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# Global Tax Alert

News from Transfer Pricing

## Bulgaria adopts mandatory transfer pricing documentation

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### Executive summary

On 13 August 2019, supplementations to the Bulgarian Tax and Social Insurance Procedure Code (the Code) were promulgated in the *Bulgarian State Gazette*. The Code provides that the transfer pricing (TP) of transactions between related parties that occur as from 1 January 2020 must be analyzed and documented by 31 March of the following year. In the case of non-compliance with the new mandatory TP requirement and/or lack of TP documentation, a penalty of up to 0.5% of the volume of the related-party transactions required to be documented, could be imposed.

The legislative changes adopted introduce several requirements, such as a detailed review of the respective industry and local competitors, in-depth analysis of the functions performed, assets employed, and risks assumed by the local taxpayer and its counterparties, and reconciliation to actual financial reporting, among others.

### Detailed discussion

#### **When should the TP documentation be available?**

Under the Code, the local TP file needs to be prepared by 31 March of the year following the year of the transaction and must be presented to the tax authorities upon request during tax reviews and audits.

Members of multinational enterprises (which have an obligation to prepare a local file) should also have available the group's master file. The master file needs to be issued no later than 12 months following the deadline for the local file.

While the master file and the local file need to be updated each year, the Code allows that applicable benchmarks are updated every three years. Additionally, the financial data and the respective transaction data, which serve as a basis for comparison of the transactions under review, would need to be updated annually.

### Who has the obligation to prepare TP documentation?

Under the new law, the obligation for preparing the local TP file arises when the taxpayer is subject to corporate income tax and is engaged in cross-border related-party transactions. No mandatory TP documentation is required if the taxpayer meets the following criteria:

- (i) Had assets with a balance sheet value not exceeding **BGN38m** (approximately €19m) at the end of the previous financial year, and
- (ii) Had annual net revenue not exceeding **BGN76m** (approximately €39m) for the previous financial year, or
- (iii) Has personnel of less than **250 people** for the reporting period

Only material related-party transactions should be analyzed and documented in the TP file. For controlled transactions in goods, the materiality threshold is set at **BGN400k** (approximately €205k) and for all other intragroup transactions (such as services/intangibles) - at **BGN200k** (i.e., approximately €102k). For loans, the obligation for documenting will arise when the loan principal granted or received exceeds **BGN1m** (i.e., approximately €511k) or a total financial and interest income/expense above **BGN50k** (approximately €26k) has been accrued.

### What if a taxpayer does not have TP documentation?

Under the Code, a fine of up to 0.5% of the volume of the related-party transactions that should have been documented could be imposed in the case of non-compliance and/or lack of TP documentation. The sanction for lack of a master file ranges from BGN5k to BGN0k.

Failure to present the TP file may also lead to other negative tax consequences. For example, in the case of a disagreement by the tax authorities regarding the results of the TP analysis,

lack of proper documentation may result in an adjustment of the taxable profit and reclassification of expenses as a hidden profit distribution, thus, triggering significant additional tax liabilities.

### What is the impact for taxpayers outside the scope of the mandatory TP documentation?

As discussed above, the requirement to prepare mandatory TP documentation is only introduced to certain related-party transactions of a category of enterprises. However, this does not eliminate the obligation of all taxpayers - regardless of their size, or the value and the territorial scope of their controlled transactions - to ensure that their financial, economic and commercial relations with the other members of their group comply with the arm's-length principle. All transactions between related parties may be subject to tax control and, therefore, taxpayers bear the burden to prove to the tax authorities that the conditions, under which they are carried out, do not differ from those between independent parties.

In other words, the relief for companies below the thresholds set in the Code, is limited to:

- ▶ Eliminating the risk of sanctions, if they do not possess TP documentation, which corresponds to all requirements as set by the Code.
- ▶ Allowing a more flexible approach in the analysis of the arm's-length nature of transactions and the selected format (e.g., they may not comply with the requirement of an annual documentation update or meet the deadline set for large companies).

It is important to note that during the last few years, TP has become one of the priority topics of the Bulgarian tax administration. Essentially, this legislative change is a natural extension of the mandatory Country-by-Country reporting of large groups, which was introduced two years ago. The focus now, however, is entirely local. Instead of providing information on how the group distributes its profits and resources worldwide, the local file must prove specifically that the profits in Bulgaria are correctly determined, to the extent related-party transactions are concerned.

Regarding the Bulgarian National Revenue Agency strategy, there is a consistent policy for the development of administrative capacity in the TP field, as well as a focus on the TP practices and profitability of local taxpayers during tax reviews and audits.

For additional information with respect to this Alert, please contact the following:

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