Tax Newsletter

A new tax treaty between Bulgaria and the Netherlands will start to apply as of 1 January 2022

On 31 July 2021 **a new tax treaty between Bulgaria and the Netherlands** entered into force. The new tax treaty introduces several important changes, which will start to apply as of **1 January 2022.**

The new tax treaty may require: **the tax treatment applied so far to transactions with Dutch tax residents to be re-assessed** and **new advance clearance certificates from the Bulgarian tax authorities to be obtained for existing contracts with continuing performance** (e.g., interest, royalties and technical services/consulting fees).

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Below you may find a summary of the most important changes:

New rules for permanent establishments ("PEs")

- The threshold under which **building sites/construction projects** are considered PEs is extended to **12 months** (instead of 9 months under the old tax treaty).

- **New rules for offshore activities** are prescribed: such activities in maritime areas under Bulgarian jurisdiction or over which Bulgaria has sovereign rights may trigger a PE if exceeding 30 days in any 12-month period;

- Special provisions to prevent the avoidance of creation of a PE by **artificially splitting activities between closely related entities** are also introduced under the new tax treaty.

Taxation of dividends

- Under the new tax treaty Bulgaria and the Netherlands may impose **withholding tax on dividends at maximum rate of 15%** (unless domestic exemptions/reduced rates apply).

- **Withholding tax exemption is envisaged for (except in cases of hidden distribution of profits)**:
  (i) dividends to **pension funds**; or
  (ii) if a **company** that beneficially owns the dividend directly holds **at least 10% of the shares** of the dividend payer for a period of **at least 365 days** (i.e., one year).

- Under the new tax treaty **liquidation proceeds are explicitly equated to dividends.**

Taxation of interest and royalties

- **The new tax treaty repeals the full exemption of interest and royalties from withholding tax.** Bulgaria and the Netherlands can now impose withholding tax **of up to 5%** (unless domestic exemptions/reduced rates apply).
- For interest income**, full exemption is envisaged in certain cases only**, e.g., loans granted by banks or insurance companies; interest paid in connection with the sale on credit of industrial, commercial or scientific ("ICS") equipment, and interest paid in connection with the sale on credit of merchandise between two companies, etc.
- **The royalty definition under the new tax treaty is narrowed** and it excludes payments for the use or the right to use ICS equipment, i.e., such payment will no longer trigger withholding tax.

Taxation of capital gains

- Capital gains from the disposal of shares of a Bulgarian company deriving at least 75% of their value from immovable property **may attract 10% Bulgarian withholding tax** with certain exceptions.

Method for the elimination of double taxation

- **Bulgaria will now apply the tax credit method instead of the tax exemption method for elimination of double taxation.** This may require evidence for the tax paid in the Netherlands to be collected. The tax exemption method will be applied in limited cases only.

Stricker anti-avoidance measures

- The new tax treaty implements the **principal purpose test ("PPT")** test which should be met to benefit from the treaty relief. Treaty benefits may be refused if **one of the principal purposes of the arrangement is to achieve tax benefit**.
- The new tax treaty now contains **rules dealing with mutual assistance in the collection of taxes.**

Tax residency status / tax impact on individuals

- As opposed to the old tax treaty, **place of effective management criteria for corporate entities will no longer apply**. Disputes on tax residency of persons other than individuals will be determined by mutual agreement;

- **The additional requirement for Bulgarian nationality for determining the tax residency status of individuals will no longer apply** – the criteria for a tax liable person under the domestic law of the respective contracting state will apply;

- **The basis for applying the 183-days test for employment income is now extended**: the 183-days test will be counted on the basis of **any 12-months period beginning or ending during the respective fiscal year** (instead of counting the 183-days threshold during a given fiscal only);

- **Pensions and other similar remunerations will be taxed at the source state.**

The need of renewal of the advance clearance certificates

Advance clearance certificates for tax treaty relief application obtained under the old tax treaty cannot be relied on for income realized after **1 January 2022**. **New advance clearance procedures before the Bulgarian tax authorities may need to be initiated** (if the new tax treaty envisages favorable tax treatment for the respective type of income).

In case of any doubt whether the taxation of your transactions with Dutch counterparties will be affected under the provisions of new tax treaty, please feel free to reach out to us.

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