

# Setting up your Business in Bulgaria

## Issues to consider



Bulgaria is a parliamentary republic situated in the heart of the Balkan Peninsula at the south - east part of Europe. It is a member of NATO since 2004 and of the European Union since 2007. The territory of Bulgaria is almost 111,000 sq. m. inhabited by 7 million citizens. Political stability, high educational level of the population and very low corporate and personal income taxes (10% flat) make Bulgaria a very attractive place for foreign investments.

However there are a number of issues which you must consider when you are looking to set up your business in Bulgaria.

This document takes you through some of the common questions we come across and gives you practical information about the issues you need to consider.

### **What type of Business Structure should we use?**

There are advantages and disadvantages to all of them, and there is no one correct answer, it's all dependent on your specific business circumstances and needs. A brief overview of the main structures is below:

#### **Establishment (a branch of your overseas business)**

The Branch is not considered as a separate legal entity but for taxation purposes it is given a Bulgarian ID number upon its registration in Bulgaria. The parent company should appoint one or more managers who will manage and represent the branch.

Main characteristics:

- Not a separate legal entity but an extension of the overseas parent company;
- No limited liability or ring-fencing of the Bulgarian operations;
- If there is a permanent establishment in Bulgaria then profits arising from this PE are subject to Bulgarian Corporate Income tax;
- Must file parent company accounts, prepared under Bulgarian Company Law, with the Commercial register for public inspection, even if these are not made publically available overseas. The accounts are filed annually until June 30th of the following year.

#### **Limited Liability Company:**

The so called OOD is a company formed by one or more persons (individuals and/or legal entities) whose liability is limited to the amount of their contribution to the company's equity.

Main characteristics:

- Provides limited liability and ring-fencing to Bulgarian operations
- Gives a perception of a local business, with longevity
- Corporation tax to be paid on company profits
- Limited companies should at least have:
  - One shareholder who can be an individual or a legal entity;
  - Minimum required equity of 2 (two) BGN (approximately 1 euro);
  - Company name must be unique. It is impossible to have two companies registered

# Setting up your Business in Bulgaria

## Issues to consider



in Bulgaria with the same name with one exception – companies registered before January 2008 may have the same name if they are registered in different districts of Bulgaria;

- Seat and management address – which serves as a correspondence address for all state and municipal authorities;
- At least one manager - this form of company does not have board of directors;
- Determination of the scope of activities.

Companies' accounts require auditing if in the current or the preceding year two of the following three criteria are exceeded Assets - 2 million BGN; Revenues - 4 million BGN; average number of staff members – 50.

Companies having certain types of legal structures like joint stock companies, partnerships limited by shares or performing special type of activities: credit institutions, insurers and so on are subject to independent financial audit irrespective of the above mentioned criteria.

### Limited Liability Partnership:

Limited Liability Partnership is not regulated by the Bulgarian law as a form of doing business.

### How much Corporation Tax will the business pay?

Current Corporation Tax rates in Bulgaria are:

Tax rate (%)		Taxable profit (Cur)	
Rate	10	whole profit	tax-adjusted profit

(NB: rates are for the tax year to 31/12/2016)

Corporate income tax is due on the accounting profit after adjustments for tax purposes. Tax losses may be carried forward up to five years and may be offset against future taxable profits.

The annual corporate income tax return has to be submitted by 31 March of the following year. The financial year coincides with the calendar year.

Special tax rate is applicable for companies dealing with sailing as well as companies engaged in gambling.

The Bulgarian Government does not plan to change the tax rate.

Bulgaria has the lowest corporate income tax rate in the European Union.

### What if we use Bulgaria to set up our holding company?

# Setting up your Business in Bulgaria

## Issues to consider



Dividends distributed to resident companies are not included in their taxable income except for dividends distributed by:

- Special purpose investment companies;
- Non EU/EEA foreign entities.

The Bulgarian legislation does not have a special holding company regime.

### **What if we make cross-border transactions between group companies?**

The Bulgarian transfer pricing rules require that taxpayers apply arm's length prices to their related party transactions. Arm's length prices are those which unrelated parties would have agreed upon in similar circumstances. This requirement is imposed both to cross-border and domestic transactions.

Largely based on the 1995 OECD Guidelines, the Bulgarian transfer pricing rules envisage 5 methods for determining arm's length prices:

1. The Comparable Uncontrolled Price Method;
2. The Resale Minus Method;
3. The Cost Plus Method;
4. The Transactional Net Margin Method;
5. The Profit Split Method.

A taxpayer is obliged to prove the arm's length character of its related party transactions during a tax audit by applying one of the above methods.

The legislation does not include any specific requirements to the format and the contents of transfer pricing documentation which taxpayers should produce as an evidence to arm's length pricing. However, a transfer pricing manual was released by the Bulgarian Revenue Agency in February 2010 and it points out the items that would appear appropriate to include in the documentation.

The manual also contains a set of other useful guidelines related to different transfer pricing topics. For instance, with respect to intra-group services, the manual suggests specific profit mark-up ranges that have proved customary for Bulgaria.

Typical transactions between affiliated entities that are covered by TP regulations are:

- Sale and purchase of goods;
- Provision of management services;
- Property rental charges;
- Transfer of intangible assets e.g. trademarks, patents;
- Sharing of knowledge, expertise, business contacts etc.;
- Provision of financial support e.g. inter-group loans and charging a "market" interest on loans.

However even if an entity is exempt from the Bulgarian transfer pricing regime it may fall under the scrutiny of the other international tax jurisdictions where it transacts. There may

# Setting up your Business in Bulgaria

## Issues to consider



also be other tax regulations which ensure transactions are undertaken at a commercial value.

### What Employment Taxes and Social Security will need to be paid?

Band of income (CU)	Tax rate (%)
Income under labour contracts	10%
Income under civil contracts	10%
Economic activity as a sole trader	15%

(NB: rates are for the tax year ending at 31 December 2016)

The tax on employment income is withheld by the employer at source on a monthly basis. The tax on income under civil contracts is deducted and remitted by the legal entity (payer) on a quarterly basis (with the exception of the fourth quarter) Bulgarian resident individuals are subject to personal income tax (PIT) on their worldwide income, whereas non-resident individuals are subject to tax only on income arising from Bulgaria.

**Bulgarian tax resident individuals** are those who

- have a permanent address in Bulgaria; or
- are present in Bulgaria for more than 183 days in a 12-month period; or
- are sent abroad by the Bulgarian state, its institutions and/or Bulgarian entities; or
- have their centre of vital interests located in Bulgaria.

We would advise any new entrant to Bulgaria or person who spends time working in Bulgaria to take professional advice in order to determine whether they can be considered as Bulgarian residents for tax purposes.

### Personal income tax allowances

Some of the available tax allowances are the following:

- voluntary contributions for pension and unemployment insurance in Bulgarian and EU/EEA funds up to 10% of annual tax base
- voluntary health and life insurance contributions in Bulgarian and EU/EEA funds up to 10% of annual tax base
- donations to certain qualified beneficiary organizations in Bulgaria and EU/EEA Member States at the amount of 5%, 15% or 50% of the annual tax base
- interest on mortgages of young families on the first BGN 100,000 (EUR 51,130) of the credit under certain conditions
- statutory predetermined deductions depending on activity, for example 25% for income under civil contracts, 10% for rental income and capital gains from sale of immovable property

Employers and employees also have to pay Bulgarian social contributions, which are called Social Security (SS) and Health Insurance (HI):

**Current Social Security rates are**

# Setting up your Business in Bulgaria

## Issues to consider



Band of income (BGN)		SS Rate (%)	HI Rate (%)
Employer	Up to 2,600	12.6 (+ from 0.4 till 1.1)	4.8
	Over 2,600	0	0
Employee	Up to 2,600	9.7	3.2
	Over 2,600	0	0

(NB: rates are for the tax year ending at 31 December 2016)

It is the employers' legal responsibility to pay over employee's tax and social security contributions to the Bulgarian tax authorities. Employers' obligation is to submit regularly to the National Revenue Agency data on: the employment earnings, the social security contributions, the social security duration in days and the taxable employment earnings under the Personal Income Tax Act – separately for each individual who is subject to social security. The EU Regulation 883/2004 on social security is applicable.

Bulgaria has a Reciprocal Agreement with EU countries and many others whereby when an overseas national of those countries is seconded to Bulgaria for a defined period of time and continues to pay social security contributions in their home country, then the employer and employee are exempt from paying contributions in Bulgarian.

### What is Value Added Tax (VAT) and should the business be registered?

The Bulgarian VAT legislation is based on the EU VAT rules and Directive 2006/112/EC.

#### VAT rates

- 20% for domestic supplies, intra-community acquisitions and importation from non-EU countries
- 9% for hotel accommodation services

#### Exemptions

- With the right to deduct input VAT – intra-community supplies, exportation to non-EU countries, international transport of goods and passengers, certain supplies related to international transport, sale of duty free goods under certain conditions, certain transactions related to international trade, specific supplies under international treaties, etc.
- No right to deduct input VAT – transfer or rental of land or rights “*in rem*” over land (except for building land and land adjacent to new buildings), the transfer of old buildings or parts thereof, rental for residential purposes to individuals (an option to tax these transactions is available); financial and insurance services; gambling; certain services related to health, education, religion, culture, etc.; other specific supplies (e.g., importation of certain goods and up to a limit).

#### VAT registration



# Setting up your Business in Bulgaria

## Issues to consider



Entities are obliged to register for Bulgarian VAT purposes if they have performed:

- Transactions with a place of supply in Bulgaria for which the VAT should be charged by the supplier exceeding BGN 50 thousand (approximately EUR 25.6 thousand) for the preceding 12 months
- Intra-community acquisitions exceeding BGN 20 thousand (approximately EUR 10.2 thousand) during the calendar year
- Distance sales in Bulgaria exceeding BGN 70 thousand (approximately EUR 35.8 thousand) during the calendar year

Entities established in an EU Member State performing supply of goods with installation in Bulgaria to customers non-registered for VAT purposes are obliged to register irrespective of their taxable turnover.

Foreign entities which receive services with a place of supply in Bulgaria for which the recipient has to self-charge Bulgarian VAT are obliged to register irrespective of their taxable turnover.

Any entity may apply for voluntary VAT registration. However, if voluntarily registered, such entity will not be able to deregister for two years following the year of registration.

### **Fiscal representative**

In order to register for VAT purposes foreign entities have to appoint a local fiscal representative, except when they have a registered branch in Bulgaria. The requirement does not apply to EU based entities.

### **Reverse charge mechanism**

Foreign entities not established and not VAT-registered in Bulgaria performing certain supplies to local businesses will not have to register for VAT purposes. The VAT will be self-charged by the local customer.

Supplies to which reverse charge of VAT applies include:

- Services provided to businesses (with some exceptions);
- Supply of goods with installation;
- Supply of natural gas and electricity;
- Supply of goods under a triangular transaction (i.e., a supply of goods between three entities VAT-registered in three different EU Member States. Under certain conditions the ultimate customer self-charges VAT, while the supplies for the first two entities are exempt with right to deduction of the input VAT).

Please note that certain specific conditions may also apply.

### **VAT returns and payment**



# Setting up your Business in Bulgaria

## Issues to consider



Monthly VAT returns are filed and the tax is due by the 14th of the following month. The tax period is a calendar month.

European sales list (VIES) returns have to be filed monthly by the same deadline if intra-community supplies of goods or certain services have been performed during the respective month.

### **VAT refund**

VAT can be refunded through the VAT returns within:

- 2 months (period for carry forward and offsetting of the claimable VAT against VAT payable) and 30 days of filing the last VAT return (period for effective refund);
- 30 days of filing the VAT return for entities which have performed exempt supplies with the right to deduction exceeding 30% of the total turnover from taxable supplies for the last 12 months. Since 2016 this is applicable also in the sector of agriculture but there are some requirements which should be met.

An investor in a large investment project which has received authorization by the Ministry of Finance can receive a refund within 30 days. The investor can also apply reverse charge for VAT on importation of goods (without effective cash outflow).

EU based foreign entities which are not registered and established for VAT purposes in Bulgaria can receive a refund of the local input VAT incurred for goods and services used for supplies with a place of supply outside Bulgaria. A specific procedure before the authorities of the EU Member State of establishment has to be followed.

Non-EU based entities may be entitled to a refund on a reciprocal basis (i.e., if their country of tax residence provides the right to refund of VAT to Bulgarian entities). A specific procedure before the Bulgarian revenue authorities has to be followed.

### **Can we provide Share option plans to our staff?**

Share plans are not commonly used by employers in Bulgaria, partly because a significant number of the largest employers are former state-owned enterprises that have been privatised without becoming listed companies. During the privatisation process, it was common for privatised companies to distribute or sell company's shares, vouchers or coupons to their employees. This process, however, came to an end together with the privatisation of former state-owned companies and the applicable law was revoked in 2002. Currently, even among listed companies, share plans are extremely rare.

At the same time, share plans are frequently offered to directors and senior officers of Bulgarian subsidiaries, branches or other offices of multinational corporations that offer such plans to their global workforce. References in this article are therefore limited essentially to offers by multinational corporations.

### **How else can we compensate our employees?**

# Setting up your Business in Bulgaria

## Issues to consider



Bulgaria has a very comprehensive range of compensation and benefit options available for companies to offer their employees.

Pensions, private medical insurance, life and disability cover are now commonplace benefits provided by many Bulgarian businesses to their employees.

**To discuss your requirements please contact the International Office on +44 (0) 1245 449266 or [email](#) us directly.**

### **Kreston International**

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The information in this document was prepared as at 01 June 2016.