

PROFIT TAX LAW - NECESSARY CHANGES

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Pursuant to the State Budget Law the revenues from direct taxes for the year 1996 had to amount to about 26% while those from indirect taxes, duties and duty taxes had to be about 74% of the total. It is well known that Bulgaria's budget for 1997 has not been passed yet. Pursuant to the Budget Structure Law the revenues must comply with the laws that are operative at the moment. It is impossible to pass laws for a few weeks only and to carry out both a tax reform and a change in the ratio between direct and indirect taxes. The tendency in the relative share of taxes in the total tax revenues is connected with long-term strategy and at least for the next two years no changes of principal nature are possible therein. The tax law, which has been created for a very short time, with all its complexity of legal norms, shows the tendency of being "imposed" on the economic life, which is extremely various. Practice has proven that in these cases the law is incomplete and the tax rate is usually unacceptable. The reaction that usually emerges is one of avoiding the burdens created by the law as well as taking advantage of its incompleteness.

The comment will be limited only to the suggestions for the changes that are necessary in the Profit Tax Law (PTL). This Law has been operative since July 1, 1996 and it is in conformity with the modern corporate tax laws as far as its structure is concerned. The idea of wholly settling this tax matter by way of a law was not actually realized and a significant part of the regulation has to be provided by the Rules for Application the PTL (RAPTL). Unfortunately, the Rules have introduced some additional changes in the PTL this being a violation of Statutes Law. However, it is impossible to make the necessary revision within the short time that is left until passing the 1997 State Budget Law of the Republic of Bulgaria, or more precisely - within the remaining part of the year.

PTL was passed on the ground of motives that no tax preferences exist in EU and according to the recommendations no possibility is allowed for the tax legislation to regulate the opportunity of any tax alleviation. Finally, the PTL contains some preferences, most of them being granted to privatized enterprises, companies with foreign participation, to takeover cases of alleviation used under Decree No 56, which has been repealed, as well as to cooperatives of disabled persons. However, no preferences were granted to the hundreds of thousands of companies, which are the actual taxpayers.

It is not the global preferences under the repealed Decree No 56 that are needed, but the specific preferences are the ones that are necessary now. They have to be in accordance with the economic realities and the interests of Bulgaria. There are a number of different classifications of the types of preferences but they interweave with each other. Due to that fact I will limit my comment to specific suggestions only.

FIXED ASSETS (FA)

DEPRECIATION EXPENSES:

Tax recognition of accelerated depreciation is urgently needed due to the following reasons:

a) The rates established by art. 15 of the PTL concerning the depreciation that is recognized for tax purposes are meant to guarantee the fiscal aspect and not the interests of goods producers. They do not take account of the physical and economic wear and tear in the circumstances of the rapid innovations. Even under

the conditions of normal economy these depreciation rates cannot ensure the normal turnover of capital, i.e. the restoration of the initial investments in FA in their pecuniary form. Pursuant to the Accountancy Law (AL), art. 18 and paragraph 4a of the Additional Provisions to the act, it is the "historical price" that matters. No annual revaluation is carried out considering the official statistical data about inflation;

b) The introduction of the currency board would significantly limit the inflation rate but for the time being the actual price of the FA that were acquired 3-4 years ago is approximately 10 times higher than the value on the grounds of which the depreciation expenses are calculated.

Suggestion : Paragraphs 2 and 3 of art. 15 of the PTL have to be repealed. The following is to be added at the end of art. 15, par. 1, second sentence: "... in the due order stipulated under art. 20 of the Accountancy Law".

Art. 15 can be edited again in the following sense: "Accelerated depreciation rates of FA are applied and they amount up to 50% increase of the depreciation rate recognized for tax purposes".

In any case it is reasonable to grant the companies the right to make a single reassessment of the FA and this reassessment must take the inflation into account. It is well known that since the Note of the Council of Ministers No 179/year 1991 no reassessment has been made. It is recommendable that the updating be carried out in due course established by the Council of Ministers rather than by way of expert estimates. An opportunity of this type is stipulated under art. 33 of the AL but it is for 5 years now that the Council of Ministers has not exercised its rights of carrying out this revaluation.

BUYING FIXED ASSETS

It is necessary that a mechanism be created aimed at facilitating the process of buying FA that are intended for the industry. The orientation towards important branches of industry is possible as well. It is preferable to establish a mechanism of tax on profit, according to which no tax on profit is charged in cases where the investments are intended for production purposes, these investments being meant for creating, expanding or modernizing the machines and equipment.

Should no tax on profit be due in cases of investments for certain purposes the budget will indirectly support the development of the industry. No structural reform is possible without the development of the industry. In the long run it is through these tax alleviation that the budget revenues will be guaranteed after a short period of time. The improvements in the actual state of economy would have their effect on the national income and this, on its part, would increase both the budget revenues and the opportunities of redistribution of national income.

Expanding the production immediately results in an increase in the indirect taxes (VAT, excise).

Suggestion: Here is a possible text:

"The profit tax is not due where investments are made for production purposes according to the subject of activity.

In case of impossibility of applying tax alleviation because of insufficient amount of the positive financial result at the moment of acquiring or creating the respective

asset, this alleviation is used in the form of tax credit within a term of after creating or acquiring the asset.

Tax preferences apply regardless of the expenses on depreciation”.

The mechanism of non-charging the tax on profit creates opportunities for controlling the expenses as well as for assessing whether the expenses are meant for creating FA. Thus an anomaly can be overcome, this anomaly having been a part of art. 87, par. 4, subpar. 2 of the repealed Decree No 56. Such expenses are recognized in Germany, the USA and other developed countries although perfect technologies are available there.

CURRENT EXPENSES ON FA

Art. 16, par. 2, subpar. 8 of the PTL, which is currently operative, states that the financial result prior to tax transformation is recognized if the expenses on improvements, modernization and reconstruction of FA are within the limits of up to 5% of their balance value. The basis is the "historical price" of acquisition reduced by the depreciation expenses. It is clear that this text prevents the owner of FA from making the expenses necessary for the normal utilization of the respective equipment.

Suggestion:

a) the percentage is to be corrected from 5 to 10-15 per cent on the basis of the updated price of the FA resulting from a reassessment (made after the Note of the Council of Ministers No 179/ year 1991);

b) art. 16, par. 2 subpar. 8 has to be edited anew in the following sense: " ... where the expenses on improvements, modernization and reconstruction bring about an increase of the value of the assets and these expenses have been reported as current expenses exceeding 50 per cent of the balance value of the respective asset”.

CORPORATION CREDIT under the circumstances of a currency board turns out to be extremely topical. After art. 94 of Decree No 56 on Economic Activity was repealed, art. 21, par. 1 of the PTL has been operative so far. It is under a complex of requirements that it creates the limitation on this crediting, the limit being 10 per cent of a specific value pursuant to the Accountancy Law. I suggest that this limitation should be totally repealed.

SALARY REGULATION

Paragraph 5 of the Interim and Concluding Provisions of PTL was repealed and thus the tax nature of regulating salaries was dropped off. Actually, the Council of Ministers has no rights provided by law to carry out the process of income regulation. The compromise mechanism that has been established by way of an Enactment of the Council of Ministers could be challenged on the basis of the Statutes Law due to the lack of grounds for this regulation.

The restoration of paragraph 5 of the provisions of the PTL is unacceptable under the conditions of the liberalisation, which has already started. It is even less admissible to accept the resumption of the tax scale concerning the cases where the tax limit has been exceeded. Nevertheless, it is reasonable to accept a text that should grant the Council of Ministers the right to regulate the incomes of commercial companies where the participation of the state is predominant. In 1997 the absence of limitations

resulted in a turn on the labor market, the private sector not being capable to maintain the level of incomes. One of the numerous anomalies is connected with the fact that the available financial resources are used for increasing the salaries rather than for paying off the bank credits.

I am bewildered by the fact that the unrealistically high incomes in many regions and the insufficient goods' stock have not resulted in a second wave of inflation. The danger still exists as long as no limitations are introduced.

TAX RATE

The profit tax is 36 per cent; in cases when the profit does not exceed 2 million leva it is 26%. The municipal tax is 6.5%; insurance installment is based on the salary according to the labor category (the average is 44%); there are also obligatory contributions to the Professional Qualification and Unemployment Fund.

It is hard to accept both a reduction of profit tax and a simultaneous establishment of tax preferences. The very amount of a tax credit for FA is dependent on the amount of the profit tax.

My personal opinion is in favor of preserving the level of tax rates and introducing certain preferences. It turned out that the limit of 2 million leva for reduced taxation has lost its effect within the period from the elaboration of the PTL to the moment of its adoption. Less than an year after the adoption of PTL this limitation further lost its significance. The new level of differentiating tax rates should be corrected to at least 15 million leva (USD 10000).

SMALL AND MEDIUM-SIZE ENTERPRISES (SME)

have still not received protection by the legislation. There is a consensus that this flexible form of production can help exiting the crisis, that it has good prospects and it is closely connected with the process of privatization and the elimination of monopolistic structures. Preferences for the SME must be regulated under the PTL but preferences should be granted at the right time. The draft law on SME could hardly be discussed prior to passing the Budget Law for the year 1997.

We hope that the Law on SME will be adopted by the end of 1997 and we do hope that tax preferences will be adopted simultaneously with the law, should this be necessary, due to the fact that the precursory changes in the PTL do not satisfy some of the tax alleviations. The PTL is the law where the alleviation should be properly and systematically stated.

EXPORT PREFERENCES

would be much more easily regulated by means of by-laws - the customs regime, premiums, subsidies and other instruments. The establishment of tax preferences is a long process that takes time and it is connected with a specific complex of conceptions that have not been clarified so far and as a result they cannot be hastily included in the eventual changes of the PTL.

ESTABLISHING BRANCH PRIORITY

is a long process too, which is a result of an advanced strategy, so it could not affect the PTL at this stage.

INCOME TAX (IT)

belongs to the category of indirect taxes and in 1996 its share in the total tax revenues was 13.6%. This share is high for a country with high rates indirect taxes if inflation is not taken into account and the great increase in the incomes, which is due to inflation, is not considered.

There is a direct link between the tax under art. 13 of the Income Tax Law and art. 4 of the same law. The sharp rise in inflation emerged after passing the changes and amendments to the Income Tax Law for 1997. In early May the minimum salary fixed by the Council of Ministers amounts to more than the minimum income, which is not subject to taxation. The current changes in the tax brackets would bring about some complications and this particularly refers to the level that fixes the obligation of advance taxation.

Once the principle of "tax vacation" is accepted with reference to direct taxes some changes in the Income Tax Law should be accepted as well. It is well known that the increased tax rate does not necessarily result in adequate increase in tax revenues. It is generally accepted that Bulgarian informal economy amounts to 45-50% of the gross domestic product. The relative reduction of taxes, in particular the direct ones, would result in a significant increase in their collection and this would increase budget revenues. Prerequisites should be gradually established for decreasing the relative share of the informal economy, especially as some actions of the present cabinet would inevitably bring about their results.