



Taxation

Introduction

Tax is a very complex and involves area we have gone to considerable efforts to ensure the accuracy of the following information, however it is provided without prejudice and you are strongly advised to seek formal guidance from a tax specialist or financial adviser before committing to a particular plan or strategy.

Investment options

When foreign people want to invest in properties in Bulgaria they have two options – to invest either directly or through a local entity. When the investment is direct, the tax treatment of the foreign investors depends on whether or not their activities include a permanent establishment. In case that there is not such establishment, the investor will be liable for only 15% withholding tax on the rentals and capital gains. The double tax treaty allows even a lower tax rate in some cases.

A Company, investing in Bulgarian real property, should be aware that the taxable income includes the gross income from the property, and that property-related expenses such as repairs, maintenance, renovation as well as the interest on loans used for buying the property are allowable against tax. Depreciation is also a part of the taxable income. The Municipal Tax which is due is 10% of the profits.

If you buy land depreciation will affect any immovable property affixed to it but not the land itself. Depreciation for tax purposes is at a rate of 4% per year. If you buy real estate with the intention to re-sell it, it is considered an "investment property". It means that your property is non-depreciable and is subject to annual revaluation to the market value.

Property Ownership, Tax Evaluation and Transfer

In Bulgaria when you want to transfer the ownership of a building or land you will have to use notaries and a Notary Act system. At this moment the notary charges are based on the tax evaluation rates.



The local municipal council conducts the tax evaluation of the property. For a new property it should be done upon completion of the property and

before the Notary Act has been signed. This evaluation represents the minimum value that must be reflected on the Notary Act. It is this value that is most likely to appear on the Notary Act in property transactions in Bulgaria. Tax evaluation rates depend on type of property, location, size, construction and others, and may vary regionally across Bulgaria but in general range from around 25% to 50% of the current market value.

In general, if a purchaser wishes to reflect a value higher than the tax evaluation on the Notary Act, extra costs incurred as a result of this action are paid by the purchaser. These costs will include extra notary fees, municipal taxes and VAT.

The developers of some apartments require that the "tax evaluation price" of the apartment be entered into the Notary Act (i.e. Title Deed) on completion of the property. This price may be lower than the actual price. When the individual sells property in Bulgaria, the identical system works with a tax evaluation prior to the Notary Act.

It is not uncommon for the owner to want to not declare the real price of the property on the Deed of Transfer. This is done so the owner pays a lower tax. You should understand the consequences for such a transaction. Having a Title Deed with lower price does not invalidate the transaction but there may be financial consequences, such as not having official documents for the money spent and higher taxes if you decide to sell the property afterwards on its real value.

In Bulgaria if an investment property or Land purchase is held for 5 years it can be sold free of any gains tax in Bulgaria, however consideration has to be given to the individual's tax situation in the UK.

Tax Evaluations

The Bulgarian property system uses Notaries and a Notary Act in order to transfer the ownership of buildings and/or land. Upon completion of the property and prior to signing the Notary Act, the local municipal council conducts a tax evaluation of each property. This valuation represents the minimum value that must be reflected on the Notary Act. It is this value that appears on the Notary Act in property transactions in Bulgaria. Tax evaluation rates vary by municipality across Bulgaria but in general range from 25-50% of the full market value.



When an individual comes to sell a property in Bulgaria, the same system works with a tax evaluation prior to the Notary Act. In general, if a purchaser wishes to reflect a value higher than the tax evaluation on the Notary Act, extra costs incurred as a result of this action are paid by the purchaser. These costs can include extra notary fees, municipal taxes and VAT. In particular for new build properties, a higher Notary Act price can increase the purchase price by up to 14% alone.

Tax due on Sale or Transfer

The transfer is subject to notary and municipal fees. The notary fees are paid on the higher of the market price or the tax value of the property at varying rates, with the maximum being BGN 3,500. In addition, 2% of the market value of the property is paid to the municipality in which the property is situated upon completion. This is similar to UK Stamp Duty. An example: if the property costs 50 000 euro all these fees (except legal fees) are approximately 1300 euro. Details of the responsible parties for all legal fees should be included in the agreement between the vendor and the buyer.

Property Ownership

The owner of a building or a plot is obliged to pay a property tax. Where a building is built on a state or municipal plot, the value of the plot will also be included in the tax base. The tax is equal to 0.15% of the book value of the property; owners also pay waste-collection fees. These fees are advised when you register your ownership with the municipality, which must be done within 60 days of issuance of the new Notary Act.

Property Rental

If you rent out your property, tax on the income is payable and the way the tax is determined depends on whether the Lessor is a person or a Company.

If the real estate is owned by more than one person, the income is divided in proportion to the participation in the ownership.

Personal Rental

As a person you are allowed a statutory deduction of 20% of the gross income for expenses considered necessary. They do not need to be accounted, or proved by invoices or other documents. No expenses exceeding the 20% are accepted for tax deduction purposes. Rental loss is not recognized.



Bulgarian Tax Residents

The income is subject to advance monthly tax payments at the rate of 15% and to final tax on an annual basis according to a progressive tax scale which is updated annually (See example given below).

Foreign Tax Residents

Rental income from property located in Bulgaria received by individuals who are foreign tax residents is subject to a 15% final withholding tax. No treaty relief is possible.

Company Rental

As a Company, the income from rental is registered in the accounts and included in the balance sheet. Property-related expenses can be offset against the Company profit. Such expenses include repairs, maintenance, renovation and similar costs, as well as depreciation and interest on loans used for the acquisition of the property. The resulting profit is then subject to a flat corporate tax rate of 15%. Tax losses can be carried forward for a five-year period. Losses cannot be offset against profits from previous years.

Examples

A person/Company is letting an apartment at the rate of 500 eu/month
 $500 \text{ eu} \times 12 \text{ months} = 6000 \text{ eu}$ is the rental income

Personal Rental

$6000 \text{ eu} / 12 = 500 \text{ BGN}$ – 20% = 9600 BGN is the taxable income of the person

According to the progressive tax scale: 9600 BGN (for annual taxable base of over 7200 BGN the tax is calculated as

$1188 \text{ BGN} + 24\%$ on the remaining above 7200 BGN = 1765 BGN is the tax due by this person

Company Rental

$6000 \text{ eu} / 12 = 500 \text{ BGN}$ – 15% = 1800 BGN – This is the maximum tax assuming that no expenses have been made with regard to the property. However this situation is fictitious, and expenses made for management and maintenance, renovations, advertising, commission, insurance, etc. can all be offset against the profit made by the Company.

Value Added Tax (VAT)



Transactions with land and lease of property for residential purposes are exempt from Value Added Tax. All other real estate transactions are subject to VAT at the uniform rate of 20%. The buyer is entitled to a VAT refund, provided that they are registered for VAT purposes. This is only possible if the buyer is a Company because in Bulgaria persons cannot be VAT registered. However a Company which is buying a property can be refunded the VAT providing the owner who is selling is also VAT registered.

Gains Tax

When you sell a property Capital Gains Tax is due on the difference between the purchase price and the sale price. This is taxed differently according to whether the buyer is a person or a Company.

For Bulgarian tax residents, the Capital gain is added to the gross annual income and then taxed according to the progressive tax scale.

For foreign tax residents, any capital gain from disposal of real estate on the territory of Bulgaria is subject to 15% withholding tax. No treaty relief is possible.

Dividends (including any distributed profit from companies or partnerships) paid by Bulgarian resident entities to Bulgarian tax residents are subject to 7% withholding tax at the source (the paying Company or partnership) which is the final tax on this kind of income. Stock dividends (i.e. Company profits distributed as new shares or as an increase in the existing par value of shares) are not taxable.

Currently dividends paid to foreign tax residents by Bulgarian legal entities are exempt from tax. However, this is expected to change as from 2007.

Interest, except for interest on deposits in local commercial banks and branches of foreign banks and the State Savings Bank, as well as interest on claims awarded by court, is taxable with a 20% final tax.

Property taxes and rates

The owner of a building, apartment in a building or a plot of land with planning permission is obliged to pay a real property tax. Property tax is calculated at 0.15% of the tax value of the property. In addition, a garbage collection tax is due by the owner, and it is the municipality that determines the amount and updates it periodically.

If the owner is a Company, the taxable base is the book value of the property.

Agricultural land is currently exempt from local taxes, but this is expected to change.

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The Personal Income Tax Act (PITA)

The Personal Income Tax Act sets forth the rules on the taxation of incomes of individuals, residents and non-residents, sole proprietors, as well as the incomes of certain corporate entities, explicitly stated in the Act, derived in a calendar year.

Under PITA tax liable persons are individuals - residents and non-residents, and corporate entities explicitly enumerated in the Act. Under PITA residents, irrespective of their citizenship, are deemed those persons: who have their permanent domicile in Bulgaria; who reside in the country for more than 183 days in a 365-day period. Residents are liable for their worldwide income.

Non-residents are deemed those individuals who do not fit the Act's criteria for residents. Non-residents are liable only for their income derived from Bulgarian sources.

Foreign experts are taxed only on their Bulgarian-source income irrespective of the duration of their stay in the country.

Bulgarian sources of income

Bulgarian sources of income are deemed all incomes derived by an individual from the conduct of business on the territory of Bulgaria. A person is deemed to have carried out business on the territory of the country when: he has a permanent establishment or a fixed base on the territory of the country; or when he has assigned or performed an assignment on the territory of the country, whether in person or through a procurator, agent or in some other way.

Any income under a contract of employment or derived from rendering services is deemed to have been derived from a Bulgarian source where labour has been extended or services have been delivered on the territory of the country, regardless of the source of payment for the labour extended or services rendered.

However, some kinds of income paid out by residents or from a permanent establishment to a non-resident on the territory of the country are deemed to have a Bulgarian source. This income includes, for example dividends and distribution of profits of entities with or without legal presence, interest, royalties, rentals, payments under lease, franchising, factoring, as well as emoluments of freelancers, or members of a managing or controlling body of a Bulgarian corporate branch of a foreign entity, etc.



Income derived from the use of real estate and capital gains from the sale of real estate located in the country, as well as income from transactions with quotas in local companies and income from securities transactions, is also treated as income from a Bulgarian source.

Gross income

Income from employment includes all payments, including prizes in cash or in kind paid out by the employer or at its expense to the tax liable person during the calendar month.

The tax base of income derived under employment relationships is formed by deducting the taxable income with the installments made for social, health, pension and other insurance premiums which the employee is bound to make by virtue of law. The taxable income is reduced with the sums paid for voluntary social, pension and health security.

Tax Exempt income

Income derived from the sale or exchange of certain types of movable and immovable property, provided the following is true:

- An apartment, house or villa, including the land on which they are build, if they have been used over a minimum of 3 years' period as a main home;
- Up to 2 apartments, houses or villas, including the land on which they are built, if they have been used over a minimum of 5 years' period as a secondary home;
- Means of transport if they have been used over a minimum of 1 year's period

Income derived from the sale of shares, quotas and other equity interest in a commercial Company.

Compensation received as a result of pension, health and social security.

Interest accrued on deposits in the State Savings Bank and other Bulgarian incorporated commercial banks and branches of foreign banks, as well as the interest on court-awarded claims.

Company profits distributed as new quotas and shares in commercial companies, as well as the profits distributed as an increase in existing quotas and shares' par value i.e. if the dividends are not distributed as profit but re-invested.



Taxes on specific types of income

Royalty payments and technical services fees are subject to a 15% withholding tax when paid to non-Bulgarian tax residents. No additional tax is levied. Fees for management services are not regarded as technical services' fees and are not subject to withholding tax.

Mandatory BULSTAT registration

Foreigners who perform business activities, provide independent personal services or own real estate in Bulgaria are required to obtain BULSTAT registration numbers with the Bulgarian Registry Agency.

Social security contributions:

The most common current aggregate social security and health insurance rate is 42.5% (36.5% for foreign citizens), including:

- ✓ 26% for the Pension Fund
- ✓ 3% for the Additional Universal Pension Fund
- ✓ 3% for the General Illness and Maternity Fund
- ✓ 3.5% for the Unemployment Fund
- ✓ 6% to the Health Insurance Fund
- ✓ 0.5% for the Guarantee Fund for Employees' Receivables (applicable only to employment contracts)
- ✓ 0.5% Occupational Accident and Disease Fund (it varies between 0.4% and 1.1%)

Employer/employee participation

The contributions are payable by the employer and the employee at a certain ratio – in 2005 at 70:30. By 2009 this ratio will reach 50:50. The contributions are remitted by the employer. The contributions due to the "Occupational Accident and Disease Fund" and the "Guarantee Fund for Employees' Receivables" are exceptions to the above rule and are due by the employer only.

Tax on corporate income:

All companies and partnerships (including non-incorporated partnerships) are liable to corporate income tax. Corporate income is taxed at the rate of 27%. This rate is reduced to 20% for enterprises with taxable profits up to BGN 50,000. In addition to the corporate tax there is a municipal tax at 10%. The municipal tax is deductible from the taxable base for corporate income tax. Thus the aggregate tax rate (including corporate and municipal tax) for annual taxable income up to BGN 50,000 is 28%, whereas for income above that aggregate tax rate is 34.3%.

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Bulgarian resident entities are taxed on a worldwide basis. Other entities are taxed on their Bulgarian-source income. Non-business organizations (including governmental) are taxed for their business activities.

Corporate tax:

A Company is resident in Bulgaria for tax purposes if it is registered in Bulgaria. Companies resident in Bulgaria are subject to tax on their worldwide income. Foreign entities with headquarters abroad are subject to tax on Bulgarian-source income, but their Bulgarian branches are deemed Bulgarian resident companies for tax purposes.

Tax exemptions.

Tax incentive for investments in depressed regions: Entities investing in regions with a high unemployment rate are given the right for a reduction of the corporate income tax. These regions are listed annually in an appendix to the Corporate Income Tax Act. They should provide that:

- The investment is in the form of acquisition, modernization or reconstruction of tangible fixed assets such as buildings, equipment, transmitters, electricity transmitters, and telecommunication lines etc.
- The funds for the investment are generated from the contributions made by shareholders for acquisition of new shares in the Company making the investments.
- If the requirements for the tax reduction are met the corporate tax is reduced by an amount representing 10 per cent of the amount of the share contributions used in the above manner.
- The sum usable for reduction is accounted for as reserves and if greater than the corporate tax in the respective year it can be used to reduce the corporate tax in the following five years.
- Entities already enjoying the tax incentive regarding regions with a high unemployment rate may choose to continue to use the old incentive (which is already repealed) or to start using the new incentive if conditions are met.

Customs duties

A new Customs Act has entered into force as from 1 January 1999. It provides for different customs arrangements with economic impact such as customs warehousing, inward processing, placing of goods in free zones



and free warehouses, etc. In general, goods imported in Bulgaria are subject to:

- customs duty - a percentage of the customs value.
- VAT 20% of the customs value + customs duty.

The rates of customs duties applicable to certain products are significantly reduced in 1999 as a result of the application of Free Trade Agreements between Bulgaria and: EFTA, CEFTA, Turkey, Macedonia.

Please note that the details outlined in this chapter are for information purposes only and they do not represent tax advice. They contain information based on the current Bulgarian legislation and tax regulations.

BPLI strongly advises that you seek professional advice for each individual case and that no decision is taken solely on the basis of the information contained herein.