TAX ON INBOUND INVESTMENT

Bulgaria

LEXOLOGY
Getting The Deal Through

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Tax on Inbound Investment

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Quick reference guide enabling side-by-side comparison of local insights into acquisitions (from the buyer's perspective), post-acquisition restructuring, and disposals (from the seller's perspective), including stock versus asset/liability transactions; domicile of acquisition company; company mergers and share exchanges; tax benefits of issuing stock as consideration; transaction taxes; treatment of deferred tax assets; interest relief; protections for acquisitions; spin-offs; migration of residence; interest and dividend payments; tax-efficient extraction of profits; methods of disposal including for tax mitigation and deferral purposes; and recent trends.

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ACQUISITIONS (FROM THE BUYER'S PERSPECTIVE)

Tax treatment of different acquisitions

What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

Acquisition of stock in a company

By acquiring shares in a company, the buyer acquires stock in the target company comprising all rights and obligations attached to it. Any tax liabilities or other tax attributes of the target company will remain with that company after the completion of the transaction.

This means that if any carry-forward losses exist as at the date of the transaction, they will be available for setting off against future profits of the target company.

The buyer is interested in performing a stock deal in the case of existing contracts or other assets attached to the target company that cannot be easily transferred or in the case of existing non-transferable licences and other permits in the name of the target company.

Legal and financial due diligence of the target company performed before the transaction is a must in the case of acquisition of stock in a company deal.

The acquired shares' value is based on the acquisition cost, which will become part of the assets of the buyer. When transaction is performed between connected parties it is important that the arm's-length principle applies for tax purposes.

Acquisition of stock in a company is exempt from value added tax under Bulgarian law.

In the case of further disposal of stock in a local company, any capital gain is subject to corporate income tax at the rate of 10 per cent. Double taxation treaties applying different rules need to be considered as well.

Acquisition of an enterprise or part of an enterprise (as a going concern)

It is possible for the subject of the transaction to be a complex of assets and liabilities being all assets and liabilities of the seller's company or specific part of them representing a separate operating unit.

Acquisition of an enterprise or part of an enterprise is exempt from value added tax under Bulgarian law.

In the case of acquisition of an enterprise representing the assets and liabilities of the seller's company, the acquirer will be jointly liable for all tax liabilities of the seller up to the value of the assets and rights received under the transaction.

Any existing carry-forward losses that could be attached to the complex of the transferred assets and liabilities will not be available to set off against the future profits of the buyer in this case.

Acquisition of separate business assets and liabilities

Unlike the acquisition of stock in a company, in an asset deal any tax attributes do not follow these assets. Usually, all tax attributes stay with the seller. The buyer is not entitled to set off future profits against any accumulated tax losses available to the selling company in respect to the transferred assets.

The asset deals are usually subject to 20 per cent VAT with some exceptions.

Merger

In the case of a merger, the acquiring company is not allowed to utilise any carry-forward losses accumulated by the merging company. Some minor exceptions may exist when the merger results in the formation of a place of business in Bulgaria for the first time.

Law stated - 31 December 2022

Step-up in basis

In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

In the case of a purchase of stock in a company, the buyer takes into consideration the accumulated depreciation of the assets and usually continues to apply the same depreciation rates. The depreciation rates of the assets, including long-term intangibles with limitations on the periods of use based on legal or contractual grounds, must comply with the maximum applicable legal rates for tax depreciation and the company's tax amortisation plan.

In an asset deal, the purchase price cost basis may lead to an uplift in the tax basis of purchased assets in comparison to the carryover of the seller's tax position. In general, the buyer reports the acquired assets at their acquisition price value and then the assets may be depreciated over their expected useful life, bearing in mind the buyer's tax amortisation plan at place.

Goodwill is not subject to depreciation under Bulgarian law.

Law stated - 31 December 2022

Domicile of acquisition company

Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

The domicile of the acquisition company is irrelevant for the transaction from a tax perspective as per Bulgarian law. The tax implications will be equal in both scenarios – when the acquiring company is established in or out of the country.

In the case of the purchase of stock in a company when the acquiring company is non-resident, it is subject to 5 per cent withholding tax on dividends. Local companies are obliged to withhold tax on payment of dividends and liquidation quotes to non-residents. Applicable double taxation treaties could apply different rules that need to be considered as well.

When a dividend or liquidation quota is distributed to an entity that is tax resident in a member state of the European Union or of another country that is a party to the Agreement on the European Economic Area, it is not subject to withholding tax in Bulgaria. The exception does not apply in the case of hidden distribution of dividends in favour of those entities.

Capital gains in the case of transfer of shares in a Bulgarian company realised by a non-resident entity are subject to 10 per cent withholding tax as well. An exception exists when it comes to shares in a listed company on regulated markets in the European Union or the European Economic Area. Applicable double taxation treaties may apply different rules.

Law stated - 31 December 2022

Company mergers and share exchanges

Are company mergers or share exchanges common forms of acquisition?

Mergers are the usual form of acquisition where the type of merger depends on the business considerations, as well as on the applicable tax provisions. Some specific tax rules apply in the case of a merger, as well as in the case of the transfer of an enterprise or part of an enterprise (as a going concern).

Under the Bulgarian Corporate Income Tax Act, local companies and permanent establishments that cease to exist after corporate reorganisation, are subject to 10 per cent corporate tax for the last tax period.

Share exchange is not a typical mechanism when making corporate changes. No special tax rules apply in such cases.

Law stated - 31 December 2022

Tax benefits in issuing stock

Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

There are no tax benefits to the acquirer in issuing stock as consideration rather than cash.

Law stated - 31 December 2022

Transaction taxes

Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Transfer of stock in a company

Transfer of shares in a limited liability company is valid only when the Share Purchase Agreement is executed by both parties before a notary public. The deal is subject to notary fees calculated on the basis of the share price. State fees in insignificant amount for registration of the share transfer with the Bulgarian Commercial Register are due as well.

Transfer of shares in a joint stock company is done by endorsement certificates and no notary fees are due.

In the case of a joint stock company, the share transfer is subject to an announcement in the Bulgarian Commercial Register only when the deal leads to a change in the sole owner of the capital. In this case, a state fee of an insignificant amount is due as well. When the deal results in a change in some of the shareholders (where two or more shareholders exist), no requirement to announce the deal with the Commercial Register exists.

Acquisition of stock in a company is exempt from value added tax.

Transfer of an enterprise or part of an enterprise (as a going concern)

The transfer of an enterprise or part of it is subject to notary fees calculated on the purchase price.

Acquisition of an enterprise or part of it is exempt from value added tax under Bulgarian law.

Transfer of assets

Transfer of immovable assets (land, buildings, in-rem right) as well as motor vehicles is subject to notary fees. The

notary fee is defined based on the higher value between the purchase price and the tax evaluation of the transferred asset.

Any transfer of immovable assets and rights over such assets is subject to (1) state fees for inscription with the Land Register and (2) municipality fees varying between 2 per cent and 4 per cent in different municipalities in Bulgaria.

The asset deals are generally subject to 20 per cent VAT with some exceptions.

Where notary fees are due in some of the options described above, the amount of those fees does not exceed around €3,000 according to the applicable notary fees tariff.

No stamp duties exist in Bulgaria.

Law stated - 31 December 2022

Net operating losses, other tax attributes and insolvency proceedings

Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

Local companies have the right to carry forward their net operating losses during the next successive five years for corporate income tax purposes.

In the case of a merger or other reorganisation (such as spin-off, for example), the net operating losses formed by the transformed company (the target company) cannot be carried forward in favour of the acquiring company or the newly established company, so they cannot be set off against future profits.

The same rules apply in the case of a transfer of an enterprise or a separate part of an enterprise – the net operating losses formed by this enterprise or attached to transferred part of this enterprise cannot be carried forward and utilised by the acquiring company.

In the case of an asset transaction, the net operation losses attributed to these assets stay with the seller (ie, when tax losses are accumulated and available to the selling company in respect to that transferred assets the buyer is not entitled to set off future profits against them).

No special tax rules and tax incentives apply for acquisitions or reorganisations of bankrupt or insolvent companies. When bankruptcy proceedings are terminated with an approved recovery plan providing for incomplete satisfaction of creditors, then the tax financial result is defined by an increase in the accounting financial result with the amount of the reduction of the obligations.

Law stated - 31 December 2022

Interest relief

Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility generally or where the lender is foreign, a related party, or both? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

Thin capitalisation rules

Bulgarian thin capitalisation rules apply only if debt-to-equity ratio exceeds 3:1.

The amount of non-deductible interest from the taxable income of the company in the same year is calculated based on a special formula.

Any non-deductible borrowing costs can be carried forward and deducted in future years without limitation in time.

Thin capitalisation rules do not apply to:

- interest expenses on finance leases and bank loans, unless they are concluded between related parties or are guaranteed or secured by, or granted based on the order of a related party;
- penalty interests;
- interest expenses not recognised for tax purposes under other provisions of the law; and
- capitalised interest expenses.

Non-deductible borrowing costs of a merging company formed based to the thin capitalisation rules cannot be carried forward and deducted by the acquiring company or newly formed company in the case of a reorganisation (merger, spin-off, etc). The same applies in the case of a transfer of an undertaking or part of an undertaking in view of the acquiring company.

Interest limitation rules

In parallel to the thin capitalisation rules, interest limitation rules may apply as well if the net borrowing costs of the local company for the respective year exceed €3 million. Credit institutions are outside of the scope of these interest limitation rules.

Net borrowing costs are deductible for tax purposes in the year when up to 30 per cent of the company's tax-adjusted earnings before interest, taxes and amortisation (EBITDA) were incurred. Any non-deductible borrowing costs in the same year can be carried forward and deducted in future periods without limitation based on special formulas.

Income from interests realised by foreign lenders (forming no place of business in the country) is subject to withholding tax. In this case, any double taxation treaty provisions should be examined for possible different tax treatment.

Debt pushdowns may be achieved in the form of a transfer of loan from the target company to the acquiring company, subject to the consent of the lender.

Debt pushdowns may be achieved as well if the loan is capitalised being subject to an in-kind contribution to the capital of the company.

Arm's-length principle

The interest on loans received from related parties must still comply with the arm's-length principle for tax purposes, even if such interest is not subject to the thin capitalisation rules and/or the interest limitation rules.

Law stated - 31 December 2022

Protections for acquisitions

What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient? Is tax indemnity insurance common in your jurisdiction?

In the case of an asset transaction, the tax liabilities formed by the selling company generally do not pass to the acquiring company. Some limited tax warranties may be agreed when it comes to immovable assets (land, buildings, in-rem rights).

In the case of an acquisition of stock in a company, usually the deal follows a due diligence conducted by the buyer.

Representations and warranties of the seller are part of the sale-purchase agreement and refer to proper fulfilment of all tax obligations of the seller and the target company. These representations and warranties may affect the acquisition price as well, which could be decreased or payment could be postponed as a result of non-fulfilment of the representation and warranties clauses. Such non-fulfilment may result in termination of the agreement as well.

In addition, the parties usually agree in the share purchase agreement on full indemnity by the seller for any unexpected tax costs incurred afterwards and related to the pre-acquisition period. Risks are usually covered by warranties or indemnities to the effect that the seller is responsible for any hidden debts and liabilities (not visible in the accounting books of the target company) materialised after the deal and that refer to time periods prior to the deal.

Any penalties and indemnities paid in favour of a foreign recipient established in preferential tax treatment (tax haven) jurisdiction represent income with a source in the country and is subject to withholding tax.

Payments under tax warranties or indemnities are not subject to value added tax as they are not treated as remuneration for goods and services.

Law stated - 31 December 2022

POST-ACQUISITION PLANNING

Restructuring

What post-acquisition restructuring, if any, is typically carried out and why?

Any post-acquisition restructuring is usually performed to increase the effectiveness of the acquiring group of companies. The purpose could be implementation of different technologies or better optimisation of labour resources.

Possible restructuring may trigger transfer of employees (according to the Transfer of Undertakings (Protection of Employment) Council Directive 2001/23/EC of 12 March 2001), or spin-off of some activities and merging of group entities.

The post-acquisition restructuring is always implemented after deep analysis of financial flows and business processes.

Law stated - 31 December 2022

Spin-offs

Can tax-neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

In the case of a spin-off, the acquiring company or the newly formed company is not allowed to utilise any carry-forward net operating losses accumulated by the transforming company.

If the spin-off materialises after certain liabilities of the transforming company are established by the authorities, the enforcement proceedings may be directed against the successor company.

Law stated - 31 December 2022

Migration of residence

Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

Migration of residence (transfer of company's seat) is a procedure defined only in the tax legislation, due to the transposition of EU legislation.

No detailed legal procedures and no appropriate legal tools are still implemented in Bulgaria on how the migration of residence of a company could be effected.

Under Bulgarian commercial law, the companies registered with the Bulgarian Commercial Register are obliged to have their seat in Bulgaria. It is not possible to change the seat (ie, to migrate the residence) to another member state without deregistration of that company based on a liquidation or insolvency proceedings.

Law stated - 31 December 2022

Interest and dividend payments

Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

Dividend payments

The gross amount of the dividends distributed by a local company is subject to 5 per cent tax.

The subject of taxation is any kind of income received as dividends – both in cash and in kind. Upon payment of dividends in kind, the market value of the in-kind payment (for example, assets, property, stock in a company, etc) should be taken into consideration for tax purposes.

The general rule is that the local entities distributing dividends in favour of non-resident legal entities are required to withhold and pay the final tax of 5 per cent on behalf of those foreign legal entities. Exceptions exist and tax is not withheld in the following cases:

- the foreign legal entities get the dividends through its place of business in the country; and
- the foreign legal entity is a resident for tax purposes in a member state of the European Union or of another country that is a party to the Agreement on the European Economic Area.

The exception does not apply in the case of hidden distribution of dividends in favour of those entities.

Withholding tax over dividend payments may be subject to different tax treatment based on any applicable double taxation treaties between countries.

Interest payments

Interest payments in favour of foreign legal entities are subject to withholding tax at the rate of 10 per cent unless these entities get the interest payments through its place of business in Bulgaria, where no withholding tax but corporate income tax will be due at the same rate.

Interest payments are not subject to withholding tax when the foreign entity receiving such payments is (1) a tax resident of another member state or is a tax resident in another member state and has a place of business in another member state and simultaneously is (2) a related party to the local entity or to the place of business in Bulgaria distributing the dividends.

Law stated - 31 December 2022

Tax-efficient extraction of profits

What other tax-efficient means are adopted for extracting profits from your jurisdiction?

Payment of dividends (in cash or in in-kind) by local companies to its foreign shareholders is a possible way to extract profits, subject to 5 per cent tax over dividends. The subject of taxation is any kind of income received as dividends – both in cash and in kind. Upon payment of dividends in kind, the market value of the in-kind payment should be taken into consideration for tax purposes.

The general rule is that the local entities distributing dividends in favour of non-resident legal entities are required to withhold and pay the final tax of 5 per cent on behalf of those foreign legal entities, with some exceptions provided by law or based on applicable double taxation treaties between countries. The exception does not apply in the case of hidden distribution of dividends in favour of those entities.

Decreasing of the company's registered capital and paying back of funds to the shareholders could be tax free only in the case that the reduced part of the capital was previously formed by shareholders' contributions. If not, such capital decrease could be treated as a distribution of dividends, where the rules for 5 per cent withholding tax apply.

It is also possible to use interests over loans provided by shareholders to extract profits. In this scenario, the thin capitalisation rules, the interest restriction rules and the arm's-length principle for tax purposes must be considered.

Law stated - 31 December 2022

DISPOSALS (FROM THE SELLER'S PERSPECTIVE)

Disposal methods

How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

When choosing the disposal method, the seller must consider the initial acquisition cost. If the initial cost of the stock in a local target company is high, it could be preferable to dispose of the target's shares, as the difference between the initial shares cost and the disposal price will generate less income tax due.

When the initial cost of the stock in a local target company is significantly lower than the disposal price, the seller may prefer to dispose of the target's business assets.

In the case of a connected party transaction, the parties to the transaction must take into account its market value for tax purposes.

Capital gains on the transfer of stock in a local company by foreign companies not having a place of business in the country are treated as sourced from Bulgaria and therefore are subject to withholding tax. The same applies in the case of the disposal of real estate assets situated in Bulgaria.

In any case, when choosing the disposal method, the parties should consider the double taxation treaties in place and possible benefits provided by them.

The acquisition of stock in a company as well as the acquisition of an enterprise or part of an enterprise is exempt

from value added tax under Bulgarian law. In contrast, the asset deals are usually subject to 20 per cent VAT, with some exceptions.

Law stated - 31 December 2022

Disposals of stock

Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Might a disposal of stock in a foreign holding company trigger taxes in the local company in your jurisdiction? Are there special rules dealing with the disposal of stock in real-property, energy and natural-resource companies?

Capital gains on the transfer of stock in a local company by foreign companies not having a place of business in the country are treated as sourced from Bulgaria and therefore are subject to withholding tax.

Any applicable double taxation treaty at place may provide tax benefits and may be exempt from taxation in the source state in the case of disposal of stock in a local company. If the non-resident company initiates the application of such a double taxation treaty, the disposal of stock in the local target company may not be subject to Bulgarian taxation.

If the disposal of stock in the foreign holding company is in place, then the local company (subsidiary) is not subject to taxation in Bulgaria.

No special rules exist in the case of the disposal of stock in real property, energy or natural resources by local companies.

Law stated - 31 December 2022

Mitigating and deferring tax

If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or mitigating the tax?

Mergers, spin-offs and other reorganisation in connection with the disposal of stock or business assets may result in tax-efficient or tax-neutral operations, depending on the numbers in the balance sheets of the companies.

Law stated - 31 December 2022

UPDATE AND TRENDS

Key developments of the past year

Are there any emerging trends or hot topics relating to tax on inbound investment?

The Council of the European Union has authorised Bulgaria to increase the VAT registration threshold from 50,000 lev (€25,565) to 100,000 lev (€51,129) by a decision derogating article 287, point 17, of Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.

The new threshold is in force from 1 January 2023.

Law stated - 31 December 2022

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