



Bulgaria proposes first-ever mandatory transfer pricing documentation requirements

Global Transfer Pricing Alert 2018-035

Bulgaria's Ministry of Finance on 5 November proposed mandatory transfer pricing documentation requirements. The proposed rules are part of the draft changes to the Tax and Social Security Proceedings Code, published on the ministry's website. Public comments on the draft are due on 5 December 2018. If adopted, the law would apply to transactions entered into on or after 1 January 2019.

Current documentation framework

Bulgarian taxpayers currently are subject only to a general obligation to prove the arm's length nature of their transactions with related parties ("controlled transactions") during a tax audit. The rules apply to domestic transactions (those between two Bulgarian companies) and cross-border ones. There is no mandatory term to prepare the transfer pricing documentation before a tax audit.

The content of the documentation is provided in the TP Manual (an administrative rather than legal document) published on the National Revenue Agency's website. The documentation consists of a master file (which provides general information about the taxpayer's group) and a local file with transfer pricing analysis of the taxpayer's controlled transactions.

What's new under the proposal?

Starting from 2019, taxpayers would be obligated to prepare the local transfer pricing file every fiscal year if (i) net sales revenue exceeds BGN 16 million, or (ii) the net book value of assets as of 31 December of the prior year exceeds BGN 8

million. Entities not liable to corporate income tax (CIT) or subject to alternative taxes under the CIT Act would be exempt from this requirement.

The local file would be prepared for transactions exceeding certain annual monetary thresholds (BGN 400,000 for goods, BGN 200,000 for services/intangibles/financial assets, and loan transactions in excess of BGN 2 million in loan principal or BGN 100,000 in interest payments). Documentation of controlled transactions with natural persons (except sole traders) is not mandatory.

Entities that are part of a multinational group would also have to provide a transfer pricing master file for the respective year.

The local file would have to be prepared by 31 March of the following year, whereas the master file would be available by 31 March of the year after the following year. For 2019, the local file should be prepared by 31 March 2020, and the master file available locally by 31 March 2021.

The rules explain also how to update the benchmark studies.

The draft does not include a requirement that taxpayers submit the transfer pricing files to the tax authorities. Transfer pricing documentation (both the local file and the master file) would be kept by the local taxpayer and provided to the revenue authorities upon request.

The proposed documentation requirements include sanctions for noncompliance. The level of the fines would depend on the size of the transactions involved, and whether it is a repeat offense, among other factors.

Comments and next steps

The draft law is a logical consequence of the increased interest in transfer pricing matters and a natural follow-up to Bulgaria's declared willingness to implement the elements of the OECD's BEPS project domestically. Parliament is likely to approve this proposal in the coming months, possibly with some small changes after a review of the public comments.

The proposed documentation requirements would impose an additional administrative burden on taxpayers. However, the new rules have a cost-benefit rationale. Transfer pricing compliance covers material businesses and transactions, reflecting higher potential tax risks. This approach makes sense, keeping in mind the size of the Bulgarian economy and its income tax rates.

Taxpayers can expect higher scrutiny during transfer pricing audits. Preparation of the transfer pricing files will help businesses to manage the risk of transfer pricing adjustments and consequently, reduce the risk of penalty interest and sanctions.

In practice, some situations often lead to transfer pricing adjustments and substantial tax assessments. That is the case when businesses are in a loss-making position or when large amounts of service fees (such as management fees or interest

charges) are charged within a group. Taxpayers in these situations should prioritize the preparation of their transfer pricing files.

The proposed rules follow international standards, and will provide more clarity to Bulgarian taxpayers on the way they prove the conformity of their intercompany pricing with the market levels. The rules can also provide guidance for taxpayers who are not obligated to prepare transfer pricing documentation and/or have controlled transactions below the statutory thresholds.

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