

# BULGARIA

## INTERNATIONAL INVESTMENT FRAMEWORK

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### **Introduction**

This paper provides an introduction to the legal framework for investment in Bulgaria. It outlines the fundamental principles of the legal environment and the major institutions of law that govern the various fields of investment activity, repatriation of funds and taxation. The paper first addresses the institutional and regulatory framework for doing business in the country and then discusses the applicable institutions of taxation. The legal framework discussed herein reflects the Bulgarian legislation as of February 20, 2006.

### **Constitutional Principles**

There are two constitutional principles that directly impact the legal environment for international investments in and out of Bulgaria and guarantee that investors are treated in a non-discriminatory way: the principle of equal treatment of foreign and local investors and the principle of priority of international treaties over domestic legislation.

Under the principle of equal treatment of foreign and local investors, foreign investors may perform economic activity in the country under the same conditions that apply to Bulgarian investors unless the law explicitly provides otherwise. The second principle is the precedence of international treaties over domestic legislation pursuant to which if an international treaty to which Bulgaria is a party sets out a more favorable regime for foreign investments than local legislation, the former takes precedence to guarantee the investors a more favorable treatment.

Effective as of the date of entry into force of the *EU Accession Treaty of Bulgaria*, foreign individuals and legal entities may acquire land in Bulgaria under the conditions resulting from the accession of Bulgaria to the European Union or under the terms of international treaties entered into effect for Bulgaria, as well as through succession. Investors that would like to commence a business venture based on or involving resources, which are in the State's domain, must follow the procedures of the institution of concessions, applicable also in respect of certain industries where the law could provide for a government monopoly.

### **Private and Regulatory Framework for Foreign Investment**

#### *Domestic Law*

#### (i) Types of Investment

#### (a) Equity

Foreign individuals or legal entities are free to invest in equity of Bulgarian companies. The types of companies recognized by law are joint-stock companies, companies limited by shares, limited liability companies, limited partnerships and general partnerships. There are no restrictions as to the foreign participation in the capital of a Bulgarian company and no prior authorizations are required for making, transforming or liquidating

an equity investment. In certain cases, acquisitions of shares in insurance companies, banks and investment intermediaries by both foreign and local persons are subject to prior approval by competent authorities.

(b) Real Estate

Direct foreign ownership of real estate is provided for in a diversified manner. Currently and until the entry into force of the *EU Accession Treaty of Bulgaria*, the Constitution precludes foreign persons from owning land. However, foreign persons may become the owners of buildings without owning the land on which a building is constructed. Foreign persons may also acquire the "right to use" land or buildings, which is similar to a leasehold, for a limited term or as long as the "user" exists as an individual or entity. Such a leasehold, however, is non-transferable and does not entitle its beneficiary to develop the property. A foreign person may also acquire the right to develop land and thus become the owner of buildings constructed in exercising its right, without receiving title to the underlying land. The right to develop land and the ownership right over a building constructed by exercising the right to develop is transferable.

Even though currently foreign persons are not entitled to own land, this restriction does not apply with respect to legal entities registered in Bulgaria the capital of which is owned by foreign persons. A foreign person may become the sole, majority or minority owner of a locally registered company and such a company is not in any way restricted in acquiring and transferring title to land or buildings or rights to use or develop real estate. Thus, no permissions are needed for a local company the stock of which is owned by foreigners in order for it to engage in real estate transactions.

(c) Securities

Bulgarian law allows securities to be purchased by local or foreign investors on an equal footing through investment intermediaries or investment companies. In addition to equity securities, the market in Bulgaria also offers corporate debt securities and government debt and compensatory instruments of a broad variety. A special right attached to a number of government securities is the option for their holder to use them as a payment instrument in the privatization, which allows for the achievement of substantial discounts. However, under the *Law on Investments Encouragement* a debt security, which at the time of the investment has a residual period to maturity of less than six months is not recognized as a foreign investment for the purposes of repatriation of proceeds.

(d) Intellectual Property Rights

Bulgaria is the member state to a number of international treaties and conventions governing intellectual property, including the *Bern Convention for the Protection of the Literary and Artistic Works*, *Hague Agreement Concerning the International Deposit of Industrial Designs*, *Lisbon Agreement for the Protection of Appellations of Origin and their International Registration*, the series of *Classification Treaties*, *Madrid Agreement Concerning the International Registration of Marks* and the Protocol thereto, as well as other treaties, administered by WIPO, with the exception of the *Trademark Law Treaty*. After becoming member of the WTO on December 1, 1996, Bulgaria has become a party to the *TRIPS Agreement*.

National legislation in the area of intellectual property protection is modern and provides protection to a broad range of intellectual property rights. Trademark protection could be granted by registration of a sign, comprising of letters or digits, all types of drawings, figures, the shape of the article or its packaging, a combination of colors, and even sound signals, as well as a combination of said elements. Collective and certification marks and geographical indications could also be filed for registration.

Protection of works of literature, including science and technical literature, periodicals and computer programs, musical works, scenic works, films and other audio-visual works, works of drawing, including works of applied art, design and folklore artistic handicrafts, etc. is guaranteed by a modern *Law on Copyright and Neighboring Rights*.

Further, Bulgaria is the member of the *Patent Cooperation Treaty*, as well as a party to the *European Patent Convention*. Objects of protection under the Bulgarian *Patent Law* are inventions and utility models. Protection of objects like industrial designs, new plant varieties, animal breeds and topographies of integrated circuits, is governed by separate laws.

(e) Lending and Financial Leasing

The law does not prohibit lending and leasing to local borrowers on an offshore basis. In line with the Bulgarian *Currency Law*, financial lending is subject to notification before the Bulgarian National Bank (the “BNB”) whereas commercial lending for import/export and financial leasing are subject to declaring before the respective customs authorities.

(f) Securitization

Foreign investors enjoy the same access to securitization vehicles, as do local investors. Debt may be secured with a mortgage on real estate granted by the debtor or a third party. A mortgage is created by way of executing a notarial deed between the mortgagor and the mortgagee and recording the mortgage in the relevant real estate registry. A mortgage authorizes the mortgagee to cause the judicial sale of mortgaged property and provides the mortgagee with priority on the proceeds, after claims for judicial expenses and taxes on the mortgaged property. In a bankruptcy setting, a mortgage ensures a first priority on the proceeds, even before bankruptcy expenses. The creation of a mortgage is subject to fees proportional to the value of the secured debt.

A creditor may decide to secure its debt with a pledge (security interest) on personal movable property or account receivables. Under Bulgarian law there are three types of pledge: (i) possessory pledge, (ii) commercial possessory pledge and (iii) registered pledge. A possessory pledge is a security interest in movable goods or transferable accounts receivable created by a pledge agreement and delivery of the goods or of the documents evidencing the accounts receivable to the secured creditor. A commercial possessory pledge is a security interest in movable goods or securities created by a pledge agreement and delivery of the pledged goods or securities to the secured creditor. A registered pledge is a security interest in movable goods or other items of personal assets specified by law, created for the purpose of securing performance of duty or payment of debt, while possession of the collateral remains with the pledgor. Registered pledge may be created in respect of the following: (i) accounts receivable, dematerialized securities and movables except for ships and aircrafts; (ii) shares of equity of general partnerships, limited partnerships, partnerships limited by shares and limited liability companies; (iii) a

floating pool of account receivables, of machines and equipment, of goods or materials, or of dematerialized securities; (iv) industrial property rights; and (v) commercial enterprise as a going concern. In the event of a registered pledge, the debtor need not transfer possession of the pledged assets to the creditor or to a third party. Registered pledges are registered in the Central Pledges Registry to the Ministry of Justice. The registration establishes the priority of the security interests in the same pledged property. A pledgee enjoys the same priorities on proceeds as does a mortgagee. A registered pledge is made especially attractive by the possibility for non-judicial foreclosure by way of sale of the pledged property directly by the secured creditor. The creation of a registered pledge is uncostly: a flat fee of BGN<sup>1</sup> 40 for the first page and BGN 10 per each additional page is payable upon registration.

(g) Concessions

A “concession” is the constitutionally defined legal means whereby the state or municipality, while retaining its responsibility for the public interest, grants rights to a private party to utilize public property and resources and to engage in public services, which are otherwise exclusively reserved for the state or the municipalities.

A concession on behalf of the State is granted by the Council of Ministers for a term not to exceed 35 years, or a total 50 years pursuant to an extension. The Constitution exhaustively lists property and resources, which may be owned only by the state and the utilization of which by a private entity may therefore be permitted only by way of concession granted by the State. Such property includes underground resources, seashore beaches, the national road network, waters, forests and parks of national importance, and natural and archaeological reserves. The possible objects of state concession are further specified in the *Law on Concessions* to include biological, mineral and energy resources of the continental shelf and the exclusive economic zone, as regards exploration, development, extraction and utilization thereof, national railway roads, ports of national importance used for public transportation and civil airports for public use, waters, inclusive of mineral waters, which are in the exclusive domain of the State, irrigation and water-supply facilities and systems, provided they are in the exclusive domain of the State.

A concession may be granted also for the exercise of activities such as the use of nuclear energy, manufacture of arms, explosives and strong biologically active substances.

A concession on behalf of a municipality is granted by the municipal council for a term not to exceed 35 years, or 50 years by way of extension. The objects of municipal concessions are defined by law.

A public National Concession Registry is created and maintained by the Council of Ministers in which information on all granted concessions is entered.

As of February 1, 2006 a *Concessions Bill* is waiting to be passed by the Bulgarian Parliament. The Concessions Bill aims to render the legal regime of concessions in

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<sup>1</sup> BGN exchange rate is bound by the rules imposed by the Currency Board, which was established in Bulgaria in July 1997. The Currency Board is the currency exchange rate management facility operated by the Bulgarian National Bank under which the Bulgarian Lev (BGN) is maintained at a fixed exchange rate of 1.95583 to the Euro (i.e. EUR 1 = BGN 1.95583).

compliance with the principles of the *Treaty Establishing the European Community* and the requirements of *Directive 2004/18/EC of the European Parliament and the Council of 31 March 2004 on the Coordination of Procedures for the Award of Public Work Contracts, Public Supply Contracts and Public Service Contracts*. The *Concession Bill* further aims at introducing the principles of transparency, free and fair competition and equal treatment of all participants in the procedures for granting concessions, as well as a uniform regime for granting concessions by the state and by municipalities.

(ii) Regulatory Framework

(a) Banking

Banking is one of the economic sectors where the principle of freedom of the market is combined with strict regulatory procedures. Banking activities may be conducted only by a bank registered in Bulgaria or by a Bulgarian branch of a foreign bank. The law treats local and foreign ownership of banks on an equal footing. Companies founded in Bulgaria have to be joint stock companies or subsidiaries of foreign registered banks in order to register as banks. A banking license is granted by the BNB following a detailed procedure set out by law.

Minority ownership in the equity of banks of up to 3% is not subject to an approval by the BNB. Ownership in excess of 10% of the equity may be acquired by one person with the approval of the BNB. Any purchase of such portion of stock absent a prior approval is null and void. The acquisition of shares on the stock exchange or other organized security market is subject to a subsequent permit and the purchaser is not entitled to exercise the voting rights to such shares until the issuance of such permit. Shareholders acquiring 10% or more of the voting stock in a local bank as a result of an increase of the capital by an additional contribution or a conversion of debentures into shares also have to obtain a permit from the BNB. Banks may only issue registered shares. Contributions for subscribed shares must be made within six months of registration. Shares for which there are outstanding contributions are subject to cancellation.

Local banks may issue debentures and other debt securities denominated in local or foreign currency. The level of exposure of banks is proportional to their own capital. Investments which a bank is allowed to make in real estate and other long-term tangible assets, together with equity participation in other non-bank companies is restricted up to the amount of its own capital, exclusive of such asset or equity acquired as a result of sale of lien items. A bank can operate as an investment intermediary on the regulated securities market.

Bank insolvency is governed by specific legislation, which was adopted in September 2002. The *Law on Bank Insolvency* differentiates the insolvency procedure of a banking institution from that of other commercial companies. Strict control is introduced over the activity of the receiver on the part of the Fund for Guarantee of the Bank Deposits (the "Fund"). The Fund represents a separate legal entity whose members are appointed by the Council of Ministers, the Bulgarian National Bank and a representative organization of the commercial banks in the country. The National Court of Auditors exercises control over the Fund in financial matters. By decision of the Fund, bankruptcy procedure may be terminated through the sale of the bank's going concern to another bank licensed to operate in the country. A joint-stock company specifically incorporated for the purposes of acquiring a bank's going concern may apply for a conditional license and start its

activity after execution of the transaction. In that case the transferee is held liable only for obligations assumed under the terms and conditions of the transaction, as approved by court. Any other claims or rights are considered lapsed. Satisfaction of creditors' claims is an obligation of the transferee, to be completed within a month's term.

(b) Insurance

The insurance industry is regulated in a fashion similar to banking. Insurance activities may be conducted only by an insurer, whereas an insurer may be (i) a Bulgarian joint stock company registered under the *Law on Commerce* and licensed under the terms and conditions of the *Insurance Code*, or (ii) a co-operative registered under the *Law on Co-operatives* and licensed under the terms and conditions of the *Insurance Code*, or (iii) as of the date of Bulgaria's accession to the European Union (the "EU"), an insurer having its registered seat in a member state of the EU or the European Economic Area (the "EEA") under the terms and conditions of the freedom of establishment or freedom of services. Further, an insurer from a third state, i.e. a state different from Bulgaria and the EU and EEA member states, may also perform insurance activities in Bulgaria through a branch registered under the *Law on Commerce* and licensed under the terms and conditions of the *Insurance Code*. A re-insurer may be a Bulgarian joint stock company licensed under the terms and conditions of the *Insurance Code* or a person licensed to perform active re-insurance pursuant to the legislation of its registered seat.

Licenses for insurance and/or reinsurance activity are granted by the Financial Supervision Commission ("FSC"), a specialized state body in charge for the regulation and supervision over the activity of, among others, insurers and insurance intermediaries, pursuant to a detailed procedure and upon submission of documents set out in the *Insurance Code*. The FSC is to rule on the application within four months as of submission thereof.

As mentioned above, as of the date of Bulgaria's accession to the EU, insurers having their registered seat in a EU or EEA member state may carry out the respective licensed insurance activity on the Bulgarian market under the freedom of establishment or freedom of services, after the FSC has been duly notified pursuant to a procedure set out in the *Insurance Code*.

The law treats local and foreign ownership of insurance companies on an equal footing. Insurance companies may issue only registered shares. A single person may acquire ownership equal to or in excess of 10%, 20 %, 33 % or 50 % of the equity of an insurance company only upon a prior notification to the FSC. In the event the acquisition is effectuated on a stock exchange or other regulated market, the notification shall be filed after execution of the transaction. Within a period of three months as of the notification the FSC is entitled to prohibit the referred acquisition if it establishes that the proposed acquirer threatens the stability of the insurance company or the interests of the insured or does not comply with the requirements set forth in the *Insurance Code* and the regulations on its implementation. The decrease in the equity percentage below the thresholds listed above is subject to prior notification to the FSC, while reorganization of insurance companies is subject to prior permission of the FSC. Insurance companies are prohibited from reorganizing by changing the form of their legal structure or by changing their subject matter of activity. Supplementary supervision is provided for with respect to insurers participating in an insurance group and it is aimed at monitoring and securing the financial solvency thereof. Foreign arbitral awards are easy to enforce, for their

recognition in Bulgaria is governed by the *New York Convention on the Recognition of Arbitral Awards*. That makes recognition quick, standardized and certain, should there not exist any of the few grounds for refusal defined in said Convention. A recognized foreign arbitral award is enforced in the same manner as a Bulgarian court decision or arbitral award.

(d) Foreclosure

Foreclosure in Bulgaria, as a general rule, is performed through the court system. Foreclosure is open to any creditor who has obtained a writ of execution based on a final Bulgarian court decision, a Bulgarian arbitral award, or a recognized foreign arbitral award or court decision. In addition, secured creditors may commence foreclosure after obtaining a writ of execution just based on their mortgage or pledge agreement, or based on a notarized contract providing for specific monetary obligations. Commercial paper, such as cheques, promissory notes or bills of exchange, is also the basis for issuance of a writ of execution and may be collected on by way of immediate foreclosure. Regardless of what entitled a creditor to commence foreclosure, it, like any court process in Bulgaria, is slow and may turn out to be inefficient. Foreclosure costs a lot in judicial fees and might easily just fade away after years of useless effort.

Where a creditor has secured its debt by way of a registered pledge, such a creditor has accomplished a lot towards collection of its owed amounts. Upon default, a creditor is entitled to obtain possession of the pledged property and sell it in a commercially reasonable manner. Where the debtor would not surrender collateral, the creditor is entitled to assistance by the court enforcement officers, which would forcefully take possession and turn it over to the secured creditor. Thus, creditors might avoid a lot of costs for judicial fees and certainly are not held hostage to anyone's unwillingness or inability to act.

(iv) Foreign-Investor-Specific Rights

(a) Domestic Law Concept of Foreign Investment

Bulgarian law is liberal in defining foreign investment. Under the law a foreign investment is any investment by a foreign person in: (i) equity in commercial companies; (ii) ownership of buildings or any other limited rights in real estate; (iii) ownership of tangible personal property held as long term assets; (iv) ownership of self-standing units of commercial companies with more than 50% state or municipal participation in the capital; (v) ownership of securities, including debt securities with a residual period to maturity exceeding six months and equity securities, or derivatives thereof; (vi) a loan extended to a local person for a term not less than twelve months; (vii) intellectual property rights; (viii) rights under concession contracts; and (ix) rights under management contracts. However, there are still certain objects of foreign investment that are defined by the law in a more restricted way. For example, ownership of debt securities with less than six months to maturity or a loan for a term of less than twelve months are not recognized as foreign investment. As a matter of fact, the bilateral treaties to which Bulgaria is a party, broaden the domestic-law-given definition of a foreign investment.

(b) Registration



Foreign investment is not subject to any special registration requirements, other than the national statistics reporting requirements, which would apply to Bulgarian investors as well.

(c) Specific Rules for Investments Encouragement

The major purpose of the *Law on Investments Encouragement* is to provide the legislative framework for improving the administrative and information services provided to investors and to set forth specific measures for fostering investment. The measures are differentiated according to the class of investment, which is being determined according to the amount of the investment.

The *Law on Investments Encouragement* sets forth the obligations of the Bulgarian Investment Agency<sup>2</sup> (the "BIA") to provide information and assistance to investors in the process of implementing their investment projects and after the investment has been made, as well as to issue certificates on the class of investment thereof. These obligations of the BIA are set out in general terms, while the specific terms under which the BIA provides services to investors are detailed in the *Rules on the Implementation of the Law on Investments Encouragement*.

The *Law on Investments Encouragement* boosts investments for the acquisition of long-term assets for the purposes of introduction of new or extension or modernization of existing production of goods and/or services that establish new job positions, whereunder the term for the investment realization is up to three years.

*Bilateral Treaties to which Bulgaria is a Party*

Bulgaria has entered into Mutual Promotion and Protection of Investment Treaties with more than fifty countries.

A comparative analysis, based on bilateral agreements for the mutual promotion and protection of investments, which Bulgaria has entered into, shows that the definition of an "investment" in such agreements is broad enough and basically covers the concept of investment in its entirety. There is hardly anything which would be considered as an "investment" and which would not qualify as an "investment" under these agreements. Under these agreements, "investments" and returns thereon may be repatriated freely after payment of taxes. In this respect, we consider that any Agreement is likely to supersede the requirement set forth in the *Law on Investments Encouragement*, whereunder debt instruments with maturity of less than six months, and credits for less than twelve months are not recognized as a "foreign investment". Also, it is very common for these agreements to include a "most favored nation" clause.

The said treaties contain also provisions on (i) fair procedures for expropriation of the objects of investment; and (ii) repatriation rights.

(v) Regulatory Framework for Outgoing Investment and Currency Control Issues

The *Currency Law* took effect on January 1, 2000 and was most recently amended in December 2005. In addition to achieving full currency control liberalization of the investment regime in Bulgaria, including repatriation of investment, the *Currency Law*

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<sup>2</sup> Former name of the authority - Foreign Investment Agency.

establishes a friendly regulatory framework for the investment abroad by domestic entities. The *Currency Law* also made possible the stipulation and the payment in foreign currency between companies registered and/or operating in Bulgaria.

The *Currency Law* lifted all currency control restrictions with respect to the investment in equity, real estate, securities, intellectual property and concessions. These forms of investment are made subject only to the legislation, which is specific to the particular field.

The *Currency Law* liberalized the outflow of investment from Bulgaria abroad. Thus, any transaction related to initial direct investments by domestic persons abroad as well as debt financing between foreign and domestic persons are made subject to a notification before the BNB within fifteen days as of their execution for statistical purposes only. In cases of commercial loans for import/export or financial leases between domestic and foreign persons, a sample declaration form should be submitted with the respective customs authorities. Finally, the *Currency Law* lifted the restrictions in the extraction, processing and trade in valuables, precious stones and metals. However, persons that conduct such activities on a lasting basis are under the obligation to register in the Ministry of Finance before commencing such an activity.

Thus, the new currency control framework enabled Bulgarian companies, including subsidiaries and branches of foreign companies, to export capital abroad and invest in other jurisdictions. This may particularly be useful in the process of establishing operations in the region through Bulgarian subsidiaries.

(vi) Regulatory Framework for E-Commerce

As of October 2001 a new *Law on Electronic Document and Digital Signature* took effect in Bulgaria. After the Czech Republic, Bulgaria is the second country from the Central and Eastern European region regulating electronic documents and digital signatures, thus creating a basis for development of electronic commerce in the country. The law defines as digital signature any information, related to an electronic statement, in a form, coordinated between the author and the addressee and secure enough for the needs of the turnover, which discloses the identity of the author, confirms his or her consent to the electronic statement and protects the content of the statement from later changes. Under the law, a digital signature should not be valid for certain documents of legal significance, such as securities, bills of lading, or for documents and transactions requiring a qualified written form, such as the notary deed. The law also provides for a certification procedure to be applied to the providers of the services.

(vii) Regulatory Framework for Residence of Foreigners in the Republic of Bulgaria

Under the Bulgarian *Law on Foreigners* any foreigner may legally enter and reside in Bulgaria on grounds of a validly issued visa, unless a visa is not required by virtue of an international treaty between Bulgaria and the respective foreigner's country of citizenship, or an act of the Council of Ministers of Bulgaria, establishing a non-visa regime.

Citizens of certain countries listed in a regulation under the *Law on Foreigners*, may enter into Bulgaria without a visa. Thus, citizens of these countries do not need a visa for a

period of stay of up to 90 days within each period of 6 months as of the date of their first entry into Bulgaria, where there is a reciprocity regime between Bulgaria and the respective foreigner's country of citizenship, and for a period of stay of up to 30 days within each period of 6 months as of the date of the first entry into Bulgaria, where there is no such reciprocity regime. The countries, which Bulgaria has reciprocity regime with under the *Shengen Agreement*, include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain and Sweden.

However, if a foreigner intends to stay in Bulgaria for more than 90 days, or 30 days respectively, within each period of 6 months, the foreigner has to (i) obtain a long-term residence visa issued by the Consular Offices of the Republic of Bulgaria abroad, and (ii) after entering into Bulgaria on grounds of such a visa, obtain a long-term (up to one year) residence permit from the competent local authorities for administrative control over foreigners, a division to the Bulgarian Ministry of Internal Affairs.

Long-term residence visa and subsequently, a long-term residence permit, may be issued to foreigners on specific grounds enumerated in the *Law on Foreigners*. These grounds include, among others, the cases where:

- a foreigner wishes to work under a labor agreement, after they have been issued a work permit by the competent Bulgarian authorities;
- a foreigner carries out commercial activity in Bulgaria in accordance with the law, where as a result of such activity at least 10 working places have been opened for Bulgarian citizens (the requirement for opening at least 10 working places for Bulgarian citizens does not apply in respect of foreigners who are citizens of the EU member countries or other countries - members of the EEA). In practice, this provision has been interpreted to include foreigners who manage and represent a Bulgarian commercial company;
- a foreigner is a representative of a foreign commercial company, registered with the Bulgarian Chamber of Commerce and Industry;
- a foreigner performs activity under the Bulgarian *Law on Investments Encouragement*; and
- a foreigner is a member of the family of a foreigner, who has already obtained a long-term residence permit.

## **Taxation**

### *Domestic Law*

#### (i) Taxation of Direct Economic Activity

The profit of direct economic activity of local entities or foreign entities acting through a Bulgarian branch or a permanent establishment in Bulgaria is currently taxed at the rate of 15%.

Although the *Law on Corporate Income Taxation* does not provide for any tax breaks or tax holidays, it introduces certain tax incentives in the form of tax deferral applicable under specific conditions compliant with the statutory regulations on state aid for regional development. There is one possibility for investors to enjoy a preferable profit tax status if investing in establishment of economic activities in regions with high unemployment rate, exceeding by 50% the national average rate for the preceding year. The tax preference is a reduction of the due corporate tax on profits at the amount of 10% of the value of certain long-term tangible and non-tangible assets acquired for the purposes of the initial investment. Furthermore, 25% of the funding for such assets should be provided by the investor and these should remain its property within the next five years. The amount of the tax reduction is accounted as reserves and is deductible from the due corporate tax for the following 5 tax years. Another tax incentive allows for a deferral of 100% of the tax on profits, addressed to tax obligors engaged in manufacturing activities, inclusive with materials supplied by the customer. The business operations of the tax obligor should be carried out in a region with unemployment rate, which exceeds by 50% the national average rate for the preceding year and the tax obligor should have no outstanding public liabilities. Again the tax deferral should be accounted as reserves and it should be applied only if the respective amounts are invested for the acquisition of long-term tangible and non-tangible assets needed for the manufacturing activities within three years thereafter.

Losses may be carried forward for a 5-year period.

#### (ii) Taxation of Incomes from "Passive" Investment

As a general rule of Bulgarian law, dividend income is not included in the tax base of an entity for profit tax purposes. Such income is taxed on the level of the payer of the income, by withholding 7% of the dividend income distributed to shareholders out of taxed profits. The withholding taxation of dividends applies both to the income of foreign and certain local recipients of such income, which are not merchants.

While all other "passive" income of local entities is included in their tax base for profit tax purposes, the law treats foreign persons' income differently. Incomes from rent, interest (including interest calculated in financial lease installments), fees for technical services, operating leasing rentals, franchising and factoring fees, yields from the sale of fixed or financial assets (save for capital gains from sale of stock in a public company on the regulated Bulgarian securities market), royalties from licenses to use intellectual property rights, compensations under management agreements and compensations realized in the capacity of members of management and supervising bodies of Bulgarian legal entities are taxed at the rate of 15%. Taxation occurs on the level of the payer of income who is under obligation to withhold 15% of the income and pay withheld amounts to the government.

Generally, the foreign recipient of income is under no technical obligation to comply or make payment of taxes, except when the payer of income is not a tax obligor. Only in that case the foreign recipient becomes tax liable person with respect to withholding said tax. Furthermore, the failure by the payer of income to withhold and pay withheld tax results in joint liability of both payer and recipient for the payment of amounts owed to the government.

As of January 1, 2005 an exemption from withholding taxation on dividends paid by local companies to residents of EU member states exists, provided that the foreign recipient: (i) does not qualify as a tax resident of a third non-member state pursuant to the provisions of an applicable Double Tax Treaty; (ii) is liable for corporate or similar profit tax under its domestic law without any choice or relief options; (iii) is the beneficial owner of the respective income and holds at least 20% of the equity of local company payer, and (iv) as of accrual of the dividend income the recipient has held such qualifying equity participation for a minimum of one year. Furthermore, a limited category of interest income is also relieved from withholding taxation comprising (i) interest paid on bonds accepted for trade on a regulated security market in the country or in a EU member state, and (ii) interest paid under a loan extended by the issuer of such bonds, if a EU member state resident that is fully-owned by a Bulgarian sole shareholder and the bonds have been issued for the purpose of financing the granting of the loan to the Bulgarian sole shareholder.

(iii) Value Added Tax (VAT)

There are two tax rates of VAT in Bulgaria, namely 20% for the general category of taxable transactions and 0% for export transactions or transactions subject to VAT relief under international agreements. VAT-taxable are all transactions for title transfer of goods or services, except for a limited category of exempt transactions, as provided for by law.

VAT may be charged only by entities that have registered for VAT purposes. VAT is also charged upon import, by the customs authorities, on the value of imported goods, whereas such value has been increased with owed customs duties and fees. However, in some cases a special VAT accrual method may apply. Upon import, instead of the customs authorities, a VAT-registered person may accrue VAT, provided it has obtained a permission to apply the special VAT accrual method issued by the Minister of Finances, and it imports special goods enumerated in a list approved by the Minister of Finances. In order for a person to be entitled to apply the special VAT accrual method, it has to meet the following requirements: (i) have realized an investment project approved by the Minister of Finances, with a duration of the project of up to two years, amount of the investments in excess of BGN 10 million for a period not to exceed two years and leading to the opening of more than 50 new working positions; (ii) be registered for VAT purposes; (iii) has no liquidated due and payable tax obligations and obligations towards the mandatory social and health security; (iv) has obtained a permission issued by the Minister of Finances; and (v) the conditions for granting state aid for regional development are existing. Upon application of the special VAT accrual method, the importer is entitled to clear the imported goods without effective payment, or securitization of payment, of the VAT due, and is entitled to a VAT credit.

Business entities have the obligation to register for VAT purposes upon reaching the statutory registration threshold of BGN 50 000 turnover from taxable transactions (exclusive export) accumulated for a period of 12 consecutive months. Exception from the latter statutory requirements is applied with respect to foreign entities which are not based or established in any form in Bulgaria and have no site or other establishment in the country but render to VAT registered local recipients a range of specified services with place of performance in Bulgaria, such as transfer of title or granting intellectual property rights; advertising; consultancy; telecommunication services; data processing; financial, insurance, reinsurance or social security services; providing personal and intermediary

services as commissionaire. Export-oriented business entities have the option for voluntary VAT registration on the grounds of turnover including export transactions (taxable at 0% VAT) of BGN 25 000, accumulated for a period of 12 consecutive months. Regardless of the taxable turnover, a local entity is also entitled to register for VAT purposes for a period of 3 years on the grounds of registered and fully paid in capital of the company of at least BGN 500 000. A foreign entity without any permanent establishment in the country (such as: a representative office, a branch, an office, a shop, construction site, quarry, etc.) but performing taxable transactions is entitled to register through a special authorized representative if the general VAT registration requirements are met unless subject to exception from registration described hereinabove.

All VAT registered persons have the obligation to open a VAT account, which is a specific bank account, opened with the approval of and maintained under the supervision of tax authorities. It is to be credited and debited with VAT amounts only and could not be used for payment of any other tax liabilities. It is obligatory for use whenever the recipient of goods or services is a VAT registered person and the VAT due under the transaction exceeds BGN 1,000.

Only VAT registered persons are entitled to a tax refund for VAT paid on goods or services received or imported. Refundable tax is initially subject to set-off against outstanding public obligations of tax payer and then undergoes a three-month deduction procedure. Following expiry of such three-month period any remainder of refundable tax, after examination for another set-off, is payable within 45 days, unless the person declares in writing that it shall deduct the refundable tax from due tax during the following up to nine consecutive monthly tax periods. Export-orientated companies favor a shorter refund period of 30 days, if their exporting transactions exceed 30% of total turnover for the preceding 12-month period. A 45 days refund period applies when such companies have paid at least 80% of the due tax subject to tax credit through VAT account. In cases when special VAT accrual method is granted thereto the refund period is reduced at 10 days.

VAT paid on assets acquired or accounted as part of the capital before the date of registration may be claimed for refund by VAT registered persons provided these assets are available and described in the registration inventory at the time of registration. This privilege may be exercised in any subsequent tax period after VAT registration.

The deregistration obligation occurs if the total taxable turnover of the registered person for the last 18 months goes under the threshold of BGN 25 000.

#### *Bilateral Treaties on the Avoidance of Double Taxation of Income and Property to which Bulgaria is a Party*

Bulgaria has entered into Bilateral Treaties on the Avoidance of Double Taxation of Income and Property with more than fifty countries.

##### (i) Taxation of Direct Economic Activity

All treaties provide that the profits from direct economic activity realized through a place of business or a branch in the other country shall be taxable only in the country where the foreign company would have its place of business. Therefore, if a foreign entity would be

taxed in Bulgaria on the profits of its local permanent establishment, such profits would not be taxable in the country of origin of the investment.

(ii) Taxation of Incomes from "Passive" Investment

A comparative analysis of the relevant bilateral treaties shows that such treaties introduce rates of withholding tax no higher than 15%, for the income from a number of sources, such as: dividends; interest, meaning any income generated by debt; royalties and yields, meaning income from certain property transfers.

Some treaties entitle an investor to a tax credit in its country of origin, for any taxes paid in Bulgaria on certain income, against taxes due on said income in the country of origin.

(c) Securities Trading

A third sector of relatively high degree of regulation is securities trading. Securities trading as a dealer or broker may only be carried out by licensed investment intermediaries. Investment intermediary capacity may be acquired by a Bulgarian joint stock company or limited liability company. A foreign legal entity when authorized to perform securities trading activities under its domestic legislation is allowed to act as an investment intermediary in Bulgaria by establishing a local branch in the country. A license for investment intermediary activities is granted by the FSC by following the detailed procedures provided for in the legislation. Minority ownership in the equity of investment intermediaries not exceeding 10 % is not subject to disclosure. Investment intermediaries may only issue registered shares. The law treats local and foreign ownership of investment intermediaries on an equal footing.

Investment intermediary activities may be carried out by Bulgarian banks or Bulgarian branches of foreign banks, provided that the banking license issued by the BNB includes the activities of securities trading.

(iii) Enforcement of Rights

(a) The Judicial Process

Under Bulgarian law civil claims are subject to a three instance civil process. The first instance courts (regional courts and in some instances, district courts) rule on the substance of the dispute submitted before them. The judgments of the first instance courts are subject to appeal before the second instance courts, as the judgments of the regional courts are subject to appeal before the district courts and the judgments of the district courts as first instance courts are subject to appeal before the appellate courts. The second instance court may confirm the judgment of the first instance court, or revoke it in part or entirely, as in the latter case, the second instance court shall rule on the substance of the dispute at hand. The judgments, with few exceptions, of the second instance courts are subject to appeal before the Supreme Cassation Court. The Supreme Cassation Court may confirm the judgment of the second instance court, or revoke it in part or entirely, as in the latter case, the Supreme Cassation Court shall deliver the case back to the second instance court to be examined and decided on the substance of the dispute by another panel of the same court.

The judicial process in Bulgaria, as of these days, is slow and inefficient. Obtaining a final court judgment in Bulgaria may take from several months to several years. If a foreign person would decide, or have to, submit its dispute to the jurisdiction of the local courts, such a litigating foreign person will enjoy the same rights and protections in court, as would do a local party to the procedure. Though, for some types of claims there is a “quick procedure” available. This procedure is specific with its short, mandatory for the courts terms and is available for example for claims for declaring of a preliminary agreement final, claims for breached intellectual property right, claims arising out of lease agreements in real estates, possessory claims and some others.

(b) Arbitration

Bulgarian law recognizes the rights of any two parties to enter into an arbitration agreement, thereby excluding the jurisdiction of Bulgarian state courts and submitting their potential dispute for resolution by an institutional or ad hoc court of arbitration. However, disputes involving rights in real estate, labor contract rights or allowance are not arbitrable. In general, disputes over rights, which are not pecuniary rights, such as disputes over internal corporate governance matters, are not arbitrable either.

Any two parties may submit their dispute for resolution to an arbitration court with a place of arbitration in Bulgaria. Where one of the parties has its seat or place of residence abroad, the arbitration agreement may provide for arbitration with a place outside Bulgaria.

(c) Recognition and Enforcement of Court Decisions and Arbitral Awards

A final Bulgarian court decision is directly enforceable without any need for recognition. The courts would issue a writ of execution based on any such final court decision. It is the writ of execution that unlocks the judicial foreclosure process to a prevailing litigant.

Where a party has been able to produce a final foreign court decision, it must go through the process of recognition of same decision by the authority before which the decision is submitted. Where such party seeks admission for enforcement of a final foreign court decision, it must apply for such admission before the Sofia City Court.

Recognition, respectively admission for enforcement, is allowed where a number of requirements set forth in the *Code on International Private Law* are met, namely (i) the foreign court or other authority has been competent to resolve the case pursuant to the applicable provisions of Bulgarian law, except where such foreign competence under pecuniary disputes is based solely on the grounds that the plaintiff is citizen of, or is registered in, the state of the respective court; (ii) a copy of the statement of claim has been served to the defendant, the parties have been duly summoned and the basic principles of Bulgarian law related to the defence of the parties have not been violated; (iii) there is no judgment entered into force issued by a Bulgarian court resolving the same dispute between the same parties; (iv) there is no pending legal proceedings before a Bulgarian court, initiated prior to the foreign proceedings, ended with the decision to be recognized/enforced, regarding the same dispute between the same parties; and (v) the recognition, respectively the admission for enforcement, of the foreign court decision does not contravene the Bulgarian public policy, the latter term being understood to refer only to the most general, fundamental principles and ideas of the Bulgarian *ordre public*.



In proceedings for admission for enforcement, the Sofia City Court shall not review the merits of the dispute. The defendant may only raise objections that subsequent facts have terminated the defendant's obligation, as the defendant may raise such objections only prior to the decision of the Sofia City Court allowing for admission for enforcement has entered into force. Once a foreign court decision is admitted for enforcement, it shall be subject to enforcement pursuant to the general rules of Bulgarian law. The procedure shall include the issuance of a writ of execution by the executive judge in case the respondent fails to perform voluntarily.

A Bulgarian arbitral award may be appealed only on special grounds provided for in the *Law on International Commercial Arbitration*, while the award is subject to immediate enforcement. The courts would issue a writ of execution just based on the fact that there is an arbitration agreement based on which a court of arbitration has issued an arbitral award.