



## New Double Tax Treaty between Bulgaria and the Netherlands

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KPMG's Tax News outline and highlight legislative changes and trends in the area of tax.

This issue puts focus on the provisions of the new DTT between the Republic of Bulgaria and the Kingdom of the Netherlands.

### Introduction

Issue 55 of the State Gazette of July 2, 2021 promulgated the new Double Tax Treaty between the Republic of Bulgaria and the Kingdom of the Netherlands for the avoidance of double taxation with respect to taxes on income and the prevention of fiscal evasion (the new DTT). The new DTT introduces new rules that significantly differ from the currently applicable provisions of the treaty signed in 1990. Below we present an analysis of some of the main changes under the new DTT with respect to the taxation of the most common types of income based on our practice.



### Permanent establishment

A construction permanent establishment (PE) is considered to exist after twelve months of activities under the new DTT (instead of nine months) and an installation project is included in the PE definition (in addition to building site and construction). Specific provisions are introduced when the performance of activities by a closely related entity at a building site, construction or installation project of another entity may be considered as activities of this other entity when determining construction PE.

Explicit provisions are also introduced on the existence of a PE in case of offshore activities (i.e. activities in the territorial sea of the other contracting state or in any area beyond and immediately adjacent to the territorial sea over which the other contracting state exercises jurisdiction or sovereign rights).

New rules are implemented based on which the preparatory or auxiliary activities exceptions would not be applicable. These exceptions would not apply where an entity or its closely related entity also carries out activities (i) which give rise to a PE of the entity/its closely related entity or (ii) the overall activity resulting from the combination of the activities of the entity or the entity and its closely related entity is not of a preparatory or auxiliary nature, provided that the business activities carried out under (i) and (ii) are complementary functions that are part of a cohesive business operation.

For application of the new rules, a separate definition of "closely related entity" is also provided.



### **Business profits**

Payments received as remuneration for technical services, including studies or surveys of a scientific, geological or technical nature, or for consultancy or supervisory services, shall be considered as payments to which the provisions of Art. 7 of the DTT with the Netherlands apply.



### **Dividends**

Dividends paid by a company, resident of one contracting state (State A) to a resident of the other contracting state (State B) may be taxed in State A under the new DTT. If the beneficial owner of the dividends is a resident of State B, however, the tax shall not exceed 15%.

Exemption from taxation in country A is provided when the beneficial owner of the dividends is (i) a pension fund or (ii) a company (other than a partnership) which is a resident of State B and which directly holds at least 10% of the capital of the company paying the dividends during a 365-day period, incl. the day of payment of dividends.

The exemption under (ii) shall not apply to a person who is a resident of the Netherlands and who is treated as a collective investment institution ('fiscale beleggingsinstelling') for the purposes of the Netherlands company tax.



### **Interest**

The new DTT alters the withholding tax (WHT) exemption on interest in the source country, which is provided for in the currently applicable treaty. Under the new DTT the source country (State A) may tax this interest. The tax will not exceed 5% if the beneficial owner of the interest is a resident of the other contracting state (State B).

The new DTT also provides for some exceptions where interest will remain exempt from taxation in State A, some of which are listed below:

- interest paid to the contracting state, its political subdivision, the central bank, etc.;
- interest paid to a pension fund;
- interest paid in connection with a loan granted by a bank or an insurance company;
- interest paid in connection with the sale on credit of industrial, commercial or scientific equipment;

- interest paid in connection with the sale on credit of goods from one entity to another, etc.



## Royalties

The new DTT also alters the WHT exemption on royalties in the source country, provided for in the currently applicable treaty. Under the new rules, the source state (State A) may tax the income from royalties. The WHT so charged, however, shall not exceed 5% if the beneficial owner of the royalties is a resident of the other contracting state (State B).



## Gains from transfer of shares and interests

The new treaty introduces WHT at source (State A) on profits of a resident of the other contracting state (State B) from transfer of shares, units and other similar interests from State A. Under the new DTT, WHT in State A shall be applied if at any time in the 365-days period preceding the transfer, such shares, units or similar interests received more than 75% of their value from immovable property situated in State A, other than immovable property in which that entity carries on its active business.

Taxation only in the resident State B is provided in specific cases such as:

- profits derived in the course of a merger or division;
- profits derived from the transfer of shares listed on a recognized stock exchange;
- profits derived by a pension fund.



## Tax avoidance and DTT relief

DTT relief will not be granted with respect to an item of income related to an arrangement/transaction one of the principal purposes/result of which is the obtaining of that DTT relief. In such cases relief may be provided only if (i) such relief is in accordance with the object and purpose of the relevant DTT provisions or (ii) at the request of the person, the relevant competent authorities establish that such relief would be granted in the absence of this arrangement/transaction.

DTT relief may also not be granted when an entity in one contracting state (State A) receives income from the other contracting state (State B) and State A treats that income as attributable to a PE of the entity in third state (State C) as far as State A does not tax the profits attributable to that PE. As a general rule DTT relief will not be granted in such cases for any type of income for which the tax in State C is less than 60% of the tax that would be imposed in State A if the PE was located there. The DTT provides for some exceptions to this general rule where relief still may be granted.



## Entry into force and implementation of the new DTT

The new DTT shall enter into force on 31 July 2021 and shall apply from 1 January 2022, both to taxes withheld at source with respect to amounts accrued on or after that date and to other taxes.

Statements for presence of grounds for application of the currently applicable DTT with the Kingdom of the Netherlands issued by the Bulgarian revenue authorities will not apply to income accrued on and after 1 January 2022.

Any company that accrues Bulgarian source income in favour of persons from the Kingdom of the Netherlands should analyze the provisions of the

new DTT regarding the possibilities for reduction/exemption from WHT due under the Corporate Income Tax Act and/or the Personal Income Tax Act. If the new DTT provides for reduction/exemption from the tax due at source under the CITA/PITA, new DTT application procedures should be initiated. The exact procedures to be followed will depend on the amount of the annual income accrued/realized by the respective foreign person.



### How can we help?

If you perform transactions with the Kingdom of the Netherlands, we would advise you to contact a representative of the Tax Department of KPMG in Bulgaria for a consultation on the tax treatment of the income and the potential for application of the new DTT.



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