

## SET-OFF AS A MEANS FOR EXTINGUISHING FINANCIAL (PUBLIC) OBLIGATIONS IN THE REPUBLIC OF BULGARIA

### Introduction

The execution of financial obligations in the Republic of Bulgaria can take three forms: voluntary execution, set-off and enforcement. Therefore, set-off is one of the forms of execution. Set-off is also a main legal means in the Bulgarian legal system which finds a wide application both in civil and commercial law, and in financial law.

It is widely accepted in legal theory that set-off is defined as the means to extinguish two counter and liquid receivables (obligations) up to the amount of the lower thereof. This is the extinction of an obligation through the set-off thereof against a counter receivable which the debtor holds against its creditor. The common conditions for the performance of a set-off are: two existing counter receivables/obligations having identical subjects, homogeneity and substitutability of the object of the counter receivables/obligations, liquidity of the counter receivables/obligations, and the receivables being due and payable.

The widely spread monetary character of financial receivables and obligations allows set-off to be used also in financial law. The subject of the present study is the influence of the specifics of regulated public relations and the sovereign method applied in financial law on the requirements and the conditions for the extinction of financial receivables and obligations through set-off.

The legal framework of the requirements and the conditions for the extinction/discharge of financial receivables and obligations through set-off may be general and specific.

The general legal framework is contained in the Taxation and Social Security Procedural Code (TSPC)<sup>1</sup>, which regulates the three hypotheses where the set-off of financial receivables and obligations is allowed.

### 1. Set-off by the revenue organs

**Revenue organs** have the right to extinguish due and payable public (including financial) obligations which are collected by them through **set-off thereof against** paid or collected, but undue, sums received from financial debtors for taxes, obligatory social security payments, fines and property sanctions, as well as sums liable for reimbursement by the National Revenue Agency (NRA) in accordance with the fiscal or the social security legislation. In this case, set-off may be performed also as against an obligation extinguished by a time bar, when the receivable of the debtor became due

and payable before its obligation was thus extinguished (Art.128(1) TSPC).

The set-off of public (including financial) obligations is forbidden when the execution of one of the obligations has been deferred or delayed, due to it hence not being due and payable.

In the cases where the debtor's receivable arises from an unduly paid or liable for reimbursement excise duty, the legislator has limited the type of obligations against which set-off may be exercised. Such receivable may be set off only for the purposes of discharging due and payable public obligations of the same person and which are collected by the "Customs" Agency. The competent organ to perform the set-off is the director of the customs at the domicile or the seat of the person concerned or of the location of the fiscal warehouse – where the person in question is a licensed warehouse owner, or the competent customs bureau which has issued the relevant certificate of customs registration.

In the case here considered, the set-off may be performed both at the initiative of the revenue organ/customs organ, and at the written request of the debtor. The request for set-off is considered if it is submitted within 5 years, counted from 1 January of the year which follows the year in which the basis for the reimbursement of the relevant sum has arisen, unless the law provides otherwise. In the cases where the financial debtor has requested the set-off, the competent revenue organ evaluates the merits of the request and can impose the performance of an inspection or a check to determine whether the conditions provided for by law for that purpose are present (Art.129(2) TSPC).

The set-off of financial counter receivables/obligations is performed through a unilateral sovereign volition of the competent revenue organ/customs organ. For this purpose, a set-off act is issued within 30 days of receipt of the request therefor, unless an inspection is scheduled for that period. The non-response within the same period on a request for a set-off act is considered an implicit refusal. If the person concerned has not appealed such implicit refusal, they can submit a new set-off request by the end of the time bar period.

The sovereign volition of the competent revenue organ cannot be changed by the debtor. The latter cannot indicate another obligation for set-off which is different than the one set off by the competent revenue organ.

As from the moment of the set-off, no execution of the extinguished obligations can be required, as it would

<sup>1</sup> Published in the National Gazette (NG), issue 105 of 29 December 2005, last amended and supplemented – NG, issue 94 of 4 December 2015.

be without legal basis. Neither party owes any interest to the other, but if any interest is paid it remains subject to reimbursement to the payor.

The set-off act, and the implicit or the express refusal for its issuance can be appealed in accordance with administrative procedure (before the director of “” in the NRA, and when it was issued by a customs organ – before the director of the “Customs” Agency) and before court. The petition therefor must be submitted within 14 days as from the receipt of the act of refusal of set-off or as from the end of the decision period in the case of an implicit refusal. When an implicit refusal is cancelled by administrative or judicial procedure, any express refusal which has followed before the taking of the cancelling decision is also considered cancelled.

Although by exception, the possibility to set off due and payable public (including financial) obligations against undue but paid or collected sums from financial debtors for taxes, obligatory social security payments, fines or property sanctions, as well as sums liable for reimbursement by the NRA in accordance with the fiscal or the social security legislation, is not only its legal right but also its obligation. Such obligation for the revenue organs arises when an enforceable administrative or judicial act or decision is presented to them, and which recognizes, to the benefit of the debtor, the right to reimbursement of sums constituting incorrectly or unduly paid or collected taxes, obligatory social security payments, fines or property sanctions. In these cases, the set-off obligation must be executed within 30 days as from the presenting of the relevant administrative or judicial act or decision.

The set-off is performed up to the amount of the lower obligation, in compliance with the legally established sequence of extinction of financial obligations.

As a result of the set-off, the financial legal relation changes, as one of the obligations in its content is extinguished. As from the moment of the extinction of the counter obligations, the accrual of interest on arrears also stops.

## 2. Set-off by the competent organ for the determination of the financial obligation

Outside of the cases outlined above, until the start of the enforcement of the financial obligation, the latter may be set off by **the organ which is competent to determine such obligation**. This organ is set out by the law which regulates the relevant financial obligation. If the relevant law does not indicate the organ which is competent to determine such obligation, such organ is indicated by the director of the relevant central administration, respectively the mayor of the municipality. The manner for the determination of the financial obligation in respect of its basis and amount is by rule regulated in the relevant law, but if the latter does not contain any provisions in that regard, this is done by an act for public receivable, which act is issued in the manner for

issuance of administrative acts provided in the Code of Administrative Procedure<sup>1</sup> (Art.166(2) TSPC). This act can be appealed in accordance with the administrative procedure before the mayor of the municipality in the case of public municipal receivable, and before the director of the relevant administration in the case of a public state receivable, in accordance with the rules of the Code of Administrative Procedure.

In the case considered, the organ which is competent to determine the financial obligation is obliged to perform the set-off on its initiative, a basis exists for extinguishing the financial obligation with a due and payable receivable of the debtor for excess sums or such liable for reimbursement, and relating to financial obligations and acts issued by the same organ and which is competent for their determination. A set-off against a financial obligation extinguished by time bar is possible here as well, when the debtor’s receivable became due and payable before its obligation was thus extinguished.

By exception, the debtor may also request that set-off be performed. If the competent organ refuses to do so, such refusal is also subject to appeal by the debtor, but in accordance with the rules of the Code of Administrative Procedure within 7 days as from the announcement of the refusal.

## 3. Set-off during an enforcement proceedings

After the start of enforcement proceedings in respect of a financial obligation, but before the date of the public sale, the extinction of such obligation through set-off remains possible. Therefore, when basis for a set-off is found during the enforcement procedure for financial obligations, on the debtor’s request or the public officer’s initiative the procedure must be stopped. The halt remains until the end of the set-off steps’ completion but for no longer than 3 months, unless an inspection is scheduled. The procedure is put on hold on the decision of the public officer to whom the debtor has presented written evidence certifying the basis for the set-off. The public officer is obliged to send the request together with the evidence to the relevant organ which is competent to perform the set-off. If as a result of the set-off the obligation is wholly or partially discharged, the enforcement procedure is ended or is continued for the remainder of the obligation, respectively. The set-off influences also any security interests undertaken by the enforcement organs, since the extinction of the main obligation extinguishes also the security interests related thereto.

## 4. Set-off of financial receivables and obligations in accordance with the special laws

### 4.1. Set-off in accordance with the Law on the Value Added Tax (LVAT)<sup>2</sup>

Value added tax is imposed on all transactions performed for a consideration and having a translative effect, as well as on the import of goods, performed by all persons registered under the LVAT. The VAT sum paid

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<sup>2</sup> Published in the NG, issue 63 of 4 August 2006, last amended and supplemented – NG, issue 95 of 8 December 2015.

by the taxable person registered under the LVAT on the purchases made by it, as well as in the case of import of goods - including before the date of its registration if they are available on the date of such registration, is determined by a tax credit which may be whole or partial. The tax credit is by its nature a financial receivable of the person registered under the LVAT against the state budget. On the basis of the existing legal framework, the taxable person has *the legal right to set-off against (to deduct from)* its fiscal obligations for payment of VAT the sum constituting its tax credit.

The taxable person may exercise their set-off (deduction) right of the tax credit sum for the fiscal period during which this right has arisen or in one of the next 12 fiscal periods. A fiscal period within the meaning of the LVAT is the time period after the end of which the registered person must submit a reference-declaration with the results for such period. This period is of 1 month for all registered persons and coincides with the calendar month. The result for the fiscal period is the difference between the aggregate sum of the tax payable by the relevant person for this fiscal period and the aggregate sum of the tax credit for which the set-off right has been exercised for this fiscal period. The registered person determines by themselves the result for each fiscal period – tax to be paid in the state budget or tax to be reimbursed by the state budget.

The right to set off the tax credit against the tax obligations to pay VAT of the same person arises upon the performance by such person of the following two obligations: to include the amount of the tax credit when determining the result for the relevant fiscal period and to indicate the document relating thereto in the purchases diary for such fiscal period.

In the cases where the result for the relevant fiscal period is a tax to be reimbursed by the state budget, a new legal right arises together with a corresponding obligation for the competent revenue organ to set off this obligation of the budget against other existing, due and payable public obligations of the registered person which are collected by the National Revenue Agency, if they have come into being by the date of submission of the reference-declaration. When exercising this right the competent revenue organ is obliged to follow the below sequence:

- in the presence of other due and payable and unpaid fiscal and social security payments obligations collected by the National Revenue Agency, and arisen by the date of the submission of the reference-declaration, the revenue organ sets off these obligations against the tax to be reimbursed as indicated in the reference-declaration;

- when there are no due and payable and unpaid obligations of the types mentioned above, as well as in respect of the remainder left after their discharge, the registered person sets off the tax to be reimbursed or its remainder against the tax due to be paid in as indicated

in the reference-declarations submitted in the next two consecutive fiscal periods;

- if after the end of the indicated fiscal periods there is a remainder of the tax to be reimbursed, the revenue organ sets off this remainder against, and in discharge of, due and payable public receivables collected by the National Revenue Agency, or reimburses it within 30 days as from the submission of the last reference-declaration.

The LVAT provides also **two special cases** where the right to set-off in respect of a formed tax credit may arise.

A) Right of set-off of tax credit for available assets and received services before the registration date

The person registered for the purposes of VAT taxation receives the right of set-off of tax credits for the assets, within the meaning of the Law on Accounting, purchased or otherwise acquired before the date of its VAT registration. This legal right arises only for any available assets if at the same time the conditions provided for by Art. 74(2) LVAT have also been fulfilled. This legal right of set-off of tax credit arises also for services received before the date of the VAT registration.

The set-off right of tax credit in the case here considered arises on the date of the person's registration under the LVAT, but subject to the following condition – that the registered person provides a registration inventory of such assets and services within 45 days. The right of set-off of tax credit ends if the registered person has submitted the registration inventory of the assets and services after the 45th day as from the registration date. This legal right may be exercised during the fiscal period during which it has arisen or in one of the next 12 fiscal periods, with the available assets, the services received and the tax included in the registration inventory being reflected in the purchases diary for that fiscal period.

B) Right of set-off of tax credit for a second registration

The registered person has the right to set off the tax calculated and paid by it in case of its de-registration under the LVAT for the assets which are available as at the date of the subsequent registration. In this case, the legal right arises **when the following cumulative conditions have been fulfilled**: the assets available, within the meaning of the Law on Accounting<sup>1</sup>, at the date of the subsequent registration under the LVAT have been taxed at the de-registration and are intended to be used to make taxable supplies; the tax calculated at the de-registration has been effectively paid in or has been set off by the revenue organ; a registration inventory on basis of an example has been submitted for the assets no later than 45 days as from the registration date.

The set-off right in this case arises on the date of the second registration under the LVAT, but subject to the following condition – that the person who has registered for the second time submits a registration inven-

<sup>1</sup> Published in the NG, issue 95 of 8 December 2015.

tory of the assets and services within 45 days. If the registered person does not comply with this deadline, its legal right of set-off is extinguished.

The set-off right may be exercised during the fiscal period during which it has arisen or in one of the next 12 fiscal periods, with the available assets and the tax included in the registration inventory being reflected in the purchase diary for that fiscal period.

#### **4.2. Set-off under the Law on corporate revenue taxation (LCIT)<sup>1</sup>**

One of the taxes regulated by the LCIT is the corporation tax. The taxable object thereof is the fiscal profit determined in accordance with the rules and conditions provided in such law. The perception of corporation tax is yearly therefore the fiscal period for its determination is a calendar year. The fiscal period for newly-incorporated taxable persons covers the period from the date of their incorporation to the end of the relevant year and for liquidated ones – the period from the beginning of the relevant year until the date of their liquidation, unless otherwise provided by law.

On the basis of the fiscal financial results indicated in the tax declaration from the previous year and the projected fiscal profit for the current year, tax debtors must make monthly or quarterly advance payments for corporation tax. The obligation to make monthly advance payments exists for taxable persons whose net revenue from sales for the preceding year is above 3,000,000 lv., and all other taxable persons must make quarterly advance payments. The following are not obliged to make advance payments: taxable persons whose net revenue from sales for the preceding year is below 350,000 lv., and newly-incorporated taxable persons for the year of their incorporation other than those coming into existence as a result of a transformation in accordance with the Commercial Law.

The monthly and quarterly advance payments are made in the amounts determined by the formulae set out in the law. The amount of the advance payments due by the taxable persons to whom corporation tax is assigned for the current year is reduced proportionally to the amount of the assigned portion of the tax. The taxable persons can on their own initiative reduce the amount of their advance payments, when they consider that they exceed the yearly corporation tax due. This right can be exercised through the submission of a declaration based on example to the competent territorial directory of the NRA.

The monthly advance payments are made by the 15th of the month for which they pertain, and the quarterly are made by the 15th of the month following the

quarter for which they pertain - there is no advance payment for the fourth quarter.

After the end of the calendar year, the tax debtors who are subject to corporation tax must, by 31 March of the next year, submit a yearly fiscal declaration (based on example) for the fiscal result and the yearly corporation tax due. The declaration's obligatory annexes are: yearly activity account including its annexes and, if applicable, a copy of the report under the Law on Independent Financial Audit<sup>2</sup>. The taxable persons who at the same time have complied with the following conditions are not obliged to submit a yearly activity account: they have had no activity during the year and they have not reported any revenues or expenses for the year in accordance with the accounting legislation.

When calculating the corporation tax due in the yearly fiscal declaration, the taxable persons have the right to a tax credit for taxes which are similar to, or were imposed instead of, corporation tax, and were paid abroad. The amount of the tax credit is determined separately for each country and type of revenue and is limited to the amount of the Bulgarian tax imposed on such profits or revenues.

The declaration is submitted at the territorial directory of the National Revenue Agency at the registered office of the taxable person. The corporation tax due must be paid in the state budget by 31 March of the next year. For that purpose, a set-off is performed between the tax due and the advance payments made for the relevant year.

If the yearly corporation tax due based on the yearly fiscal declaration is lower than the the advance payments made for the relevant year, the tax debtor may set off the excess against subsequent advance and yearly payments due by it for the same tax, for the year following the one for which the excess exists.

#### **4.3. Set-off under the Law on the taxes over the revenues of natural persons (LTRNP)<sup>3</sup>**

The LTRNP regulates the taxation of revenues of all kinds, received by national and foreign natural persons during the fiscal year, except for revenues which are declared as non-taxable under the same law. The revenues' taxation is performed for the year which coincides with the calendar year. The yearly taxable revenue and the yearly tax base are determined separately for each revenue source, while the revenues liable to be taxed with final taxes are excluded. The rules for determining the taxable revenue for each type of revenue source differ. The yearly tax bases calculated for the revenues of the taxable persons (with the exception of revenues from economic activities as unipersonal trader, revenues from other economic activities and from patent

<sup>1</sup> Published in the NG, issue 105 of 22 December 2006, last amended and supplemented – NG, issue 95 of 8 December 2015.

<sup>2</sup> Published in the NG, issue 101 of 23 November 2001, last amended and supplemented – NG, issue 95 of 8 December 2015.

<sup>3</sup> Published in the NG, issue 95 of 24 November 2006, last amended and supplemented – NG, issue 95 of 8 December 2015.

activities) form the aggregate yearly tax base, on the basis of which the tax due is calculated.

Despite taxation being performed for a fiscal year, in the presence of taxation of revenues from several sources it is required that advance payments are made during the year – i.e. revenues from employment activities, from economic activities including by natural persons who are not traders within the meaning of the Commercial Law, rent or other revenues from the usage for consideration of rights and property, as well as revenues from other sources under Art.35 LTRNP.

Thus employers, in their capacity as taxable persons in respect of the tax over revenues from employment activities, are obliged to make advance payments each month on the basis of the monthly tax base at the final payment of the taxable revenue calculated for the relevant month. The amount of the advance payment is determined by multiplying the monthly tax base by 10%.

Tax debtors who are natural persons performing economic activity as traders, within the meaning of the Commercial Law, including unipersonal traders, make advance payments at a tax rate of 15%, in accordance with the rules and conditions set out in the LCIT. Natural persons who are not traders, within the meaning of the Commercial Law, make advance tax payments at 10% of the taxable economic activity revenue. Natural persons receiving rent or other revenues from the usage for consideration of rights and property owe tax at 10% of the difference between the taxable revenue and the social security payments which such persons are obliged to make for their own account. There are no advance payments to be made on revenues perceived during the fourth quarter of the fiscal year.

After the end of the calendar year, national natural persons submit a yearly fiscal declaration based on example for:

- the revenues perceived during the year and taxable on the aggregate yearly tax base and the yearly tax base;
- the revenues taxable with patent tax under the Law on Local Taxes and Duties;
- the revenues perceived during the year from sources located abroad in respect of dividends, liquidation proceeds, supplemental voluntary insurance, voluntary health insurance and life insurance;
- shares held in companies, locations of economic activity, establishments and real estate situated abroad, as well as monetary loans granted and received.

Foreign natural persons submit yearly fiscal declaration only for the revenues perceived during the year and taxable on the aggregate yearly tax base and the yearly tax base, as well as the revenues taxable with patent tax under the Law on Local Taxes and Duties.

When completing their yearly fiscal declaration, the taxable natural persons have the right and the obligation to set off the sums of the advance tax payments made by them during the fiscal year against the final tax amount calculated in the declaration. The national natu-

ral persons have the right to set off also the final revenue tax paid in during the tax year as per Art.37 LTRNP.

When the calculated yearly amount of the revenue tax on revenues from employment activities is lower than the tax paid in advance, the employer is obliged, by 31 January of the next year, to reimburse the difference to the person concerned. In these cases, such person has a right of set-off between this reimbursed sum and any subsequent payments which they must make to the state budget for taxes on revenues from employment activities of themselves or other person(s) (Art.49(6) and (7) LTRNP).

### Conclusion

In conclusion, it can be pointed out that set-off is a method widely used in practice for the discharge of financial obligations. Its application is conditional upon specific circumstances regulated by both the TSPC and the special laws (the LVAT, the LCIT and the LTRNP).

Set-off serves both a discharge and a security function. As a result of the discharge function, the financial legal relation is changed, due to one of the obligations, and any security interests undertaken in regard to such obligation, being both discharged. As from the moment of the discharge of the counter obligations, the accrual of interest on arrears stops as well, and the debtor is released from its obligation.

The security function is linked to the defence of public interests and serves as a guarantee against an eventual insolvency of the financial debtor.

The sole holder of the potestative legal right to perform set-off is the state. Therefore, such set-off right is exercised by the competent organs through a unilateral sovereign volition, even in the cases where the exercise thereof is performed on the initiative of the debtor. This method of discharge is hence applicable regardless of the debtor's will.

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### **Димитров П. Залік як засіб погашення публічних фінансових зобов'язання в Республіці Болгарія**

Широковідомий монетарний характер фінансової заборгованості і зобов'язань надає можливість застосування юридичного інституту заліку також і в фінансовому праві. Розглядається вплив специфіки отрегульованих суспільних відносин і застосовуваного незалежного методу у фінансовому праві на вимоги і умови для використання заліку з метою сплати фінансової дебіторської заборгованості і зобов'язань.

Проаналізовано загальна і спеціальна правові основи вимог і умов, при яких можливе погашення на основі заліку фінансових заборгованостей і зобов'язань. Розглянуто окремі гіпотези, в яких допущено залік фінансової заборгованості і зобов'язань державними органами, залік органом, в компетенції якого перебуває встановлення фінансового обов'язка, залік в процесі здійснення примусового виконання, а також залік фінансової заборгованості і зобов'язань в порядку спеціальних законів. Особливу увагу приділено акту, на основі якого здійснюється залік фінансової заборгованості і зобов'язань, а також компетентним органам видачі.

*Ключові слова:* залік фінансової заборгованості і зобов'язання, акт заліку, податок на додану вартість, податковий кредит, корпоративний податок, оподаткування фізичних осіб, оподаткування доходів.

### **Димитров П. Зачет как средство погашения публичных финансовых обязательства в Республ-ки Болгария**

Широко распространенный монетарный характер финансовой задолженности и обязательств предоставляет возможность применения юридического института зачета также и в финансовом праве. Рассматривается влияние специфики отрегулированных общественных отношений и применяемого

независимого метода в финансовом праве на требования и условия для использования зачета в целях уплаты финансовой дебиторской задолженности и обязательств.

Проанализированы общая и специальная правовые основы требований и условий, при которых возможно погашение на основе зачета финансовых задолженностей и обязательств. Рассмотрены отдельные гипотезы, в которых допущен зачет финансовой задолженности и обязательств государственными органами, зачет органом, в компетенции которого находится установление финансовой обязанности, зачет в процессе осуществления принудительного выполнения, а также зачет финансовой задолженности и обязательств в порядке специальных законов. Особое внимание уделено акту, на основе которого осуществляется зачет финансовой задолженности и обязательств, а также компетентным органам выдачи.

*Ключевые слова:* зачет финансовой задолженности и обязательства, акт зачета, налог на добавленную стоимость, налоговый кредит, корпоративный налог, налогообложение физических лиц, налогообложение доходов.

### **Dimitrov P. V. Set-off as a Means for Extinguishing Financial (Public) Obligations in the Republic of Bulgaria**

The widely spread monetary character of financial receivables and obligations allows the use of the legal concept of set-off in financial law as well. This article considers the influence of the specificities of regulated public relations and the sovereign method applied in financial law on the requirements and the conditions for the use of set-off for the purposes of the discharge of financial receivables and obligations.

This article analyses the general and the special legal framework regulating the requirements and the conditions for the use of set-off for the purposes of the discharge of financial receivables and obligations. It considers different cases where the set-off of financial receivables and obligations is allowed – set-off by revenue organs, set-off by the organ competent to determine the financial obligation, set-off during an enforcement procedure, as well set-off of financial receivables and obligations in accordance with certain special laws.

A particular attention is given to the sovereign act on the basis of which the set-off of financial receivables and obligations is performed – the set-off act, as well as the organs competent for its issuance.

*Keywords:* set-off of financial receivables and obligations, set-off act, value added tax, tax credit, corporation tax, taxable persons, revenue taxation.

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