

In the State Gazette issue 95 dated 01 December 2009 the Amendments and Supplementations Act to the Corporate Income Taxation Act (AASCITA) was promulgated.

We will try herein to present the most important changes of the legal provisions without enumerating them exhaustively.

1. Subject to taxation

With AASCITA the scope of the subjects of taxation is expanded. According to the current Corporate Income Taxation Act, foreign legal entities are subject to taxation for their profits realized through a permanent establishment in the Republic of Bulgaria and for the explicitly enumerated in the law types of income derived with a source from Bulgaria. In accordance with the new regulations of CITA as of 01.01.2010, foreign legal entities shall be taxed under CITA for gains realized from disposal of the property of their permanent establishment in Bulgaria.

2. Unrecognized revenue for tax purposes

According to CITA, in force as of 01 January 2007, all the revenue related to the unrecognized expenses for tax purposes under Art. 26, shall be considered as tax non-deductible (up to the amount of the unrecognized expenses), i.e. the financial result shall be decreased with the amount of this revenue (Art. 27, para 1, item 2 under CITA).

In accordance to AASCITA, considered as of 01 January 2010, Art. 27, para 1, item 2 CITA is amended, the revenue related to the tax non-deductible expenses such as: not documented expenses, fines and penalty interest for violation of legislation, donations and expenses not related to the economic activity and hidden distribution of profits shall not be excluded from the taxable base.. The change aims to limit the cases when the tax liable entities try to manipulate their financial result. At the same time the new provision could lead to double taxation (by taxation of the revenue and the impossibility the related expenses to be deducted).

3. Donations

By virtue of AASCITA the scope of the tax deductible expenses on donations is expanded. Pursuant to Art. 32, para 2 of CITA, the accounting expenses on donations made for the benefit of the Fund for Medical Treatment of Children shall be recognized for tax purposes (up to 50% of the accounting profit). As from 01 January 2010, Art. 32, para 2 of the CITA is supplemented with two new funds, donations to which shall be tax deductible:

- Fund for Assisted Reproduction;

- Fund for Transplantation.

The limitation of the amount of the deductible expenses on donations is preserved – up to 50% of the accounting profit.

4. Gain and losses arising on subsequent measurement (revaluation and write down) of financial assets and liabilities, reported by financial institutions

Art. 96 of CITA is supplemented by a new para 2, according to which, the gains and losses arising on subsequent measurement of financial assets and liabilities, which have not been recognized for tax purposes during preceding period (by virtue of Art. 34 of CITA or on the grounds of the provisions of CITA (revoked)) and if the company subsequently gains a statute of financial institution, shall be tax deductible by virtue of the general rules of CITA (i.e. by exception the financial institution may apply Art. 35 and Art. 37 of CITA).

The new provision has retroactive effect and shall be applied as of 01 January 2009 г.

5. Declaring and payment of corporate income tax

In relation to the declaring of the annual corporate income tax, AASCITA introduces the following important changes:

- The obligation for submission of the annual financial statements and a copy of the audit report issued by virtue of the Independent Financial Audit Act along with the annual tax return is revoked.
- A new requirement is introduced, which provides that the annual tax return shall be submitted only with an annual activity report by virtue of Art. 20 of Statistics Act. Tax liable entities, which have not performed any business activity during the year and have not reported any revenue and expenses for the respective year, according to the accountancy legislation, shall not submit annual activity report. The obligation for enclosing annual activity report to their annual tax return is also applicable for legal entities performing gambling activities, maritime merchant shipping and the budget funded enterprises.
- The provision, which gives a possibility for submission of adjustment tax return, is revoked.
- The right of discount for tax liable entities (in amount of 1% of the annual corporate income tax due but no more than BGN 1,000), when they submit the annual tax return along with the annual activity report electronically until 31 March of the following year and pay the tax in the same time limit, remains.

The changes enter into force as of 01 January 2010 but shall be applicable also when declaring the corporate income tax for 2009. The annual financial statements for 2009 and audit reports shall not be submitted before the National Revenue Agency.

6. Corporate income tax for last tax period

Supplementations to the provisions of Chapter 21 and particularly the provisions of Art.161-163 of CITA are made and focused in the following directions:

- The last tax period for the non-personified companies and the social security funds is determined as a period from 1 January of the year when the termination begins until the date of the termination. In this case, the tax return shall be filed on the date of the termination and the tax due shall be paid until this date.
- A general text, which settles the payment of the corporate income tax due for the last tax period, is introduced – the corporate income tax due shall be paid until the date of submitting the claim for deregistration under liquidation; until the date of the deregistration under insolvency, until the date of termination of the permanent establishment or the date of termination of the non-personified entity and the social security fund, in case these dates are before 31 March and the tax for the preceding year has not been paid.

7. Transfer of permanent establishment

The new provisions of Art. 47b, in force as of 01 January 2010, explicitly regulate the rules for calculation the tax financial result upon transfer of permanent establishment, when the gain/loss from the transfer is not included in the accounting financial result (AFR) of the permanent establishment.

The main rules, for calculation the tax financial result (TFR), are as follows:

- AFR of the permanent establishment shall be decreased, respectively increased with the gain, respectively the loss¹ derived from the transfer of the permanent establishment;
- Tax temporary differences related to assets and liabilities of the permanent establishment shall be tax deductible, in the year of transfer of the permanent establishment, by observing the general rules of CITA;
- Tax depreciable assets shall be written-off by observing the rules provided in Art. 66, para 1 and 2 under CITA (the adjustment is made with the accounting and tax carrying amount of the written-off asset).

8. Revenue and expenses, profits and losses, reported by a controlling venturer in a jointly controlled venture

With the new provision of Art. 32a under CITA the accounting revenue and expenses, profits and losses, reported by the controlling venturer in a jointly controlled venture, shall be determined as tax non-deductible, when the method of proportional consolidation is applied and the jointly controlled venture is a tax liable entity.

¹ The profit/loss from the transfer of permanent establishment shall be calculated as a difference between the selling price of the permanent establishment and the book value of the assets, decreased with the book value of the liabilities at the date of the transfer.

The new provision has retroactive effect and shall be applied as of 01 January 2009.

9. Distribution of dividends related to investments reported under the equity method

AASCITA introduces a new provision defining the tax treatment of distributed dividends related to investments reported under the equity method.

According to the new Art. 47a CITA and **as from 1 January 2009** upon determining the tax financial result of shareholders and partners their accounting financial result shall be decreased with the amount of dividends distributed by local entities or foreign entities - tax residents of an European Union (EU) member state or a country – party under the European Economic Area (EEA)² Agreement, as follows:

- Financial institutions shall reduce their accounting financial result with the distributed dividends in the year of their reporting by the financial institution;
- Entities, which are not financial institutions, shall decrease the accounting financial result with v dividends for the period from acquisition till writing-off of the investment in the year of the writing-off of the investment.

Dividends distributed from profits, realized before acquisition of the investment, and dividends distributed by licensed entities with special investment purpose (the income from the stated dividends are subject to corporate income tax) remain beyond the scope of the new provision.

10. Tax relief

10.1. A new tax relief having the nature of state aid for farmers is introduced with the new provision of Art. 189b CITA. The tax relief provides the right for remittance of corporate income tax at the amount of 60%. The use of the relieved tax regime is possible in case certain conditions stipulated in Art. 189b, para 2 and 3 CITA are simultaneously met (i.e. the remitted corporate income tax should be invested in new buildings and new farmer's equipment which are not a substitute to existing fixed assets).

Art. 179 CITA, which was stipulating a similar tax relief for farmers, has been revoked.

The tax relief under Art. 189b CITA shall be applied until 31 December 2013 after the issuance of a positive decision by the European Commission for compatibility with the regulations in the area of state aids. In case no positive decision is issued by 31 March 2011, the tax relief could be applied for year 2010 as well.

10.2. As from 1 January 2010 the tax relieves under Art. 180 and 189a CITA are revoked, namely:

- The relief for Bulgarian "Air Traffic Services Authority" in the form of corporate income tax remittance up to 60%;

² The countries – parties under the EEA Agreement are Norway, Iceland and Lichtenstein.

- The tax relief expressed in remittance of corporate income tax amounting up to 100% for persons performing activity and investments in agriculture, processing industry, production, high technologies and infrastructure.

11. Withholding tax

A procedure for recalculation of withholding tax is regulated with the new provision of Art. 202a CITA, by means of which foreign legal entities are entitled to choose to recalculate the withholding tax paid by them in Bulgaria by submitting a tax return of a standard form to the Territorial Directorate of NRA - Sofia by 31 December of the year following the year of charging the income. The recalculated tax should be equal to the corporate income tax, which would be due for the same income realized by a local entity. In case expenses related to the income under Art. 12 of CITA are made, for which tax on the expenses would be due if they were made by local entities, then the amount of recalculated tax shall be increased with the amount of this tax. If the amount of paid withholding tax exceeds the amount of recalculated tax, the difference is subject to refund up to the amount of withholding tax, which cannot be deducted as tax credit by the foreign legal entity in the country of residence.

12. Gambling activity tax

New, higher rates of the alternative taxes are determined as from 1 January 2010, i.e.:

- The gambling activity shall be charged with 15% alternative tax;
- The revenue from supporting activities by the means of the Gambling Act shall be charged with 12% alternative tax;
- The amount of alternative tax due by entities performing gambling activity with gambling installations is increased (i.e. for casino roulette - from BGN 18,000 to BGN 22,000).

The amendments concern the provisions of Art. 223, 226, 230, 238 and 245 CITA.

13. Administrative-penal provisions

The amount of the sanction for non-performing the obligation for declaring corporate income tax are preserved – for non-submission of annual tax return and annual activity report within the legal terms shall be imposed a property sanction amounting from BGN 500 till BGN 2,000 and for second violation – from BGN 1,500 till BGN 5,000.

14. Amendments to the Additional Provisions of CITA

The following definitions are included by amendments to the Additional Provisions of CITA: disposal of property of a permanent establishment, annual activity report and agricultural technical equipment, and the existing definitions regarding hidden distribution of profits, royalties and non-processed plant and animal products are amended and supplemented.

15. Other amendments

The Accountancy Act is also amended and supplemented with AASCITA in relation to broadening the scope of cases in which consolidated annual statements may not be prepared.

Amendments are also introduced to the National Revenue Agency Act and the Statistics Act with respect to the new obligation of taxable persons to prepare and submit annual activity report instead of annual financial statements and audit report.

The information in this material has as purpose only to note certain issues related to applying the new taxation regime introduced with AASCITA and is not exhaustive. Should any questions on the application of the said provisions arise, please do not hesitate to contact us at tel.: 02/943 37 00, fax: 02/943 37 07, e-mail: office@afa.bg or at 38, Oborishte Str., Sofia 1504.