

AMENDMENTS TO THE INDIVIDUALS' INCOME TAXES ACT

in force as at 1 January 2010

Law on Amendment and Supplementation of the Individuals' Income Taxes Act has been published in State Gazette (SG) issue 95 of 1 December 2009. Additional changes have been adopted also by § 67 of the Transitional and Final Provisions of the 2010 State Budget Act of the Republic of Bulgaria published in SG issue 99 of 15 December 2009. The changes shall enter into force on 1 January 2010. A part thereof referring to procedural obligations shall be applied with respect to 2009 as well (see i. 8 and i. 10 below).

The more important amendments and supplementations to the Individuals' Income Taxes Act (IITA) are as follows:

1. Tax-exempt income

The following changes have been introduced in Art. 13:

- As from 1 January 2010 income from sale or barter of *one immovable residential property* shall be treated as tax-exempt income, if over three years have passed from the property acquisition date to the sale/barter date (para 1, i. 1, letter "a"). In contrast, in its wording in force till the end of 2009, the said provision stipulates that the property ownership period is irrelevant to the tax treatment of the income from sale/barter thereof;
- *The provision of para 2 has been enhanced.* According to the adopted amendment, income shall not be deemed to arise in case property is obtained as a result of reinstatement of ownership by virtue of law. In its recent wording, the said provision refers only to the hypothesis of "restitution", i.e. reinstatement of ownership over property nationalized in the past, which is not the only hypothesis provided for in our legislation;
- *Para 3 and respectively i. 3 of Art.26, para 2 IITA have been repealed.* As from 1 January 2010, income of individuals registered as agricultural producers or tobacco producers earned from production of unprocessed animal or vegetable products (excluding decorative plants, is taxable – see i. 5 below;
- New para 4 of Art. 13 has been added, whereby the implemented practice of *not determining taxable income at the date of acquisition of shares received in consideration of contributions in kind made into the capital of commercial companies* according to Art. 72 and Art. 73 of the Commercial Act, is explicitly provided for in the law. Taxable income shall be determined for the year of disposing of the shares corresponding to the contributions in kind made. In this regard, Art. 33, para 6 IITA has been supplemented in its part concerning the price of acquisition of property contributed in kind, which price shall be deductible when determining the result (profit/loss) arising on sale or barter of shares obtained in consideration of the contribution in kind. In particular, if the object of the contribution in kind is property, the

gains on sale/barter whereof are tax-exempt in accordance with Art. 13, para 1 IITA at the time of recording of the contribution in kind in the commercial register, then the acquisition price deductible shall be the amount of the contribution in kind recorded in the constitutional document/articles of association of the commercial company corresponding to the shares sold/exchanged (supplemented i. 5 of Art. 33, para 6 IITA). In all other cases, the documented price of acquisition of the property contributed in kind shall be taken into account (new i. 9 of Art. 33, para 6 IITA).

Alike the rest paragraphs of Art. 13, the new para 4 shall not be applicable in case the individual operates in the capacity of a sole trader (the recent para 4, already para 5 has been supplemented).

2. A new type of employment relation within the meaning of IITA

The definition of the term “employment relations” has been expanded to include the new letter “i” of § 1, i. 26 of the Additional Provisions of the law. According to this definition, as from 1 January 2010, employment relations shall be deemed also the relations with shareholders or members of cooperative societies, or stockholders of over 5% of the capital of a joint-stock company, for personal service provided to the relevant company / cooperative society.

Income of the above mentioned type paid till the end of 2009 shall be treated as income from other business activity, wherefore individuals – beneficiaries are entitled to 25% tax allowance. **As a result of the reclassification of this income as employment one starting from 1 January 2010, tax allowance shall not be applicable any more but the gross income amount shall be subject to tax.** On the other hand, these remunerations would not have to be taken into account (as ones forming taxable turnover) when determining if an obligation for registration under the Value Added Tax Act arises.

A transitional provision has been created with regard to the reclassification of the discussed type of income under IITA - § 24, according to which income of the said type that have been accrued but not paid by 31 December 2009 **shall be subject to advance tax pursuant to Art. 42** (i.e. as income from employment without tax allowance) **when paid after 31 December 2009.** In this case only, the advance tax shall be calculated on the monthly tax base determined for the income paid during the relevant month.

In general, the advance tax on employment income is calculated on the basis of the income amount accrued for the relevant month – para of Art. 42 IITA. The said provision has been supplemented with a new sentence concerning calculation of the monthly tax base for income under § 1, i. 26, letter “i” of the Additional Provisions of IITA: the tax base may be determined by deducting social security and health insurance contributions under the Social Security Code (SSC) and the Health Insurance Act (HIA) paid in advance through the company, which the income beneficiary is obliged to make if he/she is a self-securing person.

Art. 25 IITA has been supplemented with a new para 2 by analogy, dealing with calculation of the annual tax base when there may be deducted not only the contributions paid in advance but the total statutory contributions at account of the self-securing person for the relevant tax year.

The tax on income from employment under § 1, i. 26, letter “i” of the Additional Provisions of IITA shall not be subject to annual recalculation in accordance with Art. 49 IITA. The said provision has been supplemented with a new para 8 stipulating the above mentioned rule. Accordingly, **individuals that have earned income from the “new” type of employment relations within the meaning of IITA are obliged to submit annual tax returns for that income. This is stipulated explicitly by the newly created para 2 of Art. 52** (§ 16 of the Law on Amendment and Supplementation of IITA, published in SG issue 95 of 1 December 2009) **and the addition to Art. 50, para 3 IITA** (§ 67 of the Transitional and Final Provisions of the 2010 State Budget Act of the Republic of Bulgaria published in SG issue 99 of 15 December 2009).

3. Statutory social security contributions paid abroad are deductible when forming the tax base for calculating advance tax on employment income – as from the beginning of 2010 such contributions paid at expense of the individual may be deducted not only upon formation of the annual tax base of employment income **but also for advance tax purposes.** It is open the issue of what documents shall be required by the revenue authorities for evidencing the monthly amount of contributions paid abroad and correspondingly, proper calculation of the monthly tax base under Art. 42, para 2 IITA and of the advance tax.

4. Income of mariners

IITA contains a definition of the term “mariner” (§ 1, new i. 54 of the Additional Provisions of IITA) in force as from 1 January 2010, as well as special provisions for taxation of the income of these persons. In general:

- the new rules shall be applied **only** with respect to individuals hired under an **employment relation** as members of the crew of a maritime ship recorded in the register of ships of a **EU members state**;
- accordingly, income of mariners represent employment income;
- advance tax shall be calculated in accordance with Art. 42 IITA but at a tax rate of 1% (para 4 of Art. 42 has been supplemented). A transitional provision (§ 29) has been created, according to which advance tax on income of mariners accrued after 31 December 2009 for previous tax years shall be determines in accordance with Art. 42, para 4 in force at the date of accrual of the relevant income;
- the annual tax base for income of mariners shall be 10% of the amount calculated according to the general rules for determining the annual tax base of employment income (new para 3 of Art. 25);
- employers shall determine the annual amount of the tax in accordance with Art. 49 IITA (para 1 and para 3 of the said provision have been supplemented).

5. Income of registered agricultural producers / tobacco producers

As mentioned in i. 1 above, as from 1 January 2010 income of registered agricultural producers / tobacco producers from production of unprocessed agricultural products shall be taxable (para 3 of Art. 13 and i. 3 of Art. 26, para 2 IITA have been repealed). Dependent on the circumstance whether the activity is carried out in the capacity of a trader, correspondingly registered sole trader, or as an individual that does not have that capacity, the discussed type of income may be taxed:

- either with tax on the annual tax base under Art. 28 IITA – in the first mentioned case above;
- or with tax on the total annual tax base – in the second case when income shall be treated as income from other business activity, wherefore individuals are entitled to 60% tax allowance (except for the production of decorative plants) when calculating the taxable income amount – a new i. 1 has been created in Art. 29 IITA (the other changes in Art. 29 are of editorial nature).

For the purpose of achieving equality in treatment, the new para 6 of Art. 48 provides for the possibility of remission of tax under Art. 28 IITA at an amount of up to 60% with respect to the annual tax base of income from production of unprocessed vegetable and animal products, subject to the conditions for remission of corporate tax under Art. 189b of the Corporate Income Taxation Act. Additional conditions have been stipulated for benefiting from the said preference, including in view of observance of European law in the field of state aids (new para 7 of Art. 48 and §§ 26-28 of the Transitional and Final Provisions of the Law on Amendment and Supplementation of IITA). Aids apply following approval by the European Commission.

6. An option for recalculation of the final tax on income of non-residents that are tax residents of another EU member state or Norway

In response to an infringement procedure against Bulgaria as an EU member state whose legislation contains provisions leading to limitation of the fundamental freedoms under the Treaties because of inequality in treatment between residents and non-residents coming from other EU member states, new provisions have been created in IITA – Art. 37a, para 2 of Art. 66, para 4 of Art. 68. They define the right of each individual that is a tax non-resident of Bulgaria but is a tax resident of another EU member state or of a member state to the EEA Agreement, wherewith Bulgaria has an effective Double Tax Treaty (DTT) in place and which DTT contains either an information exchange clause or a cooperation in collection of taxes clause (for the time being, this is only Norway):

- to submit an annual tax return under Art. 50 IITA, wherein to declare all taxable income received during the relevant tax year, including that wherefrom final tax has been withheld (excluding income under Art. 38);
- to be refunded the positive difference, if any, between the final tax on income under Art. 37 and the tax on the total annual tax base calculated for the same income, subject to the

condition that the tax non-resident individual may not benefit effectively from a tax credit for that difference in the state whereof he/she is a tax resident.

7. Tax relieves

- Regarding the relives for **donations**:

The Assisted Reproduction Fund Centre and the Transplantation Fund Centre have been added to the scope of organisations, donations whereto qualify for tax relief up to 50% of the sum of annual tax bases under Art. 17 IITA.

- Regarding the relief for young families – it remains in force and should be applicable for 2009 as well. The changes in the new Art. 22a IITA (created by § 67, i. 1 of the Transitional and Final Provisions of the 2010 State Budget Act of the Republic of Bulgaria published in SG issue 99 of 15 December 2009) compared to the recent provision (Art. 22a repealed by § 3 of the Law on Amendment and Supplementation of IITA, issue 95 of 1 December 2009) are that:

- the relief may be benefited from only by tax resident individuals;
- a document issued by the creditor bank, certifying the amount of interest payments on the first BGN 100,000 of the home purchase mortgage loan principal made during the year, shall be enclosed with the annual tax return under Art. 50 IITA for the purpose of benefiting from the relief.

The other conditions defining the eligible individuals remain the same:

- the mortgage loan contract to have been concluded by the tax liable person and/or his/her spouse whom she/he has married;
- the tax liable person and/or the spouse to have been under 35 years of age at the date of entering into the mortgage loan contract;
- the mortgaged property to be the only home of the family during the tax year.

8. Obligations for declaring monetary loans in the annual tax return under Art. 50 IITA

The new i. 5 has been created in Art. 50, para 1 IITA, according to which tax residents shall declare, in their annual tax returns, circumstances regarding monetary loans given and/or received thereby where the loans received have not been made available by credit institutions within the meaning of the Credit Institutions Act, namely:

- the outstanding part of monetary loans given during the tax year, if they total over BGN 10,000;
- the residues outstanding at the tax yearend of monetary loans given during the same tax year or during any of the previous five tax years, if the amount of such residues totals over BGN 40,000;

- the outstanding part of monetary loans received during the tax year, if they total over BGN 10,000;
- the residues outstanding at the tax yearend of monetary loans received during the same tax year or during any of the previous five tax years, if the amount of such residues totals over BGN 40,000.

Individuals shall be subject to fine under IITA for any failure to observe the above obligation to declare circumstances or if they declare untrue. The fine is stipulated as a percentage of non-declared amounts – 10% and 15% in case of second-time violation, unless the individual is not subject to a graver penalty (new Art. 80a).

The obligation to declare monetary loans is in force for 2009 as well (§ 67, i. 5 of the Transitional and Final Provisions of the 2010 State Budget Act of the Republic of Bulgaria published in SG issue 99 of 15 December 2009).

9. Relief from the obligation to submit an annual tax return

The provision of Art. 52 IITA has been supplemented whereby the scope of individuals relieved from the obligation to submit an annual tax return has been limited. The changes are as follows:

- each tax resident individual that has given/received monetary loans according to Art. 50, para 1, i. 5 IITA (see item 8 above), is obliged to submit an annual tax return wherein to declare particular circumstances about such loans, regardless of whether and what income he/she has received during the relevant tax year;
- an individual that has not received/given monetary loans and has earned only employment income, except from income from employment relations of the types under § 1, i. 26, letters “f” or “i” of the Additional Provisions of IITA, may not submit an annual tax return provided that he/she has had one employer only at 31 December of the relevant year and if that employer has recalculated on an annual basis the tax on employment income received by the individual during the tax year.

10. Annual report on the activity

As from 1 January 2010 and for 2009 inclusive, individuals that operate as traders within the meaning of the Commercial Act (including sole traders) shall submit only reports on the activity together with their annual tax returns under Art. 50 IITA and not annual financial statements and copies of the auditor’s report (where financial statements are subject to statutory audit). Pursuant to the new i. 53 of § 1 of the Additional Provisions of IITA, the report on the activity is the report under Art. 20, para 4 of the Statistics Act.

Traders that have not carried out any activity during the relevant year and have not accounted for income or expenses according to the accounting legislation are relieved from the foregoing obligation.

11. Obligation of income payers to submit information

Paragraph 4 of Art. 73 IITA has been supplemented to clarify expressly that in the event of termination by liquidation or announcement of an enterprise to be bankrupt, the enterprise shall submit the report under Art. 73, para 1 on income paid to individuals within the deadline and according to the procedure for filing the tax return under Art. 162 of the Corporate Income Taxation Act.

The information set out above is intended just to draw the attention to particular issues regarding application of the recent changes in IITA and is not exhaustive. In case you have questions regarding the application of the new provisions, please do not hesitate to contact us at tel. 02/943-37-00, fax 02/943 37 0, e-mail office@afa.bg or at: Sofia 1504, 38 Oborishte St.