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GLOBAL TRANSFER PRICING SERVICES

# Global Transfer Pricing Review

Bulgaria

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TAX



# Bulgaria



## KPMG observation

Tax authorities are showing increased interest in the topic and in recent years KPMG in Bulgaria has observed several material tax audit assessments related to transfer pricing.

Bulgarian taxpayers increasingly seek to prepare transfer pricing documentation or localize their group-level master files in order to mitigate the tax risk associated with related party transactions.

The Bulgarian tax authorities currently do not have access to the Amadeus database and their transfer pricing efforts are mainly focused on:

- scrutinizing available transfer pricing documentation
- exploring potential internal comparables
- obtaining comparable data from competitors of the taxpayer.

The preparation of transfer pricing documentation therefore provides the taxpayer with a relatively strong defense for the price levels of its related party transactions.

## Basic information

### Tax authority name

The tax authority in Bulgaria is the National Revenue Agency at the Ministry of Finance. The National Revenue Agency reviews transfer pricing issues in the course of ordinary tax audits.

### Citation for transfer pricing rules

The transfer pricing legislation in Bulgaria is contained in:

- Article 15 of the Corporate Income Tax Act
- Article 27, paragraph 3 of the VAT Act
- Article 116 of the Tax and Social Security Procedure Code (TSSPC)
- Ordinance N-9 of 14.08.2006 on the application of transfer pricing methods.

Under the rules set out in the legislation, if related parties perform transactions at prices different from market levels, the taxable base may be adjusted to market prices. This applies for corporate income tax, withholding tax and, in limited cases,

for VAT purposes. As a result of these adjustments, an additional 10 percent corporate income tax or withholding tax and in certain cases, a negative VAT effect of 20 percent may apply.

Further, the difference between related party transaction prices and market levels may be classified as hidden distribution of profits. In such cases, a 20 percent administrative penalty and 5 percent withholding tax may be applied.

Taxpayers have the burden to prove to the authorities that their transactions are performed under market conditions. If they are unable to do so, the tax authorities are allowed to establish an appropriate market price and adjust the taxable base to it.

In 2010 a transfer pricing Manual was published by the tax authorities, containing guidance on transfer pricing issues. The Manual is generally based on the 2009 Organisation for Economic Co-operation and Development (OECD) Guidelines and the European Union (EU) Transfer Pricing Code of Conduct.

### Effective date of transfer pricing rules

Detailed transfer pricing rules were first introduced through Ordinance N-9 of 14 August 2006.

### What is the relationship threshold for transfer pricing rules to apply between parties?

The Tax and Social Security Procedure Code (TSSPC) sets a threshold of direct ownership of five percent of the capital of a company. Other criteria for related parties also apply, including common directors, ability to exercise control, etc.

### What is the statute of limitations on assessment of transfer pricing adjustments?

The general statute of limitations for tax liabilities is 5 years from 1 January of the year following the year when the tax was payable (i.e. when the corporate tax return was filed). For example, the statute of limitations for corporate income tax due for 2009 expires at the end of 2015.

## Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be prepared or submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Tax liable persons are required to report transactions with related parties and with entities established in jurisdictions with a preferential tax regime executed during the year in a special appendix to their annual corporate income tax return.

What types of transfer pricing information must be disclosed?

The tax liable persons should report the value of the transactions with related parties and entities established in jurisdictions with a preferential tax regime executed in the year for which the corporate income tax return is submitted, regardless of the type, form and time of conclusion of the contract, or whether payment related to the transactions has been made/received during the year. Specific rules apply for the reporting of the provision/receipt of loans.

What are the consequences of failure to prepare or submit disclosures?

Administrative sanction in the amount of EUR 50-500 for first breach and in the amount of EUR 100-1,000 for a second breach.

## Transfer pricing study overview

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

No. However, general tax consequences may arise due to lack of transfer pricing documentation.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

By preparing transfer pricing documentation, taxpayers may mitigate the risk of additional tax and

administrative penalty liabilities, which in the worst case scenario can amount to 57 percent of the value of the transaction.

If taxpayers provide transfer pricing documentation, the tax authorities tend to review its conclusions and accept them if no inconsistencies are found. If no documentation is available or if major inconsistencies are found, the authorities are allowed to assess the transfer prices under their own analysis.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

The transfer pricing Manual recommends preparing transfer pricing documentation for a given fiscal year by the date of submitting the corporate tax return. However, there is no statutory deadline for preparation of documentation.

When a transfer pricing study is prepared, should its content follow Chapter V of the OECD Guidelines?

Generally yes, although Bulgaria is not an OECD member and the OECD Guidelines are not mandatory for taxpayers and the tax authorities. However, the tax authorities usually accept the principles outlined in the OECD Guidelines.

The transfer pricing Manual of the tax authorities also refers to the EU Transfer Pricing Code of Conduct as a source for the content of transfer pricing documentation.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

## Transfer pricing methods

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes.

Is there a priority among the acceptable methods?

There is a priority among the methods in the following order:

- Comparable uncontrolled price (CUP) method
- Resale Price and Cost Plus methods
- Transactional net margin method (TNMM) and Profit Split method.

If there is no priority of methods, is there a “best method” rule?

Not applicable.

## Transfer pricing audit and penalties

When the tax authority requests a taxpayer’s transfer pricing documentation, how long does the taxpayer have to submit its documentation?

Usually, the tax authorities submit a request for provision of documents and the taxpayer has 14 or 15 days to comply. However, this deadline may be extended or the tax audit procedure may be suspended for up to three months.

If the taxpayer does not submit the documentation within the required deadline, the tax authorities may assume that no documentation is available and may perform a transfer pricing analysis of their own.

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

The decision of the tax authorities may be appealed at the administrative level (before a regional appeal directorate) and subsequently at the judiciary level (before a court).

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

An administrative penalty of 20 percent may be applied where an expense charged by a related party is deemed to be hidden distribution of profits.

### To what extent are transfer pricing penalties enforced?

The extent of enforcement cannot be monitored in detail as tax proceedings are not public until the court appeal phase. Nevertheless, in recent years KPMG in Bulgaria have observed a significant increase in the number and materiality of transfer pricing issues being identified by tax authorities.

### What defences are available with respect to penalties?

The established way of substantiating related party transactions is by the preparation of a local transfer pricing file covering the Bulgarian market.

In a limited number of cases, transfer prices may be defended by building up arguments based on pricing policies, cost allocation methodologies, market analyses etc. However, such an approach highly depends on the specific circumstances of the case and its success may not be guaranteed.

### What trends are being observed currently?

As noted, there is an increasing interest in transfer pricing issues by both taxpayers and the tax administration. It has been noted in transactions involving goods that the authorities generally seek price adjustments but in services transactions they tend to focus on the actual provision of the services.

## Special considerations

### Are secret comparables used by tax authorities?

Tax authorities have indicated in informal discussions that they may use secret comparables. However, the feasibility of this approach is not yet certain.

### Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes, the authorities require a benchmarking study to start the initial search from the Bulgarian market.

### Do tax authorities have requirements or preferences regarding databases for comparables?

No. However, Amadeus is generally accepted.

### What level of interaction do tax authorities have with customs authorities?

Moderate, however, currently increasing.

### Are management fees deductible?

Yes, subject to proper documentation and benefit for the recipient.

### Are management fees subject to withholding?

Yes, subject to tax treaty provisions.

### Are year-end transfer pricing adjustments permitted?

Yes, subject to substantiation with documents, budgets and a transfer pricing study.

### Other unique attributes?

None.

## Other recent developments

Tax authorities have recently issued rulings with guidance on the transfer pricing aspects of:

- cash pooling schemes
- selling goods at prices under market levels under certain conditions.

## Tax treaty/double tax resolution

### What is the extent of the double tax treaty network?

Extensive. About 70 tax treaties are in force.

### If extensive, is the competent authority effective in obtaining double tax relief?

With respect to the usual application of tax treaties – frequently.

With respect to mutual agreement procedures (MAPs), only a limited number of MAPs have been initiated so far and they are not yet complete.

### When may a taxpayer submit an adjustment to competent authority?

Not applicable.

### May a taxpayer go to competent authority before paying tax?

There are no formal rules. A taxpayer may submit a request for guidance from the tax authorities on specific issues.

However, receiving an answer from the tax authorities does not guarantee consistent treatment of the issues in future.

## Advance pricing agreements

### What Advance Pricing Agreement (APA) options are available, if any?

No APAs or advance rulings of any kind.

### Is there a filing fee for APAs?

Not applicable.

### Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Not applicable.

### Please provide some information on how successful the APA program is and whether there are any known difficulties?

Not applicable.

## Language

### In which language or languages can documentation be filed?

Based on the TSSPC, all documentation must be submitted to the tax authorities in Bulgarian. If submitted in another language, the authorities may translate it at the expense of the taxpayer.

### KPMG in Bulgaria

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