

## Amendments in the Corporate Income Tax Act, Promulgated in December 2007

In State Gazette issue 110 dated 21 December 2007 Law on the Amendment and Supplementation of Corporate Income Tax Act (LASCITA) is promulgated. We will try to present and comment herein on the main amendments to the legal provisions without enumerating them comprehensively.

### 1. Documenting of expenses

A relieved regime for the documenting of the expenses subject to tax on expenses (representative expenses and expenses on exploitation of vehicles) is introduced. It is sufficient a fiscal cash register bill (cash receipt from a fiscal device). Regarding the cars, used for management purposes, the expenses, subject to tax on expenses, shall be recognized also when no road sheet has been issued.

### 2. Permanent tax differences

**2.1.** The new version of Art. 26 (4) CITA clarifies that VAT expense, accrued by the entity itself or by the revenue authorities in the course of a tax audit related to supplies executed by the entity, shall not be recognized for tax purposes. As non-deductible expenses are added the expenses for accrued VAT, reported during the realization of the responsibility according to Art.177 of the VATA, as expenses representing hidden distribution of profit (new point 10 and 11 from Art.26 of CITA).

In this respect, the new definition of “hidden distribution of profit” in point 5 of § 1 of the Supplementary Provisions of CITA shall be considered as well. It shall be mentioned the circumstance that with the amendment of Art. 267 CITA, the penalty that applies to cases of a hidden distribution of profit is reduced from 50% to 20% of the amount of expenses representing hidden distribution of profit.

**2.2.** With the provision of Art. 28 CITA a certain limit of the reported expenses on missing goods in commercial outlets, in which the clients have direct physical access to the goods, shall be recognized for tax purposes.

### 3. Expenses on travel and stay

The edition of Art. 33 CITA, regulating the expenses on travel and stay of individuals, is amended. Such expenses that are done for the benefit of a shareholder or a partner, related to traveling shall not be tax deductible. This amendment comes into force as from 1 January 2007.

#### 4. Expenses for provisions and accruals for unused leaves

With the amendment of Art.38 CITA it is clarified that a reverse of the temporary differences, related to not deducted provisions in the previous years and for accruals for unused compensation leaves is done when instead of reporting as revenue from reimbursement of the provision/accrual, the reported expenses are reduced. In relation to the expenses, which apply to accruals for unused compensation leaves, a clarification is made that in case of capitalization of the expenses to the value of the tax depreciable asset, they will not be separately tax deductible, but in the way of depreciation of this asset.

#### 5. Accrued remuneration of individuals

These amendments and supplementations to Art. 42 CITA have the aim to clarify the application of this regulation in the following issues:

- it is specified that the expenses on obligatory security contributions related to non-recognized expenses on remunerations also shall not be tax deductible until being paid;
- the tax financial result for the respective year shall be decreased by the revenue (released/refunded amounts) reported in relation with the accrued non-paid remunerations and security contributions on them and by the respective reduction of the expenses related to non-paid remunerations and security contributions on them;
- it is explicitly clarified that this regulation shall not be applied to income and security contributions, which are capitalized to the amount of the depreciable asset.

#### 6. Thin capitalization

In respect of interest expenses to which the provisions of the thin capitalization do not apply, are added the interests, capitalized to the value of the depreciable asset in accordance with the accounting legislation.

#### 7. Tax treatment of the liabilities

With the current amendment of Art. 46, para 1, CITA, regulating that the tax financial result shall be increased with the amount of the not paid liabilities in the presence of certain conditions, the requirement that the accrual of the liability should have effect on the tax result in a previous period is revoked. Simultaneously are created new paragraphs 3 and 4 to Art. 46 CITA, related to subsequent decrease of the financial result at the time of liability payment or the recognition of the revenue related thereto.

## 8. Depreciable assets and tax depreciation plan (TDP)

- The value threshold for the recognition of the tax fixed assets is changed from BGN 500 to BGN 700.
- The requirement that the marketing and other similar research, company strategies and business plans for tax purposes should be treated as fixed intangible assets, is revoked.
- An additional clarification is made whereby the total amount of the accrued accounting depreciation is pointed out as an increase of the financial result regardless of whether it has decreased the accounting financial result or has been capitalized to the amount of other assets.
- The mobile phones are included in Category IV of assets, which are depreciated for tax purposes at a maximum depreciation rate of 50%.

## 9. Advance tax payments

The current amendments in CITA (new para 2 of Art. 83, CITA) provide for two categories of persons, which **shall not make advance payments for corporate income tax at all**:

- Persons whose net sales for the prior year do not exceed BGN 200 thousand;
- Newly established persons in the year of their establishment but excluding the newly established as a result from transformation under the Commercial Act.

The approach for the assessment of the advance tax payments during the year, is amended. The purpose of these amendments is to introduce a single base for the assessment of advance tax payments for the whole year– the previous year. For this purpose, a balancing is made in April of the advance tax payments for the first quarter of the year to the amount, which would have been paid when calculating the advance tax payments on the basis of the tax result for the previous year.

In § 56 of the Transitional and Concluding Provisions of LASCITA is specified that the overpaid amounts of corporate income tax, profit tax and municipal tax under the revoked CITA, which were not deducted or refunded by 31 December 2006 can be deducted from the current advance tax payments of corporate tax and from the corporate income tax due for 2007 and the following years.

## 10. Tax treatment of financial institutions

The most substantial amendment in this respect, which shall come into force as from 1 January 2007, is the correction of the errors made in the definition of the term “financial institutions” in point 26 of §1 in the Transitional and Concluding Provisions of CITA.

## 11. Restructuring

### 11.1. Restructuring through transfer of property to the sole owner

The texts in CITA, effective so far, did not comprise a regulation for the cases in which a restructuring is made through transfer of the company's property to its owner – an individual registered as a sole trader (Art. 265-265c of the Commercial Act). Precisely the regulation of the tax effects of such kind of restructuring is the purpose of the new Art. 116a CITA.

### 11.2. Tax return in case of restructuring

With the LASCITA the present edition of Art. 117 has been supplemented with the specification that when the restructured company is terminated, then a tax return shall be submitted for the last tax period thereof. The tax return shall be submitted to the Territorial Directorate of the National Revenue Agency by place of registration of the newly established or the acquiring company, while in the case of restructuring by a division – according to the registration of one of the newly established or acquiring companies.

### 11.3. Obligations in the specific regime of taxation of the restructuring

The amendments and supplementations in this section aim to fill in the gaps in the law about:

- the tax treatment of the revaluation reserve, transferred in the course of restructuring and referring to assets, which are not tax depreciable ones;
- the tax effects to the acquiring company in cases, where:
  - (i) The acquiring company recognizes the assets and liabilities, which have not been recognized by the restructured company.
  - (ii) The acquiring company does not recognize an asset, which has been reported by the restructured company.
  - (iii) The acquiring company does not recognize a liability of the restructured company.
  - (iv) A clarification is made for the cases to which the regulations of Art. 140, para 3 are not applicable.

### 11.4. Gains of foreign persons on the acquisition of shares in cases of spin-off

The provision of Art. 149, CITA, is amended with a new paragraph 8. The purpose has probably been to clarify the treatment as at the date of restructuring of the acquired by the foreign person new shares as a result of spin-off. It specifies that at the time of restructuring, there is no gain realised by the foreign person related to the acquisition of shares as a result of spin-off, unless in case of share invalidation. It is regarded that income is gained on subsequent disposal of the shares thus acquired and that the acquisition price evidenced with documents, is zero.

## 12. Tax incentives

The amendments and supplementations in Chapter 22 of CITA shall be in force retrospectively, i.e. as from 1 January 2007 and they are material.

- The definition of de minimis state aid is also amended – de minimis aid exists where the amount of the de minimis aids obtained by the person for the last 3 years, including the current one, does not exceed the Bulgarian levs equivalence of EUR 200 thousand, while for the persons in sector highway transport – EUR 100 thousand.
- The limitations for using de minimis state aid are amended (Art.182, CITA) by including new restrictions to the activity of the person, using the aid and the subsequent investment of the remitted tax.
- There are new additional requirements to the persons, who use the state aid for regional development (Art. 189, CITA), which are related to the subsequent investment of the aid granted, term of the investment (at the amount exceeding 37.5 million EUR), for which the aid is granted and term for activity performance.
- An obligation is created for the persons, receiving a state aid in the form of a reduction or remittance of the corporate income tax, to declare in the annual tax return the circumstances, related to the satisfaction of the conditions for granting of the state aid and the way of investing the aid.
- The definition for “initial investment” in point 29 of § 1 in the Additional Provisions of CITA is also amended. Additional definitions are also created (points 45-52 of § 1 in the Additional Provisions of CITA).
- The deadlines are set, within which the tax incentives under Chapter 22 of CITA may be used. The tax incentives under Art. 182-189, CITA (excluding those in Art. 187) may be used by 31 December 2013. An additional clarification is made that the incentive under Art. 184, CITA, can be used when the realization of the respective initial investment has started after 31 December 2006, but before 1 January 2014. Simultaneously with this, there is a stipulation that there is no surety for the application of the incentive under Art. 184 CITA for 2007 and that it could be used only if the European Commission permits its usage by 31 March 2008.
- § 26 of the Transitional and Concluding Provisions of CITA is revoked. It permitted that the tax incentive under Art. 20 of the Investment Act (remittance of 30% of the due corporate income tax) might be used in 2007 (for the last year). As a result, the persons that have used this preference by 31 December 2006 will not be able to use it in 2007.
- § 57 of the Transitional and Concluding Provisions of LASCITA regulates the tax treatment of the funding, reported as a result of the remitted tax under the revoked Profit Tax Act and/or under the Investment Act, upon transition from national to international accounting standards.

### 13. Withholding tax and tax on expenses

The amount of the withholding tax on dividends is reduced from 7% to 5%.

Regarding the declaration of the accrued and paid withholding tax, with the amendment in Art. 201, para 1 CITA, it is clarified that the declaration of the deducted and paid tax shall be made by the end of the month, following the quarter in which the tax is paid.

Art. 217 CITA, is amended by introducing an obligation for declaring the amount of the tax on expenses in the annual tax return. This amendment, in contrast with the two above, shall be in force as from 1 January 2007.

### 14. Transitional provisions

Several transitional provisions (§§ 62-64 of the Transitional and Concluding Provisions of CITA) are introduced with a temporary effect – only in defining the tax financial result for 2007, which set a specific number of problems, related to:

- the treatment of income and expenses, profits and losses, reported by the partners in entities under joint control as a result of the application of the method of proportional consolidation; and
- the tax treatment of dividends in cases, where the investment is reported following the equity method (in financial institutions and other companies).

In general the amendments and supplementations of CITA are in force as from 1 January 2008, although **it is provided that part of the amendments shall be in force retrospectively (from 1 January 2007)**. In the presentation above we have commented on those amendments of the legal provisions, which are in force from 1 January 2007.

The purpose of the information in this paper is only to point out certain issues, related to the application of the new regime of taxation under LASCITA and therefore, it is not exhaustive. Should any questions about the application of the new provisions arise, please do not hesitate to contact us on telephone number: +3592 943 33 70, fax number: +3592943 37 07, e-mail: [office@afa.bg](mailto:office@afa.bg) or at the postal address: 1504 Sofia, 38, Oborishte Str.