Tax treatment under the VAT Act of the Republic of Bulgaria of supplies of goods and services between a civil corporation and its participants

I. General provisions

The civil corporation contract is legally settled in art. 357 of the Obligations and Contracts Act of the Republic of Bulgaria (OCA). An unincorporated entity may be established by a contract between two or more persons who intend to unite their activities to achieve a common economic goal. According to the civil law of the Republic of Bulgaria the unincorporated entity does not have a separate legal personality, i.e. the participants in it are holders of the rights and obligations according to their participation. The unincorporated entity does not have either substantive or procedural legal capacity.

According to Art. 9, para. 2 of the Tax-Insurance Procedure Code of the Republic of Bulgaria (TIPC) unincorporated entities and insurance funds in proceedings under the Code shall be treated as legal persons. Within the meaning of Art. 1, para. 2 of the Accounting Act of the Republic of Bulgaria /AA/ unincorporated entities are enterprises.

Therefore, civil corporations established under the OCA, including those under Art. 276 of the Commercial Act of the Republic of Bulgaria (CA[1]) should keep separate accounting under the general rules of the accounting laws and standards.

[1] The Consortium is a contractual association of traders aimed at achieving a particular business objective, it is governed by the relevant rules of civil corporation, provided that it is organized in compliance with this procedure.

With regards to the procedures for establishing liabilities for taxes and mandatory social security contributions, **including in proceedings for imposition of interim measures and on appeals of tax assessments the unincorporated entities are treated as legal entities. Ie. for tax purposes unincorporated entities /civil corporations, incl. the consortium under Art. 276 of the CA/ should be considered as separate legal entities**, which are subjects of tax rights and liabilities.

In the case of civil corporation under Art. 357 et seq. of the OCA the parties do not assume any rights and obligations between themselves as provided for the bilateral agreements. The obligations are not reciprocal but mutual. For these reasons, in its consistent practice the court held that claims may not be filed between partners regarding the civil corporation contract, until it is terminated or one of the partners has left the entity[2]. The rights and obligations of the entity are rights and obligations of the partners themselves. The property of the civil corporation is co-owned by all partners. Everything acquired by the partners is their common property according to the shares held.

II. Tax treatment under the VAT Act of the Republic of Bulgaria

[2] Decision № 2906 of 20.12.2005 of the SCC under civil case№ 2188/2004, IV civil department, Rapporteur-judge Lidia Rikevska - Each partner is obliged to direct his efforts towards a single objective. The obligations of the individual partners are aimed at serving the common goal, which is why they cease to be reciprocal and become mutual. For this reason they become "partners" rather than "parties" to the contract. Art. 358, para. 1 of the OCA obliges the partners, as specified by the contract, to make contributions in cash or other property.

The cash, substitutable or fungible objects become common property of all partners. While the civil corporation exists, there may be no claims due by one partner to the other. The claims against the other partner may be brought only under Art. 359, para. 3 and art. 364 of the OCA and only after termination of the corporation.

Once the partner has waived the opportunity to claim a share of the common assets of the corporation, a claim of ownership may not be filed to revise the bilateral agreement reached in the annex for its termination."

2.1. Lack of supply within the meaning of Art. 10, para. 1 pt. 3 of the VAT Act of the Republic of Bulgaria (VAT Act), respectively taxable supply if a participant in a civil corporation is assigned work beyond the agreed share.

According to a decision of 29.04.2004 on case 77/2001 of the Court of Justice of the European Union operations carried out by members of a consortium, in compliance with the provisions contained in the consortium agreement and corresponding to the share of each member, do not constitute supply of goods or services for remuneration within the meaning of Art. 2 para. 1 of the Sixth Directive. This means that in this case there is no taxable supply of goods or services pursuant to Art. 6, resp., Art. 9 of the VAT Act. For all goods and services provided for general use of the consortium /civil corporation/, according to the shares of the partners, there is no taxable supply within the meaning of the VAT Act. If goods or services outside those agreed in the contract are contributed to the consortium (civil corporation), there will be a taxable supply within the meaning of Art. 12 para. 1 of the VAT Act.

Practically, the goods and services supplied by the partners within the consortium fall under the provision of Art. 10, para. 1 pt. 3 of the VAT Act. This is the hypothesis of lack of supply of goods and services. The property contributed by the partners to the civil corporation is aimed at achieving a common goal and no remuneration is due, which is why it may not be characterized as a supply. This stems both from the fact that there is no reciprocity of considerations and there is no remuneration.[3]

The services, including goods provided by the partners of the civil corporation in view of achieving the common economic goal in compliance with the **civil corporation contract, are associated with the completion of the**

[3] Clarification of the NRA No. 53-00-1124 of 18.02.2013 on the tax treatment of the supply of goods and services by a unincorporated entity

objective for which it was created, so they are governed by the regime applicable to the contributed property[4].

In another decision No. 1827 from 12.07.2012 of the Administrative Court –Varna, Bulgaria under adm. case No. 1073/2012[5], the court held that the civil corporation may receive as a contribution in kind the ownership or use of certain property, even receivables "but not an obligation for future action by a partner /in that context the explicit provision of Art. 72, para. 5 of the Commerce Act of the Republic of Bulgaria (CA), which prohibits contributions in kind to include future labor or services/". The provision of Art. 72, para. 5 of the CA does not apply to unincorporated entities. The contribution of future goods and services by the partners is completely acceptable as long as the activities to be performed by each participant are allocated in advance.

In compliance with a decision of 29.04.2004 of the Court of Justice of the European Communities(CJEU), Fifth Chamber, under Case C-77/01 contributions made within the consortium according to the share held, are not considered supplies for the purposes of VAT. In this case no additional compensation is received for the contributions made. Therefore, there is no supply within the meaning of Art. 10, para 1 pt. 3 of the VAT Act of the Republic of Bulgaria (VAT Act). This thesis adopted by the National Revenue

[4] Decision No. 388 of 22.01.2014 of the Administrative Court - Sofia on administrative case No. 2890/2013 - "due to the fact that unincorporated entities are treated as legal persons and in view of achieving neutral tax treatment of goods and services supplied by the partners within the consortium, art. 10, para. 2 of the VAT Act shall be applicable. Ie the provision of goods and/ or services to the Consortium shall be treated as non-cash contribution (in-kind contribution) by the shareholders. For such goods and/ or services the partners may not issue invoices to the Consortium, because this does not represent a supply. This means that the Consortium, acting as the person who receives the goods or services, is the successor of all rights and obligations in relation thereto, including the right of deduction of tax credit and the obligations for adjustment of the tax credit used. This applies to goods and services received by the Consortium corresponding to the transactions undertaken by its members under the consortium agreement, corresponding to the share of each partner

[5] Substantiated by a decision of the Supreme Administrative Court of the Republic of Bulgaria on administrative case No. 9920/2012

Agency of the Republic of Bulgaria(NRA) and the Supreme Administrative Court of the Republic of Bulgaria could not be fully shared, since the regulation of Art. 10, para. 1 pt. 3 of the VAT Act provides for an in-kind contribution to the capital of trade companies.

It is well-known that tax provisions may not be interpreted broadly, which includes filling of gaps by applying "analogia legis." The civil corporation is not a separate legal entity, so it does not have separate property and everything acquired is owned by the partners, respectively provided for use. Despite the lack of an explicit rule, the provision of Art. 10, para. 1 pt. 3 of the VAT Act should be completed by the legislature with the words "including in an unincorporated entity".

According to CJEU the members of the consortium shall not receive remuneration for their contribution within the consortium, but such shall be paid for the work completed in addition to their agreed share. The above means that in cases where a participant in the consortium is assigned to perform a supply of goods or services for remuneration, VAT shall be charged. This rule applies only to the portion of the contribution exceeding the agreed share participation according to the civil corporation contract.

The contributions to the civil corporation may consist of future goods or services, if this is agreed in advance. The work fulfilled by the partners in accordance with the shares under the contract does not constitute supply, since these are operations related to their general activity, which lack any consideration. This proposition was incorporated in the practice of the Supreme Administrative Court of the Republic of Bulgaria and the CJEU.

Where the contribution of goods and/ or services is associated with the completion of the overall objectives for which the consortium was established,

there will be no supply of any goods or services[6]. No remuneration is due for a contribution to the consortium including a service, either by the other partners or the entity itself. If the contract of civil corporation provides that each participant shall be responsible for a particular job, having a particular value and there is a separation protocol, there will be no supply, provided that the future work is completed pursuant to a common objective[7]. Even if remuneration is provided for individual participants according to their shares, there will be no supply of goods or services.

The other supplies of goods or services carried out by a participant outside the provisions of the contract, i.e. outside the share participation in the civil corporation, are invoiced to the civil corporation and they are subject to the general rules of the VAT Act. In general, these are supplies that are performed after signing the contract establishing the civil corporation, for which the hypothesis of Art. 10, para. 1, point 3 of the VAT Act is not fulfilled[8].

In the event of an inspection of the participants in a civil corporation, they may seek recovery of VAT unduly charged on the civil corporation.

2.2. Tax base for the assignment of a service to a participant in a civil corporation, outside the agreed share.[9]

In a judgment of 26.04.2012 on Joined Cases C-621/10 and C-129/11, the CJEU considered that: "Article 80 paragraph 1 of Directive 2006/112/EC of 28

[6] Decision 8661/ 24.06.2014 of the Supreme Administrative Court on administrative case 15530/2013

[7] Decision No. 4198 of 26.03.2013 of the SAC on administrative case No. 8449/2012 of the SAC, rapporteur Svilena Prodanova

[8] Clarification No. 53-00-295 of 14.06.2012 on the application of the VAT Act with regards to supplies conducted by unincorporated entities (consortium)

[9] The author has considered the practice of the courts regarding the treatment of the activity of consortium members, but believes that in case of full reassignment of the work of a partner there will be a taxable supply of goods and services for the part exceeding his share as referred to in the contract.

November 2006 on the common system of value added tax must be interpreted as meaning that the conditions of application it sets out are exhaustive and, consequently, that national legislation cannot on the basis of that provision provide that the taxable amount is to be the open market value of the transaction in cases other than those listed in that provision, in particular where the taxable person has a full right of deduction of VAT, which is for the national court to ascertain". **The latter means that for transactions between connected persons where the recipient is registered for VAT, the tax base is determined by the general procedure, not under Art. 27 para. 3 of the VAT Act. If the participant in a civil corporation is a VAT registered person and he has been given a reassignment to perform taxable supplies of goods or services outside the agreed share, the tax base is not the market price.**

If the recipient of the particular taxable supply is entitled to a tax credit, the rule of Art. 80, paragraph 1 of Directive 2006/112 shall not apply. According to Art. 80, para. 1 letters- "a" and "c" - in order to prevent tax evasion or avoidance, Member States may in any of the following cases take measures to ensure that, in respect of the supply of goods or services involving family or other close personal ties, management, ownership, membership, financial or legal ties as defined by the Member State, the taxable amount is to be the open market value:

a) where the consideration is lower than the open market value and the recipient of the supply does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177 /these texts correspond to art. 68 - 73 and art. 81 of the VAT Act/;

b) where the consideration is lower than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177 and the supply is subject to an exemption under Articles

132, 135, 136, /on exempt supplies under chapter IV of the VAT Act/ and 371, 375, 376, 377, 378, paragraph 2, 379 paragraph 2 or Articles 380 to 390 / they all relate to derogations/;

c) where the consideration is higher than the open market value and the supplier does not have a full right of deduction under Articles 167 to 171 and Articles 173 to 177. Due to the above in case of supplies between connected persons, where the recipient is entitled to deduction of full tax credit, the determination of the tax base shall not be conducted under art. 27, para. 3, point 1 of the VAT Act, but according to the general rules of the VAT Act - art. 26 of the VAT Act.

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