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TAX REGIMES IN BULGARIA, CROATIA AND ROMANIA

BULGARIA

The two main categories of taxation in Bulgaria are the direct taxation of individuals and corporations, and the indirect tax forms of the Value Added Tax, and excise duties. Local taxes and charges are also present in the country.

Residents of Bulgaria are liable to pay personal income tax for their world-wide income. Non-residents are liable only for their income derived from Bulgarian sources. The total annual income, after adjustments are made, is taxed in accordance with an annual progressive scale.

Under the Corporate Income Tax Act (CITA) all companies and partnerships (including non-incorporated partnerships) are liable to corporate income tax. The corporate income tax rate is 15 percent. Bulgarian resident entities are taxed on a world-wide basis. Other entities are taxed on their Bulgarian-source income. Non-business organisations (including governmental) are taxed for their business activities. Although branches are not legal persons, branches of non-resident companies have separate balance sheet and profit ant loss accounts. They are subject to corporate income tax at the standard rate of 15 percent. Annual profit must be declared no later than 31 March of the year following the taxable year.

The Value Added Tax is a multi-phased, indirect tax. It is charged on the value of domestic trades in goods and services, as well as on the import of products and services. Exports are taxed at 0 percent. Taxable are all trades executed by a VAT-registered seller (supplier) of goods/services. The VAT rate is 20 percent. A taxpayer under the Law on VAT is any person exercising an independent economic activity. Registration for VAT purposes is either mandatory or voluntary. In case the taxable turnover (excluding exports) of the taxpayer for 12 consecutive months exceeds BGN 50,000 that taxpayer is obliged to register under VAT. In case the taxable turnover including exports exceeds BGN 50,000 for 12 consecutive months, the enterprise may register voluntarily under VAT.

Excise tax is a one-phased indirect tax payable by the producers or importers of certain specified products and services whenever such products or services are sold or imported. The basis of taxation is the sales price or import value of the goods and services. Goods subject to excise tax are beer, wine, alcoholic drinks, tobacco and cigarettes, coffee, fuels and automobiles. Gambling devices and games are services liable to excise tax.

Local taxes are either direct taxes levied on the property of natural or legal persons, or taxes on public services made available to taxpayers. Revenues from local taxes are paid in favour of local (municipal) budgets. Local taxes in Bulgaria are the following: real estate tax, inheritance tax, tax on gifts (donations), tax on the non-gratuitous acquisition of real estate, transport vehicle tax, road tax and local charges.

CROATIA

The Croatian tax system was radically reformed in 1991. Currently the following taxes are applied in Croatia:

- Profit tax (corporation tax)
- Income tax
- Value added tax
- Special taxes on certain products
- Real estate transfer tax
- Gambling tax
- Local taxes

The most recent amendment to the Profit Tax Law came into force on the 1st of January 2005. Profit tax is levied on trading companies and legal persons who pursue activities for the purpose of earning a profit. It is also applied in the case of foreign-owned permanent establishments, which perform their activities in the territory of the Republic of Croatia entirely or partially. Under some conditions it is also levied on natural persons (for example if total profit exceeds HRK 400,000, or if they prefer to pay profit tax instead of income tax and they signal this to the tax authorities. The corporate income tax rate for all taxable persons is 20 percent. The current depreciation rates have been in effect since 30 June 2001. Only linear depreciation is allowed in Croatia. The highest rate of depreciation (25 percent) is provided in the case of intangible assets, and equipment and machinery.

The new Income Tax Law came into force on the 1st of January 2005. Income tax must be paid by every natural (domestic and foreign) person drawing income in the Republic of Croatia. Income tax applies to income from wages and pensions, income from self-employment, income from the leasing of economic rights, insurance payments from retirement savings accounts and life insurance policies, and income from capital assets. Tax exemptions are provided in case of supporting one’s spouse and children and a handicapped family member, and it is deducted from total taxable income. There are four income tax rates in Croatia: 15, 25, 35 and 45 percent.

The reformed version of the Value Added Tax Act came into force on the 1st of November 1999. Value added tax must be paid by every businessperson who delivers taxable goods or renders taxable services. The Croatian VAT system is an all-phase system with deduction of input tax. VAT is applied to supplies of goods and all services rendered domestically by a businessperson for valuable consideration; self-supplies; and imports of goods. There is a tax exemption for a wide range of goods and services, such as renting of rooms for housing purposes, health care services, basic food like bread and milk, books and scientific magazines, specific drugs, services for foreign tourists (if their stay is paid from abroad). VAT is also not levied on the export of processed goods as well as the related transport and all other shipment services, merchandise for duty-free shops, and merchandise and services rendered for consular and diplomatic posts or missions, provided this arrangement is reciprocal. The VAT rate is set at 22 percent in Croatia.

Special taxes are levied on all supplies of petroleum derivatives, and on all imports of these goods, on tobacco products, on beer, on the imports of new vehicles or used cars and other motorized vehicles, as well as on coffee.

The real estate transfer tax amounts to 5 percent, and is must be paid on the sale or exchange of real estate. Private individuals are only required to pay the real estate transfer tax of 5 percent, while companies must pay for buildings that were constructed after the 1st of January 1998 in the following way: real estate tax is payable only on the land, and VAT (22 percent) is payable on the building.

The gambling tax is set at 10 percent and is paid only by natural persons. Games of chance are divided into two categories: classic games of chance which can only be staged and organized by the Croatian lottery company, and special games of chance in casinos are staged and organized by trading companies domiciled in the Republic of Croatia and licensed by the Croatian government on the basis of the outcome of a public tender.

Several types of taxes are levied by local and regional government, cities and government districts (inheritance tax, tax on holiday homes, motor vehicle tax, watercraft tax). Some of these taxes, such as excise on restaurant business, advertising tax, business tax, and extra income tax in cities with over 40,000 inhabitants also have to be paid by foreigners.

ROMANIA

A major reform of the tax system of Romania took place in the beginning of 2005. Besides making tax cuts, it also involved fiscal reform, in which the emphasis was shifted from direct to indirect taxation. The tax regime was simplified.

The earlier progressive income tax (with a minimum rate of 18 percent, and a maximum rate of 40 percent) was replaced by a 16 percent flat rate. The income sources that were affected by the changes in the income tax are independent activities, employee's wages, retirement benefits exceeding 9 million ROL, agricultural activities, awards exceeding 9 million ROL, and other sources. For dividend' income the duty has been raised from 5 to 10 percent.

The taxation of corporations has also been changed. All legal entities doing business in Romania are liable to pay corporate income tax on their taxable profits. Earlier the standard profit tax rate was 25 percent, applicable to both Romanian incorporated companies and to foreign legal persons operating through a "permanent establishment" in Romania. The corporate profit tax rate has now been reduced to a 16 percent flat tax (thus to the same rate as the personal income tax).

The tax on micro-enterprises' income has been raised to 3 percent, and social security contributions have been decreased by 2 percentage points.

All persons who conduct a business activity (production, trade and services) independently, who are independent professionals or sell their property are required to pay value added tax. Imports are also subject to this tax. Below a minimum turnover threshold of ROL 2 billion (approximately EUR 47,600) there is no obligation to pay value added tax. The standard VAT rate is 19 percent, while a reduced rate of 9 percent is applicable to medication, hotels, books, school books, artificial limbs and orthopaedic products.

Other indirect taxes include customs duties, customs surcharge, and excise tax. Except for agricultural and food products, customs duties generally amount to up to 30 percent depending on the type and technical characteristics of the goods. A 2 percent customs surcharge is applied on customs value of imported goods. Exemptions include natural gas, crude oil, electrical power and certain categories of pharmaceutical products. Excise tax applies on imports and production of alcohol, cigarettes, coffee, fuel, cosmetics and perfumes, and some electric home appliances, such as microwave ovens, video cameras, and air conditioners.

The main withholding taxes applied in Romania are on royalties (15 percent), on interest (10 percent), on commissions (15 percent), on revenues from international transport activities (15 percent), and on revenues obtained from technical assistance (15 percent).

THE IMPACTS OF GENERAL ELECTION ON THE ECONOMIC POLICY OF BULGARIA

In Bulgaria, a change of power will continue a 15-year trend in Bulgaria in which no government has been re-elected. The present main opposition party, the Socialists won the general election on 25 June but fell short of winning an outright majority in the parliament. The National Movement, the party of the cumbersome prime minister, Saxe-Coburg has not ruled out cooperation with the Socialists but insists the former monarch must remain the prime minister. Whereas the Socialists are unlikely to accept him as prime minister.

The parliament is to be convened quickly to try to ensure a speedy formation of a government. The mandate goes first to the largest party but if there is no success after a week the baton passes to the second biggest. If there is still no success, the president of the republic may choose any of the remaining parties. If they fail, the president appoints a caretaker cabinet, dissolves parliament and calls a new election in two months.

Despite ushering Bulgaria into NATO and to the EU's accession, visa-free travel, monetary stabilization, crime reduction, as well as achieving high economic growth and reducing unemployment, the outgoing government led by Saxe-Coburg paid the price for his unfulfilled pledge. Since the fall of communism, every government has had to implement painful economic and social reforms. The outgoing government also had to face voter frustration over stringent economic reforms by successive governments, while average salaries have remained low at $255 a month, leaving many Bulgarians struggling to make ends meet. Bulgarians' per capita GDP is 30 per cent of the EU average on purchasing power parity standard.

Bulgaria expects to join the Union on January 1 2007, together with Romania, but this may be postponed for a year if reforms fall behind schedule. A special 'safeguard' clause is implemented in the accession treaty that can postpone accession for a year if progress is lacking in required reforms.

The EU requires that Bulgaria must implement reforms in areas such as deregulation of services, corporate law, agriculture, environment and justice and home affairs. The constitutional changes, aimed at making the judiciary more accountable, require a two-thirds majority in parliament. A prolonged delay in forming a stable coalition government would undermine an already tight timetable for carrying out constitutional changes and other judicial reforms and risk a year's postponement of European Union accession. A European Commission team is to arrive in Sofia in late August to prepare a progress report in November. On the basis of this report the European Council will confirm the date of Bulgaria's accession.

Brussels wants to see fast reforms in Bulgaria to avoid delaying its EU entry for a year - a prospect that would rattle investors betting on the country's euro zone convergence. All major parties have vowed to keep to the EU path and ruled out cooperation with the nationalist Attack party, which ran on an anti-EU and xenophobic ticket and won 8.18 per cent of the vote. Meanwhile there is a growing sentiment in Western Europe against further EU enlargement after the rejection of the 25-member bloc's constitution by French and Dutch voters in the past few weeks has raised the stakes in Bulgaria's EU entry drive.

The outgoing government has to pay the political price for the very painful economic reforms which have to be done to join the NATO and the European Union. The positive achievements include 5.6 percent economic growth in 2004, a record foreign direct investment, single-digit inflation and a drop in unemployment to less than 12 percent from 18 percent in 2001.

Besides the positive outcomes the economic reforms resulted in adverse effects as well. Analysts state that Bulgarians were not hurt so much by the pain of reforms as by the fact that the burden was not shared by all. For example, unemployment in some regions of the country soared to 80-90% and income inequalities has increased substantially. The outgoing government has pledged to pursue European integration and to raise living standards in 800 days. Several advisers of the government contemplate boosting business activity through tax cuts and zero-interest credits. Some economists believe that such program is excessively populist but others are optimistic.

If the cumbersome government could stay in office, what is very unlikely, the main guideline of the economic policy would remain unchanged. Before the elections, the coalition government called on Bulgarians to give them a chance to carry on with their work, saying the remaining 18 months until the country is admitted into the EU are of "decisive importance" and this work should be continued and completed with the same political consistency. More money was, however, promised for welfare purposes, which may undermine the budgetary stability.

During the election campaign, the Socialist Party has promised of a less painful continuation of economic reforms and significant social cushions for the poor and low-paid. Moreover, a Socialist-led government will also make EU membership its priority. The Socialists' declared top priority would be to lead Bulgaria into the European Union in 2007. But to join on time, Bulgaria must carry out EU-required reforms.

In the election manifestos of the parties, one of the main promises was a substantial increase of income of the population. The National Movement, the party of the envisages an average monthly salary in Bulgaria worth BGN 500 (EUR 250) by the end of the next mandate, an unemployment rate cut to 10% coupled with a GDP growth of 8%. The other political parties also came up with similar offers. None of the parties suggests an average monthly salary of less than BGN 500. For the sake of comparison, its current level is half that figure. The Socialist Party would go for a sharp one-time increase of salaries by up to 20% as of January 1, 2006. This idea is core for Coalition for Bulgaria dominated by the BSP. Its election manifesto is entitled, Ten commitments for socially responsible government.

Concerning unemployment, parties sound pretty similar. The Socialist Party intends to introduce special programs for the regions struck by high unemployment. National Movement and Socialist Party will work to providing subsidized employment. A look into all election manifestos reveals a shared intention to cut the tax burden. The Socialist Party will alleviate the tax burden at the expense of taxpayers with very high incomes and expensive properties. The National Movement vows to introduce a flat taxation rate for the incomes of individuals, as well as to cut VAT to 18%.

The election manifestos of both leasing parties abound in other lucrative offers addressed to business and individuals. All political parties looked in the same direction – creating conditions for a bigger economic growth and for considerably improved living standards, simply because the population badly needs such measures. During the election campaign, the political parties did their best, even using populist promises, to capture the support of the voters. Most of them are grossly disenchanted with the hardships of transition, which has continued for 15 long years. The main question is whether the new government will want to carry out these populist promises or count with the realities and its economic policy program will be more moderate and realistic.

WORSENING CURRENT ACCOUNT BALANCE IN ROMANIA

Current account balance deteriorated significantly in the first four months in comparison with the same period of last year in Romania. Between January and April C/A deficit reached EUR 1391 million which means current account deficit increased by 77.2% compared to the first four months of 2004, according to a publication issued by the National Bank of Romania (NBR).

The main reason for the notable worsening of the C/A balance is the gradually increasing foreign trade deficit. While export of goods increased by 18.2% in this period, the growth rate of imports was even higher and reached 22.9%. Thus, foreign trade deficit reached EUR 1.6 billion or increased by almost 50%. The high increase of imports is a consequence of the strong consumption growth and credit expansion which characterizes the Romanian economy. The significant increase (+45.4%) in import of transportation means reflects well the impact of the aforementioned factor.

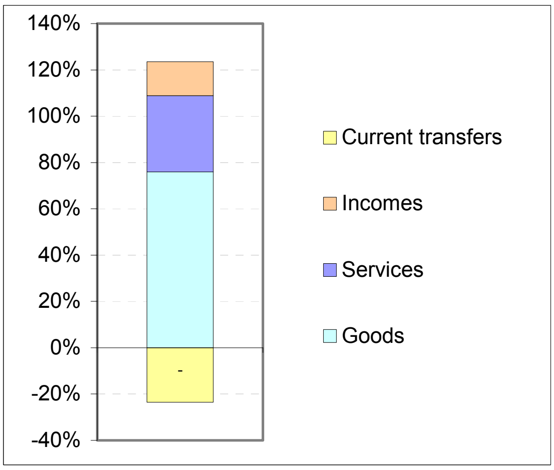
TABLE 1. – CURRENT ACCOUNT COMPONENTS

	2004 (January - April)			2005 (January - April)		
	Credit	Debit	Balance	Credit	Debit	Balance
CURRENT ACCOUNT (A+B+C)	7556	8341	-785	9185	10576	-1391
A. Goods and Services (a+b)	6661	7734	-1073	7942	9754	-1812
a. Goods, fob (exports / imports)	5823	6900	-1077	6881	8483	-1602
b. Services	838	834	4	1061	1271	-210
B. Incomes	95	479	-384	184	660	-476
C. Current transfers	800	128	672	1059	162	897

Source: NBR

Regarding the other elements of current account, services balance reached EUR 210 million deficit after a slight surplus in the first four months of 2004, while incomes balance worsened by almost EUR 100 million. Only the balance of current transfers improved in this period, the surplus increased by 33.5% between January and April. However, this remarkable increase was not able to counterbalance the significant worsening of the other balances.

CHART 1. – ROLE OF C/A ELEMENTS IN THE WORSENING TREND (JAN-APRIL 2005)



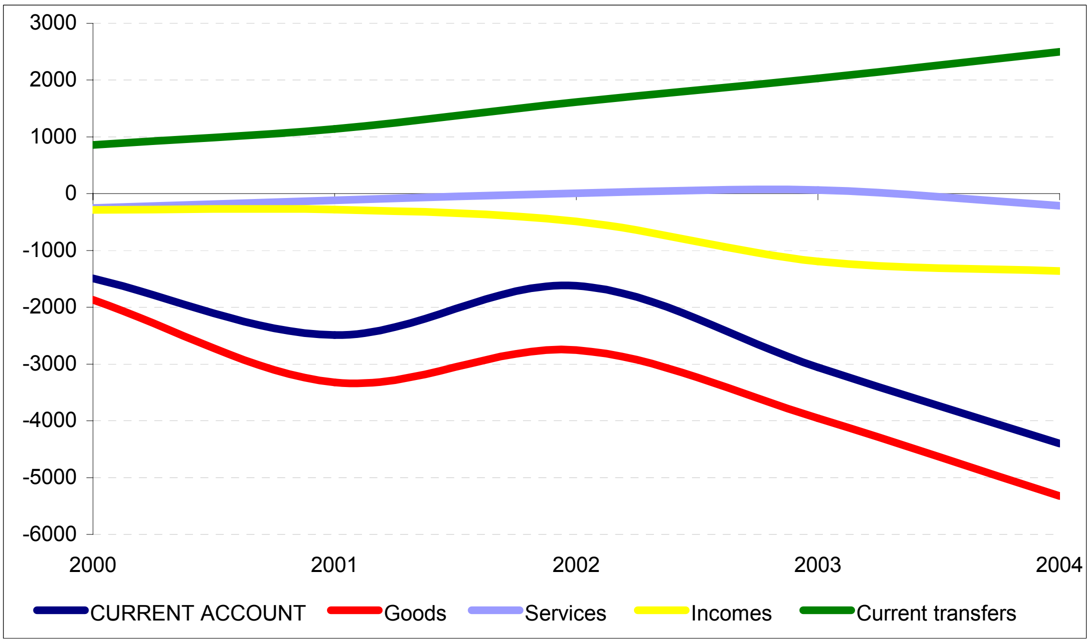
Source: NBR, own calculations

The graph above shows the roles of each element of the current account balance in the deterioration of the balance. It is easy to notice that the worsening balance of goods and services is responsible for the majority of the deterioration, while the roles of incomes and current transfers are almost neutralized by each other.

Background

The recent deterioration of foreign trade balance and current account balance started after 2002. Current account deficit almost doubled in 2003 compared to the previous year. This high increase was due to the same (domestic) factors as those which move current trend, namely consumption and investments. In 2004 foreign trade balance worsened further and thus, current account deficit reached EUR 4.4 billion or increased by 43.9%.

Chart 2.
Development of Current Account balance and its Components, 2000-2004 (mill. EUR)



Source: NBR

Between 2002 and 2004 the current account deficit per GDP figure jumped from 3.4% to 7.5%. It means the deficit increased from EUR 1623 million to EUR 4403 million in two year which represents a +171% growth. In that period both the balance of goods and services and incomes balance worsened while only the balance of current transfers improved. It is observable that current tendencies are the same as those in 2003 and 2004.

Outlook

According to our expectation, recent trend will characterise the Romanian economy in the entire year. In 2005, current account deficit per GDP figure will widen further due to significant private consumption and relatively weak foreign demand. On the other hand, if the Romanian government will come to a decision to increase VAT rate from January 2006 then it may have a further boosting impact on import of goods in the last month of this year.

As a consequence, the pace of imports will overpace that of the exports, however, both will reach two-digit increase. Owing to the further deterioration of foreign trade balance, current account per GDP figure is expected to reach 8.4% in 2005, compared to 7.5% of 2004.

THE ATTRACTIVE BULGARIA – PROMINENT FDI INFLOW IN 2004

On 8 June, 2005 Mr. Pavel Ezekiev, Executive Director of InvestBulgaria Agency has been specially awarded by the Bulgarian International Business Association (BIBA) for his contribution in the promotion of foreign investments in Bulgaria. This award was handed to him on the South East Europe Ministerial Conference on Investment and Trade 2005, which was hosted by Bulgaria on 9 and 10 June, 2005. It is undoubted that the year 2004 was an unexampled term regarding the volume of foreign investments in Bulgaria. With its high FDI per GDP ratio (9.2%) Bulgaria exceeded all CEE countries, including Romania with 5,6% and the Czech Republic with 4,4% last year. For 2004 Bulgaria holds the first place in the region in terms of attracted FDI per capita. According to Mr. Ezekiev's expectations, "in 2005 Bulgaria will keep its leading role in the attraction of investments in the region".

ABOUT THE REGION

In the last 15 years the value of the FDI to the South East European countries was not enough high mainly due to stability problems. After the breakup of former Yugoslavia, wars and political conflicts have evolved, and these factors frightened away the foreign investors from the whole region. This process has turned over in the late '90s when these countries have begun to enhance their stability. And to that day the stability is one of the most important allurements of the region. In the last few years the level of the foreign direct investments in the region has raised, which was influenced mainly by Romania, Croatia and Bulgaria. These countries have advantages compared to the other countries of the region in two areas:

- in political stability,
- in progression of European integration.

Furthermore, Romania and Bulgaria have more favorable productivity- and labor-cost rate than that of the Western-Balkans.

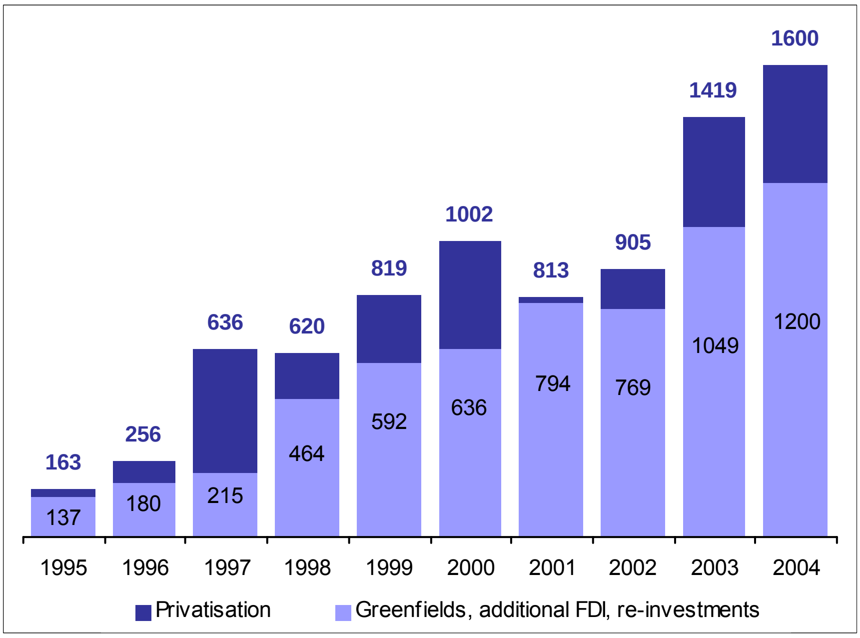
ABOUT THE ROLE OF THE FDI

Between 1992 and 2000 the the volume of FDI attracted by Bulgaria has raised persistently, especially from the year 1996 and 1997, when privatization has meant the main engine of FDI development. From 1992 to 1999, total foreign investments in Bulgaria equaled to USD 2.78 billion. In 1999 Bulgaria attracted USD 755 million in foreign investment, an increase of USD 135 million over 1998.

Mr Pavel Ezekiev summarised this process on the South East Europe Ministerial Conference on Investment and Trade 2005: *"The official statistical data for the period 1992-2004 shows that the stock volume of the foreign direct investments (FDI) in Bulgaria amounts to USD 10.145 bln. The investments in green field and expansion projects for the 13-years period account for 69% of the total FDI in Bulgaria, while the share of FDI in the privatization is 31%. In the period 2001-2004 Bulgaria has attracted a record FDI volume of USD 6.3 bln. which represents a 62% share. FDI in privatization for the same period account for 23% of the total volume of investments and the green field investments are 73%. Regarding the countries, which are the leading investors in Bulgaria, the statistics shows that the traditional leader Greece is replaced by Austria. The Austrian companies have invested a total of USD 1.67 bln. in the period 1992-2004. The second biggest investor for the 13-years period is Greece (USD 1.03 bln.), followed by the Netherlands (USD 928 mln.), Germany (USD 917 mln.) and Italy (USD 715 mln.). In 2004 the top 3 of the leading investors by countries is headed by Austria, the Netherlands and the Czech Republic."*

The list of the top 15 leading investors is headed by 5 brand new companies: CEZ (Czech Republic), EVN (Austria), Viva Ventures (Austria), E.ON (Germany) and Sisecam (Turkey).

CHART 3. – FDI INFLOW IN BULGARIA FROM 1995 TO 2004:



Source: BNB, Bulgarian Investment Agency

ABOUT THE FUTURE

It is a very likely and logical expectancy that Bulgaria will keep on the high level of the FDI in 2005 as well, because on the one hand the attractive factors are not expected to decline in the future and on the other hand the country needs foreign investors for its structural changes to catch the final objective, the EU-membership for the proposed date. And furthermore it is also clear that the fact that the European Commission has closed the negotiations with Bulgaria is a good point in the eyes of the foreign investors, it enhances their trust in the country.

The following factors are greatly influences the inflow of foreign direct investment:

- Highly-skilled, multilingual workforce at Europe's most competitive wages
- Stable and predictable business and political environment
- EU membership on January 1, 2007 gives access to markets of over 500 million consumers
- The lowest operational costs and tax rates in a European market economy
- Industrial goods traded duty free between Bulgaria and the EU, EFTA, CEFTA and Turkey
- Excellent climate, natural scenery, food and hospitality
- Flat corporate income tax rate of 15% (2006 expected rate: 12%)
- VAT exemption on equipment imports for investment projects over Eur 5 million
- Annual depreciation rate of 30% for machinery & equipment, 50% for new equipment used in entirely new investment or expansion and 50% for software and hardware
- Acquisition of land and property through Bulgarian registered company with 100% foreign ownership
- Seamless administrative services through InvestBulgaria Agency
- 55 treaties for avoidance of double taxation
- 52 agreements on mutual protection and promotion of foreign investment

Source: http://investbg.government.bg/18/page.html