Analysis on Tax Justice

Bulgaria

CSOs as equal partners in monitoring public finances

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BALKAN MONITORING PUBLIC FINANCES

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This document has been produced as a part of the project "CSOs as equal partners in the monitoring of public finance", which started beginning of 2016 and is implemented by a consortium of 10 organizations from 7 countries and will last for four years.

The aim of the project is to improve the transparency and accountability of policy and decision making in the area of public finances through strengthening the role and voice of NGOs in monitoring the institutions that operate in the area of public finances. In this way, the project will strengthen CSO knowledge of public finance and IFIs and improve CSO capacities for monitoring. Additionally, it will help advocate for transparency, accountability and effectiveness from public institutions in public finance. Moreover, this project will build know-how in advocating for sustainability, transparency and accountability of public finance and IFIs. This project will also increase networking and cooperation of CSOs on monitoring of public finance at regional and EU level. Lastly, it will increase the understanding of the media and wider public of the challenges in public finance and the impacts of IFIs.

Key project activities are research and monitoring, advocacy, capacity building and transfer of knowledge/practices and networking in the field of the 4 specific topics: public debt, public-private partnerships, tax justice and public infrastructure.

More information about the project can be found on http://wings-of-hope.ba/balkan-monitoring-public-finance/ and on the Facebook Page Balkan Monitoring Public Finances

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CONTENT

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1. PERCEPTION OF TAXES

Justice, including tax justice, is rather an ethical category. In Bulgaria there is no legal definition of 'tax justice'. The only statutory text that refers to justice is contained in **the Constitution** of the Republic of Bulgaria Article 60, paragraph 1: Citizens shall pay taxes and duties established by law, proportionately to their income and property. [1]

[1] Constitution of Republic of Bulgaria http://www.parliament.bg/bg/const

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2. SHORT OUTLINE OF THE TAX SYSTEM

Bulgaria has the lowest direct taxes in the EC: 10% compared to 39.4% average for the highest income groups in the EC. The corporate tax of 10% is lower than that of the 30% average for the EC. However, these low rates for taxes are compensated with the invisible indirect taxes in place, which amount to 55.3% compared to Europe's average of 34.5%.

Since 2008 a 10% tax is applied on **corporate profits** in Bulgaria. A higher income tax of 15% is levied on sole traders. These are the smallest companies, in terms both of turnover and number of employees.

A flat rate 10% tax is also levied on personal income. In addition to the fact that the same burden is applied to all income groups, there is no income tax-exempt threshold for taxes on salaries. Although there is no legal definition of 'tax justice', it is obvious that a 20 euro tax on a 200 euro monthly salary is a considerably more serious burden than a 200 euro tax on a 2 000 euro monthly salary.

Progressive taxation was revoked in 2008, in the absence of any resistance. The reasons for this are the following: On the one hand, the 'reform' was executed instantly, without any debate even among MPs. On the other hand, low-income groups do not have a powerful voice to stand for their interests; besides the minimum wage was raised, so as the decrease in income would not be felt immediately.

Value Added Tax is 20% - the same for all products and services, with the exception of tourist services, where VAT is 9 percent. Bulgaria still refrains from using the practice of differentiation of VAT on essential goods - food, medicine, water, electricity, books, textbooks and so on. Debates were initiated last year, proposing various options for differentiated rates, but so far without success.

Bulgaria is active on the issue of **double taxation:** about 70 international agreements were concluded with different countries in order to prevent repeated taxation.

Tax relief for individuals comes in several types: for disabled persons, donations, young families, voluntary additional insurance.

There are two basic kinds of **tax breaks for companies**: for regional development and for carrying out production activities in municipalities where the unemployment rate is 25% higher than the national average. However, according to report big companies are avoiding tax by incurring pseudo-costs, where funds are transferred to related parties, e.g. fees for consultancy services, loans, trademark payments to

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the parent company.[2] Thus, although they have billions in BGN of turnover, it appears that those companies are running at a loss and therefore they do not pay taxes. Even in the case of registering a minimum profit for one year, under Bulgarian law these companies are entitled to deduct the losses of the previous five years from their final financial result. For example, an oil refining company has a revenue of over BGN 5 billion for 2015, but at end of the year it turns out that it closes with a loss of BGN 122 million.

The proposals for **a global tax system and disclosure of tax and other information by large multinationals** are hardly discussed in Bulgaria. There is not even so much as an official governmental position on those issues, neither from the Ministerial Council, nor from the Ministry of Finance. No public debates are held, except for a few publications in specialized media in the past three years. However, since the outbreak of the scandal about the Panama papers and the letterbox companies in Luxembourg, the problem of tax avoidance is gaining publicity. The only statement from the Ministry of Finance on a related topic was published in a pro-corporate newspaper: in response to a question from journalists, the Ministry replied that the Government did not support the introduction of a minimum income tax rate in the European Union, as this would reduce economic growth and opportunities for development. [3]

An important detail illustrating the heavy protection of low taxation exercised by Bulgarian authorities is the fact that in the autumn of 2015 Bulgaria filed a complaint to the European Commission against Greece. [4] The cause for the complaint was the inclusion of Bulgaria in the list of countries applying a preferential tax regime. One of the arguments against the measures taken by Greece was that there is no practice for EU Member States to label other Member States as having preferential taxes.

2.1. Corporate disclosure

It is worth mentioning that transparency regarding taxes is relatively high in Bulgaria. The Trade Registry provides comprehensive and accessible data about the financial results of companies.

[2] 2017, “Runway Taxes: Who pays taxes in Central and Eastern Europe?”, Za Zemiata, Glopolis, Demnet, Lapas, IGO & Ekvilib Institute, Prague 2017.
[3] States against corporations: the fight over taxation, Capital newspaper, http://www.capital.bg/politika_i_ikonomika/bulgaria/2015/10/06/2622742_durjavite_sreshtu_korporaciite_bitkata_za_danucite/
[4] Presentation of the complaint of the Republic of Bulgaria against the Republic of Greece at the oral hearing before the European Commission. Ministry of Finance http://www.minfin.bg/document/16463:2

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3. TAX DODGING

"In 2015 the top ten companies by revenue in Bulgaria received a net tax credit. In other words as a group, the ten biggest companies in Bulgaria received more from the state in terms of tax rebates and offsets than they put back in." Dimitar Sabev, researcher, 2016

The paradox of companies declaring losses is possible due to the Law for corporate taxation, which defines the negative financial result as a tax loss, which can be transferred until it expires 5 years later (art. 70). The corporate tax laws allow for deduction of former losses from the tax base, and there are many companies in Bulgaria that have declared losses for many years.[5] In this way, the Bulgarian largest business is actually a receiver of taxes. According to the report research conducted in 2016 for the report "Runway Taxes", the top ten companies declared 156 million leva tax credits for 2015. The ten companies with highest turnover for 2015 in Bulgaria paid a combined 44 million leva (€ 22,5 million) in corporate taxes. This is a relatively low contribution to the national budget.

The top ten Bulgarian companies' combined sales amount to **roughly one quarter of the gross domestic product**, and the tax receipts from their business are equal to only 2,3 percent of the corporate taxes collected for 2015. On the top of the list is the Russian oil giant Lukoil, similar to Brikel EAD, a briquette production plant and a thermal power plant.

The big companies are privileged unlike the individuals and small companies, such as compensating VAT. The tax on individual incomes are much higher, and for the 2016 budget, the Ministry of Finances planned 2,8 bln leva (or 1,43 bln euro) income from individuals (in the Law for taxation on private individuals) and only 1,8 bln leva (0,92 bln euro) from corporate tax.

The study investigated the 10th largest companies in Bulgaria, six of which are foreign owned, two are Bulgarian state companies, and two Bulgarian private companies. Seven out of them are in the energy field (production and trade with fuels and energy), two are trade companies, and one large-scale metallurgical complex. Four of these companies have declared losses, and for the last 10 years only in 2007 Lukoil has not declared millions of losses. The accumulated losses are equal to 1,78 bln leva. In 2015, the oil refinery did not pay but received income from corporate tax of 21 million leva.

[5] idem 2

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It is with no doubt that the tax regime in Bulgaria allows for absurd privileges for the biggest corporate players.

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4. PROGRESSIVE TAXATION

In Bulgaria, as in most countries in central and eastern Europe, in the beginning of 21st century advised by the IMF, the flat rate taxation was introduced. The result was a drastic increase of inequality between different social classes and deterioration of the social medium. Some shocking declarations have been made, such as that of the Association of the industrual capital, which stated that the poor should pay higher rate than the richer part of the society. Unfortunately, this happens in practice.

There is no non-taxable minimum for the lowest income groups, neither there is a differentiated base for VAT for socially valuable products, such as basic food, textbooks for kids and medicaments. The Bulgarian tax system, in none of their components, puts forward the people with lower incomes. In the country with lowest GDP per capita and with the highest inequality, this prioritizes the economic elite.

The tax model has been questioned by various groups in society, however a very outspoken neoliberal community of economists stay firmly behind the flat rate tax regime.

In 2016, there was a study undertaken by Market Links, an agency with experience in social research, for the period between 3rd and 11th August 2016 jointly with “Za Zemiata”, showed that 32.8% of the Bulgarians support the progressive taxation, while 22.8% defend the existing system.[6] There is a large group of 28.9% who do not respond. People further supported the statement that for them “tax justice” means “rich pay more, the rest – less” with 47.7% support.

Overall, the majority of people are not in favour of tax avoidance (59.9%).

[6] 2016. *15% of the Bulgarians boycott companies avoiding taxes*. Sabev, D. September 16th 2016. Available at: https://taxdog.wordpress.com/2016/09/16/tax-research/

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CONCLUSIONS AND RECOMMENDATIONS

The analysis prove that a more thorough debate is needed for analyzing and questioning the current tax model. The public debate is often concentrated on more visible taxation, such a consumer and worker's tax, however corporate tax debates are not in the public domain, due to lack of information and focus on corporate tax avoidance in the public domain, as shown in the 2016 study.

Recommendations:

- More just distribution between consumers, businesses and workers;
- Revision of flat rate tax system as opposed to progressive taxation
- Revision of corporate tax and public debates on corporate tax evasion, which include also country by country reporting by the companies.

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REFERENCES

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