VAT recovery on bad debt

As of 01.01.2023 the VAT Act (VATA) introduces the possibility for reduction of charged VAT by the supplier upon bad depts for supplies within the territory of Bulgaria.

I. “Bad debt” for VAT purposes

According to the VATA a receivable may be determined as bad debt in one of the following circumstances:

1. expiration of three years for receivable with three years prescription period or expiration of five years for receivable with five years prescription period as of the moment the receivable became due;
2. the receivable or part of it was ruled undue according to a court decision;
3. the receivable was settled by force of law;
4. after finalization of enforcement proceeding, the receivable remained fully or partly unrecoverable;
5. insolvency proceeding of the debtor ended with agreed recovery plan which provides for partial recovery of the supplier’s receivable;
6. expiration of 365 days as of the moment the receivable became due for receivable up to BGN 600;
7. the debtor – the recipient of the supply, ceased to exist after finalized insolvency or liquidation proceeding.

II. Application requirements

In case of bad dept, the supplier is allowed to decrease the VAT charged on the supply if the following conditions are simultaneously met:

1. the invoice issued for the supply meets the legislative requirements;
2. the recipient and the supplier are not related parties as of the moment of the supply as well as of the moment of determining the receivable as bad debt according to the legislative requirements (see Section I. above);
3. the receivable is not transferred against consideration;
4. the supplier can prove that actions for collection of the receivable were undertaken;
5. the supplier notified in writing the recipient, who was registered under the VATA at the time of the supply, that the former considers the respective receivable as bad debt and can prove that the notification was sent to the registered address of the recipient.

III. Application mechanics

1. When the recipient of the supply:
   • was not registered under the VATA at the time of the supply, or
   • has ceased to exist as of the moment the requirement for determining the receivable as bad debt was met.

The reduction of the tax base and the VAT charged is done by the supplier:
- If only the four conditions listed in Section II.1-II.4 above are met;
- by issuance of a protocol under a procedure (not yet promulgated as of the current moment) according to the Regulation for application of the VATA;
- within three months from expiration of the tax period during which the condition for bad debt under Section I. above was fulfilled.

The issued protocol is included as negative amount in the sales ledger and the VAT return for the respective tax period.

The reduction of the VAT charged is determined as difference between the tax charged for the supply and the tax credit utilized by the supplier for the goods and services received, which are directly related to the made supply, up to the fully or partially outstanding amount for the supply. The VATA does not provide a definition which supplies are considered as directly related to the supply from which the bad debt originated; therefore, a clarification might be introduced by the Regulation for VATA application or through the tax authorities’ written guidance.

2. When the recipient of the supply:
   • was registered under the VATA at the time of the supply, and
   • was still existing as of the moment the requirement for determining the receivable as bad debt was met.
The reduction of the tax base and the VAT charged is done by the supplier:

- if all the five conditions listed in Section II.1-II.5 above are met;
- by issuance of a credit note under the requirements of the VATA.

For a bad debt with tax base exceeding BGN 100,000, the supplier shall notify the tax authorities within three months after expiration of the tax period during which the condition under Section I. above for determining the receivable as bad debt was met. The tax authorities shall issue a permission within 60 days of filing of the notification whereas the absence of response by this deadline is deemed a permission for issuance of a credit note.

The supplier issues credit note within three months:

- from the receipt of permission from the tax authorities – for a bad debt with tax base exceeding BGN 100,000, or
- from expiration of the tax period during which the condition for bad debt under Section I.1-I.6 above was fulfilled only in instances when the supply recipient utilized tax credit under the invoice – for a bad debt with tax base not exceeding BGN 100,000.

IV. Application limitations

Reduction of the tax base and the VAT charged in case of bad debt is not allowed in instances when the VAT registered supplier knew or should have known as of the moment of the supply that the amount due for the supply would remain outstanding. Under the VATA, it is established that the supplier should have known when the supply:

- was fictitious,
- circumvents the legislation, or
- is at a price which considerably differs from the market price.

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