

TAX EXPENDITURES AS AN INCENTIVE FOR THE AGRICULTURE IN BULGARIA

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Abstract

The government can use different ways to stimulate certain industries or categories of taxpayers. It can be achieved with direct payments and subsidies that increase the budget revenues. It is also possible to achieve this aim by reducing budget revenues by failing to collect some of them to be ceded to preferred groups of taxpayers. These are so-called tax expenditures. In Bulgaria, official statistics on their value and impact have been kept since 2007. Following the requirements of the EU, a national definition of the term tax expenditure is adopted in Bulgaria, which should correspond to the specifics of our tax system. Despite the relatively small share of the tax expenditures - about 2% of total tax revenues in Bulgaria, their values are subject to continuous analysis and control of their effectiveness. The lower it is, the state fails to collect additional revenues without generating benefits for the economy. At the same time, how our tax policy can use them to stimulate an industry such as agriculture, where employment is still quite high, is a priority of this study. The purpose of this article is to assess and analyze the tax expenditures applicable for agriculture in Bulgaria. Modern approaches and methods such as the method of analysis and synthesis have been used in solving the research tasks and achieving the main goal in the research; inductive and deductive methods, comparative methods, and logical description. Continuous analysis and assessment of each tax preference and relief are necessary to be made to establish their effectiveness. This also concerns tax expenditures. If they are ineffective, the state simply fails to collect additional budget revenues without creating benefits for society and the economy. The tax legislation in Bulgaria provides for the application of a small number of tax revenues due to its broad tax base and low tax rates. However, a significant part of them is intended for agriculture. It can be concluded that along with tourism, agriculture enjoys the most tax reliefs.

Key words: tax expenditure, agriculture, Bulgaria

INTRODUCTION

The tax policy is a key tool for the state to achieve economic growth. This is a particularly pronounced trend in countries such as Bulgaria, where the rules of the existing Currency Board impose a ban on the monetary policy. This argument concentrates, even more, the attention of the economic life in our country to the implementation of an effective tax policy.

The main goal of the tax policy is the efficiency and transparency of the tax system. The tax system is effective if it provides the fiscal needs of the state, achieves high economic growth and a good standard of living for citizens. The compromise between fiscal, economic, and social goals is achieved through tax flexibility and stimulating taxpayers' behavior through tax incentives. The Bulgarian tax system provides some

preferences aimed at supporting selected economic sectors and specific activities. Tax preferences can be various forms - low tax rates for income tax and dividend tax, reduced tax rates, tax holidays, investment tax credits, accelerated tax depreciation, tax losses carry forward, and others. The tax preferences mean a reduction of the tax liability, and hence tax revenues in the budget. Losses from tax revenues arising from the tax preferences are treated as tax expenditures.

Agriculture is a key sector for the Bulgarian economy. It forms over 10% of the GVA and GDP of the country in the years of the last century. Agriculture begins to gradually lose ground in total value added after 2000. In 2019, the share of the agricultural sector in GDP is 3.8% [13]. The average incomes [6] in agriculture remain significantly below the average incomes in other sectors of the economy. Agriculture is a risky, difficult, and

often expensive activity, which largely depends on the weather and climate. This in turn leads to an outflow of labor resources from this sector of the economy [7]. All these arguments require the need to apply different incentives in the agricultural sector, including tax preferences.

The purpose of this article is to assess and analyze the tax expenditures applicable for agriculture in Bulgaria.

The object of the present study is the tax system of Bulgaria, and the subject is the tax expenditures applicable for agriculture in Bulgaria in the period 2007-2019.

MATERIALS AND METHODS

For setting this research paper, the authors established the following more important tasks as:

- to structure the tax expenditures in Bulgaria by branches;
- to estimate the tax expenditures by beneficiary taxpayers - legal persons and individuals;
- to assess and analyze the tax expenditures for the agricultural sector in Bulgaria
- to make recommendations for improving the system of tax expenditures related to the agricultural sector.

Modern approaches and methods such as the method of analysis and synthesis have been used in solving the research tasks and achieving the main goal in the research; inductive and deductive methods, comparative methods, and logical description.

RESULTS AND DISCUSSIONS

Agriculture in Bulgaria is one of the traditional industries. Our tax policy applies various instruments and approaches to stimulate the sector, including the use of tax expenditures.

The number of taxpayers who benefit from these benefits also depends on the number of people working in the sector. Traditionally in Bulgaria, many people work in the agricultural sector. In the last several years the share of those employed in the agriculture is declining (Fig. 1).

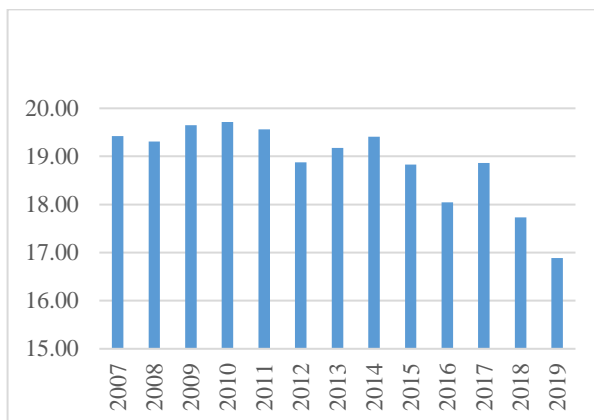


Fig. 1. Share of employees in the agricultural sector in Bulgaria 2007-2019 (%)

Source: Eurostat [8].

According to Eurostat, in the EU-28 in 2019 almost 10 million people work in the agricultural sector. This is 4.11% of total employment (Fig. 2).

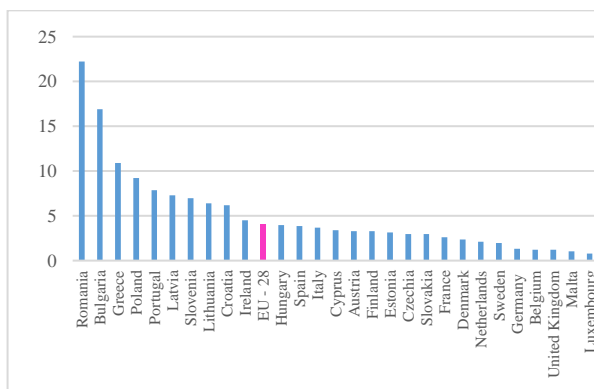


Fig. 2. Share of employees in the agricultural sector in EU-28 2019 (%)

Source: Eurostat [8].

There are only three countries where employment in agriculture constitutes more than 10% of total employment. These are Romania, Bulgaria, and Greece. Bulgaria's leading position shows good potential opportunities for applying different tax instruments to influence a large number of taxpayers.

Such an influence can be achieved in different ways. For example, to stimulate more companies to invest in the agricultural sector, the state can: 1/ grant direct subsidies; 2/ exempt from taxation part of the incomes of the companies in the agricultural sector. Even if the final effect is equivalent, the mechanism for achieving it is different. In the first case,

the subsidy is associated with an increase in the expenditure side of the state budget. In the second case, it is associated with a reduction of the revenue side and that part of it which the fiscal fails to collect. This is the main measure to differentiate the differences between the tax expenditures and other instruments of the tax policy. The tax expenditures are connected with less revenues in the budget. The other instruments are connected with more expenditures. Tax expenditures have economic as well as social objectives. Some of the tax expenditures are introduced either to ease the tax system or as a requirement of the EU member states.

The tax expenditures have a relatively short and dynamic history. The term was first introduced by the American tax specialist Stanley Surrey in 1967. In the early 1970s, only America and Germany use tax expenditures [12]. Five more countries are added by the end of 1983. These are Canada, Austria, Australia, France, and Spain. Almost all OECD countries apply tax expenditures by the end of 1996 [16]. Nowadays the tax expenditures are widely applied among the EU countries. Article 12 paragraph 2 of the Budgetary Framework Directive obliges member states to publish information on the impact of tax expenditures on budget revenues since 2014. The main aim of such a report is to provide transparency and public awareness concerning the application of such tax incentives. Most countries issue such a report usually annually with some exemptions.

In Bulgaria, Tax expenditure report is issued for the first time in 2011. It covers a three-year period from 2007 to 2009. The second one is issued for two years 2010 and 2011. The third report introduces its annual publication [14].

At the very beginning, our national legislation, unlike that of other European countries [2], does not provide a requirement to report tax expenditures. Therefore, at this point, its main purpose is to ensure transparency and clarity concerning the various preferences of the legislation. A new Public Finance Act is adopted in Bulgaria after the entry into force of the European directive. The new act replaces the existing

Law for the Structure of the State Budget. According to Article 16 paragraph 4 of the new law, the Ministry of Finance must prepare an annual tax expenditures report. The additional provisions of the law introduce a definition of the term tax expenditures for the first time in our legislation.

When we analyze the different approaches in the definitions of tax expenditures in a huge number of countries, we realize their serious difficulties in adopting such a definition. Due to the serious differences in the tax systems of every single country, each one is encouraged to introduce its definition. There is no single definition of the tax expenditures to apply in all EU countries.

One of the first definition is in USA legislation in 1974. According to The Congressional Budget Act, tax revenues are "revenue losses attributable to provisions of federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability" [3]. According to Anderson [1], tax expenditures are "provisions of tax law, regulation or practices that reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax".

One of the most common definitions is adopted in Bulgaria before the introduction of the Public Finance Act. This is the definition of the OECD. According to it, tax expenditure means

"transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by a direct expenditure" [15].

After 2014 in our country a national definition is adopted. Within the meaning of §1, item 9 of the Additional Provisions of the Public Finance Act, tax expenditure means "indirect expense made through the tax system by virtue of a legislative provision which leads to reducing or deferring budget revenue in order to achieve a specific economic or social objective"[17].

For the annual Tax expenditures reports in Bulgaria, a broader definition is adopted. It specifies that tax expenditure "is an indirect

expenditure made through the tax system to promote economic or social goals by virtue of provisions of tax law or regulation that reduce or postpone revenue for a certain category of taxable persons relative to a benchmark tax for the respective tax“.

The tax expenditures can take various forms as presented in Fig. 3.

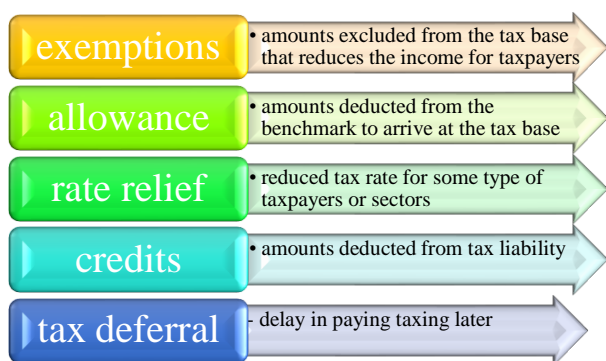


Fig. 3. Types of tax expenditures

Source: Own determination

The significance of the tax expenditures and their value in Bulgaria are shown in Table 1.

Table 1. Tax expenditures in Bulgaria 2007-2019

year	Total Amount of Tax Expenditures (in BGN)	% of GDP	% of Tax Revenue
2019	707,563,767	0.59	2.01
2018	634,804,219	0.59	1.97
2017	636,205,181	0.63	2.15
2016	641,987,825	0.69	2.39
2015	522,544,048	0.6	2.1
2014	494,296,293	0.6	2.15
2013	576,074,446	0.74	2.58
2012	562,778,019	0.72	2.61
2011	551,230,519	0.73	2.68
2010	464,302,410	0.66	2.44
2009	388,418,277	0.57	2.61
2008	402,298,663	0.58	2.4
2007	470,532,532	0.78	3.26

Source: Ministry of Finance [14].

These data allow us to conclude that the tax expenditures in Bulgaria show a smooth and secure downward trend in both as % of GDP and as % of total tax revenues. Nevertheless, every year the government fails to collect

about 2% of its possible revenues to stimulate certain industries, taxpayers, etc. to achieve certain economic or social objectives.

Regardless of the form of the existence of the tax expenditures in Bulgaria, they affect two main categories of taxes:

(1) personal income taxes and corporate taxes and

(2) VAT and excise duties. In countries like ours with a broad tax base and low rates, the number of tax expenditures is not large and vice versa.

These four types of taxes treat in different ways the individual industries. The preferential ones in Bulgaria are namely agriculture, energy, tourism, financial sector, transport, and others. Transport is not treated as a preferential industry after 2015. The taxes that concern the agricultural sector in Bulgaria are three in number – individual and corporate income tax and excise duties. The overall distribution of tax expenditures by individual preferential sectors, including agriculture, are presented in Fig. 4.

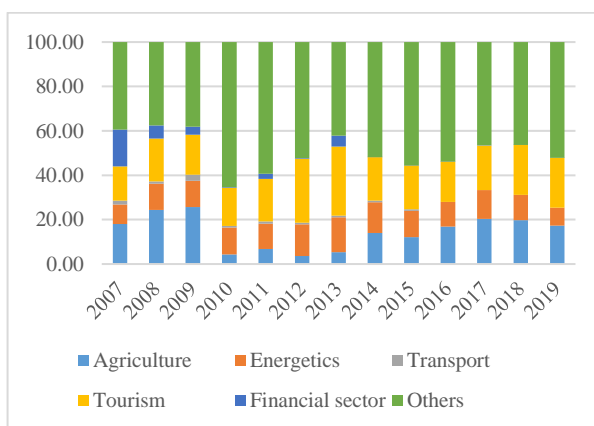


Fig. 4. Tax expenditures by industries 2007-2019

Source: Ministry of Finance [14].

From the above figure, we can summarize the conclusion that agriculture is one of the most preferred industries in Bulgaria. In the period 2007-2009, it has a leading position. In the period 2014-2019, it maintains its leading positions on a par with tourism. Both sectors have close competing shares. The exception is the period 2010-2013. The low values are due to the elimination and subsequent recovery in 2014 of one of the most serious preferences for the agricultural sector - remittance of excise

duty on purchased gas oil used in primary agricultural production.

The main tax expenditures intended for agriculture in Bulgaria are:

-Refund of excise duty on purchased gas oil used in primary agricultural production according to the Excise Duties and Tax Warehouses Act [9].

-Remission of up to 60 percent of the corporate income tax for registered agricultural producers according to Corporate Income Tax Act [4].

-Remission of the annual income tax up to 60 percent for sole proprietors registered as agricultural producers according to Income Taxes on Natural Persons Act [10]

Some tax expenditures are difficult to measure [5] and therefore to assess their impact. The lack of assessment is because often the tax returns do not contain the necessary data or contain summary information that cannot be used to assess the given tax expenditure [11].

For this reason, the authors focus on the three tax preferences aimed only at agriculture.

(1)The first preference has the highest share. This is the possibility for remittance of excise duty on purchased gas oil used in primary agricultural production according to the Excise Duties and Tax Warehouses Act.

Over the years, this measure has been applied and reported in various forms. In the period from 2010 to 2013, the measure is canceled. After 2013 it is recovered as special deducting excise duty in return for fuel vouchers in the form of State aid. In this form, the measure functions until June 2016, when it is canceled again. After that and until 2023 the measure is implemented as “special procedure for remittance of excise duty on purchased gas oil used in primary agricultural production” according to article 47a of the Agricultural Producer Support Act and article 45e of the Excise Duties and Tax Warehouses Act. According to the new rules, it is possible to return part of the value of the excise duty on the gas oil used for mechanized activities in the primary agricultural production.

The farmers that want to participate in this aid should apply to the Regional Directorate of Agriculture. In addition to the application, the farmers submit copies of the invoices for

purchased gas oil and a certificate of presence or absence of obligations. Invoices should be issued to the registered farmer applying for the aid. An individual annual quota in liters is set for each farmer, which is lower than:

-the maximum admissible amount of gas oil, and

-the quantity of purchased gas oil on invoices.

Only the quantity of gas oil in the invoices is taken into account for the determination of the individual annual quota. The discount from the value of the excise duty per liter of purchased gas oil [5] is equal to the ratio of the total amount of state aid provided for the respective year in the State Budget Act and the sum of the individual annual quotas of the farmers for the respective year.

The remitted excise duty on purchased gas oil used in primary agricultural production has the largest relative share as % in the tax expenditures under the Excise Duties Act and as % in the tax expenditures.

This can be traced in Figure 5. The period 2010-2013 is not reflected in the figure due to the canceled measure during the mentioned years.

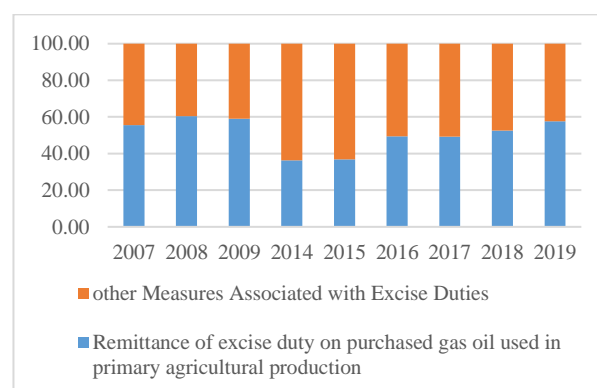


Fig. 5. Share of remittance of excise duty on purchased gas oil used in primary agricultural production 2007-2009/2014-2019 (%)

Source: Ministry of Finance[14].

In the period 2007-2009 and 2014-2019, taxpayers reimburse between 0.9% -2.23% of total excise revenues in the form of excise duty on purchased gas oil used in primary agricultural production. The amount of the remitted excise duties increases with the years. This fact shows that the tax preference is becoming increasingly popular among taxpayers (Table 2).

Table 2. Share of remittance of excise duty on purchased gas oil used in primary agricultural production and absolute amount 2007-2009/2014-2019

year	Amount (in BGN)	% of Tax Revenue from Excise Duties
2007	63,126,287	1.90
2008	80,846,524	2.00
2009	85,847,866	2.23
2014	43,214,075	1.07
2015	40,570,568	0.90
2016	72,590,105	1.51
2017	83,991,849	1.69
2018	83,993,454	1.61
2019	83,580,834	1.52

Source: Ministry of Finance [14].

(2) *The second tax expenditure in the agricultural sector is a part of the corporate tax.* It has existed since 2007. The measure allows a remission of up to 60 percent of the corporate income tax for registered agricultural producers according to the Corporate Income Tax Act.

Legal entities registered as agricultural producers enjoy tax relief under the Corporate Income Tax Act. According to this state aid, the corporate tax [4] shall be remitted in the amount of up to 60 percent to taxable persons, registered as an agricultural producer, for their taxable profit from the activity of production of non-processed plant and animal products. The tax could be remitted only where the following requirements have been met in aggregate:

- the remitted tax is invested into new buildings and new agricultural equipment, required for carrying out of the activity referred to the activity of production of non-processed plant and animal products and acquired by the end of the year, following the year, for which the remittance is applied;
- the assets are acquired under market conditions, corresponding to those for non-affiliated persons;
- the activity referred to the production of non-processed plant and animal products must continue being carried out for at least three years after the year of remittance;
- the remitted tax must not exceed 50 percent of the current value of the assets, determined as of the date of granting of the aid;
- the current value of all assets determined as of the date of granting of the aid may not

exceed a limit of the equivalent in BG levels of EUR 500,000. The limit may not be bypassed through the artificial division of the assets;

- the assets do not replace the existing assets;
- as regards the assets the farmer is not recipient (beneficiary) under any other national or European aid.

The tax preference can be used together with the filing of the Annual Tax Return by the taxpayer.

The remitted tax on the profit of the agricultural producers constitutes about 10% of the tax expenditures associated with the Corporate Income Tax Act (Fig. 6).

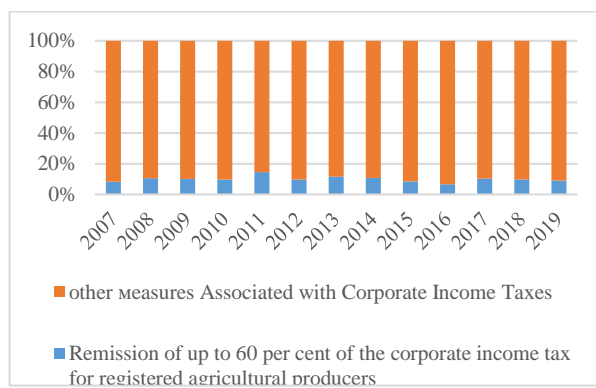


Fig. 6. Share of remission of up to 60 percent of the corporate income tax for registered agricultural producers 2007-2019 (%)

Source: Ministry of Finance [14].

Given a large number of possible tax reliefs under this law, 19 for the last 2019, we can conclude that farmers are actively taking advantage to reduce their tax liability. This measure is among those with the highest relative share within the measures associated with corporate tax in almost all years of the analyzed period.

The remitted tax for agricultural producers occupies a share ranging from 0.73% and 2.51% of total revenues under the Corporate Income Tax Act (Table 3).

The same trend in the amounts of tax expenditure during the period considered cannot be established.

The reason is that the analyzed measure allows for application only in cases of realized tax profit.

This cannot always be realized, especially in the different years of decline or growth in the national economy.

Table 3. Share of remission of up to 60 percent of the corporate income tax for registered agricultural producers and in absolute amount 2007-2019

year	Amount (in BGN)	% of Tax Revenue from Corporate Taxes
2007	21,510,000	1.07
2008	16,960,000	0.70
2009	14,129,000	0.73
2010	20,349,083	1.50
2011	37,475,865	2.51
2012	20,349,083	1.22
2013	31,055,219	1.90
2014	25,776,116	1.44
2015	22,598,164	1.14
2016	21,164,419	0.96
2017	27,691,708	1.13
2018	25,803,422	0.99
2019	25,629,746	0.90

Source: Ministry of Finance [14].

(3) *The third tax expenditure for the agricultural sector has the smallest relative share.* This measure allows the income from business activity as a sole entrepreneur to be remitted in the amount of 60 percent to persons, registered as agricultural producers, for an annual basis of taxation from the activity for production of non-processed plant and animal products. Although this measure exists in this form and without changes since 2010, the statistical data for this tax expenditure in Bulgaria are collected later. The values are from 2016 to the present and can be traced in Figure 7.

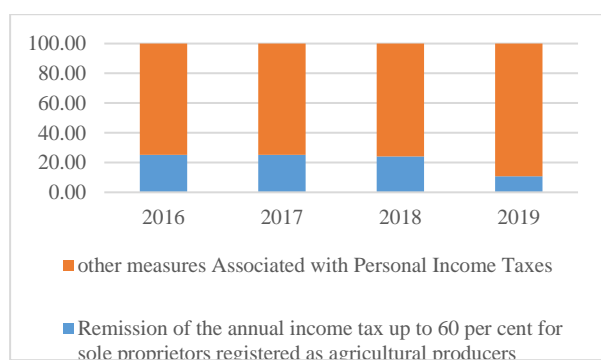


Fig. 7. Share of remission of the annual income tax up to 60 percent for sole proprietors registered as agricultural producers 2016-2019 (%)

Source: Ministry of Finance [14].

The share of the remission of the annual income tax up to 60% for sole proprietors registered as agricultural is around 25% of the value of all tax expenditures associated with personal income taxation in the first three years. In the last 2019 year, this value is halved. The reason for such a reduction is

related not to a change in the amount of this tax expenditure. It is due to the very quick increase in the amount of the other measures associated with personal income taxation. This conclusion can also be traced from the data shown in Table 4.

Table 4. Share of remission of the annual income tax up to 60 percent for sole proprietors registered as agricultural producers 2016-2019

year	Amount (in BGN)	% of Tax Revenue from Personal Income Taxes
2016	15,078,114	0.51
2017	18,012,663	0.54
2018	15,601,316	0.43
2019	13,306,734	0.33

Source: Ministry of Finance [14].

It would be recommended to analyze the values of this tax expenditure in the future, to see if it has become inefficient. In this case, the state simply fails to receive additional revenue, without generating benefits for economic growth.

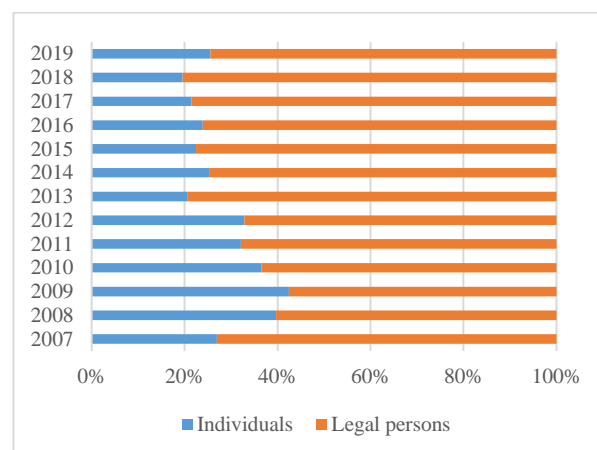


Fig. 8. Tax expenditure estimates by beneficiary 2007-2019

Source: Ministry of Finance [14].

These values may be due to the observed in the last 5-6 years a steady trend of a declining share of individuals benefiting from tax expenditures compared with legal persons. This conclusion can be traced from the data presented in Figure 8.

CONCLUSIONS

Tax relief may be granted to certain categories of taxpayers not only through direct payments as a part of the expenditure part of the state budget. A source of such relief may be the

reduced fiscal revenues, which the state fails to collect. These are namely so-called tax expenditures.

There are different definitions of the term tax expenditures. Due to the specific features of the tax system of the countries, each of them should adopt its own. For the first time in Bulgaria, such a definition has been available since 2014 with the adoption of the Public Finance Act.

Continuous analysis and assessment of each tax preference and relief are necessary to be made to establish their effectiveness. This also concerns tax expenditures. If they are ineffective, the state simply fails to collect additional budget revenues without creating benefits for society and the economy.

The tax legislation in Bulgaria provides for the application of a small number of tax revenues due to its broad tax base and low tax rates. However, a significant part of them is intended for agriculture. It can be concluded that along with tourism, agriculture enjoys the most tax reliefs. Tax expenditures must be clearly and comprehensibly defined for the taxpayers. This implies a continuous assessment of the degree of complexity of the tax reliefs. Tax expenditures should be aimed at stimulating investment, research and development, and energy efficiency, i.e. they should also bring future benefits to businesses and the economy as a whole.

Although the assessment and reporting of the tax expenditures, including those related to agriculture, requires time and resources, it is a necessary condition for increasing the efficiency and fairness of the tax system. It will give a chance to improve the tax system and structure more effective government incentives.

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