



REPUBLIC OF BULGARIA  
MINISTRY OF FINANCE

# Tax Expenditure Report

## Tax Expenditure

2020

Tax Policy Directorate

**TABLE OF CONTENTS**

<b>INTRODUCTION .....</b>	<b>3</b>
<b>I. TAX EXPENDITURE REPORT – ESSENCE .....</b>	<b>4</b>
<b>II. WHY IT IS NECESSARY TO REPORT TAX EXPENDITURES IN BULGARIA .....</b>	<b>4</b>
<b>III. TAX EXPENDITURE REPORTING .....</b>	<b>5</b>
<b>IV. DEFINING TAX EXPENDITURE .....</b>	<b>6</b>
<b>V. WHAT IS A BENCHMARK TAX .....</b>	<b>7</b>
<b>VI. DEFINING BULGARIAN BENCHMARK TAXES .....</b>	<b>7</b>
6.1. Benchmark Tax in Profit and Income Taxation .....	8
6.2. Benchmark Tax in Terms of Consumption Taxation – Value Added Tax and Excise Duties ...	8
<b>VII. METHODS OF MEASURING TAX EXPENDITURES .....</b>	<b>9</b>
<b>VIII. TAX EXPENDITURE ESTIMATES.....</b>	<b>10</b>
8.1. Total Amount of Tax Expenditures.....	10
8.2. Tax expenditure Estimates by Type of Tax.....	11
8.3. Tax Expenditure Estimates by Type of Tax Measure .....	13
<b>1. Tax Measures Associated with Value Added Tax.....</b>	<b>13</b>
<b>2. Tax Measures Associated with Excise Duties .....</b>	<b>14</b>
<b>3. Tax Measures Associated with Corporate Income Taxes .....</b>	<b>15</b>
<b>4. Tax Measures Associated with Personal Income Taxes.....</b>	<b>17</b>
8.4. Tax Expenditure Estimates by Goal.....	18
8.5. Tax Expenditure Estimates by Economic Sector and Subsector .....	18
8.6. Tax Expenditure Estimates by Beneficiary .....	19
8.7. Tax Expenditure Estimates of temporary measures to address with consequences of the spread of COVID-19 in 2020.....	20
<b>IX. POSSIBILITIES FOR IMPROVEMENTS IN TAX EXPENDITURE REPORTING .....</b>	<b>23</b>
<b>CONCLUSIONS .....</b>	<b>24</b>

### INTRODUCTION

Tax policy is one of the components of the fiscal policy of the state and is an important instrument in the regulation of the macroeconomic proportions. Besides being a key component in the fiscal policy, tax policy should also be considered as an important means for stimulating foreign direct investment, economic growth and employment.

The main goal in tax policy is to set up the scope of taxation in such a way as to ensure high efficiency and transparency of the tax system. From the fiscal policy perspective, the tax system efficiency refers to ensuring that government fiscal needs are provided for, while maintaining the highest possible economic growth and ensuring a sufficient fairness in the taxation of persons.

The balance between the fiscal, economic and social goals of the tax policy is achieved by distinguishing the object of taxation (consumption, income or property) and designing the taxes themselves, including their respective taxable base, tax rates and tax incentives. The implementation of different solutions provides greater flexibility in terms of taxation scope and inducing taxpayer behaviours in line with government expectations. In this regard, it should be taken into account that the incentives are targeted at certain specific taxpayer groups, while on the other hand, depriving the government of some of its potential tax revenue, or, to put it differently, the government foregoes a portion of its tax revenue in order to achieve a certain economic or social goal.

The Bulgarian tax system provides tax incentives aimed at inducing taxpayer behaviours enhancing the development of certain regions, selected economic sectors and specific types of activity, or aimed at achieving a certain social goal.

Bulgaria's tax policy is characterized by predictability, but at the same time encourages the development of the business by preserving low tax rates of the direct taxes (corporate income tax and personal income tax), a broad tax base and a small number of tax incentives. An analysis of the tax systems of other EU Member States shows that the countries with higher direct tax rates have a significant number of tax incentives and relief. From a legal point of view, tax incentives can take various forms: low tax rates for profit tax and dividend tax, reduced tax rates, tax exemption of certain categories of profits and incomes, tax holidays, investment tax credits, accelerated tax depreciation, tax loss carry forward, etc. The common feature shared by the various forms of tax incentives is a reduction in tax liabilities and hence a reduction in potential tax revenues in the budget.

Any loss of tax revenue resulting from granting tax incentives is considered tax expenditure.

In fact, the tax expenditures are substitutes for budget expenditures, and under certain conditions they can be an alternative to direct transfers from the central government or municipal budget.

Unlike budget expenditures, tax expenditures often remain outside the scope of in-depth analysis and direct monitoring and control. One of the main reasons is that budget expenditures are usually dealt with in a single piece of legislation, while tax expenditures tend to be scattered across a number of tax legislation acts, in various forms which makes them hard to identify,

analyse and evaluate. Such a situation is detrimental to the transparency of a country's financial governance and jeopardizes the proper allocation of public funds. That is why measuring tax expenditures is key to national fiscal policy-making.

On the one hand, tax expenditures measuring makes it possible to properly distribute and redistribute public funds, while, on the other hand, it serves as a point of reference in measuring the efficiency of each tax expenditure item and the tax system as a whole.

### **I. TAX EXPENDITURE REPORT – ESSENCE**

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Tax expenditure reporting has become a long-established practice in most of the Member States of the European Union and of the Organisation for Economic Co-operation and Development.

Annual Tax Expenditure Reports are prepared and published in order to provide transparency concerning provisions regulating tax incentives.

In a number of European Union Member States the issuance of Tax Expenditure Reports is regulated by law, with those Reports having a direct link to the central government budget and are included in the budget process.

A Tax Expenditure Report is issued annually but there are some exceptions as well, with some countries reporting their tax expenditures once every two or three years.

The Ministry of Finance of the Republic of Bulgaria prepares a Tax Expenditure Report for the first time in 2008. The first Tax Expenditure Report covers a three-year period (2007-2009), and the second Tax Expenditure Report covers a two-year period (2010-2011). The Tax Expenditure Report for 2012 introduces the practice of preparation of annual reports on tax expenditures.

This document contains a quantitative assessment of the different types of tax incentives and tax reliefs for 2020, a description of the analysis methodology and the information used for the assessment, and provides information on each tax expenditure. Tax expenditures are included in the report by type of tax measure (incentives)<sup>1</sup> related to value added tax, excise duties, corporate income taxes and personal income taxes.

### **II. WHY IT IS NECESSARY TO REPORT TAX EXPENDITURES IN BULGARIA**

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Bulgaria's national legislation provides the requirement to report tax expenditure pursuant to the provisions of Article 16(4) of the Public Finance Law.

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<sup>1</sup> Note: The descriptions of the tax measures contained in this document are only intended to present them in general. These descriptions do not replace the relevant legislation and secondary legislation and should not be used by the taxpayers in settling their tax issues. For these purposes, taxpayers could contact the National Revenue Agency or may consult the Agency's web page for additional information on the administration of the tax system in Bulgaria.

The report aims, on the one hand, to increase transparency in public finance, and on the other hand, to raise public awareness of the tax preference system and the size of tax incentives. In this context, the report should also be considered as a key component of the government's report and feed into the public domestic tax policy.

Tax expenditures presented in this report have been estimated on the basis of aggregated reporting data stated in tax returns and customs declarations provided by the National Revenue Agency and the Customs Agency, and on the basis of data provided by Ministry of Agriculture, Foods and Forestry and on the basis of statistics provided by the Bulgarian National Bank and the National Statistical Institute.

Regarding the data sources, attention should be paid to the requirement introduced on 01.01.2020 for submission of information by employers under Article 73(6) of the Personal Income Tax Act for income from employment relationships for 2019, including data on tax reliefs used with the employer for these incomes. The change is part of the concept of introducing the principle of the pre-filled tax return and removing the paper form of the official notices under the Personal Income Tax Act for the taxable income earned during the year and the withheld tax of individuals. Given the availability of this information, this year's report also includes the value of tax expenditures from tax preferences used with the employers, currently during the year or in the annual recalculation of the tax by the employer under the main employment relationship. A comparison of the data for 2019 and 2020 regarding the amount of the relevant tax expenditures under the Personal Income Tax Act is thus ensured.

The report will continue to be updated every year, providing a convenient, easily accessible starting point for information on tax expenditures in Bulgaria.

### III. TAX EXPENDITURE REPORTING

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Tax expenditure reporting covers the following main stages:

- Making a list of the existing tax incentives under the Value Added Tax Law, the Excise Duty and Tax Warehouses Law, the Corporate Income Tax Law and the Personal Income Tax Law for 2020;
- Defining tax expenditure;
- Defining benchmark taxes by type of tax;
- Identifying which of the tax incentives are tax expenditure and which are part of the benchmark tax;
- Making a list of the 2020 tax expenditures;
- Selecting methods of measuring tax expenditures;
- Analysing the available information and the sources of information measuring tax expenditures;
- Measuring Tax Expenditures;
- Identifying opportunities to improve the process of preparing a tax expenditure report.

## IV. DEFINING TAX EXPENDITURE

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From a legal point of view, tax incentives can take various forms: low tax rates for profit tax and dividend tax, reduced tax rates, tax holidays, investment tax credits, accelerated tax depreciation, tax loss carry forward, etc.

The term 'tax incentive' is a specific measure of tax legislation resulting in the reduction of the taxable base or the amount of the tax payable. These measures are used for achievement of policy goals which divert from the main function of the tax system on account of lower tax revenues.

Although there is a very close link between tax incentives and tax expenditures, the definition of the term 'tax incentive' is not sufficiently exhaustive to enable the identification of tax expenditures.

The identification of tax expenditures is a complex process, yet it is a prerequisite for measuring their value. It should be noted that not all tax treatments which represent measures granting tax incentives constitute tax expenditures proper. Some tax measures have been adopted in order to rationalise the tax system or to reduce tax administration costs, or they ensue from international obligations or obligations relating to European Union membership.

An analysis of other countries' Tax Expenditure Reports and the research of a number of publications by international organisations points to the conclusion that there is no single or generally accepted definition of tax expenditure. On the one hand, this is due to the substantial diversity among the various national tax systems, and on the other hand, to their diverging approaches to the function of tax expenditures.

A considerable number of the countries which issue regular Tax Expenditure Reports have adopted the OECD (Organisation for Economic Co-operation and Development) definition of tax expenditure. According to OECD, "Tax expenditure is a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax (i.e. the standard tax system), rather than by a direct expenditure".

The OECD definition of tax expenditure was also adopted in Bulgaria for the purposes of preparing the first Tax Expenditure Report which recommended adopting a national definition of "tax expenditure" for the purposes of analysing and measuring tax expenditures in Bulgaria.

This recommendation has been reflected in the Public Finance Law effective as from 1 January 2014 by introducing the definition of "tax expenditure".

### Defining tax expenditure

Within the meaning of §1, item 9 of the Additional Provisions of the Public Finance Law, **"tax expenditure" means indirect expense made through the tax system by virtue of a legislative provision, the application of which by a certain category of taxpayers leads to reduction or deferral of budget revenues compared to the application of the benchmark tax for the respective type of tax to achieve a certain economic or social goal.**

## V. WHAT IS A BENCHMARK TAX

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Tax expenditure reporting is considered to be the best international practice in terms of government budgetary and fiscal transparency and an increasing number of countries adopt this practice. The scope of tax expenditure reporting varies from country to country. This is because by definition "tax expenditure" depends on the way in which the tax standard system is determined. Global practice indicates that there is no single generally accepted model for benchmarking taxes due to the diversity of tax systems in the various countries. Each country defines its own benchmark taxes for the purposes of its own research and analysis. Some countries only provide information on narrowly defined categories of tax measures. Many countries, however, have adopted the practice of reporting information on a greater number of tax measures they consider to be deviations from their tax system.

Defining a benchmark tax is therefore crucial for determining whether a given tax provision constitutes a tax expenditure or it is an inherent feature of the tax system.

When defining the benchmark tax, the characteristics of the tax system are described which are considered as part of the benchmark tax in order to identify the tax expenditures. The elements of the benchmark tax include the subject and the object of taxation, the tax period, the tax base, the tax rate and other characteristics. This practice also contributes to the transparency of data in this report as well by providing an unbiased basis for choosing which tax measures to include in it.

## VI. DEFINING BULGARIAN BENCHMARK TAXES

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In the process of defining the benchmark taxes (the standard tax system), each tax provision should be analysed very well in order to determine whether it is an inherent feature of a given tax or an incentive for a certain group of taxpayers, activities, economic sectors, etc.

To define a benchmark tax, it is necessary to indicate the most important principles of taxation, and identify those elements of the tax system which, in legal terms, may be a measure granting tax incentives, but in practice are part of the benchmark tax and should not be considered tax expenditure items. The general principles of a tax system are universality, comprehensiveness and justice of taxation. Other elements which should be recognised as part of the benchmark are the standard tax rates (the respective rates of value added tax, corporate income tax and personal income tax, etc.), the tax depreciation system, the possibility to reduce the annual taxable base (e.g. by deducting the obligatory social security and health insurance contributions), and the principles set up in the EU law, which are binding for all Member States.

It is not possible to define a single benchmark applicable to all taxes. The characteristic elements and peculiarities of the individual taxes require a definition of a benchmark for each type of tax. A specific issue is the issue regarding the value added tax and excise duties which are harmonised at the EU level and the structure of which ensues from Community Law and for which it is the provisions in EU legislation that should be the starting point in determining the benchmark taxes. For the purposes of this report in relation to identifying and estimating tax

expenditures, the basics are defined which are followed for defining the benchmark tax in terms of two categories of taxes: taxes on profits and income, and taxes on consumption.

### 6.1. Benchmark Tax in Profit and Income Taxation

The benchmark in profit and income taxation is based on the following main principles:

- Universality of taxation: profits and income of legal persons and individuals are subject to taxation, regardless of their economic activity or their region of operation;
- Completeness of taxation: any profit/income is subject to taxation, regardless of their source, the category of payer, or the purpose for which such profit/income is intended;
- Individual taxation: the tax is levied on each legal person or individual which/who receives the proceeds or income;
- Annual assessment of the tax payable;
- Standard tax rates for taxes on profits or income;
- Tax depreciation system with the annual tax depreciation rates in accordance with Article 55(2) of the Corporate Income Tax Act (CITA).

Tax provisions which correspond to the above principles ought to be considered elements of the benchmark tax and a point of reference in identifying tax expenditures. The benchmark tax will also include all provisions related to avoiding double taxation, i.e. tax exemption or applying the tax exemption methods regulated in bilateral double taxation agreements to which the Republic of Bulgaria is a party signatory.

### 6.2. Benchmark Tax in Terms of Consumption Taxation – Value Added Tax and Excise Duties

In terms of VAT and excise duties, the benchmark tax will follow the principles which are binding for all EU Member States and are enshrined in EU legislation.

The tax base for these taxes is consumption and it covers goods and services consumed in Bulgaria. In this regard the standard provides for the relevant tax to be applied on the place of consumption and therefore to be applied for goods and services imported into Bulgaria, excluding the goods and services exported from the country.

In view of the circumstance that a multi-phase system applies to VAT, the benchmark tax provides for the tax to be applied to the sale of goods and services at all stages of production and sale, and the persons registered within the meaning of the VAT Act may exercise their right to deduct the tax credit at each stage. The fact that some entities, such as state and local authorities and not-profit organisations are not entitled to deducting a tax credit for the paid tax on goods and services used for supplies which are not subject to VAT taxation, is also treated as part of the benchmark tax.

Mandatory exemptions from taxation according to European legislation are a benchmark. All possible tax exemption options which are not binding for Member States and are a matter of

national regulation ought to be considered a deviation from the benchmark tax, i.e. tax expenditure items.

The same refers to tax rates. The benchmark tax involves a standard rate. The standard VAT rate is established in Article 66 (1) of the Value Added Tax Act (VATA) and is 20 % in 2020. The standard rates for excise duties depend on the type of the excise goods and are regulated in Chapter Three, Section IV of the Excise Duties and Tax Warehouses Act (EDTWA). Reduced tax rates (for value added tax and excise duties) ought to be treated as tax expenditure items.

Any legal provision which narrows the scope of taxation due to administrative or control considerations – for example, exemption from excise duty for alcoholic beverages produced by individuals for their own consumption and not intended for sale, should be considered a benchmark, and not a tax expenditure item.

There is no particular standard regarding the tax period. The deadline for declaring and paying VAT from domestic transactions is monthly, but the tax due on imported goods is usually paid within the term provided for import duties. The tax period for excise duty under the excise declaration is also monthly.

### VII. METHODS OF MEASURING TAX EXPENDITURES

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One prerequisite for the proper distribution of public funds is to determine their amount accurately beforehand. Unlike direct transfers (public budget expenditures), the amount of tax incentives is not known ex ante. The possibilities of determining their precise amount subsequently (after the end of the financial year) are also limited, particularly in cases where there is no requirement for detailed reporting of tax expenditures in the tax returns.

That is why measuring tax expenditures requires estimations arrived at by applying a specific set of methods.

The most common method of measuring tax expenditures is the method of ceding revenue (revenue foregone), which involves estimation of amounts not paid into the budget as a result of the existence of a given tax expenditure item.

Other applicable methods include the method of receiving revenue (revenue gain) and the outlay equivalent method.

The revenue gain method is based on estimating amounts which would have been paid into the budget, had certain tax expenditures been eliminated from the tax system, but factoring in any changes in taxpayer behaviour resulting from eliminating such expenditures.

The outlay equivalent method consists in measuring cash outlays which would be required to finance a given goal outside the tax system (for example, cost of raising the amount of social assistance or subsidies for purchasing new technology).

**For the purposes of this report, the method used is that of revenue foregone.**

## VIII. TAX EXPENDITURE ESTIMATES

Tax expenditures have been estimated for 2020.

Tax expenditures presented in this Report have been estimated on the basis of reporting data stated in tax returns and customs declarations, and on the basis of data provided by the Ministry of Agriculture, Foods and Forestry and on the basis of statistics provided by the Bulgarian National Bank and the National Statistical Institute.

All tax expenditures have been estimated, and their measurement includes:

- Total amount of tax expenditures;
- Tax expenditure estimates by type of tax;
- Tax expenditure estimates by type of tax measure;
- Tax expenditure estimates by goal;
- Tax expenditure estimates by economic sector and subsector;
- Tax expenditure estimates by beneficiary.

This edition of the report identifies, for the first time, the temporary tax expenditure in the context of the measures introduced in 2020 for tackling consequences of the COVID-19 crisis. These are measures the deadline for the implementation of which is set out in law. For the purposes of estimating and analysing tax expenditure for 2020, the temporary measures are only in the area of VAT. The estimation of these tax expenditures is prepared and presented separately in order to ensure comparability of data in the comparative analysis on an annual basis.

### 8.1. Total Amount of Tax Expenditures

Year	Total Amount of Tax Expenditures (in BGN)	% of GDP	% of Tax Revenue
2020 <sup>2</sup>	706,526,157	0.60%	1.97%

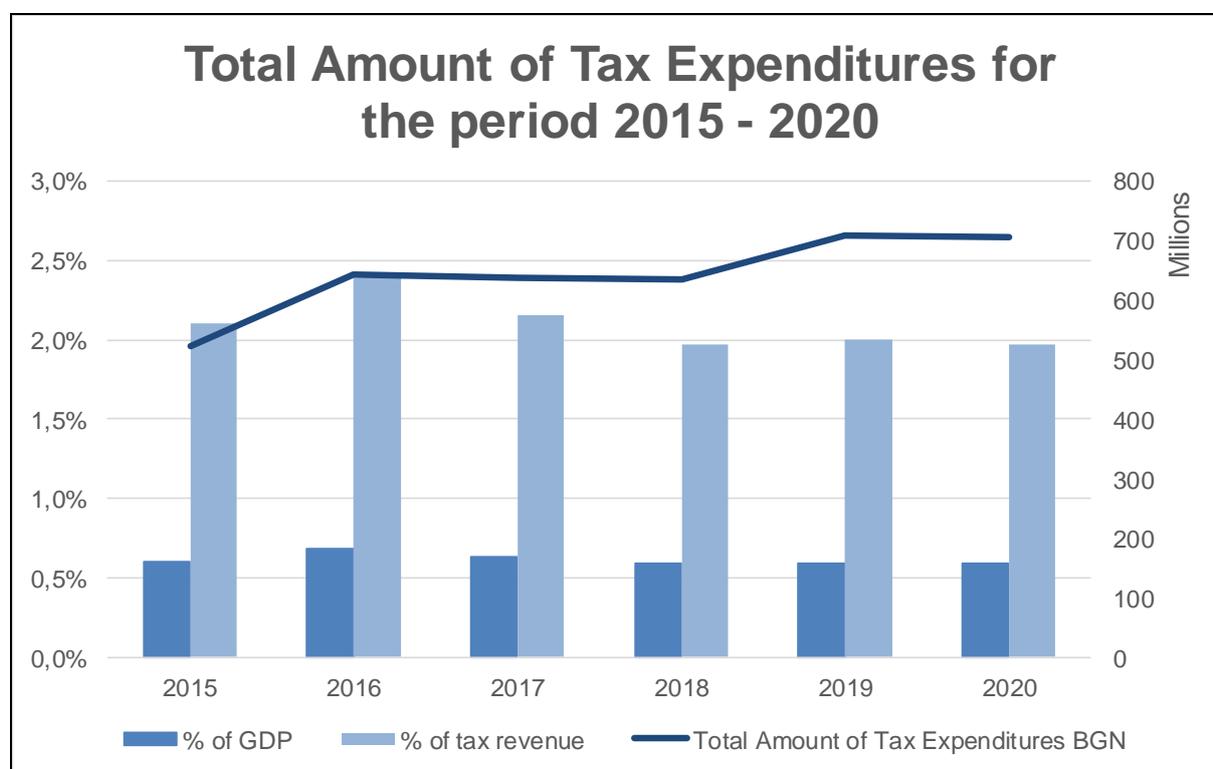
#### **2020**

As to tax expenditures, the number of the permanent measures remains the same in 2020, and in absolute terms there is a small decrease of 0.1% (BGN 1.0 million) as against the previous year.

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<sup>2</sup> In order to ensure comparability, it is only tax expenditures under permanent measures that are included in the analysis and the charts for 2020. The temporary tax expenditures are assessed and presented separately.

The analysis indicates that the estimated loss of revenue resulting from tax expenditures is less than 1% of GDP (0.60% of GDP for 2020) and maintains its share at the level of the previous two years.



Reducing the number and the amount of tax expenditures is often seen as an improvement in the tax system as it simplifies the tax code and broadens the tax base. The latter is crucial for the developing economies because using domestic revenue is a key determinant of economic development.<sup>3</sup>

In countries with a broad tax base and low tax rates for profit and income taxation such as Bulgaria, the number of tax expenditure items is low, up to 40. Conversely, in countries with a narrow tax base or high tax rates, the number of tax expenditure items is several times higher.

## 8.2. Tax expenditure Estimates by Type of Tax

Tax expenditures in 2020 were estimated by type of tax: value added tax, excise duties, corporate income tax and personal income tax.

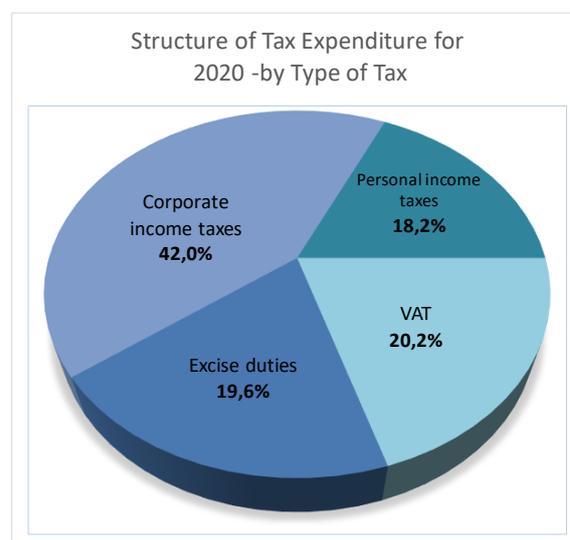
For 2020, a total of 40 tax expenditure items were identified. On the basis of the information available, 30 tax expenditures were measured (accounting for 75% of all expenditure items identified). Tax expenditures not measured account for 25% of all expenditure items.

<sup>3</sup> Neubig, Tom and Agustin Redonda (2017). "Shedding Light on Hidden Government Spending: Tax Expenditures", IMF Public Financial Management Blog, International Monetary Fund, <https://blog-pfm.imf.org/pfmblog/2017/12/shedding-light-on-hidden-government-spending-tax-expenditures.html> . 11

## Tax Expenditure Report 2020

Type of Tax	Number of Tax Expenditure items	Number of Tax Expenditure Items Measured	Estimate (in BGN)	% of Tax Revenue
VAT	2	1	142,774,924	0.40%
Excise duties	7	7	138,544,266	0.39%
Corporate income taxes	19	10	296,957,673	0.83%
Personal income taxes	12	12	128,249,295	0.36%
<b>Total, all taxes</b>	<b>40</b>	<b>30</b>	<b>706,526,157</b>	<b>1.97%</b>

The largest relative share in the estimated tax expenditures under the permanent measures of the tax policy is occupied by the tax expenditures associated with corporate taxes (42.0%), followed by tax expenditures associated with VAT (20.2%), excise duties (19.6%) and associated with personal income taxes (18.2%).



The analysis of the sources of information used to make a tax expenditure measurement aimed at reducing the share of unmeasured tax expenditures indicates that only a quarter of the measures defined as tax expenditures cannot be estimated. The absence of an estimate is due to the fact that tax returns do not contain the relevant data, or contain aggregated information which cannot be used to measure the respective tax expenditure item reliably. When no other source of information has been identified, the tax expenditure cannot be estimated reliably.

In this regard, due to unavailable detailed and comprehensive information reflecting the exact impact of some of the tax expenditures on the state budget, the quantitative assessment of their effects in the annual reports is not possible. This circumstance is reflected in the "Amount" field on the respective tax expenditure row as „The tax expenditure has not been measured“.

For example, the annual tax return filed under Article 92 of the Corporate Income Tax Act contains aggregated information concerning the tax deductible cost of depreciation/amortisation for all tax depreciable tangible and intangible assets. The12

information provided by means of the tax return is not sufficiently broken down to enable the estimation of tax expenditures under tax measures “Accelerated tax depreciation of up to 50 % for machines and equipment” and “Accelerated tax depreciation (100 % per annum) for assets generated as a result of R&D”.

On the one hand, the administrative procedures, including the procedure of filling in and filing tax returns, are considerably simplified in order to reduce the administrative burden and the cost of compliance for taxpayers. On the other hand, the unavailability of certain information concerning tax incentives under corporate and personal income taxation prevents the measuring of the actual size of some tax expenditures.

### 8.3. Tax Expenditure Estimates by Type of Tax Measure

Tax expenditures have been estimated by type of tax measure for the following types of taxes: value added tax, excise duties, corporate and personal income taxation.

#### 1. Tax Measures Associated with Value Added Tax

##### Tax Expenditures Associated with Value Added Tax (from permanent measures)

Tax Measure Type	Year of introduction	% of Tax Revenue from VAT	Amount (in BGN)
Special regime for charging VAT on imports and a 30-day deadline for VAT refunds	2007	X	The tax expenditure has not been measured.
Reduced tax rate (9 %) for accommodation provided at hotels and other similar establishments	2007 <sup>4</sup>	1.30%	142,774,924
<b>Total</b>		1.30%	142,774,924

The tax expenditure under the “Reduced tax rate (9%) for accommodation provided at hotels and other similar establishments” tax measure has the biggest relative share in the tax expenditures associated with value added tax. Compared to the previous year, this measure reports a decrease by BGN 16.8 million (10.5%) for 2020. The factor behind the decrease of the tax expenditure amount for the reference period in terms of activities related to accommodation in the country is the epidemiological situation and the restrictive measures introduced to overcome the pandemic in the country.

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<sup>4</sup> The tax measure was introduced in 2007 at a reduced tax rate of 7 % and which was changed to 9% as from April 2011.

## 2. Tax Measures Associated with Excise Duties

<b>Tax Measure Type</b>	<b>Year of introduction</b>	<b>% of Tax Revenue from Excise Duties</b>	<b>Amount (in BGN)</b>
Refund of excise duty paid on alcohol and alcoholic beverages when used for medical purposes	2006	-	0 <sup>5</sup>
Zero-rate excise duty on electric power for household consumption	2007	0.42%	22,787,841
Reduced excise rate on natural gas used as motor fuel and zero-rate excise duty on natural gas used for household purposes	2006 <sup>6</sup>	0.47%	25,472,142
Reduced excise rate on ethyl alcohol (rakiya) produced in specialised small distilleries, amounting to BGN 550 per 1 hectoliter of pure alcohol	2006	0.01%	800,017
Reduced excise rate on beer produced by small independent breweries	2009	0.06%	3,434,733
Remittance of excise duty on purchased gas oil used in primary agricultural production	2006 <sup>7</sup>	1.54%	83,985,752
Zero-rate excise duty on sales of coal and coke to individuals	2007	0.04%	2,063,781
<b>Total</b>		<b>2.54%</b>	<b>138,544,266</b>

Compared to the estimate for 2019, the amount of tax expenditure in this group decreases by BGN 6.5 million (4.5%). The decrease in the total amount of tax expenditures associated with excise duties is almost entirely due to the two tax measures: “Reduced excise rate on natural gas used as motor fuel and zero-rate excise duty on natural gas used for household purposes” and „Zero-rate excise duty on sales of coal and coke to individuals“ tax measures which decrease by BGN 3.6 million (12.4%) and by BGN 3.0 million (59.6%), respectively, compared to 2019.

<sup>5</sup> In 2020, there is no refunded amount for paid excise duty on alcohol and alcoholic beverages used for medical purposes

<sup>6</sup> The „Reduced excise rate on natural gas used as heating fuel for industrial purposes“ tax measure was introduced in 2006 at a tax rate of BGN 0 per 1 gigajoule. In April 2012 it was changed to BGN 0.85 per 1 gigajoule.

<sup>7</sup> Over the years, State Aid has been provided and reported in different forms. In the period from 2010 to 2013 the measure was canceled, after that recovered as a special procedure for deducting excise duty in return for fuel vouchers in the form of state aid for the agricultural sector until June 2016 when it was canceled. The measure continues being implemented during the period under consideration as a „Special procedure for remittance of excise duty on purchased gas oil used in primary agricultural production“ measure regulated in Article 47a of the Agricultural Producers Support Act (APSA) and Article 45e of the Excise Duties and Tax Warehouses Act, which is valid until 31.12.2023 (Art. 47a(2) of the APSA). The total amount on the State Aid provided is approved annually by the State Budget Act (SBA) of Republic of Bulgaria for the relevant year.

- For 2020, as well as for 2019, the following two tax measures have the biggest relative share in tax expenditures associated with excise duties: “Remittance of excise duty on purchased gas oil used in primary agricultural production” – 60.6% of the total amount of tax expenditures associated with excise duties for 2020;
- “Reduced excise rate on natural gas used as motor fuel and zero-rate excise duty on natural gas used for household purposes” – 18.4% of the total amount of tax expenditures associated with excise duties for 2020.

### 3. Tax Measures Associated with Corporate Income Taxes

Tax Measure Type	Year of introduction	% of Tax Revenue from Corporate Taxes	Amount (in BGN)
Tax rate of withholding tax on Income from dividends and shares in liquidation surplus - 5 %	2007	0.52%	15,009,545
Tax exemption of any income from disposition of financial instruments admitted to trading on a Regulated Market	2007	X	The tax expenditure has not been measured.
Tax exemption from corporate income tax for collective investment schemes, national investment funds and special purpose vehicles	2007	X	The tax expenditure has not been measured.
Tax exemption from corporate income tax for the Bulgarian Red Cross	2007	X	The tax expenditure has not been measured.
Tax exemption from corporate income tax and income tax for institutions of higher education	2007	X	The tax expenditure has not been measured.
Tax exemption from corporate income tax and income tax for the Bulgarian Academy of Sciences, the Academy of Agriculture, etc.	2007	X	The tax expenditure has not been measured.
Remission of up to 100 per cent of the corporate income tax for undertakings engaging in manufacturing activities in municipalities with high unemployment rates	2007	0.33%	9,516,607
incl. tax relief constituting de minimis aid		0.10%	2,735,604
incl. in cases of tax relief constituting regional aid		0.24%	6,781,004
Remission of up to 60 per cent of the corporate income tax for registered agricultural producers	2007	0.94%	26,872,133

## Tax Expenditure Report 2020

Remission of corporate income tax for undertakings employing people with disabilities	2007	0.04%	1,063,906
Remission of 50 per cent of the corporate income tax for social security and health insurance funds	2007	0.0001%	4,117
Accelerated tax depreciation (100% per annum) for assets generated as a result of R&D (art.69 of the CITA)	2007	X	The tax expenditure has not been measured.
Tax losses carry forward	2007	7.30%	209,034,809
Tax deductible expense for donations	2007	0.17%	4,834,232
Tax deduction for hiring unemployed persons	2007	X	The tax expenditure has not been measured.
Remission of 50 per cent of the income tax for budget enterprises	2007	0.02%	590,432
Tax exemption of fringe benefit expenses on food vouchers	2007	1.04%	29,748,812
Accelerated tax depreciation (art.55, par.3 and 6 of the CITA)	2007	X	The tax expenditure has not been measured.
Tax-recognized cost upon grant of scholarships	2007	0.01%	283,080
<b>Total<sup>8</sup></b>		10.37%	296,957,673

The “Tax losses carry forward” measure is included as a tax expenditure item under the corporate taxes in Bulgaria and it should also be kept in mind that in some countries this measure is defined as part of the tax benchmark. For 2020 the relative share of the tax expenditure under the “Tax losses carry forward” tax measure is 70.4 % of the total amount of the tax expenditure group under CITA. On an annual basis, the tax expenditure from this measure increases by 6.1% (BGN 12.1 million). The group of tax expenditure under corporate taxes not only has the largest number of tax expenditures identified but is also distinguished by the high share of unmeasured tax expenditure – 8 out of 20 (40%). This circumstance is due to the above-mentioned lack of access to the information needed for the assessment of a given tax expenditure.

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<sup>8</sup> The „Tax deduction when submitting electronically an annual tax return and annual activity report and corporation tax paid until 31 March of the following year, but not more than BGN 1,000“ measure has been abolished since 1.01.2018 and pursuant to the provisions of § 48 of CITA, the tax returns for which the obligation to be submitted arises after the 31st day of December 2017 shall be submitted only by electronic means.

## 4. Tax Measures Associated with Personal Income Taxes

Tax Measure Type	Year of introduction	% of Tax Revenue from Personal Income Taxes	Amount (in BGN)
Tax relief for persons with reduced working capacity <sup>9</sup>	2007	1.87%	78,364,526
Tax relief for personal contributions for contributory service upon retirement <sup>9</sup>	2007	0.01%	243,998
Tax relief for personal voluntary social and commercial insurance contributions <sup>9</sup>	2007	0.18%	7,540,737
Tax relief for donations <sup>9</sup>	2007	0.01%	432,844
Tax relief for young married couples	2009	0.02%	862,784
Tax relief for children <sup>9,10</sup>	2005	0.15%	6,369,686
Tax relief for children with disabilities <sup>9</sup>	2015	0.04%	1,826,792
Tax incentives for sole proprietors (incentives under CITL which can be used by sole proprietors)	2007	0.08%	3,293,455
Tax relief when applying the "Exemption with progression" method of avoiding double taxation	In force since the year of entry into force of the respective DTAC related to the method applicable - "Exemption with progression"	0.29%	11,977,474
Tax deduction for electronic submission of annual tax returns by 31 March of the following year: a 5 % rebate of the balance of tax due under the annual tax return, but not more than BGN 500, provided that the persons have no public obligations subject to coercive enforcement at the time of submission of the return, and the tax due is paid until 31 March	2007	0.06%	2,398,483
Remission of the annual income tax up to 60 per cent for sole proprietors registered as agricultural producers	2010	0.35%	14,776,630
Tax relief for non-cash payments	2017	0.004%	161,886

<sup>9</sup> In 2019, the scope of the information used in assessment of tax expenditures has been extended. Besides the persons who submitted an annual tax return for 2020 under Art. 50 of the Personal Income Tax Act, it also includes the persons who have used the relief with the main employer.

<sup>10</sup> Tax measure was introduced in 2005, was in force until end- 2008, then was canceled and was resumed again in 2015.

effected			
<b>Total</b>		3.07%	128,249,295

The tax expenditures associated with personal income taxes are largely related to traditional measures for achieving social goals. In this group, the biggest relative share is attributed to the tax expenditure under the “Tax relief for persons with reduced working capacity” tax measure - 61.1% of the total amount of the tax expenditures under PITA for 2020.

The tax expenditure under “Tax relief for children” and “Tax relief for children with disabilities” have been estimated on the basis of the size of these tax reliefs for the incomes received during the 2020, as established in the law.

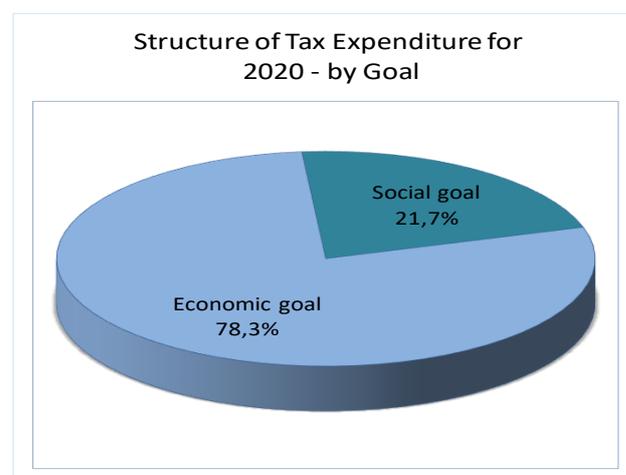
### 8.4. Tax Expenditure Estimates by Goal

Tax expenditures are presented in two main groups in accordance with their goals – an economic goal and a social goal. Tax expenditures with an economic goal refer to tax measures aimed at promoting foreign direct investment and innovation, increasing employment, developing certain regions and economic branches in the country.

Tax expenditures with a social goal refer to tax measures aimed at certain categories of individuals.

Goal	Amount (in BGN)	% of Tax Revenue
Economic goal	553,230,827	1.54%
Social goal	153,295,330	0.43%
<b>Total</b>	<b>706,526,157</b>	<b>1.97%</b>

For 2020 the relative share of tax expenditures with an economic goal and of tax expenditures with a social goal in the total amount of tax expenditures for 2020 was 78.3% and 21.7%, respectively.



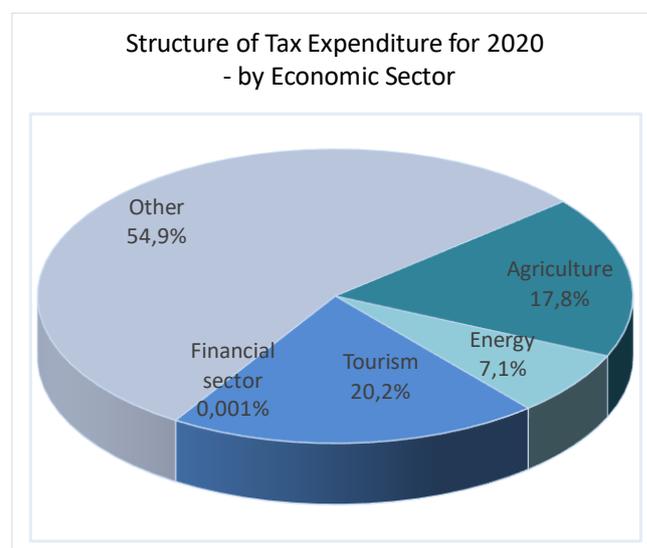
### 8.5. Tax Expenditure Estimates by Economic Sector and Subsector

The distribution of tax expenditures for 2020 by economic sectors and subsectors is as follows:

Economic sector	Amount (in BGN)	% of Tax Revenue
Agriculture	125,634,515	0.35%
Energy	50,323,764	0.14%
Tourism	142,774,924	0.40%
Financial sector	4,118	0.001%
Other	387,788,837	1.08%
<b>Total</b>	<b>706,526,157</b>	<b>1.97%</b>

**Note:** For the purposes of estimating tax expenditures, the category of „Other” includes several economic sectors (food and beverages, pharmaceuticals, etc.) and tax expenditures associated with general tax measures (for example, „Tax losses carry forward”) or tax measures for promoting regional development and employment which, on the one hand, cover a considerable number of sectors and, on the other hand, are hard to differentiate by economic sector (for example, „Remission of up to 100 per cent of the corporate income tax for undertakings engaging in manufacturing activities in municipalities with high unemployment rates”).

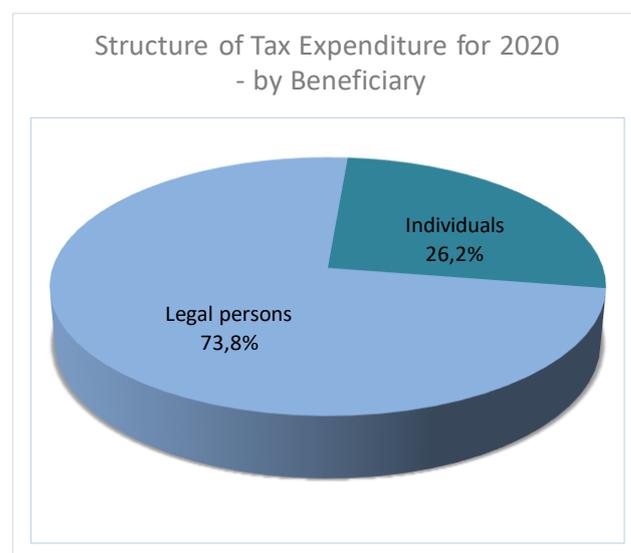
The distribution of tax expenditures by economic sectors and subsectors shows that a significant part of them (which could be attributed to a specific sector) are under measures which aim at stimulating tourism (20.2% of the total amount of the measured tax expenditures) and agriculture (17.8%). These sectors may also include part of the expenditures in the „Other economic sectors” category inasmuch as it includes general tax measures the distribution of which is not possible.



Tax expenditures have been grouped into two main categories of beneficiaries: legal persons and individuals.

Beneficiary	Amount (in BGN)	% of Tax Revenue
Legal persons	521,566,168	1.450%
Individuals	184,959,989	0.52%
<b>Total</b>	<b>706,526,157</b>	<b>1.97%</b>

**Note:** For the purposes of estimating tax expenditures, the “Legal persons” category includes resident legal persons, including non-personified entities and permanent establishments of non-resident persons in Bulgaria.



For 2020 the relative share of tax expenditures where the beneficiaries are legal persons was 73.8%, and that of tax expenditures where the beneficiaries are individuals was 26.2% of the total amount of tax expenditures for 2020.

### 8.7. Tax Expenditure Estimates of temporary measures addressing the consequences of the spread of COVID-19 in 2020

Year	Total Amount of Tax Expenditures from temporary measures (in BGN)	% of GDP	% of Tax Revenue
2020	94,042,031	0.08%	0.26%

In 2020, tax expenditures were also influenced by the temporary measures introduced to overcome the crisis due to the spread of COVID-19. At the national level, the measures and the actions during the state of emergency in the conditions of the COVID-19 pandemic and after it are regulated by the Law on the Measures and Actions During the State of Emergency Announced by a Decision of the National Assembly of 13 March 2020, and for Overcoming the Consequences (promulgated, SG, issue 28 of 2020; amended and supplemented, issues 34, 38, 44, 55, 60, 64, 71, 92, 98, 101, 103 and 105 from 2020). In the field of tax policy, the measures support of businesses and employment. The effect of these measures for 2020 is expressed in providing liquidity support to enterprises by extending the deadlines for filing and paying taxes within the first half of 2020, while maintaining the conditions for discounts.

In the context of the continuing epidemic emergency situation arising from the spread of COVID-19, additional measures were adopted in 2020 related to reducing the VAT rate on certain goods and services from 20% to 9%, exemption from VAT and customs duties on imports of certain medical goods necessary to combat the effects of the COVID-19 pandemic and an increase in the amount of tax reliefs for children for the income gained in 2021. These tax policy measures, taken in response to COVID-19, have an impact on tax revenues for the period 2020-2022 and on the assessment of tax expenditures, respectively:

**Measure: "Reduced tax rate (9%) for the supplies of other goods and services related to COVID-19"**

The expansion of the application of a reduced VAT tax rate of 9 per cent took place by supplementing the provision of Art. 66(2) of the VAT Act and refers to:

1. Supplies of books on physical carriers or electronic supplies, or both (including textbooks, cognitive booklets and study sets, children's picture, drawing and colouring books, music printed or in manuscript form), other than publications which are fully or mainly intended for advertising, and other than publications which are fully or mainly composed of video content or audio-music content (in force from 1.07.2020 to 31.12.2021 - SG, issue 55 of 2020);

2. Restaurant and catering services consisting of the supply of prepared or unprepared food, including the supply of takeaway food; this does not apply to restaurant and catering services consisting of supply of spirit drinks, including in the cases of Article 128 (in force from 1.07.2020 to 31.12.2021 - SG, issue 55 of 2020, amended, issue 71 of 2020, in force from 1.08.2020 to 31.12.2021);

3. Food suitable for babies or for infants in accordance with appendix No. 4 (in force from 1.07.2020 to 31.12.2021 - SG, issue 55 of 2020);

4. The supply of joint services to tourists in the cases under Art. 136, as well as excursions organized by tour operators and travel agents with random bus transport of passengers (New, SG issue 71/2020, effective from 1.08.2020 to 31.12.2021);

5. The supply of sport facility use services (New, SG No. 71/2020, effective 1.08.2020 to 31.12.2021);

6. Baby diapers and similar baby hygiene items under Annex № 4 (in force from 1.07.2020 to 31.12.2021 - SG, issue 55 of 2020):

6.1. Adapted infant milk and powders for infants or small children under EU code 1901 10

00.

6.2. Homogenised vegetable purees for babies or young children in containers of a net content not exceeding 250 g under EU code 2005 10 00.

6.3. Homogenised fruit purees for babies or small children in containers of a net content not exceeding 250 g under subheading 2007 10 of the EU CN.

6.4. Mixed homogenised meat, fish, vegetable, fruit or nut purees for babies or small children in containers of a net content not exceeding 250 g under EU code 2104 20 00.

6.5. Baby diapers under EU code 9619 00 81.

It is evident from the above that the implementation of the measure does not cover the entire 2020. For some goods, the assessment of the effect of the implementation includes a six-month period, and for others the period is five months. This should be taken into account when analysing the tax costs for the following periods of application.

The tax expenditure under the "Reduced tax rate (9%) for other goods and services in connection with COVID-19" measure is estimated at BGN 91 million for 2020.

**Measure: "Exemption from VAT on imports of certain medical goods"**

Exemption from VAT and customs duties on imports of certain medical devices necessary to address the COVID-19 pandemic applies in accordance with Commission Decision 2020/491 of 03.04.2020 and on the basis of the adopted CMD № 80 of 23.04.2020, supplementing CMD № 75 of 2007. The period of application of the measure was successively extended and at the time of preparation of this report the exemption on imports of goods from the approved list is from 30 January 2020 to 31 December 2021. Goods imported by state organizations are eligible for VAT exemption. In connection with this measure, the 2020 report estimates VAT tax expenditure.

The tax expenditures for VAT revenues on imports of medical goods, according to an approved list and imported by government organizations, which were necessary to address the COVID-19 pandemic in 2020, in accordance with CMD № 80 of 23.04. 2020, RMS № 400 from 18.06.2020, PMS №237 from 27.08.2020 and PMS 332 from 26.11.2020 for 2020 are estimated at BGN 3.10 million.

**Tax Measures Associated with Value Added Tax from temporary measures**

<b>Tax Measure Type</b>	<b>Year of introduction</b>	<b>% of Tax Revenue from VAT</b>	<b>Amount (in BGN)</b>
Exemption from VAT on imports of certain medical goods	2020	0.03%	3,056,211
Reduced tax rate (9 %) for the supplies of other goods and services related to COVID-19	2020	0.83%	90,985,820
<b>Total</b>		<b>0.85%</b>	<b>94,042,031</b>

### **Other measures to address the spread of COVID-19 which influence budget revenues:**

In connection with the proposal of the European Commission of 28.10.2020 for the introduction of VAT relief on the supply of diagnostic kits and vaccines against the virus, amendments to the VAT Act were adopted, effective as from 01.01.2021 (Art. 36b and 64a of the VAT Act), for exemption with the right of deduction (i.e. by applying a zero tax rate) for the following supplies taxable on the territory of the country: 1. The supply of COVID-19 vaccines and services directly related to these vaccines; 2. The supply of medical devices for in vitro diagnostics of COVID-19 and the services directly related to these devices. These exemptions also include intra-Community acquisitions (purchases from other EU Member States). The relief measures are temporary and will be applied until December 31, 2022. As a tax expense, this measure will be manifested in 2021 and 2022.

The Law on the 2021 State Budget of the Republic of Bulgaria introduced a change, related to the increase of the amount of the tax reliefs for children for the incomes earned in 2021. For the tax relief for children, under Art. 22c of the Personal Income Tax Act the following amounts are deducted from the amount of the annual tax bases under Art. 17 of the Personal Income Tax Act: BGN 4,500 - for one minor child; BGN 9,000 - for two minor children; BGN 13,500 - for three or more minor children. The amount of the tax relief for children with disabilities under Art. 22d of the Personal Income Tax Act is also increased, with the amount of the annual tax bases under Art. 17 of the Personal Income Tax Act being reduced by BGN 9,000 for raising a minor child with a type and degree of disability of 50 and over 50 per cent, as determined by an effective decision of a competent authority. This measure will also be reflected when reporting tax expenditures for 2021 and 2022.

## **IX. POSSIBILITIES FOR IMPROVEMENTS IN TAX EXPENDITURE REPORTING**

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- Regular review and measuring of tax expenditures, issuing a Tax Expenditure Report annually;
- Analysis of the information requirements and information sources for the purposes of tax expenditure measurement;
- Reducing the share of unmeasured tax expenditures;
- Update of the Tax Expenditure Report for previous years, where possible, to assess the unmeasured tax expenditures;
- Assessing the tax expenditure efficiency;
- Conducting a cost-benefit analysis before introducing any future tax expenditures;
- Developing short- and mid-term forecasts for tax expenditures.

### **CONCLUSIONS**

The Bulgarian tax system provides a relatively small number of tax expenditure items. Generally, tax expenditures are aimed at stimulating economic development and growth by promoting investment, innovation and employment.

The Report shows that a considerable part of tax expenditures related to corporate income tax incentives have not been measured, due to the unavailability of information about them. In that regard, appropriate actions continue to be taken to reduce the share of unmeasured expenditure, without increasing the administrative burden and the costs of taxpayers.

Last but not least, it should be noted that part of the tax expenditure measures introduced several years ago should be subject to an in-depth review to explore the question of the extent to which they are effective and how justified it is to retain them in their present form.

#### **For additional information, please contact:**

Tax Policy Directorate

Ministry of Finance