MINISTRY OF FINANCE

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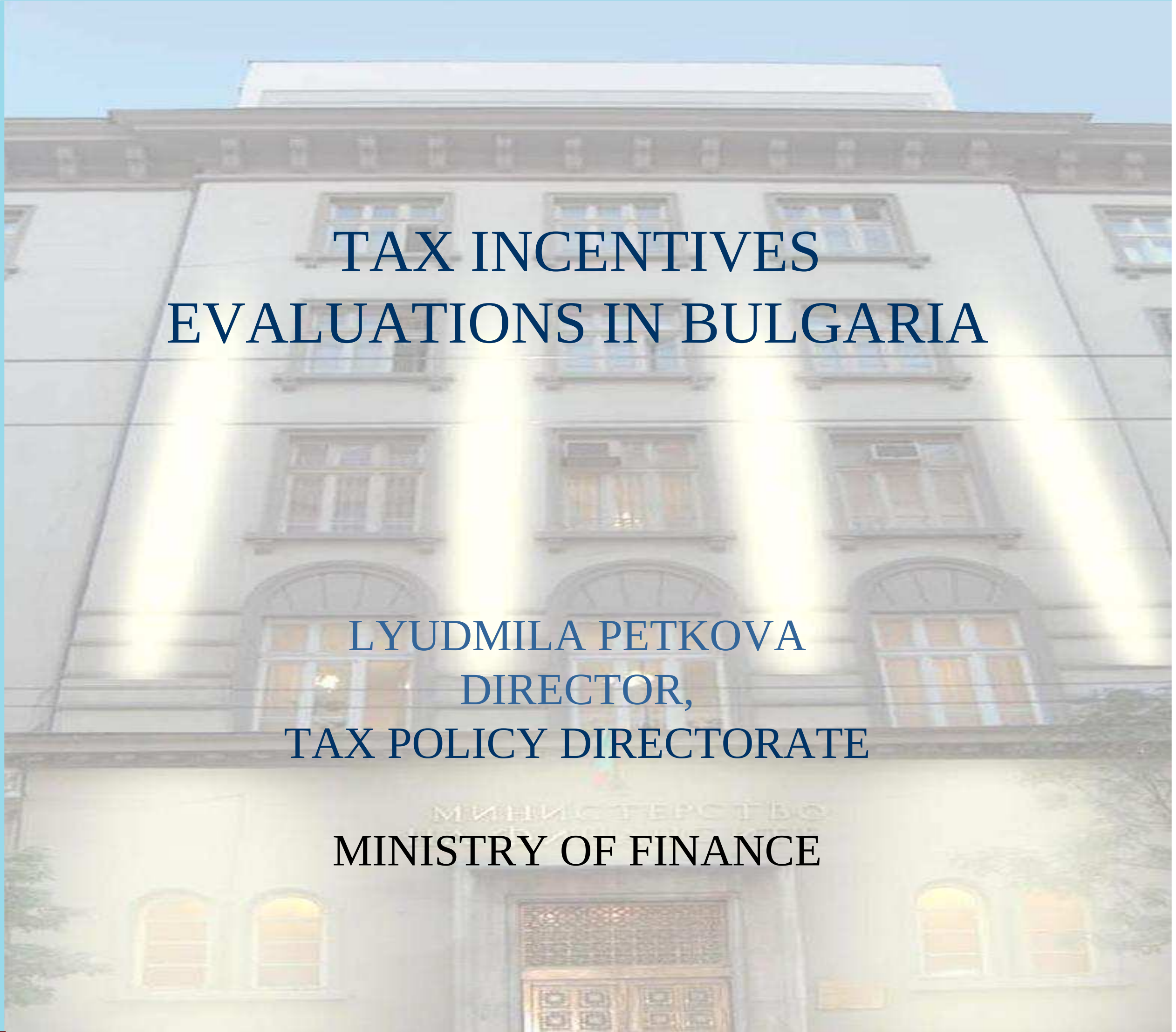

TAX INCENTIVES EVALUATIONS IN BULGARIA

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FOCUS OF PRESENTATION

- The focus of this presentation is on the system of tax incentives and preferential tax regimes in Bulgaria.
- The presentation includes:
- Review of the system of tax incentives - main characteristics;
- Effectiveness of the system of tax incentives;
- Tax incentives for foreign direct investment.

- In its essence the tax incentives comprise fiscal measures and instruments, which are implemented for attraction of foreign direct investment (FDI) to stimulate the development of particular regional and strategic economic branches, energy efficiency and innovation, to improve the employment, etc.
- Tax incentives, from legal perspective may, take different forms: low tax rates, reduced tax rates, tax holidays, investment tax credits, accelerated depreciation, tax loss carry forward, etc.

- In its Program for European Development of Bulgaria for the period 2009 – 2013 the Bulgarian Government stipulated seven priorities of its administration.
- The first and main priority of the Bulgarian Government is to stimulate the investment and innovation activity as well as to develop beneficial business environment.
- One of the measures of this government priority program is to improve the existing system of tax incentives and to remove tax impediments to investment.
- Taking into account the impact and the leading role of tax incentives for the economic development of the country, the employment as well as for the performance of the measures set for implementation among the government priorities in the field of tax policy for 2011, analysis was made of the currently implemented system of tax incentives and preferential tax regimes in Bulgaria.

- The analysis comprises a detailed survey of the system of national tax incentives and preferential tax regimes.
- With regards to each one of the tax incentives a detailed description of the characteristics, objectives, terms of use and beneficiaries has been made.
- The tax incentives are assessed also in terms of efficiency.

REVIEW OF THE SYSTEM OF TAX INCENTIVES AND PREFERENTIAL TAX REGIMES IN BULGARIA

- Bulgarian tax system, as the majority of tax systems worldwide, envisages a number of tax incentives the objective of which is to stimulate the behavior of taxpayers, support specific types of activity and selected sectors of the economy, or change progressive features of the tax system.
- In the Bulgarian context, tax incentives have been identified as having a number of objectives including:

- Encouraging foreign direct investment;
- Encouraging innovation such as the accelerated tax depreciation (100%) for assets formed as a result of research and development activities;
- Encouraging business activities such as the remission of corporate income tax for registered agricultural producers;
- Encouraging energy efficiency such as reduced tax rates of excise duty;
- Particular social objective.

MAIN CHARACTERISTICS OF THE SYSTEM OF TAX INCENTIVES (2)

- The tax incentives in Bulgaria are stipulated mainly in:
  - Value Added Tax Act;
  - Excise Duties and Tax Warehouses Act;
  - Corporate Income Tax Act;
  - Personal Income Tax Act.
- In the Value Added Tax Act and the Excise Duties and Tax Warehouses Act a small number of tax incentives are regulated (exemption from taxation and reduced tax rates).
- This is due to the fact that the above said tax laws are harmonized entirely with the EU legislation which does not provide for as many opportunities at the choice of Member States in terms of tax incentives.

- The main tax incentives for business activities are stipulated in the Corporate Income Tax Act.
- The greatest relative share in the corporate tax incentives is for the incentives aimed at attracting foreign direct investment. To stimulate innovation the Bulgarian legislation contains one tax incentive.
- The tax incentives stipulated in the Personal Income Tax Act have mainly social objectives - they are oriented towards particular categories of individuals (people with disabilities, young families, pupils and students, people with low income, etc.)

- The review of the system of national tax incentives is done with the objective to establish to what extend the currently implemented system is effective and whether it is advisable to take measures for its improvement.
- In terms of each tax incentive a brief assessment is made, including responses to four main issues, and in particular:

- Is the tax incentive clearly defined;
- Are the provisions stipulated and related to its implementation, understandable to the taxpayers;
- Is the tax incentive effective and does it achieve the stipulated objective;
- Does it require any future steps (amendment, supplementing, or repealing).

- The Bulgarian system of tax incentives includes strictly constrained number of incentives for stimulating only activities with high national priority.
- The analysis shows that in their greater part the tax incentives are clear and comprehensive to the taxpayers and do not need any simplification and clarification.
- The tax incentives to a large extend are predictable to the beneficiaries as their term of use is set in advance (particularly in terms of corporate tax incentives).
- Last but not least, it should be stated out that some part of the tax incentives approved several years ago have lost their impact on the taxpayers and are ineffective so that there is no real benefit to the economy and to the society.

TAX INCENTIVES STIMULATING FOREIGN DIRECT INVESTMENT

- The main tax incentives for stimulating foreign direct investment are:
  - Low corporate income tax rate – 10 %;
  - Exemption from corporate income tax;
  - Remission of corporate income tax;
  - Accelerated depreciation;
  - Tax loss carry forward.
- VAT incentive for large investment projects.

- Description – the tax incentive comprises a tax rate for corporate income tax of 10%.
- Objective of the tax incentive – to stimulate foreign direct investment.
- Terms of use – no preconditions required.
- Beneficiaries of the tax incentive – the tax rate is applied on equal basis to all taxpayers regardless of the region, the branch they perform their economic activity from or the type of activity.
- The low tax rate of the corporate income tax is a tax incentive which causes the least possible deviation to the market.

- Description – the tax incentive comprises an exemption from taxation with corporate income tax of the profits gained from transactions concerning particular financial assets performed on the stock market. Respectively, such kind of loss is not recognised for tax purposes.
- Objective of the tax incentive – to develop the secondary market of securities and to indirectly stimulate economic investments.
- Terms of use:

- The transaction has to be executed on a regulated market for securities in Bulgaria or in another Member State of EU;
- In terms of particular financial assets: shares and interests in collective investment schemes.

- Beneficiaries of the tax incentive – local and foreign legal entities.

- Description – the tax incentive comprises exemption from taxation from corporate income tax of collective investment schemes, licensed investment companies of closed type incorporated under the Act on Public Offering of Securities as well as companies with special investment purpose set up in compliance with the Act on Special Investment Purpose Companies. The collective investment schemes are contractual funds or investment companies of open type.
- Objective of the tax incentive – to stimulate the development of the capital market in Bulgaria and as well as investment in the economy.
- Beneficiaries of the tax incentive – collective investment schemes, licensed investment companies and companies with special investment purpose.

REMISSION OF CORPORATE INCOME TAX FOR ENTERPRISES, PERFORMING ACTIVITIES IN MUNICIPALITIES WITH HIGH UNEMPLOYMENT

- Description – the tax incentive comprises remission of corporate income tax up to 100% to the benefit of enterprises with production activities in municipalities with high unemployment rate.
- Objective of the tax incentive – stimulate investment in production activities in municipalities with high unemployment rate.
- Terms of use:

- unemployment in the municipalities where the production activity is performed should be at least by 35% higher than the average for the country (municipalities with high unemployment). The municipalities with high unemployment are listed on annual basis in an Order of the Minister of Finance issued after a proposal by the Minister of Labour and Social Policy.

- the remitted tax shall be invested back in municipalities with high unemployment rate within 4 years of the beginning of the fiscal year in which the tax is remitted.
- the enterprise shall select whether or not to use the incentive as:
- de minimis state aid, or
- regional state aid,

and at its discretion it may comply with particular requirements stipulated by CITA and based on the regulations of EU in the field of state aids.

- Beneficiaries of the tax incentive – local legal entities and permanent establishments of foreign legal entities in Bulgaria, forming profit in compliance with Corporate Income Tax Act.

- Description – the tax incentive comprises remission of up to 60% of the corporate income tax to registered agricultural producers in terms of their profit from production activities employing unprocessed agricultural products and/or unprocessed animal products.
- Objective of the tax incentive – to stimulate the development of agriculture and to attract investment in this sector of the economy.
- Terms of use:

- the remitted tax shall be invested in new buildings and new agricultural machinery and equipment until the end of the year following the year of the remission;
- the acquisition of the assets (newly built buildings and brand new agricultural machinery and equipment) shall be done in compliance with the market conditions corresponding to the ones of unrelated parties.

- the activities on the production of unprocessed agricultural and animal products should continue to be carried out for a period of at least three years after the year of remission;
- the remitted tax shall not exceed 50% of the value of the acquired buildings and agricultural machinery and equipment;
- the acquired buildings and agricultural machinery and equipment shall not replace existing agricultural machinery and equipment;
- in terms of acquired buildings, agricultural machinery and equipment the agricultural producer should not have received another state aid from the national budget or from the budget of EU.

- Beneficiaries of the tax incentive – legal entities or sole proprietors, registered as agricultural producers.

- Description –for tax purposes, a depreciation rate of 50% may be applied with regards to machinery, production equipment and apparatuses which are part of the initial investment (while, in general, the annual depreciation rate for these assets is 30%).
- “Initial investment” is the investment in new tangible and intangible assets, related to:

- establishment of new business activities;
- extension of existing business activities;
- diversification of the produced items through the development of new products;
- major change in the existing production process.

- The investment in assets replacing existing assets IS NOT an initial investment.

- Objective of the tax incentive – to stimulate the acquisition of new assets, forming part of an investment project.
- Terms of use:

- the assets should be part of the initial investment;
- the assets should be brand new, could not be second hand upon acquisition.

- Beneficiaries of the tax incentive – local legal entities, sole proprietors and permanent establishments of foreign legal entities in Bulgaria, forming profit in compliance with Corporate Income Tax Act.

- Description – the tax incentive comprises the right of the taxpayers, subjected to taxation with corporate income tax to carry forward tax loss accrued in compliance with CITA. The right of carry forward of tax loss could be exercised by the companies during the first year in which they have formed tax profit prior deduction of tax loss.
- Tax loss is a negative financial result.
- Objective of the tax incentive – to stimulate the investment in high-risk branches with uncertain rate of return and generating loss in the first years of the investment.

- Terms of use:

1. Tax loss from source in the country

- The tax loss is carried forward:
- successively in the next 5 years until exhausting;
- up to the value of the tax profit (positive tax financial result).

In case the tax loss is lower than the tax profit, the complete value of the tax loss is to be deducted.

- The newly occurred losses are carried forward in the following way:
- successively in the next 5 years;
- for each occurred loss the 5-year term starts on the fiscal year right after the fiscal year of their occurrence.

2. Tax loss from sources abroad

- Tax loss from source abroad by implementing the method “exemption with progression”
- Tax loss formed in the current fiscal year in a state with which Bulgaria has concluded a Double Tax Treaty, the applicable method for avoiding double taxation in terms of the profits is “exemption with progression” and is not deducted from the tax profits gained from source in the country or from the tax profits from other states during the current or the subsequent years.
- The tax profit is deducted:

- Only from the tax profits, gained from the source abroad;
- Successively in the next 5 years.

- Tax loss from source abroad by implementing the method of tax credit
- Tax loss formed from source abroad and the applicable method for avoiding double taxation is the tax credit, the non-deducted loss during the current fiscal year is deducted as follows:

- successively in the next 5 years;
- it is deducted only from the tax profits at the source abroad where it originates.

- In the event when the loss is accrued from a source in a Member State of EU the loss is deducted from the profit gained from a source in Bulgaria.
- Beneficiaries of the tax incentive – local legal entities and permanent establishments of foreign legal entities in Bulgaria, forming profit in compliance with Corporate Income Tax Act.

- Description – Entities VAT-registered in Bulgaria investing in a large investment project can upon receiving authorization by the Ministry of Finance:
- Self-charge the VAT on importation of certain goods (i.e., the reverse charge mechanism will apply and the VAT on importation will not be related to a cash outflow for the entity). The goods should not be subject to excise duty and should be included in a list agreed with the Ministry of Finance;
- Refund VAT under a faster procedure – within 30 days of filing the VAT return.
- Terms of use – authorization may be granted if the following conditions are fulfilled:

- the entity should have no pending tax or social security contribution liabilities;

- the investment project is approved by the Minister of Finance;
- the entity should meet the conditions and requirements for de minimis state aid.

▪ The investment project should meet certain requirements, including:

- it should be finished within two years;
- it should create at least 50 new jobs;
- the investment should exceed BGN 10 million (approximately EUR 5 million);
- the entity should be able to finance the project on its own or through outside financing.

▪ Procedure - In order to receive authorization the entity should apply before the Ministry of Finance. The application must be supported with business plans, feasibility studies, etc.

▪ Beneficiaries of the tax incentive – legal entities.

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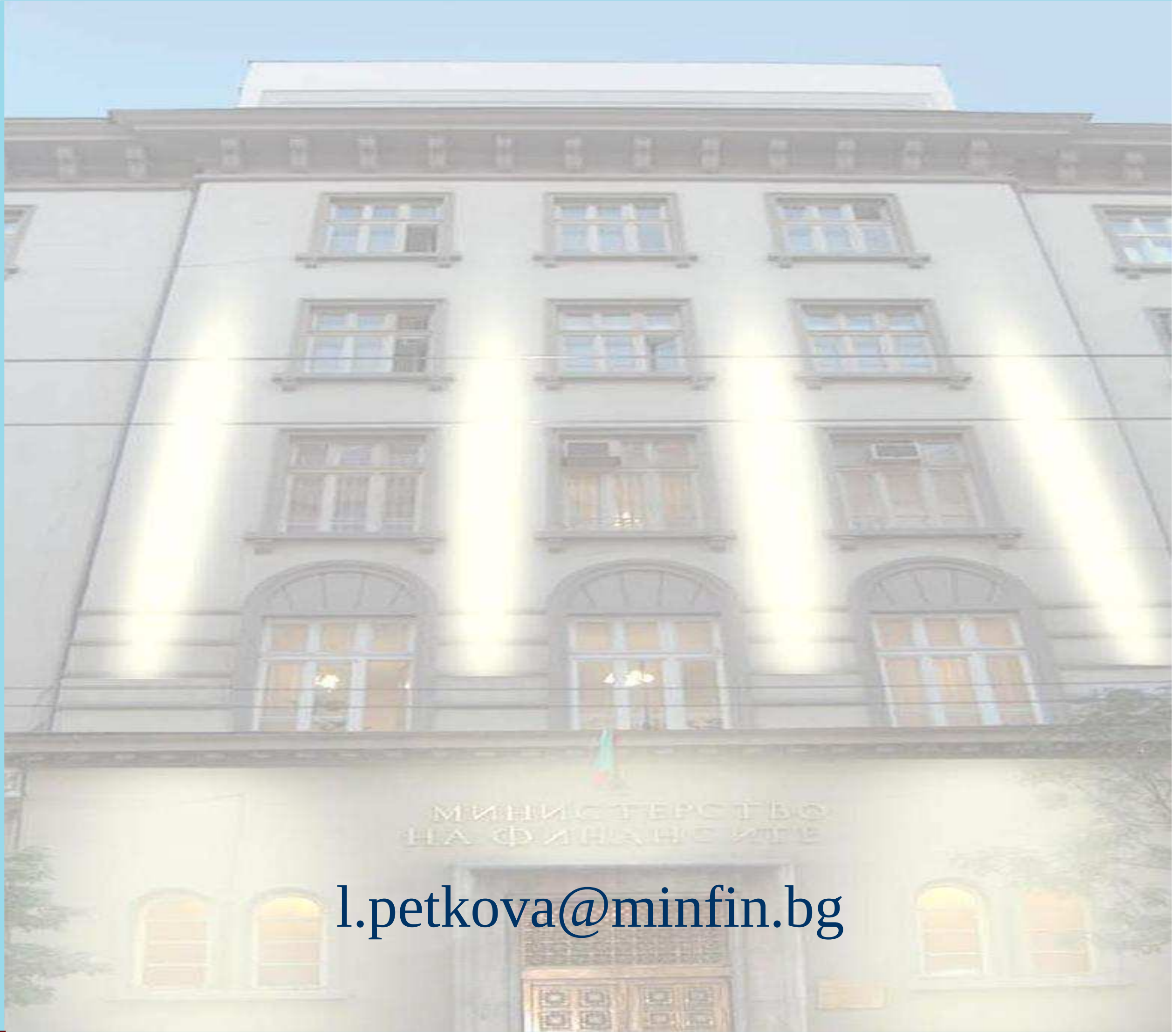

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