

AMENDMENTS IN THE CORPORATE INCOME TAXATION ACT

in force as of 1 January 2009

In State Gazette Issue 69 as at 5 August 2008 is promulgated Act for Amendment and Supplementation to the Accountancy Act (AASAA). Amendments and supplementations to the Corporate Income Tax Act (CITA) are implemented with the final provisions of the Accountancy Act.

The amendments in CITA enter in force as at 1 January 2009 and are the following:

1. Chapter 18 “Dividends within the European Community” (Art.100-111) under CITA is revoked

The revoked provisions create a specific (relieved) regime, which application is related only to dividends, distributed between residents and companies from the European Community.

In consequence of the revocation, the following provisions are dropped off:

1.1. The cumulative conditions for the “parent company” and the “subsidiary company” based on Directive 90/435/EEC regarding the common system of taxation applicable for parent companies and subsidiaries of different Member State, namely:

- ✓ The companies shall be from Member States of the European Community;
- ✓ The companies from the European Community shall have a defined legal-organizational form;
- ✓ The companies’ profits shall be taxed with a defined kind of tax – corporate or an analogical one;
- ✓ There shall be a defined percentage share capital participation of one company in the capital of the other company (ownership of at least 15% of the capital, including through place of permanent establishment) and a defined period of holding the investment (at least 2 years).

1.2. Special rights for treatment of dividends, distributed to or from companies from the European Union, applicable including for the places of permanent establishment, cooperations, cooperative unions and their companies within the Member-states of the European Community.

1.3. The requirement for bank guarantees that should have been made before the revenue authorities in case of non-fulfillment of the conditions for percentage of share capital participation and the period of holding the investment, in order to be applied the favorable regime and not to withhold withholding tax.

1.4. The special provision in Chapter 18 under CITA, which gives the right of the Bulgarian State to refuse the application of the favorable regime for tax treatment of dividends between companies within the European Community in cases, when that regime represents misappropriation – tax evasion or tax avoidance, including hidden distribution of profit.

The necessity of changes is based on the official statements of the European Community (EC) and on the judgment of the Court of Justice of the European Community (ECJ/ /C379/05 as at 8 November 2007), which the Member states shall take into consideration.

The problem, constituted by the European institutions is based on that the application of a certain national tax regime brings to breaching of main freedoms, established with the Contract for Establishment of the European Community. In that case the legal requirements based on the Directive 90/435/EEC and referred to the companies from the European Community (perceived in Chapter 18 from the Bulgarian CITA), which are not applied in case of distribution of dividends between resident companies, lead to restriction of the movement of capital between Member States.

Because of the above-mentioned reasons, Bulgaria has chosen as an approach to revoke the requirements stipulated in Chapter 18 of CITA and applicable to the companies from EC, instead of putting the same conditions to the resident companies. In this way the effect of equal rights of companies is achieved and the breaches pointed by the European Commission and the Court of Justice are removed.

2. The provided securities by virtue of Art.109 under CITA are relived.

The requirement for provision of a bank guarantee before the revenue authorities by virtue of Art.109 under CITA was related to the opportunity to postpone the payment of the withholding tax, in cases when the companies from the European Community, participating in the transaction, to the date of taking the decision for distribution of dividend, the two years term for ownership of at least 15% of the capital is not expired.

This requirement included also a restriction. The latter deprived the taxpayer from the opportunity to use his property, which represents the bank guarantee, while the tax deferral did not justify the restriction.

3. A supplementation is made to Art.27, para 1, point 1 under CITA, that the accrued accounting income as a result of the distribution of dividends by non-resident persons from Member State of the European Community, or from another country – a party of the European Economic Agreement (EEA) shall not be tax deductible.

This supplementation is related to the revocation of the special regime for taxation of dividends within the European Community (Chapter 18 under CITA) and leads to creation of a unified common regime, under which the dividends, distributed by residents will be treated in the same way as the dividends, distributed by non-residents from the European Community and EEA. This means, that the dividend income of the receiver will not be tax deductible, no matter the source of distribution (by a resident or non-resident company from EC/EEA/), i.e. this income will be excluded from the taxable profit of the receiver and will not be taxed. The taxation will be limited to taxation of the profit of the company, which distributes the dividends.

The unified, common regime is provided only to non-residents, which are residents for tax purposes of Member State of the European Union and States – parties of the European Economic Agreement – Norway, Iceland and Lichtenstein, but not to all non-residents. For dividends received by non-residents from third states, outside the EU and EEA, the prior order will be applied, i.e. the dividend income will be included in the taxable profit of the receivers.

Because of the circumstance, that the dividends distributed by companies from EU and EEA will be treated in the same way as those, distributed by resident companies, the general sanction under the Art.27, para 2, point 2 under CITA would be applicable. The relief from the taxation shall not be recognized in cases of hidden distribution of profit.

4. A new point 3 is added to Art.194, para 3 under CITA, under which the dividends and liquidation shares, distributed by resident entities to the benefit of non-residents from Member State of the European Community or from another state – party of the European Economic Agreement will be tax exempt.

This amendment is related to the above-mentioned amendments to legal provisions and is in accordance with the idea for unifying the regime of taxation of dividends, paid between residents with that of dividends distributed within the EU and EEA.

The tax treatment of dividends, which Bulgarian companies will distribute to the benefit of non-resident entities, established within EU and EEA, will be identical with that of dividends, distributed to the benefit of Bulgarian residents - traders. This means, that the Bulgarian companies, which accrue dividends to the benefit of non-resident entities, established within the EU and EEA, shall not withhold 5% withholding tax from the income received. A special procedure is not provided for evidencing the circumstances, giving the right for tax exemption. According to us, in order not to withhold withholding tax, the circumstance that the receiver of the dividend income is a resident of a certain state from the EU and EEA as at the date of distribution shall be proved.

In that case the amended provisions are related only to distribution of dividends to the benefit of non-residents, residents for tax purposes of a Member State of the EU and EEA. At the time of accrual of dividends to the benefit of non-residents from third states, outside the EU/EEA, the prior order will be applied and an obligation for withholding of 5% tax (by virtue of Art.194, para 1, point 1 under CITA) will arise. The deduction of the tax obligation in the last case would be realized through application of a Double Tax Treaty (DTT), if the DTT provides a lower rate of withholding tax for taxation of dividend income.

The aim of the information in this report is only to mark the different questions, related with the putting into practice the new tax regime of dividends, distributed within the EU/EEA and it is not thorough. Should you have any questions about the enforcement of the new legislation, please do not hesitate to reach us on telephone number: +35929433700, fax: +35929433707, e-mail: office@afa.bg or at the post address: 1504 Sofia, 38, Oborishte Str.