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RESTRICTIONS ON OFF-SHORE COMPANIES RELAXED IN BULGARIA, FACILITATING FUND INVESTMENT

On 1 July 2016 an Act amending and supplementing the Act for Economic and Financial Relations with Companies Registered in Jurisdictions with Preferential Tax Regime, their Related Parties and Beneficial Owners (the "Act") entered into force in Bulgaria.

The Act applies to companies registered in jurisdictions with a preferential tax regime as defined in the Bulgarian Corporate Income Tax Act ("off-shore companies")¹. Before these last amendments, the Act restricted substantially the business of off-shore companies and their affiliates in Bulgaria banning them completely from participating directly or indirectly in companies operating in key economic areas where public funds are allocated, including in credit institutions, insurance companies, pension insurance companies and telecom operators.²

Bulgaria is one of only a few EU countries applying such restrictions³. Following recent concerns of the European Commission about the compatibility of these restrictions with EU law, Bulgaria has decided to opt for a relaxation of the strict regime by allowing off-shore companies and their affiliates to participate in the restricted economic areas under certain conditions.

NEW SCOPE OF APPLICATION

Under the previous regime even an insignificant shareholding was enough to trigger the severe consequences of the ban. Now, the Act introduces a threshold of "*qualified shareholding*" below which off-shore companies will be allowed to participate in the restricted entities. The percentage of "*qualified shareholding*" will be defined in accordance with sector specific legislation (e.g. 10% for credit institutions). Where shareholding is not subject to specific regulation, the threshold is set at 10%. In order to prevent abuses, the Act provides that the mandatory threshold applies jointly if two or more off-shore companies participate in a restricted entity and the participating off-shore companies are either under common control or one of them controls the other.

Further, the ban will no longer apply to all affiliates of off-shore companies in general but only to their

¹ According to §1, item 64 of the Bulgarian Corporate Income Tax Act, jurisdictions with a preferential tax regime are countries or territories which are not EU Member States, do not exchange information as per Directive 2011/16/EU on administrative cooperation in the field of taxation and meet two of the following conditions: (i) there is no double tax treaty between Bulgaria and the respective country or jurisdiction or an effective bilateral or international agreement on information exchange between Bulgaria or the EU and the respective country or jurisdiction; or (ii) there is a double tax treaty or a such bilateral or international agreement in place but the respective country or jurisdiction refuses or is not capable to exchange information; or (ii) the personal income or corporate income tax (or substituting tax on penalties) on income realized by a foreign person is 60 % lower the personal income or corporate income tax on such income in Bulgaria. The Bulgarian finance minister approves a list of particular jurisdictions with a preferential tax regime which is published in the State Gazette.

² See "Restrictions on Off-Shore Companies to do Business in Bulgaria" - <http://www.wolftheiss.com/knowledge/client-alerts-newsletters/detail/restrictions-on-off-shore-companies-to-do-business-in-bulgaria/>

³ Hungary has adopted similar restrictions in respect of non-transparent off-shore companies - <http://www.wolftheiss.com/knowledge/wolf-theiss-guides/detail/wolf-theiss-corporate-monitor-fy-2014/>

controlled entities. The existence of control will be assessed based on the corresponding definitions in the Bulgarian Commercial Act. Control will be established, *inter alia*, where an off-shore company holds more than 50% of the voting rights in a shareholders' meeting or has the right to nominate more than 50% of the directors. In addition, an off-shore company will have control over an affiliate if the off-shore company participates in the affiliate's management, control or share capital, and as result the off-shore company and its affiliate companies can negotiate favorable terms amongst them.

EXCEPTIONS TO THE RULE

The Act introduces several new exceptions based on which off-shore companies and their controlled entities will be permitted to participate in the restricted areas even where their stake exceeds the "qualified shareholding" threshold. These exceptions refer to activities governed by EU or International law and will apply only if the beneficial owner(s) of the off-shore company is (are) registered with the Bulgarian Commercial Register in accordance with the Act. Subject to this condition, the restrictions under the Act will not apply, if: the off-shore company is resident for tax purposes in a country which is a party to the WTO Government Procurement Agreement or to a Bilateral Agreement on Procurement with the EU, and the respective International Agreement governs the activity restricted under the Act; or the off-shore company is resident for tax purposes in an OCTs as defined in the Council Decision 2013/755/EC of 25 November 2013 on the association of the OCTs with the EU and the Council Decision governs the activity restricted under the Act; or the off-shore company is resident for tax purposes (or belongs to an economic group with a parent company registered for tax purposes) in a country with which Bulgaria has an International Trade and/or Economic Agreement, including if Bulgaria has obligations under the WTO General Agreement on Trade.

ADDITIONAL REGISTRATION REQUIREMENTS

Off-shore companies which participate (or intend to participate) directly or indirectly in a restricted entity will continue to be obliged to register with the Bulgarian Commercial Register and disclose their beneficial owners. In addition, off-shore companies will be requested to provide the Commercial Register with information about all companies under their control which also participate in a restricted entity.

As regards statutory terms, off-shore companies will have to register with the Commercial Register before joining a public procedure covered by the Act (e.g. public procurement or privatization procedure). Changes in circumstances announced with the Commercial Register shall be registered within 30 days upon occurrence of the respective change.

SANCTIONS

The Act relaxes some of the punitive measures under the previous regime. Now, if a company (invoking an exception based on false data) has obtained a license/permit to engage in a restricted activity, this license/permit will no longer be subject to cancellation but the breaching company will be prohibited from exercising its rights as a shareholder until the breach is remedied (e.g. until its stake meets the applicable "qualified shareholding" threshold in the Act).

The Act also introduces a new fine for breach of mandatory registration requirements (i.e. for delayed registration or no registration) which is in the range of EUR 5,000 - EUR 25,000 for one breach and EUR

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10,000 - EUR 50,000 for repeated breaches.

COMPLIANCE DEADLINE

The amendments to the Act enter into force on 1 July 2016.

Companies covered by the restrictions will have to bring their activity in line with the amended Act within 6 months upon its entry into force (e.g. by performing all mandatory registrations with the Commercial Register). Failure to meet the 6-month deadline may trigger sanctions.

FACILITATING INVESTMENTS

As of 1 July 2016 off-shore companies and their controlled entities will be allowed to participate in Bulgarian companies covered by the restricted areas, including in credit institutions, insurance and pension insurance companies, payment institutions, investment intermediaries and regulated markets, by holding directly or indirectly up to, *inter alia*, 10% of the shares in such companies. This will be a simpler environment for investors interested in Bulgaria, particularly hedge and venture capital fund vehicles registered off-shore, and will encourage liquidity in key sectors, such as Bulgarian financial institutions, currently going through asset quality reviews.

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