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In Bulgaria, prior to joining the European Union, all of the main EU directives were implemented in national law. At the beginning of 2007, Bulgaria joined the European Union and since then has offered a reliable legal framework for the business operations of foreign companies.



The Bulgarian tax law system is largely adjusted to the European framework so that an investor from the European zone can easily find his way around and is not confronted with serious "cultural" differences in this respect.

The Bulgarian civil and commercial law is very similar to German civil and commercial law. This can be explained by the fact that at the beginning of the nineties the German commercial code was used as a basis for the new creation of the Bulgarian commercial law. A number of differences nevertheless remain which should be mentioned such as use of the non-possessory pledge as a means of providing security. In contrast to the German right of lien, in Bulgaria a right of lien can be transferred without transfer of the possession. This legal practice is widely used in Bulgaria to provide security covering claims. In this process the security of the company as a whole is pledged.

Despite modernisation and adjustment, Bulgarian labour law is still very conservative and bureaucratic. The general unfriendliness of the legal regulations to employers has its roots in the socialist years.

Bulgarian real estate law is not characterised by serious differences to German law. However, criticism has to be made of the functionality of the Bulgarian land register. The information supplied by the electronic land register is not very reliable as registrations are partly missing or incorrect. When checking real estate we therefore always recommend a visit to the local land register office.

Although since joining the EU the function of the Bulgarian court system can be described as reliable, a number of weaknesses nevertheless exist. In particular the Bulgarian judges are often inexperienced with the interpretation and application of European legislation which as a result can often lead to the wrong interpretation or application of European regulations. In order to take preventive action lawyers are especially called upon in the application initiating the proceedings to include a "textbook" representation of the application area of the regulation and to list conditions necessary for the application of the said provision and interpretations of the said provision.

The Bulgarian financial accounting requirements can be described as bureaucratic, and in particular bureaucratic regulations govern the presentation and retention of documents.

Practical examples

Auditing

Background facts:

The subsidiary of a large German company has been successfully doing business in Bulgaria for many years in the field of food production. The non-compulsory auditing was initially carried out by Rödl & Partner. As the subsidiary continued to grow, the company management in Germany decided to appoint a new local managing director who was primarily responsible for the purchase of raw materials and finances of the company. The new managing director immediately begins to "optimise" the processes of the company. This includes changing of the auditor with the reasoning that a non-compulsory audit can be carried out by a local company at lower cost. In the next three years the profit of the company shrinks by almost 30 %. The headquarters in Germany is perplexed by this development. The auditing department of Rödl & Partner in Bulgaria is commissioned to carry out an internal audit of the financial accounting of the subsidiary. The results of the internal audit are generally positive, the financial accounting is maintained correctly. Just a single fact stood out negatively for the auditor. In the last three years the company had procured certain raw materials at a purchase price which was far above the usual procurement price in the market. The auditor carries out a short market analysis and establishes that there are no explicable reasons which would justify such a purchasing strategy. There were sufficient grounds for suspicion that the managing director procured raw materials from certain suppliers at excessive prices and simultaneously received a "bonus" from the supplier for the conclusion of the business. After a number of telephone calls with the supplier it was established that the managing director had actually received "kick-back" payments.

What can be done now?

The lawyers of Rödl & Partner dismiss the managing director with immediate effect and file a claim for compensation with the civil court. In addition, a referral is made to the public prosecutor.

What should one have done differently from the beginning?

An experienced and independent auditor would already have discovered change to the purchasing policy of the company in the first year and informed the parent company in Germany in the management letter.

Taxes

Background facts:

The Franz & Sepp Bulgaria EOOD company, a subsidiary of Franz & Sepp AG is enjoying substantial growth. The German managing director who is also responsible for the company management of the Bulgarian subsidiary is delighted with the new construction order – the Bulgarian company has signed a contract to manage the execution of a construction order in the role of a general contractor. The total order is worth 20 million euros. The managing director dispenses with local legal and tax consulting as he has already managed similar projects in other Eastern European countries and therefore feels he has the necessary experience. In addition, the ordering party is a company with which there is a good business relationship so that he has full confidence in his business partner. The order is carried out according to the terms of the contract – the part acceptance is made according to the progress of the construction work and accordingly progress payments (after invoicing) are made.

With the final acceptance the parties agree that the final invoice to the amount of 1 million euros will not be written as the ordering party has complained about construction defects and warranty claims against the general contractor which amount to 1 million euros. Thereby the claims are to be set off against each other. In the acceptance report all the construction defects are bindingly listed. After conclusion of the project the tax office carries out a tax audit at Franz & Sepp Bulgaria EOOD. In the course of this audit the construction contract is checked extensively and it is determined that the agreed final invoice has not been written. In the tax assessment it is determined that the sales tax to the amount of 20 % of the invoice which was not written must be deemed as existent and is therefore due for payment.

What can be done now?

Rödl & Partner is commissioned to contest the tax assessment. In the preparation of the appeal the tax consultant establishes that the set-off made with the claim of the ordering party from the warranty was not documented and therefore cannot be presented as proof of the set-off. In the argumentation in support of the appeal one was only able to point out indications of the set-off, whereby such indications were in particular included in the acceptance report and in the correspondence between the parties.

What should one have done differently from the beginning?

The involvement of a local tax consultant in such large projects is inherently important. He is familiar with the practices of the tax office and right from the start would have worked

towards an exact documentation of all transactions relevant for the tax situation. The result of the tax audit would have been without problems from the point of view of the company if the parties had had documented the development of the project and the setting off process in writing.

Law

Background facts:

In 2008, the German Mittelstand company Fuchs AG wanted to outsource its production to Bulgaria. After a long search a small Bulgarian company was found which was ideally suited to handle the contract plating. The opinion of the company management in Germany was that a due diligence of the Bulgarian target was not necessary as the company was small and easy to understand. The low purchase price of 100,000 euros did not justify a costly due diligence process. In addition, the assistant to the company management was a native Bulgarian and could translate the important documents of the target company such as balance sheets, commercial register and land register extracts. In 2013 the locally competent judicial enforcement officer contacted the company and announced that the enforcement of mortgage on the company property had to be endured. The company management in Germany is outraged at the news: "What mortgage can that be! The property had no financial burden! According to the land register extract, the seller was the owner and no mortgage was registered!"

What can be done now?

Rödl & Partner was commissioned to investigate the matter. The investigation established that in 2004 a certain Mr. Ivanov, at that time owner of said property took out a consumer loan to the amount of 10,000 euros secured by a mortgage on the property. As the mortgage was made in a legally effective way and also applies to the current owner, the enforcement proceedings could only be avoided by the payment of 10,000 euros by Fuchs AG. The recourse claim has to be asserted against Mr. Ivanov.

What should one have done differently from the beginning?

When a company is acquired in a foreign country the execution of a due diligence by local professionals is always to be recommended. In the circumstances of the case just the inspection of the current land register extract was not sufficient. In Bulgaria the land register is not based on properties, but is based on the owners, i.e. the land register extract only provides

information on the current owner and his obligation. The current land register extract provides no information regarding the legal predecessors and their obligations. For this reason in Bulgaria it is usual that with the acquisition of land the complete ownership chain (with all obligations) for the last ten years are legally examined.

White-collar crime, Financial Accounting

Background facts:

During an event a tax consultant from Rödl & Partner reports on the taxation of companies in Bulgaria. In the presentation he especially highlights the corporation tax rate of 10 %. After the event a guest asks him: "Are you sure that tax rate is 10 %? I have been active in Bulgaria with my own subsidiary for 3 years now and according to the corporation tax return we pay a tax rate of 15 %." After a consultation Rödl & Partner was commissioned to carry out an internal tax audit of the Bulgarian company. This revealed that since the founding of the company the financial accounting had been made by the wife of one of the Bulgarian managing directors. As the main person managing the accounting she was also responsible for the preparation of the corporation tax return. It turned out that the tax return of the company had incorrectly shown a tax rate of 15 %. Shortly after submitting the tax return and payment of the tax the Bulgarian managing director made an application for repayment of the overpaid tax of 5 % at the tax office. For the repayment process, he gave details of a newly opened company account which was not known to anybody.

What can be done now?

The first measure should be the immediate dismissal of the managing director and the withdrawal of all bank authorisations followed by legal action against the managing director to claim reimbursement of the corresponding amounts and the simultaneous blocking of his bank accounts as a temporary protective measure.

What should one have done differently from the beginning?

Commission an independent and reputable consulting firm to do the financial accounting, the preparation of the annual financial statement and the corporation tax return. The outsourcing of the financial accounting is a method which allows the parent company to exercise regular control.