International Bar Association Annual Conference 2022

Recent Developments in International Taxation
Bulgaria

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Introduction

Among the significant developments in the field of international taxation in Bulgaria during the past year was the introduction of tax rules governing reverse hybrid mismatches, which implement the provisions of Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries ('ATAD II'). Bulgaria's tax treaty network was further developed by replacing the existing double tax treaty with the Netherlands with a new one. Recent developments in the field of VAT focused on the introduction of corrective mechanisms aimed at ensuring the neutrality of VAT. Changes aimed at reducing the tax burden in the field of personal income tax and the one-off tax on expenses in-kind have been introduced as well.

Reverse hybrid mismatches

Under Bulgarian tax law, a hybrid entity is regarded as any entity or arrangement that is treated as a taxpayer under the laws of a certain jurisdiction; however, under the laws of other jurisdictions, its income and expenses are considered to belong, for tax purposes, to another person/persons.

Hybrid mismatches are generally recognised for Bulgarian tax purposes where they arise between associated enterprises; between a taxpayer and an associated enterprise; between a head office and permanent establishment; between two or more permanent establishments of the same entity; or under a structured arrangement.

The new reverse hybrid mismatch rule provides that certain hybrid entities registered or established in Bulgaria that, in principle, do not qualify as taxpayers under domestic law could be reclassified as legal entities for tax purposes and subject to Bulgarian corporate income tax where the following conditions are met:

- 50 per cent or more of the voting rights, shareholding interests or rights to participate in the profits of the hybrid entity are held directly or indirectly by one or more non-resident associated enterprises; and
- under the laws of the jurisdiction/jurisdictions where the non-resident associated enterprises are established, the hybrid entity qualifies as a taxpayer in Bulgaria.

Where the above conditions are met, the profits of the Bulgarian hybrid entity could be taxed at a Bulgarian corporate income tax rate of ten per cent to the extent they have not already been taxed otherwise in Bulgaria or in another country.

The reverse hybrid mismatch rule does not apply to collective investment vehicles. For the purposes of this rule, a collective investment vehicle qualifies as any investment fund or vehicle that is widely held, holds a diversified portfolio of securities and is subject to investor protection regulation in its country of establishment.

'Weekend tax'

A one-off tax on expenses in-kind related to the personal use of business assets (also known as the 'weekend tax') has been reduced from ten per cent to three per cent. The tax is levied on an annual basis on the proportion of the company's accounting expenses that is attributable to private use for no consideration of certain company assets (eg, company cars, computers and mobile phones) by employees, directors and/or shareholders working at the company.

Personal income tax exemption of interest from deposits

Effective as of 1 April 2022, the interest income of Bulgarian and European Union/European Economic Area (EEA) resident individuals derived from deposits in banks or branches thereof established in EU/EEA Member States is exempt from Bulgarian personal income tax. Previously, interest income from deposits was subject to eight per cent personal income tax withheld at source.

Tax treaties

As of 1 January 2022, a new double tax treaty (DTT) between Bulgaria and the Netherlands applied with respect to taxes withheld at source, as well as with respect to other taxes within the scope of the DTT attributable to tax periods starting on or after 1 January 2022.

Among the most important changes introduced by the new DTT compared with the regime under the former treaty are set out below:

- A building site or construction or installation project is considered to constitute a permanent establishment only where it lasts more than 12 months (as opposed to nine months under the former treaty).
- Dividends distributed by a company resident in one of the contracting states to a resident of the other state may be taxed in the source state at a rate of up to 15 per cent of the gross amount of dividends. The reduced five per cent rate applicable to dividends distributed to a beneficial owner holding at least 25 per cent of the capital of the company distributing the dividends under the former treaty has been replaced by a tax exemption of dividends distributed to: (1) a company that has directly held at least ten per cent of the capital of the company distributing the dividends for a 365-day period prior to distribution; or (2) a pension fund.
- The general tax exemption regime (subject to a beneficial ownership requirement) in the source state of interest arising in that state and paid to a resident of the other state that was in force under the former treaty is abandoned under the new DTT. Interest arising in the contracting state and paid to a resident of the other state can now be taxed in the source state at a rate of up to five per cent of the gross amount of interest. An exhaustive list of interest payments exempt from tax in the source state has been introduced under the new DTT, including, among others, interest paid to banks, insurance companies and pension funds resident in the other state.
- The tax rates applicable to royalty payments remain unchanged; however, a narrower definition of royalties has been introduced under the new DTT, resulting in more limited taxing rights of the source state compared to the regime under the former DTT. In particular, the definition of royalties no longer includes payments for the use or the right to use computer programs, as well as payments made on account of a contract relating to a transfer of know-how for the use or the right to use industrial, commercial or scientific equipment.
- Capital gains from transfers of shares (which were exempt from taxation in the source state under the former treaty) can be subject to tax in the source state under the new DTT in the case in which in any moment during the 365-day period prior to the transfer the shares have derived more than 75 per cent of their value directly or indirectly from immovable property located in the source state other than the property in which the company conducts its business activity. Capital gains derived in the context of corporate reorganisation, as well as from trading on regulated markets, however, remain exempt, even where the above conditions are met.
- The new DTT introduces a principal purpose test, that is, any treaty benefit under the DTT may be refused in the event that it is ascertained that obtaining such a benefit was among the main purposes of the transaction or arrangement for which the benefit was sought.

VAT

Among the most important changes introduced in the Bulgarian VAT Act is the opportunity to cancel and reissue invoices for periods that have been subject to a tax audit that ascertained that the initially applied VAT treatment of the supply was incorrect. Under the rules previously in force, a tax assessment act precluded future VAT corrections by way of the reissuance of invoices, which often led to double VAT taxation either on the supplier or purchaser's side.