

Enlarging the European Union – Again

On 1 January 2007, the European Union became a Union of 27 Member States and an Internal Market of nearly 500 million people with the accession of Bulgaria and Romania. The Taxation Chapters have been closed with both new Member States. Are, however, the tax systems of these two Member States in line with the *acquis communautaire*? What remains to be done? What are the problem areas that still have to be dealt with? The following article deals specifically with these issues in respect of Bulgaria. A subsequent article will consider these topics with regard to Romania.

Bulgaria

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EU Accession and the Bulgarian Tax System

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1. Introduction

1.1. Opening remarks

The Bulgarian state dates back to seventh century AD. Following Christianization in 863 AD, Bulgaria welcomed the disciples of Saint Cyril and Saint Methodius in 886 AD and, based on the new alphabet (the Glagolitic, later reworked into the Cyrillic alphabet), became a centre for education and culture. More than eleven centuries later, modern Bulgaria joined the European Union, bringing its cultural heritage and the third European alphabet (the Cyrillic) with it.

Bulgaria's development after the fall of the Communist regime in 1989 generally follows that of the other former Soviet Block Eastern European states. The first free elec-

tions were held in June 1990 and the new Constitution was adopted in 1991. This confirmed the principles of democracy, private property and a free market economy. Democratic reforms were, however, initially slower than in the other Eastern European states that joined the European Union in 2004, but radically speeded up after 1997. In the ten years since then, Bulgaria has maintained macroeconomic financial stability, steady and increasing growth, low-to-moderate inflation, a reducing tax burden and falling unemployment. Bulgaria has been a member of NATO since 2004 and acceded to the European Union on 1 January 2007.

1.2. History of EU accession negotiations

The establishment of diplomatic relations between Bulgaria and the European Union dates back to 1988, which pre-dates the fall of the Communist regime. In May 1990, Bulgaria and the European Economic Community signed the Convention on Trade, Business and Economic Relations.

The European Association Agreement¹ and the Provisional Agreement on Trade and Related Matters were signed in 1993. The European Association Agreement included references to taxation, though in a limited manner. Following the approval for enlargement given at the European Council in Copenhagen on 21 and 22 June 1993, Bulgaria submitted its application for membership of the European Union in December 1995.

The first Commission Regular Report on Bulgaria's progress towards accession was issued in November 1998.² The 1999 Regular Report recommended the opening of formal negotiations.³ Consequently, accession negotiations started on 15 February 2000. The

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1. Ratified by the Bulgarian parliament on 15 April 1993. Ratification published in State Gazette No. 33 of 20 April 1993, in force from 1 February 1995, and text published on 25 May 1995 in State Gazette No. 61 of 7 July 1995.

2. See http://ec.europa.eu/enlargement/archives/pdf/key_documents/1998/bulgaria_en.pdf.

3. See http://ec.europa.eu/enlargement/archives/pdf/key_documents/1999/bulgaria_en.pdf.

process ended on 15 June 2004 at the Intergovernmental Conference. The last Chapter closed was “Competition Policy”,⁴ which concerned important negotiations on State aid issues, including those provided by way of tax relief. In the same year, the Brussels European Council declared that it looked forward to welcoming Bulgaria as a Member State in January 2007.

Except for certain problems regarding the reform of the judicial system, according to the Monitoring Report of 26 September 2006,⁵ Bulgaria was sufficiently prepared to meet the political, economic and *acquis communautaire* criteria. As a result, Bulgaria acceded to the European Union on 1 January 2007.

1.3. Tax chapter

The first Negotiation Position⁶ on Chapter 10 “Taxation” was submitted on 30 April 2001, followed by the EU Common Position⁷ and the commencement of negotiations on 27 July 2001. The Chapter was provisionally closed on 10 June 2002. These negotiations primarily focussed on VAT and excise duties. As, however, following the closure of the Chapter, the *acquis communautaire* was amended, additional transitional periods were requested in respect of excise duties and the taxation of interest and royalties.⁸

With regard to VAT, a derogation was granted in respect of an increased VAT registration threshold of BGN 50,000 (approximately, EUR 25,600) for small and medium-sized enterprises, provided that taxable persons below the threshold can opt for the normal VAT scheme and must register for VAT if involved in the supply of intellectual services.⁹ Bulgaria was also allowed to continue to apply a zero VAT rate to the international transport of passengers.

With regard to excise duties, a derogation was granted to small distilleries in that a reduced rate of 50% of the normal rate may be applied to 30 litres of fruit spirit per household per year exclusively for personal consumption. Bulgaria was also granted transitional periods regarding the application of the minimum excise duty rates on:

- cigarettes (to 1 January 2010);
- unleaded petrol (to 1 January 2011);
- gas oil and kerosene used as motor fuel (to 1 January 2013);
- electricity (to 1 January 2010); and
- coal and coke (to 1 January 2010 for district heating and 1 January 2009 for other purposes).

The only transitional period in respect of direct taxation relates to the Interest and Royalties Directive.¹⁰ This applies for eight years until 1 January 2015, during which Bulgaria is authorized to levy a 10% withholding tax on royalties and interest payments for the first four years and 5% for the remainder of the period.

2. Indirect Taxes

2.1. VAT¹¹

The Commission’s final Comprehensive Monitoring Report of 26 September 2006 acknowledged that “Bulgaria has made substantial progress in the area of Value Added Tax (VAT) ... in particular provisions for the transposition of the intra-Community regime”.¹²

The new Bulgarian Value Added Tax Act¹³ was adopted on 21 July 2006 and applies from 1 January 2007. This is the third Value Added Tax Act in the Bulgarian tax system. The first Value Added Tax Act became effective on 1 April 1994, but was later repealed as part of the reform of the tax system effected by the second Value Added Tax Act, which entered into force on 1 January 1999. The second Value Added Tax Act was amended a number of times, with most of the amendments aiming at further harmonization with the Sixth VAT Directive. The most important changes were the reduction of the registration threshold from BGN 75,000 to BGN 50,000, the widening of the scope of exempt financial services and the reclassification of certain supplies from exempt into supplies outside the scope of VAT. From 1 January 2003, a system of blocked VAT accounts applied. Under this system, any VAT payment over BGN 1,000 had to be paid to the VAT account of the supplier, whilst the supplier was generally authorized only to transfer these funds to other VAT accounts or the state budget.

The commitment to implement the intra-Community VAT regime and fully align the VAT legislation with *acquis communautaire* was satisfied by the adoption of the third (new) Value Added Tax Act. The third Value Added Tax Act strictly follows the structure, concepts and definitions of Directive 2006/112/EC and the Sixth VAT Directive, and is almost fully aligned with these Directives.

Specifically, the scope of VAT has been amended to cover only supplies for consideration. In respect of certain free supplies falling outside the scope of VAT, a self-supply mechanism has been introduced. The supply (including the intra-Community supply) of goods is defined as the transfer of ownership or other rights in

4. Opened 30 March 2001, provisionally closed 15 June 2004.

5. See http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf.

6. CONF-BG 22/01.

7. CONF-BG 50/01.

8. CONF-BG 32/04.

9. Art. 9(2)(e) Sixth VAT Directive.

10. Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States.

11. The references in this section are to Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, accompanied by references to Council Directive 77/388/EEC of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment (the Sixth VAT Directive), as appropriate.

12. See http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf.

13. Published in State Gazette No. 63 of 4 August 2006.

rem. The exceptions to this rule reflect those in Art. 14(2) of Directive 2006/112/EC,¹⁴ thereby covering the transfer of the “right to dispose of tangible property as owner” in most cases. The implications of the decisions of the European Court of Justice (ECJ) in *Safe*¹⁵ and *Auto Lease*¹⁶ may, however, give rise to further considerations. In this respect, financial leasing is regarded as a single supply of the relevant leased good, in contrast to the previous treatment (transitional provisions apply for existing leasing contracts).

The standard VAT rate has remained at 20% since the introduction of the second Value Added Tax Act. As the special 65% reduction in the tax base on travel packages sold abroad (effectively capping the rate at 7%) had to be abolished, a 7% reduced rate for hotel accommodation as part of an organized trip has been introduced.

Most of the limitations on taxable amounts have been repealed, for example, the rule that taxable amounts could not be less than the acquisition price. Nevertheless, these rules still apply to supplies in respect of building land and new buildings. This is not uncommon in other VAT systems. The inclusion of penalties and interest for late payment has also been repealed. The taxable amount is the market price in respect of supplies between related persons, deregistration and deemed supplies of repair or refurbishment services by a lessor to the lessee. The definitions of the terms “margin” and “profit margin” in the margin schemes for travel agents and second-hand goods limits the taxable margin to zero if the margins are negative. These schemes have been made mandatory and optional, respectively, following the requirements of Directive 2006/112/EC and the Sixth VAT Directive. The e-commerce special scheme and the arrangements in respect of the taxation of gas and electricity have also been fully implemented.

The higher registration threshold of BGN 50,000 (approximately, EUR 25,600) previously granted as a derogation has not been amended, but zero-rated supplies are now included in the calculation of the turnover and financial and insurance services, unless these are ancillary in nature. According to the commitments made by Bulgaria in the negotiation process, optional registration is available to any taxable person. Any input VAT on goods and some services is also deductible on registration, unless five years (20 years for immovable property) have elapsed since the acquisition of the goods. As only a limited number of services qualify for an input VAT deduction, for example, those supplied one month before registration, questions may arise in respect of services that could have longer effect. The registration threshold in respect of distance sales is BGN 70,000 (approximately, EUR 35,800).

The regime in respect of the deduction of input VAT has also been liberalized. Specifically, the VAT accounts system has been abolished, input VAT is deductible in respect of taxable supplies made outside Bulgaria (previously exempt without right of deduction), and deductibility has been extended to financial and insurance services provided to persons outside the Commun-

ity. In addition, the requirement for a supplier to reflect the chargeable tax in financial accounting has been abolished. There are, however, certain problems relating to the denominator in the pro-rata fraction (used in the calculation of the deductible proportion), as this includes supplies falling outside a taxable person's economic activities (in this respect, see the implications of the ECJ decision in *Sofitam*).¹⁷ VAT invoices must also show the name and signature of the issuing person, which is not required under Art. 226 of Directive 2006/112/EC.¹⁸

A customer's joint and several liability for the payment of unpaid VAT in respect of preceding supplies generally follows the recent ECJ decisions in *Federation of Technological Industries*,¹⁹ and *Axel Kittel and Recolta Recycling*.²⁰ Liability is extended only if holding customers liable for payment would have no effect, such that, ultimately, the nearest “existing” customer in the chain of transactions would be liable for the unpaid VAT.

The third Value Added Tax Act fully aligns the scope of exempt supplies with Directive 2006/112/EC and the Sixth VAT Directive. Consequently, the treatment of a number of supplies has been amended. In particular, supplies of building land and new buildings are subject to VAT, whilst other types of land and old buildings are exempt. (Previously, supplies of land were generally exempt and supplies of buildings taxable.) The transfer of building rights (without construction work) until the basic construction is completed is, however, also exempt from VAT. It is, however, difficult to find a justification for this in Directive 2006/112/EC or the Sixth VAT Directive. Supplies of educational textbooks are subjected to VAT, unless provided by educational institutions. The import of cars for the disabled and of prostheses other than dental prostheses are also subject to VAT, unless supplied as part of medical services. Furthermore, and contrary to the second Value Added Tax Act, services provided by lawyers, privatization transactions, supplies of agricultural goods and supplies of scrap metal are subject to VAT. Nevertheless, the adoption of the Directive 2006/69/EC has permitted the introduction of a reverse charge in respect of waste management supplies. In addition to the obligatory reverse charge provided for in Directive 2006/112/EC and the Sixth VAT Directive, the reverse charge mechanism has also been extended to registered taxable persons who receive supplies of goods together with an installation or assembly from taxable persons registered in other Member States.

14. Art. 5(4) Sixth VAT Directive.

15. ECJ, 8 February 1990, Case C-320/88, *Staatssecretaris van Financiën v. Shipping and Forwarding Enterprise Safe BV*.

16. ECJ, 6 February 2003, Case C-185/01, *Auto Lease Holland BV v. Bundesamt für Finanzen*.

17. ECJ, 22 June 1993, Case C-333/91, *Sofitam SA (formerly Satam SA) v. Ministre chargé du Budget*.

18. Art. 28h(3)(b) Sixth VAT Directive.

19. ECJ, 11 May 2006, Case C-384/04, *Commissioners of Customs & Excise, Attorney General v. Federation of Technological Industries and Others*.

20. ECJ, 6 July 2006, Joined Cases C-439/04 and C-440/04, *Axel Kittel v. Belgian State and Belgian State v. Recolta Recycling SPRL*.

As a result of the implementation of Art. 136 of Directive 2006/112/EC,²¹ supplies of goods and services in respect of which the supplier is not entitled to deduct input tax are exempt from VAT. Strictly, under the wording of Directive 2006/112/EC and the Sixth VAT Directive, it could be argued that this should only apply to supplies of goods. The widening of the scope of zero-rated supplies regarding international transport to include railway transport is also difficult to justify. The requirement to appoint tax representative, even for taxable persons of other Member States, is, however, contrary to the optional regime provided for in Art. 204(1), first subparagraph of Directive 2006/112/EC.²² It should also be noted that three Ordinances have been published on the issue of refund of VAT to non-residents.

2.2. Excise duties

The *acquis communautaire* in respect of excise duties necessitates the introduction of a harmonized structure for excise duties on the tobacco products, alcoholic beverages, energy products and electricity, and minimum rates and rules on the production, movement, storage and monitoring of excise goods. The tendency is to increase the minimum excise duty rates and widen the scope of taxation (in respect of natural gas, coal and coke and electricity).

The current scope and structure of Bulgarian excise duties was introduced in April 1994 with the Excise Duties Act, which abolished the Turnover Tax and Excise Duties Act dating from the early 1950s. A number of amendments have since been made, the main objective of which is harmonization with the *acquis communautaire*, including a gradual increase in the rates to the minimum ones. In addition to the harmonization of excise goods, coffee and cars over a certain engine power have also been made subject to excise duties.

The new Excise Duties and Tax Warehouses Act²³ was adopted at the end of 2005 and became effective on 1 July 2006, thereby abolishing the Excise Duties Act. The earlier date of implementation was introduced so that the licensed warehouse keepers and the customs administration could acquire experience in the functioning of the excise bonded warehousing system.

At the end of 2006, a comprehensive amendment to the Excise Duties and Tax Warehouses Act was implemented²⁴ so as to introduce the system in intra-Community situations and to harmonize certain concepts with the Value Added Tax Act. Excise duty of 50% of the normal rate also applies to alcohol from personal production within certain limitations. In addition, in order to comply with Directive 2003/96/EC, the taxation of coal and coke, natural gas and electricity has been introduced. Natural gas is, however, subject to a zero rate, and coal and coke for heating are subject to excise duty only if used for business purposes. Electricity for household use is exempt. Railway transport is exempt by way of refund of the excise duty on electricity.

Excise duty rates have been increased in order to reach the minimum rates for the Community. Unleaded petrol and gas oil and kerosene qualify for a transitional period (see 1.3.). These excise duty rates are EUR 30 to EUR 50 below the minimum rates. In contrast, the rate on liquefied petroleum gas is around EUR 50 over the minimum rate.

The excise duties on cigarettes are only marginally higher than half of the minimum EU rates. Recent amendments have increased the ad valorem excise duty rate, but, as this has been offset by a reduction in the specific rate, this did not bring the overall rate closer to the EU minimum.

2.3. Tax on motor vehicles

With the latest amendments to the Local Taxes and Fees Act,²⁵ which apply from 1 January 2007, the minimum rates of tax for motor vehicles with a maximum permissible gross laden weight of more than 12 tonnes and for vehicle combinations conform to EU norms. The rates structure has been harmonized with Annex I of Directive 1999/62/EC since 1 January 2006.

2.4. Indirect tax on the raising of capital

There is no capital duty in Bulgaria.

3. Direct Taxes

3.1. Company taxation

3.1.1. Taxation of dividend payments between parents and subsidiaries

Dividends and liquidation proceeds are generally subject to a 7% withholding tax. It should be noted that the definition of dividends in Bulgarian tax system is very wide and includes not only any distribution resulting in a reduction in equity, but also hidden distributions. The exemption of distributed dividends from withholding tax to companies from Member States has been provided for since 1 January 2005 and was loosely based on the provisions of the EC Parent-Subsidiary Directive,²⁶ i.e. a 20% equity participation and a one-year minimum holding period.

With the new Corporate Income Tax Act (CITA)²⁷ in force from 1 January 2007, new definitions for resident and Member State parent or subsidiary companies apply. The minimum equity participation has been set at 15% and the minimum holding period at two years. If the two-year holding period requirement is not satisfied at

21. Art. 13B(c) Sixth VAT Directive.

22. Art. 28g(2)a Sixth VAT Directive.

23. Published in State Gazette No. 91 of 15 November 2005.

24. Published in State Gazette No. 105 of 22 December 2006, in force from 1 January 2007.

25. Published in State Gazette No. 105 of 22 December 2006.

26. Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.

27. Published in State Gazette No. 105 of 22 December 2006.

the time of distribution, security in the form of bank guarantee or deposit in cash must be provided to cover the withholding tax due. This should, in principle, be in line with the ECJ's decision in *Denkavit International BV*.²⁸ The permanent establishment (PE) hypotheses provided for in the amending Council Directive 2003/123/EC have also been implemented. In addition, management costs incurred are fully deductible, whilst 95% relief is provided for dividend income.

The exemption method to relieve double taxation was introduced as a simplification measure. In this respect, it should be noted that the general method to relieve double taxation on dividend distribution provided for in the law is ordinary tax credit. No credit is, however, available for the underlying corporate income tax. The parent-subsidiary scheme is not available in cases of tax avoidance or abuse, including hidden distributions, as well as liquidations.

The regime for the distribution of dividends between resident companies is more favourable in the sense that dividends are fully exempt, regardless of the holding period or equity participation. Accordingly, the ECJ's decision in *Denkavit Internationaal*²⁹ could have implications. As this is an ongoing issue, and in the light of the *Test Claimants in Class IV of the ACT Group Litigation*,³⁰ any final conclusions are outside the scope of this article.

3.1.2. Taxation of corporate reorganizations

The previous CITA had no provisions with regard to intra-Community reorganizations. It, however, contained some provisions on purely resident-to-resident cases. The new CITA is more exhaustive and has adapted the provisions of the EC Merger Directive³¹ to local and intra-EU cases. Unfortunately, Bulgarian Company Law does not provide for reorganizations with EU resident companies. Nevertheless, as ECJ jurisprudence is valid in Bulgaria, *SEVIC*³² may give possible grounds for mergers. The Cross-border Merger Directive³³ should also be implemented not later than by 15 December 2007.

Loss transfers are not generally available, either for Bulgarian or EU companies, except where there is only a change of legal form. Losses are, however, transferable if the Bulgarian transferring company surrenders the assets to a PE of a non-resident receiving company (the latter not having previously had a PE in Bulgaria) and this is economically comparable to a change of legal form. The treatment of the multiple PEs arising from such a reorganization could, however, require further analysis.

The EC Merger Directive has been implemented as simply as possible, i.e. capital gains relating to the 10% eligible cash payment are deferred and the cancellation of the holding in the transferring company is not subject to the 15% equity participation limitation. Taxation of the capital gains in respect of the "transfer of assets" is also deferred and gains are fully exempt if the assets are held for more than five years.

It should be noted that the verbatim transposition of the EC Merger Directive into Bulgarian law would not have produced the required result, as Art. 4(1)b of the Directive states that the "deferral of taxation is applicable to assets and liabilities ... effectively connected with a permanent establishment" and cannot be applied in respect of divisions, for example, if the assets and liabilities could remain in a resulting company, rather than in a PE. Accordingly, a more asset-oriented approach has been adopted so as to divide the assets into those remaining in the tax system (qualifying for the deferral), those entering the tax system (recognized at the accounting value), those leaving the tax system and unconnected with a PE in another Member State and, therefore, not within the scope of the EC Merger Directive (taxed), and those leaving the tax system and connected with a PE in another Member State and, therefore, within the scope of Art. 10 of the Directive (exempt). Following recent ECJ decisions, i.e. in *de Lasteyrie*³⁴ and "*N*",³⁵ and the possible implications for companies, the immediate taxation of capital gains on the assets and liabilities that fall outside the scope of the EC Merger Directive could be discriminatory.

At the level of the shareholders, the taxation of unrealized capital gains on their shares is postponed until disposal. The withholding tax for non-resident shareholders is also deferred until the 60th day following the subsequent disposal of the shares received. Non-resident companies must report annually whether or not they have retained or have disposed of shares received. Resident and non-resident individual shareholders must file a tax return on the receipt of shares, but pay the 10% final tax on the capital gains on the 15th of the month following the end of the quarter of the subsequent disposal.

Another important issue that is strictly outside the scope of the EC Merger Directive is the treatment of goodwill. Specifically, the impairment of goodwill as a result of business combination is not deductible.

3.1.3. Taxation of interest and royalty payments between associated enterprises

Bulgaria has been granted a transitional period in respect of the implementation of Art. 1 of the Interest

28. ECJ, 17 October 1996, Joined Cases C-283/94, C-291/94 and C-292/94, *Denkavit International BV, VITIC Amsterdam BV and Voormeer BV v. Bundesamt für Finanzen*, Para. 36.

29. ECJ, 14 December 2006, Case C-170/05, *Denkavit Internationaal BV, Denkavit France SARL v. Ministre de l'Économie, des Finances et de l'Industrie*.

30. ECJ, 12 December 2006, Case C-374/04, *Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue*.

31. Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States.

32. ECJ, 13 December 2005, Case C-411/03, *SEVIC Systems AG*.

33. Directive 2005/56/EC of the European Parliament and of the Council of 26 October 2005 on cross-border mergers of limited liability companies.

34. ECJ, 11 March 2004, Case C-9/02, *Hughes de Lasteyrie du Saillant v. Ministère de l'Économie, des Finances et de l'Industrie*.

35. ECJ, 7 September 2006, Case C-470/04, *N v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*.

and Royalties Directive until 31 December 2014 (see 1.3.). During the transitional period, the rate of tax on payments of interest or royalties between qualifying companies will not exceed 10% up to 31 December 2010 and 5% up to 31 December 2014. The new CITA provides for a general reduction to 10% of the withholding tax for interest and royalties paid to non-residents. This is in line with the transitional period, but, as the withholding tax is normally levied on the gross proceeds, the ECJ decision in *Gerritse*³⁶ could have complicating implications.

3.1.4. Harmful tax competition

The assessment of harmful practices under the Code of Conduct on Business Taxation³⁷ in respect of Bulgaria occurred in 2006, two years after the State aid review. The potential harmful tax measures had either been repealed by then or amended to make them non-harmful.

3.1.5. State aid

A comprehensive tax reform was undertaken in mid-2004 in order to comply with the *acquis communautaire* regarding State aid. This involved amendments to the new CITA and certain provisions of the new Value Added Tax Act and the Tax Procedure Code.³⁸ The special scheme in respect of the deferred charging of VAT on imports³⁹ for qualifying investment projects had to be amended to include references to the State Aid Act.⁴⁰ (State aid in this case is, however, very limited compared to the size of the project and for medium-sized projects falls within the *de minimis* limit.) The procedure in respect of the deferral of tax liabilities in the Tax Procedure Code was also amended. Furthermore, the regional investment and employment incentives (100% tax relief and the 10% investment tax credit and additional double deduction of social security contributions) in excess of the *de minimis* threshold were made subject to additional regional aid or employment aid conditions following the relevant EU guidelines. Finally, the new CITA introduced exclusions from the *de minimis* threshold in respect of the transport, agriculture and fisheries, and export aid sectors.

3.1.6. Transfer pricing

3.1.6.1. Arbitration Convention and Code of Conduct on effective implementation

At the time of the writing of this article, Bulgaria had not ratified the EC Arbitration Convention,⁴¹ but will most probably be approached by the Commission to do so.

3.1.6.2. Code of Conduct on transfer pricing documentation for associated enterprises

No harmonized requirements regarding the Code of Conduct on transfer pricing documentation for associated enterprises⁴² have been implemented in Bulgaria. Transfer pricing documentation is required on a case-by-case basis depending on the method used. No trans-

fer pricing documentation related penalties are imposed.

3.1.7. ECJ case law

Some of the possible implications of the recent ECJ case law have already been commented on. There are, however, certain additional aspects of the Bulgarian legislation that could still require revision, most evidently the restriction of some exemptions or reliefs to situations that are related to local-income source. With regard to the issue of the cross-border offsetting of losses, as no group taxation or group loss relief is allowed under the current system, the implications of the decision in *Marks & Spencer*⁴³ have been implemented in respect of losses between headquarters and PEs (see 3.1.2.).

3.2. Individual taxation

3.2.1. Savings

The Savings Directive⁴⁴ was implemented by way of amendments to the Tax and Social Security Procedure Code.⁴⁵ Consequently, the full tax credit and the effective refund of the special withholding tax applied in the three derogating Member States (Austria, Belgium and Luxembourg) to the beneficial owners have been implemented into the Personal Income Taxes Act (PITA),⁴⁶ which applies from 1 January 2007. The special case of a paying agent has also been introduced, whilst a clearer provision on the burden of proof on the part of a special paying agent that the savings income is not paid to a beneficial owner applies. Finally, the banking secrecy provisions have been amended to permit the transfer of information on savings income to the tax authorities and the other Member States.

3.2.2. ECJ case law

The PITA has introduced a number of amendments to the current tax regime in order to remove discriminating

36. ECJ, 12 June 2003, Case C-234/01, *Arnoud Gerritse v. Finanzamt Neukölln-Nord*.

37. Set out in the conclusions of the Council of Economics and Finance Ministers (ECOFIN) of 1 December 1997 http://ec.europa.eu/taxation_customs/resources/documents/COC_EN.pdf.

38. Published in State Gazette No. 103 of 30 November 1999, in force from 1 January 2000.

39. Permitted under Art. 211 Directive 2006/112/EC and Art. 23 Sixth VAT Directive.

40. Published in State Gazette No. 28 of 19 March 2002, in force from 20 June 2002. Abolished by the new State Aid Act, published in State Gazette No. 86 of 24 October 2006, in force from 1 January 2007.

41. Convention 90/436/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

42. Resolution of the Council and of the representatives of the governments of the Member States, meeting within the Council, of 27 June 2006 on a code of conduct on transfer pricing documentation for associated enterprises in the European Union (EU TPD) (2006/C 176/01).

43. ECJ, 13 December 2005, Case C-446/03, *Marks & Spencer plc v. David Halsey (Her Majesty's Inspector of Taxes)*.

44. Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments.

45. Published in State Gazette No. 105 of 29 December 2005, in force from 1 January 2006.

46. Published in State Gazette No. 95 of 24 November 2006.

or restrictive treatment. In particular, a special non-discrimination clause has been introduced to exempt from withholding tax income that was already exempt for residents. This applies to residents of Member States of the European Union or the European Economic Area. In addition, from 1 January 2007, inbound dividends are subject to tax at the same rate as local dividends, i.e. 7% (previously, 12%).

Despite the unquestionable move towards non-discriminatory treatment, issues remain in respect of some features of the tax reliefs. In particular, as reliefs are only granted if certain income is Bulgarian source, doubts remain as to the compatibility of these provisions with the ECJ case law. For example, the exemption of gains from shares traded on the Bulgarian Stock Exchange appears to be contrary to *Weidert/Paulus*.⁴⁷ The exemption of interest income from Bulgarian banks and branches of foreign banks, Bulgarian government, municipal and corporate bonds, and debentures also appears to be discriminatory when *Commission v. France*⁴⁸ is considered.

4. Administrative Cooperation and Mutual Assistance

The Tax and Social Security Procedure Code was amended at the end of 2006 in order to implement the direct taxation Mutual Assistance Directive⁴⁹ and exchange on request, and the automatic exchange and spontaneous exchange of information. The Recovery Directive⁵⁰ and its implementing Directive⁵¹ were also implemented by way of the same amendments.

5. Conclusions

Following a substantial period of tax reform and especially with the latest laws adopted just before 1 January 2007, the Bulgarian tax system, on accession, appears to comply with the *acquis communautaire* in respect of VAT, excise duties and direct taxes. Some issues and certain details remain open, as recent ECJ case law is more challenging to the tax systems of the Member States. In this respect, the effect of this recent ECJ jurisprudence on the Bulgarian tax system may be interesting to follow.

47. ECJ, 15 July 2004, Case C-242/03, *Ministre des Finances v. Jean-Claude Weidert, Elisabeth Paulus*.

48. ECJ, 4 March 2004, Case C-334/02, *Commission of the European Communities v. French Republic*.

49. Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums.

50. Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims resulting from operations forming part of the system of financing the European Agricultural Guidance and Guarantee Fund, and of agricultural levies and customs duties, and in respect of value added tax.

51. Commission Directive 2002/94/EC of 9 December 2002 laying down detailed rules for implementing certain provisions of Council Directive 76/308/EEC on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures.