

## TAXATION

### VII

#### VII.1. Direct taxation of corporations

The taxation of corporate income and profits is governed by the Corporate Income Tax Act (“CITA”). Apart from the corporate income tax which is charged on the corporate profits, CITA also regulates certain other taxes, such as:

- Special income tax regimes applicable to insurance companies, gambling businesses and certain services provided through telecommunication means and certain investment companies;
- Taxes on corporate expenses; and
- Withholding tax obligations of corporate taxpayers with respect to dividend distributions and payments due to non-resident contractors.

##### VII.1.1. Corporate income tax

Corporate income tax in Bulgaria applies in a single rate of 15%. The tax policy of the Government envisages a further reduction of the tax rate to 15%, subject to maintenance of budgetary and economy stability.

##### VII.1.2. Profits subject to tax

Bulgarian resident companies are subject to Bulgarian tax on their world-wide profits. Companies that are non-residents in Bulgaria, but operate in Bulgaria through a branch, office, agency or other form of a permanent establishment are only liable to tax on the profits generated through their Bulgarian establishment.

Generally, a company is resident in Bulgaria if it is incorporated (registered) in Bulgaria. Most of the taxation rules, including the major rules relating to tax incentives, apply equally to resident and non-resident corporations conducting activities through a Bulgarian permanent establishment.

##### VII.1.3. Determination of profits for tax purposes

Profits are determined in accordance with generally accepted accounting principles (provided for in the respective accounting standards), subject to adjustments for tax purposes. Currently, most of the corporate taxpayers are allowed to elect to apply either the Bulgarian Accounting Standards or the International Financial Reporting Standards (IFRS) as a primary accounting basis. There is a statutory requirement for banks, insurance companies, other financial institutions and public companies to apply IFRS as a primary accounting basis. As of 1 January 2005 all corporate taxpayers will be obliged to apply IFRS only. Accounts are to be prepared in Bulgarian Leva, regardless of the functional currency of the respective company.

Generally, the taxable profit is determined in accordance with the financial result reported in the

Profit and Loss Account (“P&L”) adjusted for tax purposes. Business costs are deductible on accrual basis, except for certain items which are deducted on “when realized” or “cash” basis, such as:

- Non-realized losses from valuation, revaluation or impairment of assets (including impairment of non collectible receivables) and investments;
  - Provisions for contingent liabilities;
  - Accruals for certain payments to the personnel (such as non-used paid leave, provisions for retirement, equity compensation accruals, etc.), etc.
- Non-business costs, as well as costs which have not been properly evidenced with accounting and business documentation are non-deductible. Bulgarian accounting and tax laws contain comprehensive requirements with respect to documenting the costs which have to be observed for getting a tax deduction.

Capital profits and losses are not subject to specific taxation rules. Such profits/losses are included in the ordinary business revenue and are subject to taxation accordance to the general tax rules.

Dividends distributed by Bulgarian resident companies to a Bulgarian corporate resident shareholder are not included in the taxable profit of the shareholder.

Gains from trading shares in Bulgarian public companies on the Bulgarian stock exchange are also excluded from the taxable profit (except for gains derived from block transactions). Losses from trading such shares, however, are non-deductible.

##### VII.1.4. Valuation of depreciable assets for tax purposes. Depreciation and amortization

Tax depreciation is accrued for all fixed assets and

Maximum Tax Depreciation Rates	Annual Tax Depreciation Rate (%)
Buildings, equipment, transmission lines and pipe systems, telecommunication lines and systems	4
Plant and machinery, apparatus	30
Vehicles (except for automobiles), coverage of roads, aviation runways	10
Hardware, software and the rights to use software, peripheral devices	50
Automobiles	25
Intangible assets which are subject to a pre-determined period of use	<b>over the period of use</b>
All other assets (including other intangibles, office equipment, and goodwill)	15 %

investment properties except for land, cultural monuments and the financial assets.

As of 1 January 2004 depreciable assets are valued for tax purposes at historical acquisition costs.

Additions and improvements to such assets are recognized as separate depreciable assets and are subject to depreciation in accordance to the tax rates applicable to the main asset.

Capital expenditures which exceed BGN 500 must be capitalized as depreciable asset for tax purposes. Bulgaria has relatively flexible tax depreciation rules which leave space for tax planning of the annual depreciation charges and optimization of the tax costs or utilization of prior year losses. Under CITA, the annual tax depreciation charges are computed in accordance to the straight-line method by applying annual depreciation rates, which cannot exceed the maximum tax depreciation rates, specified below: Tax depreciation rates can be freely elected by taxpayer, within the above maximum rates, and are not linked to the accounting depreciation rates or the useful life of the asset. The election can be changed each calendar year and the change applies prospectively.

#### **VII.1.5. Valuation of inventory. Cost of sales**

Inventory is valued for tax purposes at acquisition costs. Non-realized losses (such as losses from valuation or impairment, etc.) are not recognized for tax purposes until realized. Some business losses (such as the complete loss of inventory) are nondeductible for tax purposes or are subject to limitations with respect to the size of the tax deduction available.

There are no specific tax methods for valuation of the cost of sales at disposal of inventory. All accounting methods (LIFO, FIFO, average costs) are also permitted for tax purposes.

#### **VII.1.6. Interest costs**

Interest costs are normally deductible on accrual basis, subject to the limitations provided in the Bulgarian thin capitalization rules. In some very limited cases the interest costs could be capitalized in the value of the respective depreciable assets to which the costs relate (e.g. in case of construction of huge fixed tangible assets by a taxpayer who applies IFRS as a primary accounting basis, etc.).

Bulgarian thin capitalization rules apply to substantially all forms of financing extended between related and non-related parties, except for loans and finance lease facilities provided by non-related banks or lessors.

Under these rules, if the debt-equity ratio of the taxpayer does not exceed 2:1 as of the end of the respective calendar year the interest costs can be deducted for tax purposes in full. If the debt equity ratio is higher than 2:1, then the maximum tax deductible portion could not exceed the sum of the interest income of the taxpayer and 75% of the Earnings Before Interest and Tax (EBIT). The portion that appears to be non-deductible in the current year

can be carried forward and deducted in the following three years, subject to the EBIT formula described above.

As mentioned above, interest on bank loans and finance lease facilities provided by non-related bank/lessor are always deductible in full.

#### **VII.1.7. Bad debts**

Impairment of receivables (bad debt) is deductible only when:

- Liquidation or bankruptcy proceedings are initiated with respect to the debtor; or
- The statute of limitations with respect to the receivables has expired. For most of the commercial debts the statute of limitations is 5 years.

#### **VII.1.8. Utilization of losses**

The tax loss can be carried forward for five consecutive years to offset the taxable profit reported in these years. The period for carry forward starts on 1 January of the year following the year in which the loss has been incurred and expires on 31 December of the fifth year. Losses cannot be carried back. Foreign losses can be carried forward for a period of five years to offset the profits from the same source which generated the losses.

As there is no capital gains tax or special tax treatment of the capital gains and losses, capital gains can offset the current and prior year operating losses and vice versa.

#### **VII.1.9. Dividends**

Dividends distributed by a Bulgarian resident company to another Bulgarian resident company are exempt from corporate income tax and are not included in the taxable profit. Such dividends also are not subject to withholding tax or other form of dividend tax. Foreign dividends are fully taxable with corporate income tax.

#### **VII.1.10. Foreign source income of a Bulgarian corporation. Relief for foreign tax paid**

Bulgarian resident corporation, which suffered foreign income tax on its foreign business or investment income could credit such tax against the Bulgarian corporate income tax. The tax credit is limited to the amount of the Bulgarian corporate income tax that would have been incurred had the respective foreign income been earned in Bulgaria. The foreign tax credit which has not been utilized in the current calendar year cannot be carried forward or back.

If the foreign tax have been paid to a country, with which Bulgaria has a Double Tax Treaty, the foreign tax relief could be either in the form of a tax credit against the Bulgarian corporate income taxes due, or be provided as an exemption from Bulgarian tax of the foreign income, subject to the specific provisions of the Treaty.

#### **VII.1.11. Group taxation. Transactions between related parties**

There is no group taxation in Bulgaria. Each entity is taxed as a separate taxpayer. Bulgaria has tax rules regulating the tax deductions and the taxable revenue from transactions between related parties ("the transfer pricing rules"). Transfer pricing rules apply to both domestic and international transactions between related parties. The Bulgarian transfer pricing rules are broadly similar to the generally accepted OECD standards that could be seen in the EU and OECD countries. There are still however some difficulties in the practical implementation and interpretation of these rules, and it is expected that the transfer pricing practices would undergo substantial development in the future. Currently, there are no requirements for advance transfer pricing filings or reporting, or for keeping specific transfer pricing documentation with respect to transactions between related parties. The taxpayer could not enter into advance pricing agreements with the tax authorities.

#### **VII.1.12. Tax reporting and tax payments**

The tax year coincides with the calendar year. Corporate income tax liabilities are reported annually through filing an annual tax return by 31 March of the following year. No extension of the period for filing is allowed.

The corporate income tax liability is paid through making:

- Monthly/quarterly provisional tax payments against the annual tax liability; and .Annual balancing payment, which is calculated as the balance between the annual tax liability reported in the tax return and the monthly provisional installments paid.

- Monthly provisional payments are due by companies which have reported taxable profit in the preceding year. These payments are generally based on the taxable profit for the preceding year adjusted for the inflation.

Newly incorporated entities and the companies which have reported tax loss in the preceding year make provisional tax payments on a quarterly basis. The payments are calculated on the profit earned in the respective quarter adjusted for tax purposes. The annual balancing payment is due by 31 March of the following year.

#### **VII.2. Special income tax regimes**

**Insurance companies** Insurance companies are not subject to corporate income tax. In lieu of such tax, insurance companies are charged to a direct tax on the net insurance premiums and the revenue from any other activities not related to insurance. The tax is payable monthly.

The basis for tax includes the following items: .The net insurance premiums calculated as gross premiums received less the premiums returned and

the reinsurance premiums paid; and .The revenue from non-insurance activities and investments (such as interest, rents, etc.).

If the basis for taxation is a negative figure, it is carried forward for the following months.

The general insurance companies are charged to tax at a rate of 7%. Life insurance companies are subject to tax at a rate of 2%. .Gambling businesses Gambling businesses (including telecommunication gambling) are subject to tax on the gross revenue from bets. Auxiliary and supplementary activities of gambling companies are also subject to tax on a gross basis.

The tax rates applicable to gambling businesses are 8% or 12% depending on the type of the activities.

- Provision of informational and other similar services through telecommunication Businesses which organize certain telecommunication services (such as informational services, entertainment telecommunication services, etc.) are subject to tax on the gross revenues from these activities. The tax withheld by the public telecommunication operator who provided an access to its public network for the delivery of the services. The rate of tax is 12%.

Other business activities of entities providing the above services are subject to corporate income tax in accordance with the general tax rules.

- Licensed investment companies. Licensed investment companies for trading in shares/securities are subject to the general corporate income tax rules, except that they are not taxed for their profit from trading of securities.

- Licensed securitization companies Investment companies which are licensed to conduct securitization of real properties and receivables are not subject to corporate income tax. Dividends distributed by such companies are subject to tax, even if distributed to Bulgarian corporate shareholders.

#### **VII.3. Income tax exemptions and incentives**

Most of the previous tax exemptions (capital allowances, tax vacations) aimed at attracting investors have been revoked in the recent years. Some entities which have acquired the right to use such incentives prior to their revocation are still entitled to benefit from the incentives until the expiry of their respective original term.

Presently, the major tax incentives are focused on encouragement of the development of depressed regions (regional incentives), the reduction of the unemployment (employment incentives) and advancement of the agriculture (incentives for the agricultural businesses).

##### **VII.3.1. Regional incentives**

The following basic incentives are available for investments in depressed regions included in a list approved by the Minister of Finance:

Most of the regional incentives have been recently amended with effect as of 1 January 2005. The basic conditions described below are those that shall apply

as of 1 January 2005.

As of 1 January 2005 certain companies and industries cannot benefit from the regional incentives.

These include companies in liquidation and bankruptcy, companies in financial difficulties, companies from the automotive sector, shipyards, coal mining industry, steel industry, manufacturing of synthetic fibers, agriculture and fish breeding.

The incentives are subject to some advance and subsequent filing requirements and notifications.

Where the value of the exemptions/incentives and other state aids for regional development exceeds BGN 75 million, a clearance from the Commission for Protection of the Competition is required.

Where the amount of the state grants and subsidies (excluding the grants provided tax incentives) does not exceed BGN 200,000 in a three-year period, the tax incentives can be used under less strict conditions. The following regional incentives are available:

- Tax credit for the value of assets acquired as part of initial investment. As of 1 January 2005 tax credit will be available for acquiring assets in terms of investing in depressed regions. The credit is determined at 10% of the acquisition costs of the assets. The tax credit can be carried forward for a period of 5 years. The eligible investment should be an initial investment in a depressed region, an enhancement of the investment in such a region, or commencement of a new activity related to the modernization of business processes. The investment should consist of acquisition of fixed tangible assets (except for cars) or purchase of patents, licenses or know-how. The costs of the intangible assets should not exceed 25% of the acquisition costs of the fixed assets. The assets acquired in terms of eligible investment cannot be disposed of for a period of five years, except in cases of merger or restructuring of the company.

In order to qualify for tax credit the taxpayer also has to meet some other conditions related to the financing of the investment project or designated to preserve the competition on the market.

- Tax exemption for manufacturing companies  
Manufacturing companies which invest in depressed regions (including companies involved in toll manufacturing) are entitled to complete exemption from corporate income tax, subject to the following basic conditions:

- All business sites and premises of the taxpayer have to be located in the respective depressed region;
- All assets of the taxpayer (except for cash in bank accounts and investments in associates and subsidiaries) have to be located in the respective depressed region;

- The taxpayer should not have outstanding and non-disputable liabilities for taxes or social insurance or penalty interest thereon for the respective year in which the exemption is claimed;

The amount of the tax credit for each year should be invested in manufacturing activities within a period of three years after the end of the year in which the exemption was claimed. The eligible investment

should consist of fixed tangible assets or licenses, patents and know-how at a value not exceeding 25% of the costs of the fixed tangible assets. The investor is also required to invest own funds of at least 25% of the amount of tax credit. Some other additional conditions are also required to be met. The assets acquired could not be disposed for a period of 5 years, except for in cases of merger or reorganization.

The incentive is available for a period of five subsequent years, subject to meeting its conditions in each respective year. If during the five-year period the respective region is excluded from the list of the depressed regions, the incentive survives the exclusion and can be applied until the expiry of its term. Where a company started preparatory activities for investing in a depressed region, but prior to commencement of manufacturing the region was excluded from the list, the company is still eligible to use the incentive for a period of four years.

### VII.3.2. Employment incentives

In general, the employment tax incentives and all other subsidies and aids for encouragement of the employment are subject to certain thresholds with respect to their maximum amount. In general, such incentives and aids cannot exceed 50% of the payroll costs for the new jobs for a period of two years.

The following tax incentives are currently available to investors:

- Tax deduction for employing individuals in specific social conditions.

The employer is entitled to deduct from its taxable profit, as an additional allowance, an amount equal to the compensations, social, health and unemployment insurance paid for the following employees employed for a period of at least 12 months:

- Individuals who have been registered as unemployed for a period exceeding one year;
- Individuals who have been registered as unemployed and are of more than 50 years of age; and
- Disabled persons who have been registered as unemployed.

The above tax allowance is to be used in the calendar year during which the original 12-month period of employment expires.

- Tax incentive for creating new jobs in depressed regions  
Employers who create new jobs in depressed regions for individuals registered as unemployed are entitled to deduct from their taxable profit an additional allowance equal to the social insurance contributions paid by the employer for such employees. The incentive requires that an increase of the average number of the employees be in place, that the jobs be taken by persons registered as unemployed and that the new jobs be maintained for a period of at least three years. In addition, the employer should not have non-settled indisputable tax and social insurance liabilities as at the end of the respective year.

This incentive is not available for certain companies and industries such as companies in liquidation and bankruptcy, companies in financial difficulties,

companies from the automotive sector, shipyards, coal mining industry, steel industry, manufacturing of synthetic fibers, agriculture and fish breeding. Non-tax grants and subsidies In addition to the tax incentives, the Bulgarian law provides for some non-tax subsidies and grants for reimbursement of employment costs or sharing of the training costs of the employer, subject to conditions in the law.

#### **VII.3.3. Incentives for agricultural businesses**

Agricultural businesses which produce no processed production for the market (including bee breeding, silk-worm breeding and fish breeding) are entitled to a tax credit of 60% of the corporate income tax payable. The amount of the tax credit should be reinvested in the agricultural activities. Businesses which produce and process agricultural production are not entitled to this incentive.

#### **VII.3.4. Other tax incentives**

There are also some other tax incentives which apply to specific organizations such as organizations for employment of disabled people, cooperative organizations, universities and schools, etc.

#### **VII.3.5. Taxes on the corporate expenses**

Bulgaria levies taxes on certain corporate expenses. The taxes are charged monthly. Both the expenses taxed and the amount of the tax accrued are allowed for deduction for corporate income tax purposes. The following expenses are subject to tax on expenses:

#### **VII.3.6. Benefits to the personnel (“social expenses”)**

Benefits provided to personnel provided either in-kind, or in cash, in addition to the employees' ordinary compensation and not related directly to past or current work performance are subject to tax at a flat rate of 20%. If taxed with 20% at a company level, the benefits are not included in the taxable personal income of the employees and are not subject to wage withholding tax.

#### **VII.3.7. Expenses relating to use and maintenance of company cars**

Expenses related to maintenance and use of company cars are also subject to tax. The tax is levied on the net amount of certain costs (such as maintenance, repair, fuel, lubricant and parking costs) incurred in relation to the use of cars with less than 6 seats. Certain expenses incurred in relation to company's cars (such as depreciation expenses, drivers' salary costs, and insurance premium) are not subject to tax. The tax is not due if the taxpayer can definitively prove (by travel records, etc.) that the cars have been used entirely and directly for the purpose of the taxpayer's business. The use of cars by the general administration and management staff is not considered a direct use for the purpose of the business and is subject to tax.

#### **VII.3.8. Business entertainment expenses**

The tax is levied on the gross amount of the business entertainment expenses at a rate of 20%.

#### **VII.3.9. Donations and sponsorship**

The tax is levied on the gross amount of expenses for donations and sponsorship agreements at a standard rate of 20%. A reduced rate of 15% applies to donations to eligible charities.

### **VII.4. Withholding tax obligations**

Corporate taxpayers are subject to the following main withholding obligations (other than payroll withholding):

#### **VII.4.1. Repatriation of profit/Dividend withholding tax**

Bulgarian resident corporations which distribute dividends have to withhold dividend withholding tax of 7% from the following dividend distributions:

- Dividends distributed to Bulgarian resident individuals;
- Distributions to non-resident individuals and legal entities.

Dividends distributed to Bulgarian resident corporations are not subject to withholding tax. Bulgaria does not charge tax on the remittance of the profits of branch offices or non-residents. Therefore, no withholding obligations apply to transfers of profits of Bulgarian branches or permanent establishments of non-residents.

#### **VII.4.2. Withholding obligations with respect to payments to non-residents**

Certain items of business and investment income of non-resident individuals and legal entities earned from sources in Bulgaria are subject to flat final income tax, which is normally levied by means of withholding. The domestic rate of tax is 15%. Where the recipient of the payments resides in a country with which Bulgaria has a Double Tax Treaty, the tax rate could be reduced or an exemption could be available subject to the provisions of the respective treaty.

What is specific for Bulgaria is that withholding tax is charged not only on the traditional investment income from Bulgarian sources (interest, royalties, etc.), but also on certain items of business income earned in Bulgaria or paid by a Bulgarian taxpayer (technical service fees, advisory fees, management fees, etc.). The following main items of income of non-residents are subject to Bulgarian withholding tax:

- Interest on loans and other forms of debt financing including interest on finance lease facilities and default interest;
- Royalties for transfer or use of intellectual property of any kind or for licenses thereof. This also includes license fees payable for licensing rights to software;
- Technical service fees. Technical service fees are defined as any consideration for consultancy or

advisory services, or for services of a technical nature (including installation, maintenance and other technical works), or for marketing research. Technical service fees are subject to withholding tax if paid by a Bulgarian corporate taxpayer, even if the services have been performed entirely outside Bulgaria;

- Management fees including any consideration for services or activities of management nature, if paid by a Bulgarian corporate taxpayer, even if performed abroad;

- Factoring fees and franchise payments;

- Rent charged for use of movable or immovable properties;

- Capital gains derived from disposal of real estate, shares in Bulgarian companies, securities issued by a Bulgarian entity or other financial assets.

The withholding taxes have to be deducted at the time when the respective payment is accrued to the non-resident contractor/investor, even if no effective transfer of funds has taken place. The amounts withheld have to be paid to the budget by the end of the month following the month when the payment was accrued as a liability to the contractor/investor.

## **VII.5. Double Tax Treaties**

### **VII.5.1. Treaty Network**

Bulgaria is a party to fifty three bilateral double tax treaties which provide for a relief of tax or a reduced rate of tax. Double Tax Treaties with Algeria, Egypt and Latvia have been signed, but are not effective yet. The multilateral COMECOM treaty could still apply to some former USSR countries (such as Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan)

(A broad information on the withholding system of taxation on straightforward charges is provided in APPENDIX ONE on page 67) .Procedures for claiming relief under a Double Tax

Treaty Claims of benefits under a Double Tax Treaty (such as exemption from income tax withholding or a reduced rates of tax) are subject to issuance of a decision for clearance by the Bulgarian tax authorities. The procedure for obtaining clearance decision requires that the respective non-resident entity files with the Bulgarian tax authorities certain documents, such as:

- a claim for the application of the respective treaty in a standard form;

- a statement from the Bulgarian entity which owes the payments containing some information of the type, amount and legal grounds for the payment;

- a declaration of the foreign entity confirming that this entity is the beneficial owner of the income;

- a statement of the tax residence of the foreign entity, which must be certified in advance by the tax authorities of the country of residence;

- certain incorporation documents of the foreign entity (such as certificate of incorporation or registration, including information on the directors of the foreign entity);

- a power of attorney where applicable;

- certain commercial documents (copy of the contract with the Bulgarian customer and/or other

relevant documents, such as invoices, if issued) to prove the nature, the amount and the grounds for payment of the income in question.

Within 30 days after the date of filing of the claim the tax authorities should approve or reject the claim by issuing a decision regarding the eligibility of the foreign entity to benefit from the DTT. Failure of the tax authorities to issue a decision within the 30-day period will be deemed to be an "implicit refusal" for the direct application of the DTT. If the tax authorities have implicitly or explicitly refused the direct application of the DTT, the Bulgarian customer should withhold tax

under the domestic rates of 15%. The refusal of the Bulgarian tax authorities to allow a direct application of DTT is considered provisional and not final. Therefore, the foreign entity can subsequently file a new claim for a refund of the tax withheld and the issue for the application of the treaty benefits is then finally decided.

If periodical or continuous payments are due by the Bulgarian customer on the basis of one and the same contract, then it is sufficient that one decision for clearance is obtained for all payments. The claim should be filed and the approval should be obtained prior to the due date for payment of withholding tax on the first periodical payment.

## **VII.6. VAT System**

The Bulgarian VAT legislation has its origin in the provisions of the EU legislation on the VAT system of indirect tax. However, the Bulgarian VAT legislation contains some specific national regulations.

VAT is charged as a tax on consumption on each level of sale of goods and services in the course of business. VAT is also due on importation of products into Bulgaria. Credit is given for VAT charged to VAT registered businesses, thus VAT is borne by the ultimate customer.

The standard VAT rate is 20%. Zero rate of VAT applies to exports of products, certain eligible exports of services, as well as to some other transactions.

### **VII.6.1. VAT Registration**

Bulgarian and foreign businesses which carry out taxable transactions with a place of supply in Bulgaria are required to register for VAT in Bulgaria at the time when the turnover from such transactions (determined on the basis of any preceding period not exceeding 12 months) reaches BGN 50,000. Non-residents who perform services in Bulgaria are subject to mandatory registration at the time when their transactions reach the above registration threshold, even if the respective non-resident business does not have a place of business in Bulgaria. Non-residents are registered for VAT through a VAT representative, except for branch offices of non-residents for which no such representative is required.

Voluntary VAT registration is substantially limited.

Businesses could not register voluntarily for VAT, except in some specific cases, such as: if the business carries out zero-rated exports and

has a turnover of at least BGN 50,000; if a company incorporated in Bulgaria has a registered and paid up share capital of at least BGN 500,000, etc.

#### VII.6.2. VAT charges

VAT is generally charged on the consideration agreed between the parties. In some specific cases a minimum basis for VAT charges applies. For example, where products or assets are sold at a price which is lower than the acquisition price/cost of sales, VAT is charged on a basis reflecting the acquisition price/cost of sales.

Transactions performed without consideration are also subject to VAT chargeable on market value of the products/services. Transactions between related parties are subject to VAT on the market price of the products/services.

Real estate transactions of registered businesses are normally subject to VAT, except for transfer of land and rights *in rem* with respect to land, and letting out residential properties.

Bulgarian law requires that in some cases the VAT deduction used by the respective business be subsequently adjusted and repaid. Such cases include for example loss and waste of business assets.

#### VII.6.3. VAT Exemptions

a) VAT exemption with a right to deduct VAT/Zero Rate of VAT

The following major transactions are entitled to zero rate of VAT:

- exports of products outside Bulgaria; certain transactions related to international transportation;
  - toll manufacturing services to non-residents performed in Bulgaria with respect to products imported under inward processing or processing under customs control;
  - public telecommunication services provided by licensed Bulgarian telecommunication operators to foreign operators;
  - transfer of rights on software programs to nonresidents, subject to certain conditions;
  - transfer of rights on movies to non-residents, subject to certain conditions;
  - certain services related to carrying out of international hunting tourism in Bulgaria;
  - certain transactions financed by foreign financial institutions on the basis of bilateral or multilateral governmental agreements, which explicitly provide for an exemption from VAT.
- b) VAT exemptions without right to deduct VAT
- Main transactions which are exempt from VAT without right to deduct VAT charged include:
- Financial services;
  - Insurance services;
  - Gambling activities;
  - Services of attorneys admitted to the Bar;
  - Transactions with land and rights on land, and renting out residential properties;

- All transactions with a place of supply outside Bulgaria, except for those treated as zero rated under specific VAT rules.

Under the national treatment, no VAT is charged on the transactions with a place of supply outside Bulgaria, but no VAT deduction could be claimed for such transactions. Such treatment applies, for example, to advisory and consultancy services to nonresidents, transfer of intellectual property to nonresidents (other than rights on software programs and movies), processing of information for nonresidents, certain R&D activities which result in transfer of rights on intellectual properties, etc.

#### VII.6.4. VAT reporting and payments

VAT is generally reported and paid monthly. The monthly VAT returns are to be filed and monthly VAT payments are to be made by the 14-th day of the following month.

Businesses which perform both VAT-taxable transactions and VAT-exempt transactions with no right to deduct VAT are required to file an annual VAT return by 15 April of the following year. The annual balancing payment is due within the same term. Each VAT-registered business is required to open and maintain the so called "VAT-account". The VAT account is a special bank account which is operated under the control of the tax authorities. The owner of the VAT account cannot freely dispose of the funds in the account. The balance in the VAT account can only be used for payment of VAT charged by suppliers or on importation, or for payment of VAT debts reported in the VAT returns. As of 1 January 2003 all charges of VAT of more than BGN 1,000 have to be paid through a transfer from the VAT account of the customer to the VAT account of the supplier. Excess cash in the VAT account can be released by the tax authorities following a VAT audit of the owner of the account.

#### VII.6.5. VAT refunds

Where VAT incurred on purchases exceeds VAT charged on sales, the excess VAT deduction is first carried forward for a period of three months to offset VAT debt due in these three months. If at the end of the three-month period the excess VAT or part thereof has not been recovered, the balance is refunded within 45 days after the date of filing of the VAT return for the third month (i.e., within approximately five months after the excess VAT has been incurred). The period for refund could be extended by the tax authorities if they commence a tax audit, but generally by not more than three months.

Companies whose turnover consists of at least 30% of export transactions are entitled to refund VAT with 45-days after the filing of the VAT return.

Companies, which by the end of the current month paid the major part of the monthly VAT charges of suppliers or on imports (80% or more) to the VAT accounts of the suppliers/the tax authorities, are entitled to a 45-day period of refund.

The shorter period for refund of 45 days also applies

to entities performing transactions which are exempt from VAT on the basis of international financing agreements.

#### **VII.6.6. Special rules for material investment projects**

VAT-registered investors who perform certain eligible investment projects are entitled to import assets needed for the project without effective payment of import VAT. In addition, such investors are entitled to refund VAT incurred on local purchases within 10 days after filing of the tax return, provided that at least 80% of the monthly VAT charges incurred on purchases are paid through a VAT account.

In order to benefit from the special investment rules, the investor needs to obtain an advance approval from the Ministry of Finance. In order to receive the approval, the investment project must meet certain conditions, such as:

- The size of the investment should be at least BGN 10 million for a period not exceeding two years; .The period for the completion of the project should not exceed two years;
- The project should result in the creation of at least 50 new jobs;
- The project should be eligible for state aids for regional development;
- The investor should prove an ability to finance the project.

#### **VII.6.7. Special VAT regulations for tourist sector**

Tour operators and tourist service agents who sell package tourist services in Bulgaria to non-resident tourists/tour operators are subject to special VAT regulations, as follows.

The tour operator or the agent can elect to charge VAT on a gross margin basis. In such case VAT is charged on 35% of the gross margin of the tour operator/agent calculated as the difference between the revenue from the sale of tourist services and the cost of the services purchased by the tour operator/agent. The tour operator/agent is entitled to claim 65% of VAT incurred on the purchases. If no such election is made, VAT is charged on 35% of the sales value of the tourist services and the tour operator/agent is entitled to claim VAT deduction in full (which would effectively result in a reduced rate of VAT of 7%). Hotel businesses which market accommodation to foreign tour operators for organized groups of foreign tourists are entitled to charge VAT on 35% of the consideration agreed with the foreign tour operator (which again would lead to an effective reduction of the VAT charge to 7%).

#### **VII.7. Excise duties**

Certain luxury products, as well as certain other goods listed in law are subject to excise duties. Excise duties are payable as one-time consumption tax on the import of dutiable products in Bulgaria, or on the first sale of locally manufactured products in Bulgaria by their manufacturer.

The following main categories of products are subject to excise duties:

- Liquors and beer, and raw materials with a content of alcohol; wine is zero-rated for excise duty purposes, but the producers of wine may be subject to excise duty registration and control;
- Tobacco products such as cigars, cigarettes, tobacco for consumption;
- Coffee, extracts from coffee and tea (except for herbal and fruit tea);
- Certain automobiles (with maximum 9 seats) with an engine power exceeding 120 kW;
- Fuels and certain derivatives from fuels;
- Facilities for gambling.

In addition, certain gambling games are also subject to excise duties.

Excise duties are normally charged as a flat amount per measurement unit for the respective product (BGN per piece/ton/litre, etc.).

Exports are exempt from excise duties. Where excise duties have been paid for products that are subsequently exported, a refund could be received. Where excise duties are charged on raw materials with a content of alcohol which have been used for production of dutiable liquors or non-dutiable food products or medicines, a refund could be claimed for the duties paid on the raw materials.

#### **VII.8. Local taxation**

Local taxes are charged by the local municipalities. The following main local taxes are presently being due to the local governments:

##### **VII.8.1. Real estate tax**

Owners of real properties (built up land, non-built construction plots and buildings) are subject to real estate tax on an annual basis. Non-built agricultural land and forests are not subject to tax. The buildings of farmers for use in their agricultural business are also exempt from tax.

The tax rate is 0.15% and is charged on the book value of each property as at 1<sup>st</sup> of January of the respective year (for business properties of entities) or on the tax valuation of the property (for residential properties of business entities and properties of individuals).

Transfer taxes are due on transfer for considerations of real properties and vehicles. The tax rate is 2% and is charged as follows:

- With respect to real estate properties – on the higher amount of the consideration agreed and the tax valuation of the property; and
- With respect to vehicles – on the full insurance value of the vehicle transferred.

Donations and disposals without consideration of any properties are also subject to tax at a standard rate of 5%. Waiver of debts is charged at tax at the same rate of 5%.

Exemption from transfer taxes is provided for privatization of assets, for in-kind contribution of assets to the share capital of a company as well as in

some other cases provided in law.

### **VII.8.3. Vehicle tax and Road tax**

Vehicle tax is payable by the owners of road means of transport, ships and airplanes registered in Bulgaria. The rate of tax depends on the type and the characteristics of the respective means of transport. The tax is due on annual basis.

Road taxes charged to the owners of passenger cars with maximum 8 seats. The tax rate is BGN 10 per each ton of weight of the vehicle.

Owners of vehicles other than passenger cars with maximum 8 seats are subject to service charge for use of the public roads payable to the Ministry of Transport. Such tax is paid through purchase of certificates/stickers for the use on the roads for a specific period (calendar year, month or week). In addition to the above taxes, the municipalities also collect some service charges for performance or maintenance of public services such as waste collection charge, tourist charge, charges for various administrative services.

### **VII.9. Capital taxation. Ecological levies**

#### **VII.9.1. Taxes on capital**

Except as mentioned above, no specific taxes are charged on the capital of the businesses or their net worth or on their assets. In particular, no capital duties or material stamp duties are payable on the incorporation of a Bulgarian company or on its capital or on subsequent contributions to the capital.

#### **VII.9.2. Packing charge**

As of 2004 Bulgaria introduced a packing charge levied on the import of packed products or on the sale of locally manufactured packed products on the Bulgarian market. The charge is collected for the provision of the public services related to management of packing waste. The charge is not payable if the importer/manufacturer put in place a proper system of management and recovery/recycling of the packing waste.

### **VII.10. Income taxation of individuals**

#### **IV.10.1. Individuals subject to tax**

Bulgarian income tax is charged to individuals who are Bulgarian tax residents, as well as to nonresidents who earn income from sources in Bulgaria.

Bulgarian residents are defined as individuals who have permanent domicile in Bulgaria or who have stayed in Bulgaria for a period of over 183 days in any 365-day period starting or expiring in the calendar year. Where a Double Tax Treaty applies, the residency status could be impacted by the provisions of the Treaty.

Bulgarian residents are subject to tax on their income from activities/investments in Bulgaria or abroad. Non-residents are taxable in Bulgaria for activities and investments related to Bulgaria. Bulgarian law contains detailed rules on when an

activity or investment is sufficiently related to Bulgaria to be subject to Bulgarian taxation.

#### **VII.10.2. Tax rates**

In general, individual income tax is charged over the Taxable annual income in accordance with progressive tax rates.

Certain items of income of residents or non-residents are not included in the taxable annual income and are subject to special rules of taxation with respect to the rates and the basis for tax.

#### **VII.10.3. Determination of annual income for tax purposes**

The annual taxable income is defined as an aggregate of the total income received by the individual during the calendar year, not including, however,

(i) items of income that are specifically excluded from the annual income and are taxed separately under specific rules (as discussed below) and

(ii) the items of income exempt from tax. The annual income is taxed on a "when received" basis and not on "when earned" basis.

Losses from one source of income could not offset the income from another source (e.g., capital losses cannot offset employment income, etc.).

The following deductions are generally permitted for most items of taxable income: Bulgarian statutory pension, social and health insurance paid in relation to the activity; Foreign insurance could be deducted only if it is obligatorily payable in the respective foreign country or is due on the basis of a bilateral social insurance treaty; Contributions and premiums payable to Bulgarian private insurance and pension schemes are deductible from the tax basis of certain items of active income (employment, self-employment, business, income from services or management functions). For each of

(i) private pension schemes and unemployment insurance scheme and

(ii) life insurance, including investment insurance instruments, and health insurance, the deduction is limited to 10% of the annual taxable income from respective source. In general, the amount of the deduction used may be captured back and be a subject to taxation at the time when the respective amounts are returned or paid back, or compensations/pensions are paid (except for

in some cases, such as death, disability, reimbursement of medical costs, etc);

- Standard flat deduction. Such deduction is applicable to certain activities and investment income such as income from management functions realized by registered directors or members of boards (10% of the gross income), self-employed individuals and individuals performing services (35% of the gross income), royalties related to creation of works of art and science (50% of the gross income), rents of real properties (20% of the gross income), certain business activities of individuals (50% - 70%

depending on the respective activity). No standard deduction is available for the income from employment.

- Allowances for charitable donations up to 10% of the income after the deductions referred to above.

#### **VII.10.4. Exemptions**

Certain items of income are exempt from personal income tax, such as:

- Gains from disposal of movable properties (other than means of transport, shares and securities), as well as gains from sale of means of transport owned for a period of one year or more;
- The gains from disposal of the main home of the tax payer, as well as the gains from sale or exchange of two other real estates held by the taxpayer for a period of at least five years;
- Interest on deposit and current accounts with Bulgarian banks or branches of foreign banks, interest and discounts on governmental or municipal bonds or corporate debentures, default interest paid;
- Earned investment income on pension accounts or insurance accounts;
- Certain compensations for losses (compensations for death and disability, indemnities for losses, compensations on property insurance policies);
- Prizes from lotteries and other gambling games;
- Properties received by means of donations or inheritance, as well as the gains from disposal of such properties;
- State pensions;
- Pensions and life insurance compensations paid by private schemes, except for the amount claimed as deduction against the taxable income in prior years or in the current year;
- Income of farmers from production of not processed agricultural products,
- Stock dividends, etc.

#### **VII.10.5. Wage withholding tax**

Salaries and other payments due for employment are included in the annual taxable income and are subject to personal income tax. The employer is required to withhold provisional tax from the wages of the employees on a monthly basis. The wage withholding tax is charged in accordance to monthly progressive rates which generally coincide with the annual rates of tax on a full-year basis. Therefore, where the employee worked the full year, the provisional wage withholding tax normally would coincide with his/her annual tax liability.

When during the respective year the employee received only employment income, he/she is not liable to file a tax return. Where the wage withholding tax exceeds the annual tax liability (for reasons of being employed for part of the year, etc.), the refund is determined and provided through the employer.

#### **VII.10.6. Expatriate tax treatment**

There is no special tax regime or tax exemptions for expatriates assigned to Bulgaria on a temporary basis.

Where a Double Tax Treaty is in place, exemption could be claimed for expatriates on short-term assignments, subject to the specific provisions of the Treaty.

#### **VII.10.7. Special taxation rules for certain items of income**

Certain items of income are not included in the annual taxable income of the individuals but are taxed separately with a flat final tax payable monthly or quarterly. This treatment applies to the following items of income:

- Interest receipts, except for exempt interest income;
- Corporate dividends, as well as production dividends distributed by co-operative organizations;
- Receipts from franchise or factoring agreements;
- Compensations for loss or profit or business;
- Receipts from private pension or insurance schemes (except for pensions) corresponding to the tax deduction claimed;
- Any other income from incidental transactions, activities or sources.

The standard rate of tax is 20%. A reduced rate of 15% applies to corporate dividends and to amounts paid on life insurance policies at the expiry of the term of the policy, provided that the policy was held for a period of 10 years or more.

#### **VII.10.8. Special rules for non-residents**

Certain items of income of non-residents paid by entities or sole traders are taxed with income tax in accordance with the Corporate Income Tax Act, *in lieu* of the personal income tax. This applies to the following income:

- Interest on loans and other forms of debt financing;
- Royalties for transfer or use of intellectual property of any kind or for licenses thereof;
- Technical service fees, including fees for consultancy or advisory services, or for services of a technical nature, unless the services are carried through a fixed place of business in Bulgaria;
- Management fees, unless the services are carried through a fixed place of business in Bulgaria;
- Factoring fees and franchise payments;
- Rent charged for use of movable or immovable properties;
- Capital gains derived from disposal of real estate, shares in Bulgarian companies, securities issued by a Bulgarian entity or other financial assets.

The above income is subject to 15% flat tax payable by means of withholding or personally by the nonresident taxpayer. The non-residents who are subject to tax in accordance with the Corporate Income Tax Act are not entitled to deductions or tax exemptions that are ordinarily applied to the annual taxation.

Where a DTT is in place a relief from Bulgarian tax or a reduced rate of tax may apply subject to obtaining clearance from the tax authorities.

#### **VII.10.9. Businesses of individuals/Sole**

### traders

The tax basis of the registered sole traders is the net profit determined in accordance to the tax rules applicable to corporations. The taxable profit is subject to tax in accordance to the progressive annual rates provided for individual taxation.

Certain small businesses are subject to a business tax at a flat amount levied *in lieu* of income tax.

### VII.10.10. Tax returns and payment of taxes

Where the income is subject to annual taxation, the tax return has to be filed by 15 April of the following year.

Annual tax is due to be paid within one month following the date of the filing of the taxreturn. Certain items of income are also subject to provisional tax payable through the year on monthly or quarterly basis (income of directors and members of boards, income of self-employed individuals and income from provision of services, rent income, etc.).

If the annual tax return is filed and the balancing annual payment is made by the end of January of the following year, the taxpayer is entitled to a 5% discount of the amount of the balancing annual tax payment due under the tax return.

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