



Bulgaria introduces mandatory transfer pricing documentation rules

Global Transfer Pricing Alert 2019-027

Bulgaria on 13 August introduced mandatory transfer pricing documentation requirements effective 1 January 2020.

The new law, which amends and supplements the Bulgarian Tax and Social Security Procedure Code, was published in Issue 64 of the State Gazette dated 13 August 2019. The legislation also adopts the European Union directive that implements the mutual agreement procedure (MAP) as a mechanism for dispute resolution with regard to international double taxation.

The transfer pricing documentation requirement will enter into force as of 1 January 2020 and will apply to transactions entered into on or after 1 January 2020.

Scope

The new law provides that Bulgarian entities (including nonresidents that have a Bulgarian permanent establishment) must prepare a local file. Taxpayers that as of 31 December of the prior year did not exceed the following thresholds are exempt from the local file obligation:

- BGN 38 million (USD 21.5 million) in asset net book value; and
- BGN 76 million (USD 43 million) in net sales revenue; or

- An average number of 250 personnel for the reporting period.

Entities that are exempt from corporate taxation and those that are subject to alternative taxation under the Corporate Income Tax Act, as well as entities that enter into domestic related-party transactions only are exempt from the obligation to prepare a TP file.

There is no obligation to prepare a local file for controlled transactions with individuals, except for transactions with sole traders.

The local file must be prepared for transactions that exceed the following annual monetary thresholds:

- Sale of goods -- BGN 400,000;
- All other transactions -- BGN 200,000; and
- Loans -- Principal of over BGN 1 million or interest and other revenues and expenses related to the loan of over BGN 50,000.

The listed thresholds are calculated separately for each controlled transaction. An exception is made when two or more transactions with one or more related parties are concluded under comparable conditions. In that case, the thresholds are calculated as the total value of those transactions. The local file should be prepared only for transactions that exceed the thresholds, although the taxpayer may be a party to other controlled transactions. Entities that are obligated to prepare a local file and that are part of multinational entity (MNE) groups also must have a master file for the respective year, prepared by the ultimate parent entity (UPE) or another group entity.

For more information regarding the contents of the local file and master file, see Appendix 1 and Appendix 2 below.

Due dates

The local file must be prepared by 31 March of the following year (the same as the due date for filing the corporate income tax return), whereas the master file must be available by 31 March of the year after that deadline. For example, the local file for 2020 must be prepared by 31 March 2021 (with a possible extension until 30 September 2021 if an amended corporate income tax return is submitted), whereas the master file for 2020 must be available by 31 March 2022.

The local file must be submitted on an annual basis, but if there are no significant changes in the comparability factors, the analysis could be updated once every three years. The financial data for the comparable transactions or entities should be updated annually.

There is no requirement to submit the transfer pricing documentation to the tax authorities. The transfer pricing documentation (both the local file and the master file) should be kept by the taxpayer and provided to the tax authorities upon request.

Penalties

The new law imposes penalties for non-compliance with the requirements for preparation of documentation. A taxpayer that is obligated to prepare a local file and fails to do so may be subject to a penalty of up to 0.5 percent of the total value of the transactions that should have been documented. For loans granted or received, the total value of the transaction is the principal amount of the loans.

An entity that is required to provide a master file and fails to do so may be subject to a penalty between BGN 5,000 and BGN 10,000.

The penalty for providing incorrect or incomplete data in the transfer pricing documentation ranges from BGN 1,500 to BGN 5,000.

The amount of the penalties could be doubled in case of repeated failure to meet the requirements for preparation of transfer pricing documentation.

Comments

Despite the reduced scope of entities that must prepare mandatory transfer pricing documentation, the general requirement for taxpayers to prove the market nature of their transactions with related parties during tax checks and audits remains.

The tax authorities have a license to access Bureau Van Dijk's specialized database -- TP Catalyst -- which allows them to make additional inquiries about comparable transactions or companies, as well as to conduct their own analyses. In this regard, we have observed heightened scrutiny in the review and analysis of transfer prices by the tax authorities during tax checks and audits.

Preparation of transfer pricing documentation will help businesses to manage the risk of adjustments to the tax result and accordingly, reduce the risk of the imposition of penalties, interest, and sanctions.

APPENDIX 1: LOCAL FILE CONTENT

The following information must be included in the local file:

Information about the entity:

- A description (chart) of the management and organizational structure;
- Identification data of the entity's owner/owners;
- Names and position of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices;
- A detailed description of the business and business strategy (including changes from the past year) pursued by the local entity, including an indication whether the

local entity has been involved in or affected by business restructurings or intangible transfers, and an explanation of how these transactions affect the business of the person under Art. 71b, para. 1;

- Key competitors.

Information on the controlled transactions subject to the local file requirement:

- A description of the controlled transactions and the context in which such transactions take place, including their amount;
- An identification of the associated enterprises involved in the transactions and the relationship among them;
- The amount of intragroup payments and receipts for the transactions, broken down by type and tax jurisdiction of the payers and recipient;
- Copies of the intercompany agreements concluded by the local entity;
- A detailed comparability analysis, including the characteristics of the goods, services, financial assets or intangible assets, contractual term, economic conditions, description of the applied business strategies and functional analysis covering the person under Art. 71b, para. 1 and the respective related parties - parties in the controlled transactions, as well as the changes in the comparability factors from previous years;
- A description of the chosen transfer pricing method for determination of the arm's length prices of the controlled transaction/s and the reasons for selecting that method;
- An indication of which related party is selected as the tested party (the party of the controlled transaction, in regard to which the chosen transfer pricing method is applied) and an explanation of the reasons for this selection;
- A summary of the important assumptions made in applying the transfer pricing method;
- An explanation of the reasons for performing a multiyear analysis;
- A list and description of selected comparable uncontrolled transactions (internal and external), if any, and information on relevant prices and/or financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information; the financial indicators are determined in accordance with the chosen transfer pricing method;
- A description of any comparability adjustments performed to achieve better comparability and an indication whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both;

- A description of the basis (allocation key) for allocation in cases of intercompany services and the reasons for choosing that basis (key);
- A description of the factors used to allocate the combined operating profit/loss when applying the profit split method, the reasons for choosing the relevant factors, and the method of determining the relative weight of each factor when more than one factor is used;
- A description of the reasons for concluding that, after applying the selected transfer pricing method, the results from the relevant controlled transactions are in line with Art. 15 of the Corporate Income Tax Act;
- A summary of the financial information (pricing and/or financial indicators) used in applying the transfer pricing method; and
- A copy of any existing unilateral and bilateral/multilateral advance pricing agreements (APAs) and other tax rulings to which the local tax jurisdiction is not a party and that are related to the controlled transactions described above.

Financial information

- Annual local entity financial statements for the fiscal year concerned;
- Information (excerpts and tables) and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements;
- Summary schedules of relevant financial data for comparables used in the analysis and the sources from which the data was obtained.

APPENDIX 2. MASTER FILE CONTENTS

The following information must be included in the master file:

- A description and diagram/chart illustrating the MNE's organizational structure, a list of all related parties in the group, as well as the jurisdictions in which each of them is resident for tax purposes, or, when not a resident of any jurisdiction, the jurisdiction under whose legislation it is created;
- A brief description of the MNE's business(es), including:
 - Important drivers of business profit;
 - A description, chart, or diagram of the supply chain for the group's five largest products, services, and/or intangible assets, offerings by turnover plus any other products and/or services amounting to more than 5 percent of the group consolidated turnover.
- Brief description of the related-party transactions, including:

- Movements of goods, services, and/or intangible assets;
- Movements of invoices;
- Amounts of goods, services, and/or intangible assets.
- Related-party policy, applied within the group, or description of the group's transfer pricing method that proves the arm's length character of the prices of the controlled transactions;
- Brief description of important service arrangements between members of the MNE group, other than contracts for services in the field of research and development. The description must provide information about the capabilities of the main entities that provide these services, and the transfer pricing policies for allocating service costs and determining the prices to be paid for intragroup services;
- A description of the main geographic markets for the group's products and services that are referred to in the second bullet point above;
- A brief functional analysis describing the contributions to value creation by individual entities within the group, that is, key functions performed, important risks assumed, and important assets used, as well as a description of the functional changes, if any, compared to the previous fiscal year;
- A description of important business restructuring transactions, acquisitions, and divestitures occurring during the fiscal year;
- A description of the business strategy, as well as any changes, that occurred compared to the previous taxable year;
- Information regarding intangible assets:
 - A general description of the MNE's overall strategy for the development, ownership, and exploitation of intangibles, including location of principal R&D facilities and location of R&D management;
 - A list of intangibles (patents, IP, know-how, and others) or groups of intangibles that are important for transfer pricing purposes, and which entities legally own them;
 - A list of agreements among identified associated enterprises regarding the provision or transfer of intangibles, including cost contribution arrangements and R&D service agreements;
 - A general description of the group's transfer pricing policies related to R&D and intangibles; and
 - A general description of transactions with intangibles between related parties during the taxable year, including accrued compensation, the related parties participating, the parties' jurisdiction of residence for tax purposes (or for entities that are not resident of

any jurisdiction, the jurisdictions under whose legislations they were created).

- Information related to the group's financial intercompany activities:
 - A general description of how the group is financed, including important financing arrangements with unrelated parties;
 - The identification of related parties that have a central financing function for the group, including the country under whose legislation each of them is a resident for tax purposes, or, when it is not a resident of any jurisdiction, the jurisdiction under whose legislation it is created;
 - A general description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises.
- Group's financial and tax positions:
 - The group's annual consolidated financial statement for the taxable year concerned; and
 - A list and brief description of any existing unilateral APAs and other tax rulings relating to transfer pricing issued to the related parties within the group.

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