

The New Economic and Financial Relations with Companies
Registered in Preferential Tax Regime Jurisdictions, the Persons
Related to Them and Their Beneficial Owners Act

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At the end of 2013, the new Economic and Financial Relations with Companies Registered in Preferential Tax Regime Jurisdictions, the Persons Related to Them and Their Beneficial Owners Act (hereinafter referred to as “the Act”) was adopted and became better known to the general public as “the Offshore Companies Act”. The law was promulgated in The Official Gazette, No. 1 of 3 January 2014 and entered into force on 1 January 2014.

The objectives of the new Act are to prevent companies registered in preferential tax regime jurisdictions, the persons related to them and their beneficial owners from absorbing public funds and from managing financial resources in contravention to public interests, and to combat tax avoidance.

The definitions of the terms “a company registered in a preferential tax regime jurisdiction” and “a person related to it” are set out in the Additional Provisions of the Act. The protection against the use of companies registered in preferential tax regime jurisdictions is reinforced by the rule that a person from a preferential tax regime jurisdiction means also any local or foreign legal person controlled by a company registered in a preferential tax regime jurisdiction. In practical terms, this will allow the safeguard clauses concerning the existence of a transaction between related persons to cover transactions within the country, as well as transactions with persons from countries, including EU Member States, which apply in practice preferential tax arrangements (exemption of income from foreign sources from taxation) but have registered their beneficial owners in full-fledged preferential tax regime jurisdictions due to the obligations to exchange information on the ownership. In this sense, such companies might be excluded from the market because any third party trading with them could face the risk of being exposed to tax regulation on grounds of conduct of transactions with related persons.

The Act bans the direct or indirect participation of companies registered in preferential tax regime jurisdictions and of persons related to them in licensing procedures for credit institutions, insurance activities, pension funds or health insurance funds, or in the provision of services or activities under the Financial Instruments Markets Act (investment

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intermediaries) or payment institutions, or in concession competitive procedures; public procurement tenders are restricted for consortia involving offshore companies; the acquisition of state-owned or municipal properties, gaming, mobile operators, broadcasting operators and others are also restricted. Companies registered in offshore territories are not allowed to establish or participate in an entity which is a publisher of periodicals, in public private partnerships, sociological survey agencies, auditors and independent appraisers and projects with renewable energy sources.

The statutory restrictions do not apply to companies in which a company registered in a preferential tax regime jurisdiction has direct or indirect interest and which publish periodicals but have disclosed the details of the beneficial owners who are natural persons.

Furthermore, the ban does not apply to offshore companies which belong to an economic group, where the parent company or a subsidiary is a Bulgarian company whose owners (natural persons) are known or it is listed on a regulated market in a EU Member State or another country party to the European Economic Area Agreement.

Another exemption from the restrictions applicable to offshore companies is the case, where the shares of the company in which a company registered in a preferential tax regime jurisdiction has direct or indirect interest are traded on a regulated market in an EU Member State or another country party to the European Economic Area Agreement.

The offshore company restrictions do not apply to a company registered in a preferential tax regime jurisdiction, which belongs to an economic group whose parent company is a local taxable person in a country with which the Republic of Bulgaria has an agreement on the avoidance of double taxation or an information exchange agreement.

The new Act envisages penalties for invoking the exemption provisions outlined above on the grounds of false data such as:

In the cases, where an offshore company or the persons related to it have obtained a license and/or a permit pursuant to the provisions of Article 3 of the Act and it is established that the company has provided false documents/information, the license and/or the permit will be revoked;

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Where it is established that a concession bidder has presented false documents and the company is registered in an offshore territory, the bidder is removed from the concession procedure or the tender for prospecting and exploration of mineral resources. Besides, the concession contract is cancelled or the permit is revoked if the winner turns out to be an offshore company;

Public procurement procedures follow the same rules. In such cases, the public procurement contract is cancelled forthwith, the deposit is not refunded, works performed are not paid, whereas payments already received are subject to recovery together with the statutory interest.

The circumstances which provide grounds for exemption from restrictions are to be entered into the Companies Register.

Companies registered in preferential tax regime jurisdictions are often used in tax avoidance schemes. Tax avoidance is possible also through transactions with local natural and legal persons or transactions with persons who are not established in preferential tax regime jurisdictions.

The combat against tax avoidance should target all transactions, both fictitious transactions hiding other covert transactions and real transactions in which tax avoidance is sought on the basis of prices rather than actual or fictitious performance.

Companies registered in preferential tax regime jurisdictions are used to move the income generated in fictitious transactions or non-market priced transactions towards tax-free or low-tax jurisdictions.

The Transitional and Final Provisions of the Act have introduced amendments to the Code of Tax and Social Security Procedure so that to improve the existing tax legislation and to ensure more efficient fight against aggressive international tax planning and tax avoidance schemes. The amendments create conditions for the existing covert profit distribution mechanism and the related penalties to apply also to transactions with companies registered in preferential tax regime jurisdictions.

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The issue is that, generally, preferential tax regime jurisdictions (offshore territories) are particularly difficult for the identification of relationships between the beneficial owners of the capital of local persons and the companies in these jurisdictions. The rule is that the combat against tax avoidance coupled with covert distribution of profits is expressed in refusal to reduce the tax base of the local legal person and the taxation of the dividend of the other participant in the tax avoidance, i.e. the company registered in a preferential tax regime jurisdiction.

Insofar as the taxation of the local legal person will be protected pursuant to the provisions of Article 116 of the Code of Tax and Social Security Procedure based on the presumption that the local person and the company registered in a preferential tax regime jurisdiction are related persons, the complete application of the safeguard arrangements in a universal and taxation-neutral way requires the introduction of a presumption of a relationship between the beneficial owners of the capital of the local person and the company registered in the preferential tax regime jurisdiction. This approach will enable the unhindered application of the mechanism of taxation of the covert distribution of profits to the other party to the relationship which leads to tax avoidance and, at the same time, its universal application to all cases of tax avoidance and the preservation and upholding of tax neutrality.

The persons subject to the bans under Article 3 of the Act have the obligation to adjust their activities to the requirements of the law within six months of its entry into force, i.e. before the 31 June 2014.