

**Research Project:**  
**"The Impact of European Union Enterprises Relocation on Inter-Firm Relations in Bulgaria"**

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## **Policy Recommendation**

### **Legal Framework for Foreign Direct Investment Overview**

#### ***I. Foreign Investment Regime. Applicable legislation.***

Law on Foreign Investments (published, SG No. 97/1997, last amended SG No. 110/1999)

#### ***Definitions and forms of investment***

Foreign persons may freely choose the form of investment to perform in Bulgaria. Foreign investment is defined as any investment made by a foreign person, including the accretion in value of the investment initially made, in shares and stakes in commercial companies, ownership and limited ownership rights over movable and immovable property, debentures, treasury bonds and other kinds of securities, issued by the State, by the municipalities or by Bulgarian legal persons (with a remaining term of maturity not shorter than 6 months), loans and financial leasing for a term not shorter than 12 months, intellectual property rights, rights stemming from concession contracts, etc.

There are no limitations on the share participation of foreign persons in commercial companies. There are neither minimum capital investment requirements, nor prior permission for the investment needed.

#### ***Guarantees for foreign investments.***

- Foreign investors may perform economic activities in the country under the same conditions applicable to Bulgarian investors unless provided otherwise by law. In case that a more favorable regime to foreign investments is established by international treaties to which Bulgaria is a party, these terms have precedence over local rules.
- Foreign investment made prior to the adoption of amendments in laws imposing statutory restrictions regarding the foreign investments only shall not be affected by these restrictions.
- Foreign investments in Bulgaria may not be expropriated except for exclusively important state needs which cannot otherwise be met, and subject to prior and adequate compensation in the form of another immovable property in the same location, or, with the foreign investor's explicit consent, in another location, or in cash if the foreign investor prefers so.

### ***Profit and capital repatriation.***

Foreign investors can freely purchase foreign currency and transfer it abroad upon presentation of receipts for paid taxes in the following instances:

- income generated through an investment;
- property alienation driven indemnification proceeds, when for state needs;
- liquidation quota resulting from the termination of the investment;
- proceeds from the sale of the investment good;
- sum received after the enforcement of a writ of execution.

### ***Ownership over real estate.***

Foreign persons may acquire property rights over buildings and limited property rights over land. The Bulgarian Constitution prohibits them from acquisition of ownership rights over land.

The above restriction does not concern the companies with foreign participation (irrespective of its percentage) registered pursuant to the Bulgarian Commercial Law.

These are considered domestic companies and may freely acquire full ownership rights over land, including agricultural land.

Foreign persons and companies with foreign participation need an advance authorization by the Council of Ministers to acquire ownership rights over real estate in border zones and in areas of importance for the national security, as determined by the Council of Ministers.

### ***One-stop Shop Institution.***

Bulgarian Foreign Investment Agency (BFIA) was established in April 1995 as a governmental body at the Council of Ministers. It co-ordinates the state institutions in their activities in the field of foreign investments and promotes the investment conditions in the country.

BFIA offers pre- and after-investment care, identification of suitable Bulgarian partners, up-to-date information on the investment process in the country, legal advice, support for priority investment projects, etc. All its services are completely free of charge.

Institutional support for priority investment projects.

At the request of an investor, the BFIA may propose to the Council of Ministers to form an interministerial group, comprising representatives of ministries and agencies concerned, in order to provide institutional support for certain investment projects acknowledged by the Council of Ministers as priority investment projects. This is estimated as a significant advantage for the realization of complicated projects cutting down the administrative costs.

## ***II. Taxation regime.***

The Bulgarian taxation system is changing towards the prevailing practices in the most EU members states. Some of its main features are listed below:

***Advantages.***

Financial stability.

Improvement of the legislation.

Reduction of the tax rates.

Publication of taxpayer friendly information.

***Disadvantages.***

Frequent changes in the legal framework lead to hardly predictable financial policy.

Lack of broad preliminary debate on the tax policy and legislative changes.

Certain unclearness in the applicable legislation.

Difficulties regarding the work of the tax administration.

***1. Corporate taxation.***

Legal Framework	Law on Corporate Income Tax (LCIT), published, SG No. 115/1997, last amended SG No. 111/1999
Taxable Base	Unitarian tax base: the taxpayer's worldwide income.
Taxpayers	Resident entities (incorporated and non-incorporated); Bulgarian branches of non-residents.
Tax Rates	Corporate tax: 25 % / 20 % 1; Municipal tax: 10 %2 Aggregate tax burden: 32.5 % / 28 %.

***Advantages.***

1. The corporate tax rate is gradually reduced. According to the agreement between the Bulgarian Government and the International Monetary Fund it is expected that the corporate tax rate will be reduced to 20 % / 15 % in 2001 and 15 % for all taxpayers in 2002. Therefore the aggregate tax burden (over 40 % for 1997) will fall to 23.5 % for all tax payers in 2002.

2. Accelerated depreciation. Bulgarian depreciation system allows the use of accelerated depreciation rates to some categories of assets including machinery, manufacturing equipment, apparatuses, computers, software, electricity carriers, communication lines, steam- and water-pipelines. However the text of art. 24, par. 4 of LCIT is not completely clear being in contradiction with the National Chart of Accounts.

'The lower rate is granted to taxpayers with taxable profit not exceeding BGN 50,000 for the current year, exclusive of banks and financial institutions.

2 Municipal tax is deducted from the taxable base before the tax transformation

3. Loss carry forward. The entities may carry forward losses within any year in the following 5 years. The carry-over period for banks and financial institutions is 10 years.

4. Tax incentive for investments in depressed regions. Foreign and domestic entities, investing in regions with a high unemployment rate, listed annually in an appendix to the Law on Corporate Income Tax, enjoy a reduction of the corporate income tax. The corporate tax for the recent year is reduced by an amount of 10 % of the share contributions (for company incorporation or capital increase) provided that the funds generated from the contributions are invested in acquisition, modernization or reconstruction of tangible fixed assets such as buildings, equipment, transmitters, electricity transmitters, and telecommunication lines. The reduction sum is accounted for as reserves and if it is bigger than the corporate tax due for the respective year it can be used to reduce the corporate tax in the following five years.

***Disadvantages.***

1. Weaknesses in the thin capitalization rules. With the purpose of avoiding a concealed before-tax distribution of dividends between the shareholders, the thin capitalization rules limit the deductibility of expenditures incurred through the utilization of debt financing instruments. The interest payments and loan repayments exceeding the taxpayer’s equity are not deducted from the tax base and are subject to corporate taxation. This basic legislative solution is criticized as restrictive towards the use of financing instruments between non-related persons. It causes difficulties in the realization of the long-term investment projects. There is also a possibility for double taxation on the interests in the case where a domestic company borrows from a domestic bank. If the credit amount is higher than the company’s equity, some payments will be taxed, first, as non-deductible from the tax base of the company, and, second as an income of the bank.

2. Narrow scope of application of the investment tax incentive. The practice shows that the incentive mentioned-above is applied very rarely and is ineffective for the purpose of attracting investments in particular regions for setting up production activities and green-field projects.

3. Loss carry forward limitations. The right to loss carry forward is not enjoyed if a transformation of more than 50 per cent of ‘the ownership is changed’. Cases like mergers between an affiliate and a parent company show that this provision has to be additionally précised. Thus the capital ownership is totally changed but the control on decision-making is preserved.

***2. Personal taxation***

Legal Framework	Law on Personal Income Tax (LPIT), published, SG No. 118/1997, last amended SG No. 111 / 1999
Taxable Base	The worldwide income of the Bulgarian residents; The income with source in Bulgaria of the non-residents.
Taxpayers	Bulgarian residents, including: <ul style="list-style-type: none"> <li>• Persons with permanent domicile in the country;</li> <li>• Persons residing for more than 183 days in the country in any 365 days period.</li> </ul>

	Non-residents with income with source in Bulgaria.
Tax Rates	A progressive tax rate structure with 40 % top personal income tax rate.

***Advantages.***

The personal income tax rate is reduced. It is expected that the top personal income tax rate will be reduced to 38 %, as of January 1, 2001.

***Disadvantages***

1. Income from sales or exchange of Bulgarian shares, bonds or other securities traded at a stock exchange abroad. It is not clear the tax liable persons shall be defined in this case with reference with taxation of income of foreign persons with Bulgarian source.

2. The offset of losses incurred to individuals from one kind of activity by means of gains from other sources is not allowed by the LPIT.

***3. Value added tax.***

Legal Framework	Law on Value Added Tax (LVAT), published, SG No. 153/1998, last amended SG No. 78/2000
Taxpayers	All physical and legal persons performing independent economic activities.
Tax Rate	20 %
VAT Registration	Compulsory registration — for persons with a taxable turnover exceeding BGN 75,000 during the preceding 12 months. Voluntary registration - persons with a taxable turnover exceeding BGN 50,000 but not higher than BGN 75,000. Registration of legal persons with equity exceeding USD 1,000,000 — for 3 years they must meet the turnover requirements for voluntary registration.

For the current calendar year.

Tax Credit and Refund	Only the VAT registered persons are entitled to a VAT credit. General refund period - 6 months. Refund period for exporters —45 days
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### ***Advantages.***

1. Establishment of shorter refund period. It is expected that in 2001 the general refund period will be shortened to 4 months.
2. Registration of persons with equity exceeding USD 1,000,000. This opportunity gives a favorable impact for green-field investments.
3. VAT recover for foreign persons. Foreign companies and physical persons may recover the Bulgarian VAT without VAT registration pursuant to the terms and procedures of special regulations.

### ***Disadvantages***

1. Long refund period. Even the 4-month period is considered as a long one. Establishment of a just interest for this period in favor of the tax payer is recommended.
2. VAT on the imported long-term assets. Considering the old machinery park of the Bulgarian industry there is a significant need for stimulation of technological equipment import. It is recommended that such an import shall be free from VAT and custom duties.

### ***IV. Customs Regime.***

Generally the Bulgarian Law on Customs follows the provisions of the European legislation.

### ***Advantages***

Reduction of the custom duties. As a result of the application of the free trade agreements between Bulgaria and EU, EFTA, CEFTA, Turkey and Macedonia, the rates for certain goods and especially the industrial goods are significantly reduced, in many cases down to null.

### ***Disadvantages.***

Custom duties for industrial goods imported from third countries. There is a need of reduction of the custom duties for industrial goods imported from all the other countries. The reasons for that are stated in the VAT Taxation section.

### ***V. Some questions concerning projects in the field of infrastructure***

Some large-scale investment projects in the energy sector have started in 1999-2001. During the work on their realization some basic problems had been located.

1. Incomplete legislative framework. The regulations on the application of the Law on Energy and Power Efficiency (LEPE) had to be prepared in terms provided by LEPE. Although the ones directly affecting the projects are already at hand, some of the regulations are still unprepared. This, together with the expected changes in LEPE, makes the investors unsure and causes difficulties in the project planning.
2. Two problems with the international arbitration. The first problem is that pursuant to the Bulgarian Law on International Commercial Arbitration parties who have their domicile or seat in Bulgaria may subject their dispute only to International Domestic Arbitration in Bulgaria. This means that the parties may not choose foreign arbiters,

foreign language of the procedure or a place of arbitration outside Bulgaria. This solution has a negative impact on the attraction of foreign financing to the big infrastructural projects. This is one of the main concerns of the international financial institutions in their decision-making in the field of project financing. The presence of an international arbitration clause in the long-term contracts between the credit recipient and third parties, insures their prompt execution and secures the credit operation.

Secondly, the decision for enforcement of foreign arbitral awards is subject to the general three-instance appeal procedure. This significantly slows down the effective execution of the foreign arbitral awards.

3. Opportunities for the guarantees given by the State. Another issue of great importance for the project finance opportunities is the risk sharing. The balance of the risk in a contract between a state-owned enterprise and a private company often requires negotiation of a stabilization clause. It stipulates the cases where the state covers the risk and will compensate the private company for the losses they may cause. These are the cases of legislative changes with financial consequences for the project. A clear statement of the State on this issue will push forward the performance of the big projects in the field of infrastructure.

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