YEARBOOK OF UNWE 2020 (2), PC – UNWE
ISSN (print): 1312-5486; ISSN (online): 2534-8949; http://unwe-yearbook.org/en

SOME ISSUES REGARDING THE BULGARIAN CONTROLLED FOREIGN COMPANIES' RULES

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Abstract

The controlled foreign company rules (CFC rules) are a relatively new regime in the Bulgarian domestic legislation. Their introduction in the Corporate Income Tax Act (CITA) is connected with the transposition of Directive 2016/1164. As EU Member State, Bulgaria is obliged to follow and apply the European law including in the tax law. At the same time, based on the principle of sovereignty, Bulgaria has its own domestic policy.

The CFC rules are a symbiosis of law, economics and accounting. In the Bulgarian domestic legislation, they are characterized with numerous challenges both from a theoretical and a practical perspective. Proof of this is their several amendments and the issues concerning their implementation. Due to their new existence and rather controversial nature, there are only several articles in the Bulgarian literature that do not explicitly analyze in details this issue.

The main aim of the current study is to outline some of the disputable issues regarding the CFC rules from a Bulgarian perspective. For this purpose, the author makes some recommendations and shares some thoughts regarding the CFC's future. The applied methods are the historical method, the method of systematic analysis, the formal-logical method and the comparative method.

Key words: EU law**;** controlled foreign companies; Corporate Income Tax Act; abuse of law; taxation of dividends; taxation of tax profit; Directive 2016/1164; Directive 2011/96

JEL: K22, K34

Introduction

The CFC rules are a relatively new regime in the Bulgarian legislation due to the transposition of the Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (Directive 2016/1164). Although Bulgaria should follow the postulates established in the EU law, it has its own internal policy for regulation of direct taxes based on its sovereignty. Last but not least, the introduction of new regimes into the domestic legislation, such as the CFC rules, determines the

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application of both the basic principles of the EU law and the new tendencies in the field of international corporate taxation.

Although the CFC rules are contained in three provisions (Art. 47c - Art. 47e) in CITA, there are a number of challenges regarding their application. [1]. In general, they may be divided into three main groups. The first concerns the theoretical aspects, emphasizing the relationship between the EU law and the domestic law on this issue. The second deals with the practical aspects and it is in direct connection with both the relevant international and domestic practice. The third outlines the new tendencies from a Bulgarian perspective.

Structurally, the current study consists of two main parts. The first analyzes the relevant for EU law perspective aspects to this issue. The second examines some disputable moments in the CFC rules in the Bulgarian tax law. In this regard, some recommendations are expressed. The current study ends with a conclusion, in which the results are summarized and the author's position is outlined.

Some aspects of the EU law in the field of tax law

As already stated in the introduction, Bulgaria should comply with the EU law. Distinguished by its supranational character and certain specifics, it guarantees the rule of law within the EU territory. The EU law is characterized by a hierarchical relationship to the domestic law of the Member States, relying on two main principles – its priority and its direct effect (Попова, 2015, p. 208). According to the first principle, in the event of conflict, the EU law is applied with priority to the relevant national provision. In this connection, the national courts are obliged to observe the correct EU law application, including the possibility of referring the preliminary rulings to the Court of Justice of the European Union (CJEU). Regarding the second principle - the direct effect, it may be concluded that it "immediately and directly confers on the legal entities (the natural and the legal persons) subjective rights which shall be recognized and protected by the national courts" (Попова, 2015, p. 229). It should also be noted that it is not explicitly relevant to all EU law provisions and depends on a number of factors that are not addressed in this study.

In the Bulgarian legislation, the Statutory Instruments Act (SIA) contains two relevant provisions in this regard. Pursuant to Art. 7a SIA "A statutory instrument is also issued in those cases where measures at national level, necessary for the execution and implementation of acts of the European Union or of international contracts, concluded by the European Communities, must be adopted". Pursuant to Art. 15, para 2 SIA "Should a statutory instrument contravene a regulation of the European Union, the regulation shall be applied." This may be construed as a proof that Bulgaria has undertaken the necessary measures in its domestic legislation to comply with the EU law.

The primary law, the secondary law and the CJEU's practice are the main EU sources in the field of direct taxes, which is also applicable for the CFC rules. The first group includes the EU treaties, as attention will be paid to the Treaty on the Functioning of the European Union (TFEU). The secondary law consists of regulations, directives, decisions, recommendations and opinions adopted by the relevant institutions. The CJEU's practice is the third major group.

The EU law sources are in a certain relation with each other and reflect in a certain way the fair tax treatment in the field of direct taxes and particularly the CFC rules. The domestic legislation undertakes the necessary measures to be in line with the postulates proclaimed in the EU law.

Treaty of Functioning of the European Union

Title VII *Common Rules on Competition, Taxation and Approximation of Laws*, Chapter 2 "Tax provisions", Art. 110 – 113 of the TFEU introduces the relevant rules on tax matters. It is noteworthy that they are applicable to indirect taxes, as direct taxes are "sovereign rules which remain in the exclusive competence of the Member States" (Penov, 2011, p. 17). However, the latter should follow the four fundamental freedoms proclaimed in Title IV *Free Movement of Persons, Services and Capital* of the TFEU, as well as the prohibition of discrimination. It may be concluded that the EU primary law does not contain specific provisions in the field of direct taxes, based on their sovereignty.

Pursuant to Art. 115 of the TFEU "…the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market". I support the opinion of Assoc. Prof. Kostov that the unanimity for their adoption is their hallmark and this may be construed as a guarantor for the Member States. Proof of this is the comparison with Art. 114, para 1 and para 2 of the TFEU that regulates the ordinary legislative procedure which is not applicable to fiscal provisions (Костов, 2013, pp. 13-14).

Pursuant to Art. 288 of the TFEU "A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods". I share Prof. Popova's view that "the Directive is a mechanism of cooperation between the EU institutions and the national authorities of the Member States, which aims to harmonize their legislation and does not create a single law". Unlike the regulation, it has no direct effect and it becomes part of the domestic legislation according to the necessary transposition measures. In this respect, it is relevant to estimate whether it fully corresponds to the result provided therein.

Applicable directives regarding the CFC rules

As already stated above, the directives are part of the secondary EU law. They provide the achievement of certain objectives by becoming part of the domestic legislation in compliance with certain procedures.

In the field of direct taxation, the directives play an important role. It should be noted that it is possible that other secondary EU law sources may indirectly reflect on the CFC rule, but they remain out of the scope of the current study.

Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member State (Directive 2011/96) and Directive 2016/1164 are relevant for the CFC rules.

Directive 2011/96 is transposed into Bulgarian national law in the CITA. It is essential for the CFC rules regarding the taxation of dividends as part of their eventual tax profit. It governs the subject matter of Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (Directive 90/435). Para 3 of the Preamble of Directive 2011/96 outlines that one of its aims is “to exempt dividends and other profit distributions paid by subsidiary companies to their parent companies from withholding taxes and to eliminate double taxation of such income at the level of the parent company”. In this way, the possible double taxation is avoided. The hidden distribution of profits, however, is an exception of this tax treatment.

Pursuant to Art. 5 of Directive 2011/96 “Profits which a subsidiary distributes to its parent company shall be exempt from withholding tax”. Dividends are also included in the profit. This view is followed in CJEU’s judgement on case C-375/98 Epson Europe that outlines the scope of Directive 2011/96. According thereto, all withholding taxes related to the distribution of dividends, regardless of their name, fall within its scope (para 24). The following three requirements should be realized: tax shall be conditioned by the payment of dividends, the taxable amount shall represent the income of the shares, the taxable person shall be its holder (para 23). In the judgements on joined cases C-338/08 and C-339/08 P. Ferrero e C. SpA and in case C-284/06 Burda Verlagsbeteiligungen, the CJEU has expressed position on what is meant by “tax on the distributed income”.

The CJEU’s judgement on case C-58/01 Océ van der Grinten draws a comparison between Art. 5, para 1 and Art. 7, para 2 of the Directive 90/435. In the present case, the Double Tax Treaty (DTT) between the United Kingdom and the Netherlands allows taxation of dividends at source state in the amount of 5 %, providing the right for tax credit. At first glance, this is in contradiction to Art. 5, para 1 of Directive 90/435. Upon careful reading of Art. 7, para 2, however, it allows the possibility for tax refund precisely through the tax credit (para 60).

The CJEU also paid attention to the DTT's legal nature (para 87), determining its position on the compatibility of Art. 7, para 2 with the objectives pursued in Directive 90/435 (para 89). Therefore, in the current factual background, there is no contradiction with the aim of Directive 90/435. An individual analysis of each separate case is necessary.

It may be summarized that one of the ideas, set out in the Directive 2011/96, is the avoidance of double taxation through the introduced mechanisms therein. However, this should not contradict the EU primary law.

Regarding the CFC rules, Directive 2016/1164 plays a crucial role. The provisions on this issue set therein are related to Action Plan 3 of the Base Erosion and Profit Shifting Project (BEPS). [2]. Art. 7 of the Directive 2016/1164 outlines the CFC's legal nature by introduction of the general rule. Art. 8 thereof regulates the computation of the income realized thereby.

Directive 2016/1164 consists of five instruments in relation to tax avoidance and one of them are the CFC rules. The other four are the interest limitation rule (Art. 4), the exit taxation (Art. 5), the general anti-abuse rule (Art. 6) and the hybrid mismatches (Art. 9). All of them have their impact and significance in the Bulgarian domestic legislation.

It is noteworthy that, unlike Directive 2011/96, Directive 2016/1164 does not provide new rights, but introduces certain restrictive measures against tax evasion. Moreover, it is explicitly proclaimed that the provisions of the second directive are a minimum level of protection (Art. 3), which gives the Member States the opportunity to extend its scope. In this connection, the question may arise whether it corresponds to the idea of subsidiarity and proportionality, as well as to what extent the Member States may influence its scope. Per argumentum a contrario, the inability to ensure that minimum level should be defined as non-compliance with the objectives pursued therein.

Regarding the CFC rules, a landmark case is C–196/04 Cadbury Schweppes. The UK company Cadbury Schweppes owns indirectly 100 % two subsidiaries established in Ireland, where the tax rate is significantly lower at 10 %. Their activity is to increase and to secure the financing within the group to which they belong. The UK tax authorities applied the CFC regime considering that the subsidiaries did not fall within its exceptions and that their place of establishment was only linked to lower tax payments.

In this regard, the CJEU examined whether Cadbury Schweppes' intention was mainly the abuse of law. For this purpose, it took into account the freedom of establishment enshrined in the EU primary law. The relevant practice was also analyzed (judgements on cases C-212/97 Centros and C-167/01 Inspire Art). The CJEU's understanding was that the application of the most favorable regime did not automatically lead to abuse of this freedom (para. 37). However, the right of establishment may be limited in the presence of "wholly artificial arrangements"

that are aimed precisely at a circumvention of the domestic law of the relevant Member State (para 51).

With regard to the possibility of abuse of law, the objectives of the violation of this freedom should be determined. Thus, the existence of "actual establishment" and "genuine economic activity" is crucial (para 53-55). The CFC rules under the UK domestic law should be examined whether they are proportionate (para 57). For this purpose, the presence of premises, staff and equipment may be illustrated as objective factors (para 67). Moreover, the company should have the opportunity to prove that the CFC objectively exists and carries out a real activity (para 70). This should be seen as a counter-argument to the violation of freedom of establishment through artificial arrangements.

The Cadbury Schweppes case is significant for several reasons. On the one hand, it directly reflects the domestic legislation regarding the CFC rules taking into account the EU law. On the other, it determines the limits of abuse of law. It may not be automatically assumed that the tax planning aimed at certain tax reliefs always leads to violation of fundamental freedoms and contradicts the rule of law. For this purpose, it is necessary to examine both the limits of their possible violation and the relevant reasons. The symbiosis of both subjective and objective factors, illustrated in the judgement in question, prove the absence of contradiction with the domestic legislation. This approach itself is followed in Directive 2016/1164 and it is outlined explicitly in the Bulgarian domestic legislation as well. Cadbury Schweppes marks the beginning of the CJEU's doctrine about the CFC rules and the judgement still remains relevant and significant nowadays.

As continuation on this issue is order in case C-201/05 CFC and Dividend GLO, which follows the Cadbury Schweppes' approach. The restriction on the freedom of establishment in the domestic legislation of the Member State is permissible only by existence of wholly artificial arrangements aimed at abusive tax evasion (para 76 and 77). The objective factors such as premises, staff and equipment are mentioned again as proof of an "economic activity" (para 79). In this case, it is inadmissible to restrict any of the freedoms. In order to verify whether an agreement is artificial, a Member State may provide the necessary measures for that determination in its legislation (para 85).

This case also addressed the issue of the treatment of a foreign company in a third country, since the freedom of establishment covers only the EU territory (para 88). On the other hand, the free movement of capital under the primary EU law is relevant both for the Member States and the third countries (para 90). It is possible to impose restrictive measures in certain cases – for example, by the absence of a contractual relationship with the third country for exchange of information's provision on this issue (para 95). Therefore, in certain cases tax advantage may not be granted in the case of taxation on dividends (para 97).

It may be summarized that this case does not differ from the established doctrine. In this way, it follows the relevant criteria for determination of the abuse regarding the CFC rules.

The possibility of different tax treatment in the domestic legislation was examined in CJEU's judgement on case C-298/05 Columbus Container. Columbus is a Belgian limited partnership whose shares were wholly owned by German residents. As it was treated under the German domestic legislation as a transparent company, the shareholders were taxed on its profit after deduction of the tax paid in Belgium on the same profits. According to the DTT between Belgium and Germany tax exemption was provided therefore. The question regarding the "passive income" in connection with the application of the CFC rules was also raised. Another issue was whether the freedom of establishment was violated. In other words, whether the possibility of tax deduction under the DTT did not contradict the EU primary law.

By assessment of the scope of the two approaches, the CJEU considers that even if, at first glance, the German legislation did not appear to be more favorable than the outlined in the DTT this did not necessarily reflect on the restriction of freedom of establishment (para 38). It was concluded that Columbus was not in a disadvantaged situation compared to similar companies established in Germany. Therefore, there were no arguments of discrimination (para 54). After outlining the purpose of the DTT and the EU primary law, the CJEU came to the conclusion that there was no restriction on the freedom in question (para 54). Moreover, DTT's existence did not guarantee that a Member State was exempt from income tax, but it is permissible, on the basis of its domestic legislation, to deduct tax paid (para 57).

The CJEU's judgement in case C-112/14 European Commission v UK reexamined the criteria for application of the CFC rules regarding the freedom of establishment and the freedom of movement of capital. The view was shared that in some case it is permissible to restrict the second freedom in the event of wholly artificial arrangements (para 23 and para 25). However, it is necessary to examine each case individually in order to assess whether such an approach is appropriate in relation to the objectives pursued (para 26). After the analysis of the factual background it was established that the UK legislation was not in line, as the disputable domestic provision had unreasonably wider scope. An argument in this regard was the lack of opportunity to prove in an objective way that the taxable person had acted in good faith (para 29, 30 and 31).

The question of the applicability of the German CFC rules to third countries was examined in the CJEU's judgement on case C-135/17 X-GmbH. X was a limited liability company under the German domestic law, which owned 30 % of the shares of the Swiss company Y. The latter realized profit from the transfer of receivables to another German company. As X granted a loan to Y, the passive

income from a third country determined the application of the CFC rules to Y, which was taxed in Germany proportional to its shareholding. If it was taxed in Switzerland due to the lack of preconditions for the CFC's application, the taxation should be lower.

Based on an overriding reason of general interest, the CJEU observed the doctrine that the restriction may be applicable "to prevent of tax evasion and avoidance where it specifically targets wholly artificial arrangements which do not reflect economic reality and are the purpose of which is to avoid the tax…" (para 73). For this purpose, attention was also paid to the wholly artificial arrangements from Cadbury Schweppes' perspective (para 82), specifying that the Member State's national legislation should introduce the necessary measures for objective proof (para 87). Otherwise, it may lead to unconditional exceeding of the pursued goal. While in Cadbury Schweppes this was analyzed applying the freedom of establishment, in this case the CJEU extended the scope regarding the free movement of capital. The view was shared that the wholly artificial arrangements are diverse, affecting not only the acquisition of shares, but also the transfer of profits (para 84). However, the CJEU did not provide further guidance in this regard. Tax relief is admissible if "compliance with which can only be verified by obtaining information from the competent authorities of a third country, it is, in principle legitimate for that Member State to refuse to grant that advantage if, for example, because that third country has no treaty obligation to provide information, it proves impossible to obtain that information from that third country" (para 92). The German Federal Tax Court analyzed the DTT between Germany and Switzerland and did not find such a clause. Therefore, in the present case, the German CFC regime is in line with the free movement of capital (para 96).

Based on the analyzed CJEU judgements, it may be concluded that the difference in taxation, according to CFC rules and the fundamental freedoms considered, is possible only in certain cases. In addition, the broad interpretation is inadmissible. The required measures should be provided in the domestic legislation in order to be able to assess in an objective and unambiguous way the non/existence of wholly artificial arrangements. Therefore, the reference only to the subjective criterion, i.e. the mere intention, is not a sufficient prerequisite.

I share this view for several reasons. In the first place, different treatment may lead to unwanted discrimination and thus to the restriction of the basic principles promulgated in the EU primary law. If such approach is followed by the Member States, despite their national sovereignty, it may provide the possibility for very different and inappropriate tax rulings.

Second, the CFC regime is a symbiosis of many factors that should be observed carefully and in details. Third, the criteria set by the CJEU guarantee

the fair taxation and help to improve the domestic legislation. They are directly connected with the national mechanisms for the abuse of law.

The Bulgarian Perspective of the Controlled Foreign Companies

The Bulgarian CFC rules are in force as of 01.01.2019 in the CITA in the new Chapter Nine "a" *Specific Rules for Determining Tax Financial Results in Cases of a Controlled Foreign Company.* During this short period of their existence, a number of changes have been already made (they are 8 approximately). This proves both their complexity and the possible challenges regarding their application.

Due to its still new regime in the Bulgarian doctrine, there are no distinctive practical cases, but the rules have been already analyzed by several Bulgarian tax specialists (Вейсел, 2019; Филипов, 2019; Филипов, 2019a; Ценова, 2018). For the purposes of the current study, some of the disputable texts on this matter are examined.

Art. 47c of the CITA introduces the CFC's concept which is similar to Art. 7 of Directive 2016/1164. The text also outlines the hypotheses that fall outside the scope of the provision.

In general, they are two CFC possible forms – a foreign entity and a permanent establishment (PE). This may lead to understanding their variety.

Upon careful reading of the provision of Art. 47c, para 1, p. 2 of the CITA, which is one of the two necessary cumulative prerequisites for CFC application, several aspects are crucial. [3]. The new CFC rules apply in cases where the tax rate in the Member State is approximately twice lower than the outlined 10 % in CITA. This significantly limits the scope and raises the question as to what extent this regime is applicable in general and whether it fully complies with the objectives pursued in Directive 2016/1164. Moreover, for tax purposes according to the CITA, it is essential to recalculate the entire tax profit (in the case of a hypothetical tax) first applying the relevant accounting standards, and then from a tax perspective, in order to estimate whether the taxable person falls within the scope of the provision. This may lead to an unconditional administrative burden and the possibility of numerous inaccuracies.

The analysis of Art. 47c, para 1, p. 2 of the CITA may be summarized as follows. Its main purpose is to prevent the payment of lower tax in certain cases. As there is an explicit reference to "the corporation tax actually paid on the profits", its in/correct declaration should not affect the CFC rules. A crucial point is what is actually paid and what is documented. A problem may arise by the logical interpretation of "corporation tax… on the profits". In this case, it seems that the legislator has used twice the reference to the same type of tax. It should be noted that the repealed act on this matter was named Profit Tax Act. The new

CITA regulates the corporate income tax, which is only aimed at the taxation of profits of the taxpayers outlined therein. Therefore, I believe that the term used "corporation tax … on the profits" unnecessarily burdens the text.

Another disputable text is the provision of Art. 47c, para 4 of the CITA regarding the exceptions from this regime. [4]. First, in force as of 01.01.2020, the legislator expanded the possible hypotheses, which I consider as a risky and unconditional measure. The idea of excluding the alternative taxes, which are also outlined in the CITA, seems rather unconvincing and inconsistent. The new wording of the second alternative hypothesis is even more controversial. In particular, the use of the term "part" that has no legal definition presupposes an over-broad interpretation. For example, the question arises what "part" of the activity is necessary to fall within the scope of Art. 47c, para 4, p. 1 of the CITA. The lack of an established criterion (percentage/numerical ratio, analysis of the activity's nature, based on the legal nature and/or the provided documents) may lead to the possibility of a subjective interpretation. If this part represents 1 % (applying the first proposed by me approach) of the total activity, is this a sufficient condition? It is not clear, for example, whether the part should also meet the necessary requirements of the "branch of activity" under Art. 134 of the CITA. [5]. There is also no guidance on the time criterion. Another disputable moment is, if during the half of the year this part is taxed under Part Five of the CITA, but during the rest of the year does not fall there, what should the overall treatment be. If the legislator's idea was to include all possible hypotheses in the scope, then the exception of the CFC rules seems too wide.

The new wording of Art. 47c, para. 4, p. 2 of the CITA in force as of 01.01.2020 was also amended and is structured in two separate points in its last version. It is not practically and theoretically prescribed what the reasons for inclusion of more hypotheses within the provision's scope are. The question arises whether the alternative taxes under Part Five of the CITA may be defined as "alternative forms of taxation" under p. 2. The latter may lead to the possibility of an even broader interpretation and in particular whether "taxes" are equivalent to "forms" in this hypothesis. If the answer is positive, the same expressions should be used in order to avoid possible ambiguity. If the answer is negative, then the idea of what the legislator meant remains rather unclear.

Taking into account the EU law, I share the view of Ivan Antonov (Антонов, 2018) that a possible option is starting an infringement proceedings by the European Commission (EC) against Bulgaria on this issue. This is directly related to the EC's competence to initiate official proceedings for violation of the EU law. In this context, the Conclusion of the Advocate General Tanev of 28 March 2019 in case C-569/17 is intriguing.

Why this case may be applicable also for the CFC rules despite the different subject –residential real estate loan agreements for consumers? It is the first time the CJEU has the opportunity to rule on the application of Art. 260, para 3 of the TFEU. The AG opinion on the scope of the provision in question is also of interest related to Art. 47c, para 1, p. 2 of the CITA. According to para 18 of the opinion, Art. 260, para 3 of the TFEU also covers cases of "the 'substantive' obligation to transpose itself, that is, that the Member State did not adapt its internal legal order to the directive". Fundamental is para 34 according to which "the provisions of a directive must be implemented with an unquestionable binding force and with the specificity, precision and clarity required in order to satisfy the requirements of legal certainty". Bulgaria may fall under the hypothesis of para 44 in connection with "an incomplete or incorrect transposition of the directive". In the current case, if the limitation of the scope of Directive 2016/1164 is alleged, the question arises what the possible position of the EC would be. Another intriguing point regarding Art. 47c, para 1, p. 2 of the CITA is whether the provision will not be interpreted as a state aid.

After the introduction of the CFC's concept the legislator chronologically and similarly to Art. 8 of Directive 2016/1164, examines the CFC's tax financial result in Art. 47d of the CITA. Pursuant to Art. 18, para 2 of the CITA it may be a positive value – a tax profit, and in case of negative value pursuant to Art. 18, para 3 of the CITA – a tax loss. In his commentary, Velin Filipov (Filipov, 2007) schematically illustrated how the positive tax financial result is formed. Pursuant to Art. 47d, para 1 of the CITA "the taxable person increases his tax financial result for the current year with the tax profit for the same tax period of a non-distributed foreign entity or the profit realized by a foreign business for the same tax period". With regard to this provision, the opinion expressed above regarding Art. 47c, para 1, p. 2 of the CITA of the CITA is applicable.

Regarding the tax profit attention should also be paid to Art. 47d, para 2, p. 3 of the CITA. [6]. A disputable moment may be the expression "proportionally". It is questionable whether this approach is applicable only to the direct participation in the foreign entity or includes also the indirect one. If both types of participation are taken into account, it will lead to double taxation of the tax profit. If the idea was to limit only to the direct participation, then a welcoming idea is either to supplement explicitly the provision. I consider that the case where all three alternative hypotheses in the text in question remain equal, i.e. there is no relevant criterion for proportional increase, is with limited practical significance.

Upon careful reading of Art. 47d of the CITA the understanding is that all elements of the profit are taxed, including the dividends. Pursuant to Art. 47d, para 4 of the CITA in case of their possible subsequent distribution the amount is not reduced. On the other hand, pursuant to Art. 27, para 1, p. 1 of the CITA,

the income from distribution of dividends is unrecognized for tax purposes, a permanent tax difference.

In this case, a conflict regarding the correct application of two EU directives is possible. On the one hand, according to Directive 2011/96 the taxation of dividends in the EU and the European Economic Area (EEA) should be exempt. On the other hand, according to Directive 2016/1164 the CFCs are taxed for its tax profit, including also the dividends. Despite the explicit text of Art. 27, para 1, item 1 of the CITA, this does not reflect the initial taxation under Art. 47d, para 1 of the CITA. It is noteworthy that the newer directive does not provide for a specific rule on this issue.

Such a question is significant because the directives in question outline a different tax treatment by the distribution of dividends. As they both are part of the EU secondary law, they are equally valid and there should be no competition between them. However, in the event of conflict, it is not possible to apply two controversial regimes at the same time. Nor may it be automatically assumed that the newer directive repeals the old one without an explicit provision in this regard. As the aim of the directives in the field of direct taxation is to harmonize the tax treatment, the necessity to find a proper answer to this question arises. In this connection, it is crucial to pay attention again to their nature and their place in the EU law system.

As already mentioned above, Directive 2016/1164 contains 5 groups of rules related to the prevention of abuse of law and one of these are the CFC rules. They are the minimum standard for the Member States, but there are no explicit provisions outlining the maximum. Based on the national sovereignty and the specific needs of each Member State, it may estimate the scope taking into account the fundamental freedoms. I share the view that the lack of a certain scope is an omission rather than a positive option. This may lead to significant differences in the regime in different states, which does not correspond to the objectives pursued to Directive 2016/1164. For example, Bulgaria has not chosen one of the two options in Art. 7 thereof on what should be included in the CFC's tax base. Instead, it has introduced a third separate approach, which despite the idea of a faster and easier administration, is disputable of its fairness and success. The question also remains whether it fully meets the requirements of Directive 2016/1164, as well as whether, if each Member State introduces new rules at its discretion, Art. 7 of Directive 2016/1164 may not be effective.

It should also be noted that the provision of options for own actions by the Member States should be in line with the fundamental freedoms. The CJEU's judgement on case C-168/01 Bosal stated that the observance of the EU secondary law is not a guarantee for the compliance with the EU primary law (para 26-27). In my opinion, the two directives in question and the fundamental freedoms

examined in the current study apply simultaneously, as the former do not always ensure full harmonization in the relevant field (Szudoczky, 2014) . However, any restriction of fundamental freedoms should be in line with the limitation of the abuse. In this regard, it is vital to pay attention also to para 19 of the CJEU's judgement in Case C-166/98 Socridis on the directive's transposition to domestic law.

It is essential whether the restrictive measures provided go beyond what is necessary and are actually required to attain the objectives set out therein. If the answer is negative, no problems should arise. If the answer is affirmative, the Member States should provide for internal mechanisms to counter any non-compliance. In this regard, based on the international doctrine and more precisely, the CJEU's judgement in Cadbury Schweppes, as well as the preamble to Directive 2016/1164, an identity is observed.

One of the main issues in this regard is whether Directive 2016/1164 does not provide the opportunity for application of a certain provision to a Member State or limits its scope preventing any discrimination. I consider that, in order to give a definite and affirmative answer, a thorough analysis should be made of all domestic legislations in this aspect, as well as of the relevant practice. In my opinion, it seems more logical and fair to exclude the distribution of dividends from the scope of the CFC rules, except in case of abuse. In this way, the objectives of two seemingly contradictory regimes will be combined. The provisions of Directive 2011/96 will also be preserved, which will not reflect on the current practice in the CITA. Last but not least, they will be compliant with the new provisions under Directive 2016/1164, which in explicit cases may be in conflict with the first directive for the reasons mentioned above.

The text of Art. 47d, para 7 of the CITA outlines an exception of the general rule under Art. 47d, para 1 of the CITA regarding the determination of the CFC's tax financial result. [7]. Such provision is practically conditional and it is in line with the international doctrine, but it may also raise some questions. In the first place, a problem may arise in the precise definition of "substantial economic activity" and, in particular, what is meant by "substantial". There is no definition in the Bulgarian substantive tax law, nor is there a criterion for its determination. Indeed, for each activity, given its own specifics, a different approach is applicable. However, it would be appropriate to provide some guidance – whether the substantiality should be a percentage, a numerical ratio (similar to the CFC's control) or, for example, the distinction between substantial and ancillary/preparatory activity similar to the PE's concept. Another possible uncertainty is whether, at certain intervals, if the business activity proves to be insignificant, this will affect the tax treatment. It is challenging to assess who will

establish this substantiality – the CFC itself or the tax authorities. The individual analysis of each case is the appropriate approach in this case.

The other terms in Art. 47d, para 7 of the CITA do not provide the possibility of an ambiguous interpretation – the staff, the equipment, the premises and the assets may be both CFC's property, co-ownership and even be in patrimony of another person. However, for more specific activities, a careful analysis should be performed given their nature. Some of them do not stipulate the existence of all criteria set out in the provision. One such example is e-commerce, which does not always require staff as well as additional assets. In some cases, the activity is carried out outdoors, which does not determine the necessity for premises (although the text explicitly provides for an alternative to this criterion through the use of "and/or"). In these hypotheses, it is not clear whether the exception in question should be strictly observed or whether a broader scope is possible.

Art. 47d, para 7 of the CITA ends with the principle of the burden of proof according to the Bulgarian Tax and Social Security Procedure Code (TSSPC) – the favorable facts and circumstances are proved by the person interested (the taxable person in the current case). In this regard, it is essential to pay attention to para 12, the second paragraph of the Preamble of Directive 2016/1164. [8]. Bulgaria has not exercised its right to introduce specific lists into its domestic legislation regarding the CFC rules. I believe it is appropriate to consider adopting such an approach. Such lists would facilitate both the tax authorities and the taxable person by application of the provision in question, limiting the possibility of ambiguous interpretation and enforcement. For example, lists of jurisdictions with a preferential tax regime are regularly published for CITA purposes.

Art. 47e of the CITA introduces the requirement for keeping a CFCs' register. Such provision does not exist in Directive 2016/1164. However, the register in question creates rather unnecessary administrative burdens and additional obligations for the taxable person and it is of limited practical importance. Art. 277d of the CITA outlines the cases of non-fulfillment of obligations within the meaning of Art. 47e of the CITA, in which a significant pecuniary sanction is due. [9]. It is very likely that the register's untimely renewal would lead to its application due to the probable falling into the hypothesis of "incorrect data and circumstances in the register". The question remains whether the keeping of this register is actually directly related to the CFC's legal nature and the objectives pursued in Directive 2016/1164, as well as whether the measures provided correspond quantitatively to the illegal conduct. Another issue is what is meant by "incorrect data". For some reason, the necessary information may not be filled in properly (for example, it is not clear whether the taxable person falls within the CFC's scope). In this case, it is disputable whether this "omission" may lead to the imposition of a pecuniary sanction.

As seen from the analysis of the disputable provisions regarding the CFC rules in the CITA, a number of challenges from a theoretical, practical and lexical perspective may be noticed. Some of them give rise to the possibility of ambiguous interpretation. Another issue is whether Directive 2016/1164 has been correctly transposed to the Bulgarian legislation.

Despite the relatively short implementation of the CFC rules in the domestic legislation, I believe it is appropriate its reconsideration in order to be more effective and fair. These issues are only part of the relative aspects and determine the necessity for further discussions. In my opinion, they are only part of the possible practical challenges on this issue.

Even by acceptance of the view that the CFC rules have a relatively limited scope from the Bulgarian perspective, the regime is associated with a variety of controversial points. Proceeding from the postulates set in the EU primary law, taking into account the harmonization through the EU secondary law, the CFC rules are also part of the national legal order. The inaccuracy of the regime may lead to further difficulties by the introduction of other forthcoming concepts, as well as to a vicious practice. Moreover, one of the objectives of the EU law is to eliminate the trade difficulties between the Member States through ”more favorable domestic rules that attract the companies to their markets and in doing so to develop their economies” (Драганов, 2018, p. 50).

Conclusion

The aim of the current study is to consider several significant issues both from a theoretical and practical perspective regarding the CFC rules. First, the relationship between the EU law and the domestic law is examined. Second, the CFCs, as a new regime in the CITA, are and will be a practical challenge due to the analyzed in the current study aspects. This is mainly because of their complex legal nature. For this purpose, attention is paid to some disputable issues, the solution of which will also be applicable in other tax topics. I believe that some of the aspects concerned may find relatively easy rational solutions, while for some a more detailed conceptual consideration is necessary.

In this regard, they may be divided into two groups. The first ones are rather purely stylistic and are in connection with a possible subsequent textual refinement. They do not have a significant impact on the regime, but they pose some risk of ambiguity by their literal reading. The second are related with the correct the transposition of Directive 2016/1164 and whether the Bulgarian legislation corresponds with the requirements and objectives pursued therein. This differs with both theoretical and practical aspects from both an international and national perspective. Some of the problems require a thorough analysis and

even comparison with another jurisdiction for best practices. This would be a further argument for subsequent amendments of the relevant provisions.

It may be concluded that the examined issue is characterized by significant difficulty and challenges due to the above mentioned reasons. The CFC rules are a symbiosis of accounting (both international and national), economics and law (both European and national). They are relatively new for Bulgaria and nowadays their scope is rather limited. However, this should not be a valid argument in relation to the issues raised in this study. The CFCs' specifics determine the precise consideration of the relevant provisions.

The forthcoming tendencies will outline the CFC's scope, as well as show whether the regime may meet the national needs and to what extent it is in line with the international ones. For example, I support the view of Ivan Antonov for the application of the CFC rules also to the individuals, as this may limit the possible circumvention of law.

Notes

[1] The CITA contains also other relevant provisions on the CFC rules, but they will be not examined in the current study in details.

[2] The BEPS Project is both the OECD's and G20's initiative and introduces measures against tax avoidance trying to prevent tax base erosion and profit shifting. It contains 15 Action Plans that cover the most crucial issues in direct taxation. Action Plan 3 thereof focuses on the CFC rules.

[3] Article 47c. (Last Amendment - SG No. 96/2019, in force as of 01.01.2020) (1) A controlled foreign company is a foreign entity or a permanent establishment abroad whose profits are not subject to taxation or are exempt from tax in the Republic of Bulgaria when the following conditions are met:

2. (Last Amendment - SG No. 96/2019, in force as of 01.01.2020) the corporation tax actually paid on profits including through advance payments or corporate tax overpaid, by the entity or place of business is lower than the difference between the corporation tax that would have been charged to the entity or place of business under this Act and the corporation tax actually paid on the profits of entity or place of business.

[4] Article 47c. (4) (Last Amendment - SG No. 64/2019, in force as of 13.08.2019) Paragraph 1 shall not apply to:

2. (Last Amendment - SG No. 96/2019, in force as of 01.01.2020) a controlled foreign company which is:

(a) foreign entity and for its activity in the country where it is resident for tax purposes or in another state, it is subject to alternative forms of taxation;

(b) a place of business activity abroad which is subject to alternative forms of taxation.

[5] Article 134. "Branch of activity" shall be the totality of assets and liabilities of a company which, from an organizational, functional and financial point of view, constitute an independent business.

[6] Article 47d. (2) The tax profit under para. 1:

3. Increases the tax financial result proportionally to the highest of the foreign capital holding, capital or profits of the foreign entity as well as in proportion to the period of the relevant tax period of the foreign entity in which the foreign entity was fulfilled controlled foreign company.

[7] Article 47d. (7) (Last Amendment - SG No. 64/2019, in force as of 13.08.2019) Paragraph 1 shall not apply when a controlled foreign company carries out substantial economic activity with the help of personnel, equipment, assets and/or premises necessary for the activity concerned, which is proved by the taxable person through the relevant facts and circumstances.

[8] "It is desirable to address situations both in third countries and within the Union. To comply with the fundamental freedoms, the income categories should be combined with a substance carve-out aimed to limit, within the Union, the impact of the rules to cases where the CFC does not carry on a substantive economic activity. It is important that tax administrations and taxpayers cooperate to gather the relevant facts and circumstances to determine whether the carve-out rule is to apply. It should be acceptable that, in transposing CFC rules into their national law, Member States use white, grey or black lists of third countries, which are compiled on the basis of certain criteria set out in this Directive and may include the corporate tax rate level, or use white lists of Member States compiled on that basis."

[9] Article 277d. (New - SG No. 98/2018, in force as of 01.01.2019) A taxable person who fails to fulfill his obligations under Art. 47e or pointed out incorrect data and circumstances in the register under this Article shall be punished with a pecuniary sanction in the amount of BGN 3,000 to 5,000, in the case of a repeated violation - in the amount of BGN 6,000 to BGN 10,000.

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