic law. The incorporation procedure comprises of:

- i) ratification by Parliament, which is done by passing a special-purpose statutory act;
- ii) publication in the State Gazette of Bulgaria; and
- iii) entry into force as specified in the treaty provisions.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

There are anti-treaty shopping rules, which are not general, but may vary on a treaty-by-treaty basis. For instance, the treaty with Zimbabwe provides that it may not howsoever limit either contracting state in its right to apply its domestic anti-avoidance rules. The treaty with Lebanon provides that the benefits allowed on withholding tax on interest would not be available, if the main or one of the main purposes of the deal structure is avoidance of tax.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No, the Bulgarian Constitution and the domestic tax law provide that international treaties (including tax treaties) which have been properly ratified, published and have taken force and effect for Bulgaria prevail over any contradicting

rule of domestic law. Being incorporated in the domestic law tax treaties should be applicable directly. In May 2003 though, after some debate mainly amongst legal practitioners, Parliament passed amendments to the domestic law, which provide that tax treaties shall apply only after the grounds for their applicability are proven following a special procedure before the Bulgarian tax authorities. Except for these amendments, which still raise controversy though applied for more than 2 years now, there are no rules of domestic law, which may affect treaties.

2 Transaction Taxes

2.1 Are there any documentary taxes in your jurisdiction?

Yes, there are certain taxes, which, though not documentary in themselves, are of a similar nature. Transfers of real estate and motor vehicles are effected by means of regulated documents, such as notary title deeds or notarised contracts. Such transfers are chargeable with "local tax" at the rate of 2% of the higher of the transfer value and the official tax evaluation of the asset. The official evaluation is made either by the tax authorities (for real estate) or by insurance companies (for motor vehicles). Transfers of such assets also entail governmental charges for recordation of the transferee with the relevant registries which are of smaller importance.

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Yes, Bulgaria has VAT at the standard rate of 20%. VAT at 0% rate is chargeable on:

- export supplies;
- supplies under international treaties, if that is expressly provided in the treaty; and
- supplies of automobiles to handicapped people, subject to certain preconditions.

A special rate of 35% applies to tourist services. However, the VAT base of such services is not the value of the service, as it is in general, but the margin charged by tour-operators or touring agents to clients over the payments due by the tour-operators or touring agents to third parties (e.g. hotels) for the provision of the services consumed by the tourists.

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

VAT is charged on the supplies made in Bulgaria. The regulation of the place of supply is similar to the corresponding provisions of the Sixth EC Directive. Exempt supplies are exhaustively listed in the law. Those include, inter alia, supplies of land and financial services.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

No, it is not always fully recoverable by all businesses. Only VAT-registered businesses are entitled to tax credit for input VAT and eventually to a refund of such VAT, provided that they meet certain preconditions. The essential precondition is that they utilise the received goods or services for making, in their turn, taxable supplies. If businesses have done both, taxable and exempt supplies, the VAT refund is apportioned by percentage reflecting the ratio of taxable supplies to total supplies.

2.5 Are there any other transaction taxes?

No, there are no transaction taxes, other than those specified in question 2.1.

2.6 Are there any other indirect taxes of which we should be aware?

Customs duties are payable on some goods, essentially depending on the type and origin of goods as well as on the jurisdiction from which they are imported. Excise taxes are charged on some goods, most of them deemed to be of a luxurious or health-hazardous nature.

3 Cross-Border Payments

3.1 Would there be any WHT on royalties paid by a local company to a non-resident?

Yes, the Bulgarian domestic tax law provides for WHT on royalties paid by a resident to a non-resident at the rate of 15% on their gross amount. This WHT may be reduced or even eliminated, if an effective tax treaty provides so and is proven applicable to the case.

3.2 Would there be any WHT on interest paid by a local company to a non-resident?

Yes, the Bulgarian domestic tax law provides for WHT on interest paid by a resident to a non-resident at the rate of 15% on its gross amount. An exemption from Bulgarian WHT is provided for interest accrued on bonds traded on a regulated security market in Bulgaria and/or an EU Member State. The exemption applies to interests accrued on affiliated loans extended by EU daughter companies to Bulgarian mother companies, provided that the cash lent was accumulated by the daughter company through emission of stock exchange traded bonds in Bulgaria and/or the EU.

3.3 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Yes, the Bulgarian tax law contains thin capitalisation restrictions. They apply only if debt exceeds equity more than twice. Essentially, the restrictions result in having the expenditure for interest exceeding a certain maximum non-deductible for the purpose of corporate taxation. The restrictions however do not apply to interest payable under finance leases and bank loans. Such interest falls under the restrictions, only if the parties to the interest-bearing contract (finance lease or bank loan) are affiliated. The non-deductible expenditure for interest may be off-set against taxable profits in the next 3 fiscal years.

The thin capitalisation rules do not apply to banks.

3.4 If so, is there a "safe harbour" by reference to which tax relief is assured?

No, there are no safe harbour rules. However, compliance with the debt-equity ratio specified in question 3.3 above would render a company invulnerable from thin capitalisation restrictions.

3.5 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

Debt advanced by a third party and guaranteed by a parent company would be subject to the general thin capitalisation restrictions.

3.6 Is any withholding tax imposed on dividends paid by a locally resident company to a non-resident?

Yes, the Bulgarian domestic tax law provides that dividends accrued (rather than paid) by residents to non-residents are subject to WHT at the rate of 7% on their gross amount. As an exception to the rule, the rate would be 0%, if the following conditions are cumulatively available:

- the shareholder is a resident of an EU member state under the domestic regulations of such state and is not deemed to be a resident of a non-EU member state under a tax treaty;
- the shareholder is taxable with corporate tax or a similar profit tax in its country of residence without an option or right to exemption;
- the shareholder is the beneficial owner of the dividends and holds at least 20% of the equity stock of the Bulgarian company; and
- such equity stake has been owned uninterruptedly by the shareholder for at least 1 year as of the moment of accrual of the dividend.

The 7% rate under the Bulgarian domestic tax law may be reduced or even eliminated, if an effective tax treaty provides so and is proven applicable to the case.

3.7 Does your country have transfer pricing rules?

Yes, the Bulgarian tax law requires that the terms and conditions of deals between affiliates are agreed in compliance with the arm's length principle. The tax

authorities are empowered to adjust (re-calculate) the financial results of local companies in cases of attempted or completed tax evasion, including transfer pricing. Such powers are in principle exercisable when the tax authorities establish deviation of controlled deals from the market terms and conditions and may substantiate such deviation by reliable comparable evidence.

The law lists the possible non-compliances with the arm's length principle, which are, in and of themselves, indicative of transfer pricing. The most common case is when there are increased or decreased prices for supply of goods or provision of services which differ from the market prices.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The rate of corporate tax is 15% for 2005 (following a constant trend of decrease throughout the last years).

4.2 When is that tax generally payable?

The corporate tax is payable in advance installments and one year-round installment. The amount of the tax payable is calculated by tax-payers themselves and reported in their annual tax return. Such tax return should be filed with the tax authorities no later than March 31 of the next year. The advance instalments are remitted monthly or quarterly. Their base is 1/12 of the last reported yearly taxable profit adjusted by a coefficient established annually to reflect the overall changes to the business environment in Bulgaria. Their rate is 15%, as is the rate of the yearly instalment.

If the company has positive taxable profit for the last year reported, it would be required to remit monthly advance installments, irrespective of whether it earns profits or sustains losses in the interim periods of the current year. If the company has negative taxable profit for the last year reported and positive taxable profit in the interim periods of the current year, the advance installments would be quarterly (again the rate would be 15%) and would be based on the quarter of the current year. Newly created companies are also required to pay quarterly advance installments based on their positive taxable profit in the interim periods of the current year.

The yearly installment is calculated on the basis of the total of the advance installments and reported in the annual tax return. If the yearly corporate tax payable is bigger than the total of the advance installments, the shortfall is payable along with the filing of the yearly corporate tax return. Vice versa, if the yearly payable is smaller than the total of the advance payables, the excess may be set off against future advance or yearly corporate tax payables.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base)?

The tax base for corporate tax is the taxable profit. The taxable profit is formed as a result of certain statutory adjustments of the yearly financial result, which is, in turn, the accounting profit or loss. Substantially, the adjustments

represent add-back of expenses, which are not tax deductible, and deduction of incomes.

4.4 Are there any tax grouping rules?

There are no tax grouping rules in Bulgaria.

4.5 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

No, there is no difference as far corporate tax is concerned. Capitalised profit however is not subject to withholding tax on dividend.

4.6 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

The adjustments to the profit shown in commercial accounts are either:

- add-back of expenses, which are not tax deductible (e.g. daily allowances for business trips exceeding statutory amounts; penalties for non-compliance with mandatory provisions of law; excess of depreciation costs over the statutory yearly ceiling); or
- deduction of incomes (e.g. dividends distributed from residents; interest paid by the tax authorities for overpaid taxes).

4.7 What other national taxes (excluding those dealt with in "Transaction Taxes", above) are there - e.g. property taxes, etc?

There is yearly-recurrent property tax payable by the owners of real estate in Bulgaria at the rate of 0.15% of the tax evaluation of the real estate. There is also transport vehicles tax payable by the owners of motorised transport vehicles, including automobiles registered in Bulgaria.

4.8 Are there any local taxes not dealt with in answers to other questions?

There are 17% one-off taxes chargeable on expenses for representative and entertainment events, sponsorship, some donations and social expenses of employers for the benefit of personnel (including some expenses for pension or medical insurance). Such taxes represent in themselves a deductible expense for the purpose of corporate tax.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

As far as residents are concerned, there is no special tax regulation of capital gains and losses. For legal entities (including permanent establishments), those form part of their financial result, which is, subject to certain adjustments, converted into taxable profit.

As far as non-residents are concerned, there is a special set of rules for taxing capital gains, but there is no special set of

rules regarding capital losses. The set of rules for capital gains regulates the tax base, being substantially the excess of the disposal price over the acquisition price, which may be certified by documentary evidence.

Subject to availability of varying pre-conditions, there might be exemptions from capital gain tax, e.g. gain derived from deals in securities which are traded on regulated security markets and gain derived by natural persons from the sale of their main residential premises.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

Only non-residents could be liable for tax on capital gains. Unlike that, residents (including permanent establishments) are subject to corporate tax on business profit. At present the rates of both taxes are 15%. However, the tax base for non-residents is the gross amount of the capital gain, whilst for residents it is the taxable profit (i.e. it can be reduced, subject to availability of deductible expenses). Non-residents may benefit from a lower rate or eliminated taxation under a double tax treaty.

5.3 Is there a participation exemption or relief for reinvestment?

As far as non-residents are concerned, there is no such exemption or relief.

Since the capital gain derived by residents is taxable as part of their profit, an exemption or relief would in practice be achieved to the extent that it is anyway available to the whole or part of the taxable profit. Otherwise, for capital gains (unlike dividends) as a separate item of profit, there is no special exemption or relief either.

6 Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

The formation of a subsidiary does not trigger, in and of itself, any tax.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are not. However, a subsidiary, being a local company, would be taxable in Bulgaria for its profit derived from world-wide sources whilst a foreign company, having business operations in Bulgaria through a branch, would be taxable in Bulgaria only on the profit derived from Bulgarian sources (substantially through the operations of the branch).

6.3 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

The profits gained from the business operations of the branch would be taxable with corporate tax (profit tax) at substantially the same terms and conditions as applicable to a subsidiary. The repatriation of the profit of the branch however to its principal is not taxable with dividend tax or similar.

6.4 Would a branch benefit from tax treaty provisions, or some of them?

Yes, a branch would benefit from the provisions of a considerable number of tax treaties. Most treaties provide either for a definition of “*person*” or for a definition of “*company*”, which includes, inter alia, any formation deemed to represent a legal entity or another body corporate for the purposes of taxation in Bulgaria. This definition encompasses branches, which are thereby subjected to the treatment otherwise applicable to Bulgarian companies. In other cases, a branch may seek benefit from the tax treaty provisions based on the non-discrimination clause of the treaty.

6.5 How would the taxable profits of a local branch be determined?

The taxable profit of a local branch would be determined under the same rules, which apply to local companies. The Bulgarian domestic law requires branches to keep separate accounting for the business operations of the branch, as if it were a separate legal entity dealing independently from its principal.

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Yordan Naydenov joined Borislav Boyanov & Co. in 1994 and became a partner in 2000. He is currently the head of the firm's M&A Group, where he is also in charge of the tax practice of the firm. He has advised many foreign corporate entities on their investment plans for Bulgaria and was involved in some of the largest privatisation deals and private acquisitions in Bulgaria in various sectors of the economy such as banking, energy and natural resources, food processing and brewing industry, telecommunications, etc. As part of those projects he has also advised on the tax aspects of the deals and has successfully represented and defended clients in material tax disputes.

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Petko Iliev joined Borislav Boyanov & Co. in 1999. He is currently an associate with the firm, member of the M&A Group and Head of the firm's office in Sevlievo. He has experience in advising on the tax aspects of the Bulgarian business endeavours of many international clients, including tax structuring in the field of M&A, Privatisation, Secured Lending and Project Finance. He has also successfully represented and defended clients in complex tax disputes before the tax authorities and the Bulgarian courts and is amongst the most experienced tax advisors of the firm.

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