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TAX REFORM IN PERSONAL INCOME TAXATION

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FOCUS OF PRESENTATION

- The focus of this presentation is put on personal income taxation in Bulgaria.
- The presentation comprises:
- Personal income taxation until 31st December 2007;
- The tax reform, enforced on 1st January 2008;
- The effect of the tax reform in the field of personal income taxation.

- Until 31st December 2007 Bulgaria applied progressive income taxation in terms of individuals.
- The main characteristics of the repealed tax regime are:
- Progressive scale of taxation;
- Zero-bracket amount;
- Significant number of tax incentives and tax relieves.

Annual taxable income (in BGN)	Tax
0 – 2400	Zero-bracket amount
2400 – 3000	20% on excess over BGN 2400
3000 – 7200	BGN 120 + 22% on excess over BGN 3000
over BGN 7200	BGN 1044 + 24% on excess over BGN 7200

TAX REFORM IN PERSONAL INCOME TAXATION - 2008

- In 2008, Bulgaria introduced a 10% flat tax on personal income, replacing a progressive rate with three income brackets (ranged between 20 and 24 percent with a zero-bracket amount).
- This is the lowest flat tax rate in Europe, along with those in Albania and Macedonia.
- The considerable cut in personal income tax and the removal of the progressive scale were accompanied with the abolition of the non-taxable minimum.
- By this reform a great part of the exisiting tax incentives and tax relieves were repealed.

- Main objectives of the tax reform
- to simplify the tax system;
- to increase the budget revenues by decreasing the share of the shadow economy and improving the tax collection;
- to stimulate foreign direct investment;
- to stimulate the economic development and growth;
- to create new jobs and reduce the unemployment;
- to reduce the administrative burden by decreasing the compliance costs for taxpayers;
- to reduce the administrative costs for revenue administration.

- Flat tax rate of 10% - for all taxpayers and all types of income, except for business income of sole proprietors, for which the tax rate is 15 %.
- The greater tax rate is due to the circumstance that the sole proprietors do not distribute dividends. The tax rate of the dividend tax is 5%.
- In order to achieve equity in the income taxation of sole proprietors and the income from dividends in business companies of partners and shareholders, the proposed tax rate for taxation of sole proprietors is close to the effective tax rate imposed to partners and shareholders.
- Taxable income
- Generally, the taxable income includes monetary income, as well as benefits received in-kind (except non-taxable items and "in-kind social expenses").
- Bulgarian tax residents are taxed on their worldwide income, while non-residents are taxed only on their Bulgarian-sourced income.

- Exempt income
- Certain types of income are exempt from taxation, including capital gains from the disposal of shares on a regulated Bulgarian/EU/EEA market, interest on deposits in EU/EEA based banks or branches of non-EU banks, income from disposal of certain real estate, etc.
- Deductions
- Tax deductions apply in some cases, including:
  - mandatory social security and health insurance contributions;
  - statutory recognised expenses for freelancers, for rental income, etc.;
  - voluntary personal insurance up to certain limits;
  - certain donations and other specific situations (e.g. disabilities)
- One-off tax on certain income

- On the grounds of the source and the type of income, statutory recognised expenses could be grouped in three main groups:
- 1st Group – for taxable income from business activity of individuals. The taxable income is stipulated by decreasing the gained revenue with the business expenses, as herein after:
- 60% - to business income of individuals, registered as tobacco producers or agricultural producers in case of production of unprocessed agricultural products, except for the income gained from production of decorative plants;
- 40% - to business income of individuals in production of processed or unprocessed agricultural products (incl. from sales of produced decorative plants), from forestry farm (incl. wild growing herbs, mushrooms and fruits), from hunting farm and fishing farm;

- 40% - to income from royalties, including income from sales of inventions, scientific, cultural and art products by their authors, and also remuneration of actors for performances;
- 40% - to income from exercising arts and crafts, which are not taxed with lump-sum tax subject under the Local Taxes and Fees Act;
- 25% over income from freelancing or remuneration from extra labour relationships.
- 2nd Group – The taxable income from rental or other provided against consideration movable or immovable property is stipulated by deducting 10% expenses from the gained income.
- 3rd Group - Taxable income from sales or exchange of real estates. The income (the positive difference between the selling price and the price of property acquisition) is decreased by 10% expenses.

OBJECTIVE OF THE STATUTORY RECOGNISED EXPENSES

- The statutory recognised expenses are imposed with the aim of facilitating the taxpayers when accounting the payable by them annual personal income tax.
- The facility comprises that in compliance with the provisions of the Personal Income Tax Act no documents are required from the taxpayers to prove their expenses, and the law recognises, depending on the performed business activities, expenses to some limit.
- On one hand the tax regime leads to decrease in the compliance costs of the taxpayers – no bookkeeping and accounting activities are required and is simplified the tax basis of the tax return and the income taxation.
- On the other hand the tax regime leads to decrease in the expenses of the revenue administration, and no administrative resources are engaged to audit the expenses and the accounting documents to prove the said expenses.

Example 1

- Income from royalties - BGN 5 000
- Statutory recognised expenses 40% - BGN 2 000
- Tax base - BGN 3 000
- Tax rate 10%
- Due tax - BGN 300 (3 000 x 10%)
- Net income - BGN 4 700

Example 2

- Income from rental of real estates – BGN 12 000
- Statutory recognised expenses 10% - BGN 1 200
- Tax base - BGN 10 800
- Tax rate 10%
- Due tax - 1 080 (10 800 x 10%)
- Net income - 10 920

- One-off tax is due on income received by non-resident individuals from:
- dividends and liquidation quotas distributed by a Bulgarian resident company; management and technical services fees; interest, royalties, franchising and factoring fees; income from the use of movable and immovable property; capital gains from disposal of real estate and financial assets.
- One-off tax rates
- 0% for capital gains from disposal of shares on a regulated Bulgarian/ EU/ EEA market by EU/EEA residents;
- 5% for dividends and liquidation quotas (before the tax reform the tax rate was 7%);
- 7% for income from voluntary life insurance received after the termination of the insurance policy (if older than 15 years);
- 10% for all other income (before the tax reform the tax rate was 15%).
- The one-off tax rates may be reduced under an applicable tax treaty.

- Assessment of the amendments in personal income taxation from progressive to proportional taxation, in compliance with the basic principles of the good tax policy – simplicity, efficiency, fair taxation and improved collection
- Simplicity

- The regime of the flat tax is much simpler and easier to use by the taxpayers and control by the revenue administration in comparison with the progressive taxation, which leads to decreasing the costs both to the taxpayers and the revenue administration.
- With the implementation of unified tax rate considerable part of the tax relieves has been repealed, which lead to additional simplification of the tax system and decrease in the compliance costs to the taxpayers.

- Efficiency
  - The regime of the flat tax lead to limiting the options for tax evasion.
  - As all income are levied with one and the same tax rate the taxpayers have no interest of requalifying one type of income into another and to use different schemes for tax planning.
- The carried out tax reform could be assessed with highest estimate.
- In the fiscal year 2008 are reported the first positive results from the performed tax reform – in terms of employment, tax burden, budget revenues, etc.

FIRST RESULTS OF THE TAX REFORM -2008/2007

- Employment
- 2007 - 3 252,6 thousand employed persons (unemployment rate – 6.90%)
- 2008 - 3 360,7 thousand employed persons (unemployment rate – 5.60%)
- Tax burden
- Income BGN 500 (EUR 250)

2007 - 22.70%

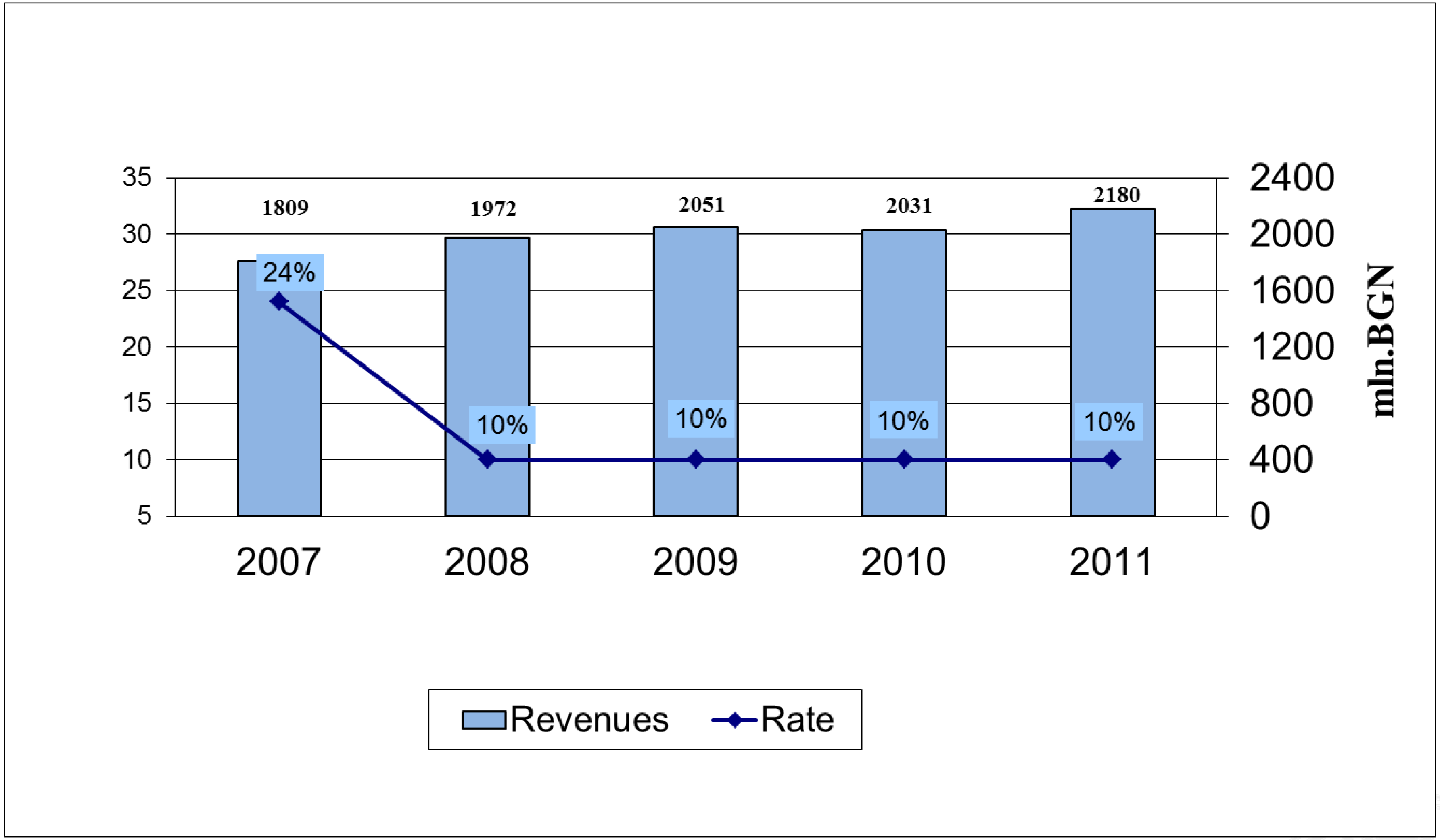
2008 - 21.70%

- Income BGN 800 (EUR 400)

2007 - 26.30%

2008 - 21.70%

- Budget revenues


35
30
25
20
15
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5
2400
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1809
1972
2051
2031
2180
24%
10%
10%
10%
10%
2007
2008
2009
2010
2011
Revenues
Rate

- Budget revenues
- The tax reform in the field of personal income taxation has a positive effect on the budget revenue.
- It should be stated out that notwithstanding the considerable decrease of the tax rate to 10%, during the whole analysed period 2007-2011 increase in the revenue is observed from taxes over the individuals income, except for 2010, when insignificant decrease of 1% is observed.
- In 2008, in comparison with 2007, the increase of the revenue in absolute amount is BGN 163 million or by 9%.
- 2009 – growth 4% in comparison with 2008.
- 2011 – growth 7.3% in comprison with 2010.

- Revenue from personal income taxes as relative share of the tax revenues and the Gross Domestic Product (GDP).

Fiscal year	2007	2008	2009	2010	2011
% of tax revenue	9,40%	8,90%	10,20%	10,70%	10,60%
% of GDP	3,00%	2,90%	3,00%	2,90%	2,90%

- The analysis in the period 2007-2011 shows increase in the relative share of tax revenues from personal income taxes.
- In terms of the GDP in the period under consideration preservation of the relative share of the revenues from personal income taxes is observed.

- Highest relative share in the personal income taxes takes the personal income tax from labour relationships (2007 -77.55%; 2011 -81.15%).
- During the period 2007-2011 an increase is observed in the revenues from personal income taxes from labour relationships and final taxation (one-off tax).

Fiscal year	2007	2008	2009	2010	2011
Personal income taxes	1809	1972	2051	2031	2180
from labour relationships	1403	1557	1688	1694	1769
from business activities as sole proprietors and other business activities	304	305	250	216	274
Lump-sum tax	36	30	21	19	17
One-off tax	66	80	92	102	120

- Personal income tax from labour relationships
- 2008 – growth 10.97% in comparison with 2007;
- 2009 – growth 8.41% in comparison with 2008;
- 2010 – growth 0.30% in comparison with 2009;
- 2011 – growth 4.43% in comparison with 2010;
- Personal income tax from business activities as sole proprietor and from other business activities
- In this category is included the income of the individuals from business activities as sole proprietor, and also income from activities as expert-accountants, auditors, notaries, lawyers, consultants, translators, insurance agents, etc..
- During the analysed period is observed a decrease in the revenues from personal income tax on extra-labour relationships.

- The greatest is the decrease in the period 2009 - 2010, that is during the time of the global financial and economic crisis.
- The decrease is a result of the declared smaller amount of taxable income from business activities as sole proprietors and the tax over this type of income.

- 2009 – decrease 18.03% in comparison with 2008;
- 2010 – decrease 13.60% in comparison with 2009;
- 2011– growth 26.85% in comparison with 2010.

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