



AMERICAN CHAMBER OF COMMERCE IN BULGARIA

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Position Paper

US-Bulgaria Treaty on Avoidance of Double Taxation

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Precis: This position paper presents the view of the U.S. business community in Bulgaria concerning the proposed US-Bulgaria Treaty on Avoidance of Double Taxation (DTT), currently under negotiation. The DTT will facilitate bilateral investment and trade in three key areas: (1) income from investments, services, and intellectual property; (2) double-taxation of personal income; (3) establishment of a competent authority process. Competitive rates of withholding tax also will facilitate bilateral trade and investment. The U.S. business community in Bulgaria supports a well-regulated regime for sharing financial information concerning tax enforcement cases between U.S. Treasury and the Bulgarian Ministry of Finance. The Bulgarian *Regulation on the Application of Double Taxation Treaties* (the "Implementing Regulation") needs review to eliminate unusually cumbersome provisions for obtaining tax relief under such treaties.

Income from Investments, Services, and Intellectual Property

Services, notably telecommunications, media, and engineering services, are one of the key areas of focus for U.S. firms doing business in Bulgaria. Similarly, the volume of U.S. investment in Bulgaria has grown substantially in the last 2-3 years. Most sales of services and intellectual property (royalties, license fees, etc.) by U.S. firms to Bulgarian clients incur 15% withholding tax, as do payments of dividends, interest, and other investment income by Bulgarian entities to U.S. recipients. Although the U.S. tax code provides for a foreign tax credit, the credit is useful only for entities that are substantially profitable and that are not tax-exempt. For all other entities, the tax withheld is a cost that must be absorbed or passed along to clients. Bulgarian entities, including U.S.-owned firms, contracting with U.S. suppliers face an administrative burden and often an adverse cost impact to apply withholding tax when the foreign tax credit is not applicable for the recipient of the payment.

Double Taxation of Personal Income

Bulgaria taxes all residents (those present more than 180 days per year) on their worldwide personal income. Similarly, the U.S. taxes its citizens on their worldwide personal income. Although the foreign earned income exclusion applies in some cases, U.S. nationals on assignment in Bulgaria or resident in Bulgaria more than 6 months per year are subject to personal income tax by both countries. Furthermore, U.S. taxpayers cannot claim a foreign tax credit for any U.S.-source earned income, so their U.S.-source earned income is subject to double taxation. Recent studies have shown that the presence of U.S. expatriates abroad is a key factor in facilitating U.S. trade and investment. Therefore double taxation discourages trade and investment by raising the cost to investors and exporters of having U.S. nationals present to represent them in Bulgaria. Similarly, double taxation raises the cost and complexity for U.S. firms to bring Bulgarian employees on assignment to the U.S. Such postings are an important means of developing Bulgaria's human capital and strengthening bilateral relations. It is vital that the DTT relieve this area of double taxation.

Establishment of a Competent Authority Process

American investors would take some comfort from the "competent authority" provisions that are typically part of a double tax treaty. These provisions generally provide for a cooperative process in which the taxpayer and representatives from each of the two countries' tax offices work to resolve disputes in the application of each country's tax law. American investment in Bulgaria has grown substantially in recent years and is poised to grow further over time. The mere presence of the competent authority process eases fears and makes that investment growth much more likely.

Withholding Tax Rates

As noted above, Bulgarian law provides for 15% withholding tax on all payments of interest, dividends, rent, royalties, etc., to a foreign entity. The DTT will provide a substantial benefit to investors by lowering this rate for U.S.-based companies. In most US tax treaties with US counterparts, the withholding rates on these types of income ranges from 0-10%. Bulgaria's treaties with other key investors provide for similar withholding rates. We would point to the following Bulgarian treaties as suitable examples of withholding tax rates for the US-Bulgaria treaty:



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Withholding Rate (%) For:

<u>Treaty Partner</u>	<u>Dividends</u>	<u>Interest</u>	<u>Royalties</u>	<u>Capital Gains</u>
United Kingdom	10	0	0	0
Netherlands	5/15	0	0/5	0/15
Austria	0	0	0	0
Italy	10	0	5	0

Austria and Italy are particularly interesting examples as they are two of the largest sources of foreign direct investment in Bulgaria. The U.K., Netherlands, and Austria are the main countries through which U.S. investment is channelled to Bulgaria, therefore the U.S.-Bulgaria DTT should be competitive with the withholding rates under those countries' treaties with Bulgaria.

It should be noted that reduced withholding would likely benefit the US government. Presumably, reduced withholding would increase the amount of dividends and royalties paid to the US. This increases taxable income in the US. In addition, and regardless of any increase in dividend and royalty flow back to the US, reduced withholding rates decreases the amount of foreign taxes that are creditable in the US. The result is higher income tax collections in the US.

Information Sharing

The U.S. has made clear its policy to conclude double tax treaties only in cases where an acceptable information-sharing mechanism for enforcement cases is in place with the counterpart country. In particular, the mechanism should allow for each country to obtain relevant bank and other financial records in enforcement cases. AmCham Bulgaria supports the inclusion of an information-sharing provision in the DTT, provided that there are adequate controls in place to prevent undue infringement of privacy and unauthorized disclosure of commercial secrets. Safeguards on confidentiality are a cornerstone of a sound business environment, but of course such safeguards should not be used as a cover for tax evasion and other financial crimes.

The Bulgarian Implementing Regulation

To date, many major US investors in Bulgaria have channelled their investments through their European subsidiaries to be able to take advantage of double tax treaty protections. Practice has shown that Bulgaria's Implementing Regulation for double tax treaties is unduly cumbersome, requiring Finance Ministry approval in most cases for each application of treaty protections. The prevailing practice in other countries is to control the application of treaties *ex post*, through tax audits, rather than requiring *ex ante* approval. AmCham Bulgaria encourages the Bulgarian government to review and amend the Implementing Regulation to bring it in line with international best practice. We encourage also the U.S. government to negotiate a clause in the DTT exempting U.S. recipients of income from Bulgaria from *ex ante* control. Otherwise there would be a lack of parity in the two country's procedures for applying the DTT.