OVERVIEW OF THE BUDGET LAW FOR FISCAL 1386 (2007-2008)

The 1386 Budget – which is premised under the overall provisions of the Fourth Five Year Plan -- is the main fiscal spending authority of the government and has the force of law. With an increase of approximately 17.5% from last year's budget, the $231.6 billion (2,316,856,559,000,000 Rials) Budget for Fiscal 1386 entails the following revenues and expenditures:

1. State-own Organizations Budget for 1386

More than 72% of the budget is allocated to state-owned companies, bank and for-profit institutes related to the government. This figure features an increase of 22% in the budget in comparison to last year's budget.

2. Participation Bonds

With an aim to complete the projects related to appropriation of profit making capital assets, the authorized ceiling for the use of the private sector's funds through issuance of participation bonds has increased by more than 250%. This year, the Council of Ministers is authorized to issue and sell more than 2 billion dollars worth of participation bonds.

3. Allocation of Funds from the Foreign Exchange Reserve Account

With due regard to the necessity of energy saving plans and for the purpose of expediting implementation of projects related to control of the use of energy resources, the Council of Ministers is permitted to utilize the amount of approximately 13.4 billion dollars from the foreign exchange reserve account toward investment in energy projects.

These investments shall be made primarily through buy-back arrangements, and then through financing schemes with the right reserved for the financing contracts to be converted into buyback. The resources that may be supplied and guaranteed by the government from foreign capital markets for financing of investment projects shall be in form of project financing or joint venture agreements.

Another purpose for which the resources of the Foreign Exchange Reserves Accounts (Forex Account) shall be utilized is for investments of the private sector. The government is authorized to allot up to 8.4 billion dollars of the Forex Account to support the investments of the private sector provided that the technical and economical feasibility plan of such projects have been approved by the relevant ministry.

In order to reinforce the presence of the state-owned banks in the country's economic system through further participation in the financing projects of the private sector's, allocation of 10% of the available balance of the Forex Account to state-owned bank is anticipated in the budge law.

4. Privatization

Toward achievement of the privatization goals defined by the Five Year Development plans and further developed by the Directives of the Leader of the Islamic Republic of Iran (the "Directives"), the Budget Law 1386 obligates the government to transfer the following state-owned assets to the private, cooperative or the non-governmental public sector during the course of calendar 1386:

- At least 60% of shares of the state-owned companies (other than lager-scale and mother industries) and the entire shareholding of the government in private entities
- 10% of shares of the state-owned entities in large-scale and mother industries
- The right of exploitation over any and all of the mines under the control of the Ministry of Industries and Mines and its affiliated companies. These rights shall be transferred for a period of at least 10 years.
- For the purpose of outsourcing the operation of the government in the power

generation sector, the following actions shall be taken pursuant to obtaining a permit from the Ministry of Power:

a) Of the funds of the Foreign Exchange Reserve Account allocated to the investments of the private sector, stipulation of the amount of USD 267 million in form of financial facilities to the private, cooperative and non-governmental public sector for the purpose of building or purchasing power plants. Priority shall be given to those projects interested in purchasing under construction power plants.

b) Allocation of USD 178 million from the source of the Foreign Exchange Reserve Account for projects related to reduction of energy waste in transportation and distribution systems and increase of efficiency in use of energy in power plants. Such funds shall be allocated to the private, cooperative and non-governmental public sectors in form of buy-back projects.

5. Oil and Gas

For the purpose of increasing the production of natural gas and other valuable standard energy products (gasoline, gas-oil fuel) and refining of very heavy crude oil and gas condensates, the Ministry of Oil through its subsidiary companies and the National Iranian Refinery and Distribution Company are authorized to take necessary actions toward implementation of the following projects through utilization of foreign financing and/or buy-back schemes up to the amount of USD 4 billion:

a) Refurbishment of Isfahan refinery;

b) Building of gas condensation refinery with the priority given to the private sector;

c) Building of two very heavy oil refineries with the priority given to the private sector;

d) Implementation of the projects for development of Abadan and Tabriz refineries and development of the North Pars, Golshan and Ferdows natural gas fields.

Repayment of financial obligations shall be made out of the additional income of the above projects.

As of May 22, 2007, the government shall discontinue rendering subsidies over petrochemical products.

6. Public Transportation and Environmental Protection

For the purposes of urban development and environmental protection, in light of the Fourth Development Plan, the government is authorized to allocate maximum of 3.5 billion dollars (35,600,000,000,000 Rials) in form of foreign financing and an amount of 375 million dollars from the Foreign Exchange Reserve Fund for development of public transportation and discarding depleted vehicles.

7. Tobacco

The Law on Prohibition of Imports of Unnecessary Goods – which among other items prohibits imports of cigarettes -- is not applicable this year to importation of cigarettes. The deficit of demanded cigarettes must be compensated through importation of tobacco.

Further the government is authorized to increase the price of Iranian cigarettes by 10% and imported cigarettes by 20%. The income generated from such increase shall be allocated to the Ministry of Health for matters related anti-smoking campaign, research and development on health effects of smoking, lung cancer and other lung deceases caused by smoking and development of sports centers.

8. Telecommunication and Information Technology

In order to promote the telecommunication and data communication industry and to improve industries related to production of software and IT goods and services, companies related to the Ministry of Telecommunication are allowed to give loan credits of up to 40 million USD (400 billion Rls)(upon approval of their general assembly) to the private and cooperative sector for their development projects, job-creating activities and other activities related to exportation of products and services. Provision of such credits shall be pursuant to the proposal of the Ministry of Telecommunication and the MPO and approval of the Council of Ministers.

9. Food, Hygienic and Cosmetic Products

Based on the new budget law, the Ministry of Health shall receive an amount of 54 million (54,000,000) Rials as registration fee from foreign companies or their local representatives requesting establishment of units for manufacturing of raw materials or finished food, hygienic, cosmetic and medical products. Similarly, a fee of nine (9) million Rials must be obtained for registration of imported food, hygienic, cosmetic and medical products imported into the country by foreign companies or their representatives

INCREASE OF SALARIES IN 1386

The High Council of Labor (HCL), ratified that the minimum daily wage in the Iranian year 1386 (March 21, 2007 to March 20, 2008) shall be 61,000 RLS. The High Council of Labor has also determined that the wages shall be increased by 10% for the calendar 1386.

In addition to the above 10% increase, a daily sum of Rls.1,250 shall payable to the workers in 1386 if one year has lapsed since their employment or from the date their salary was increased during last year. The said increase shall be known as annuity.

TAXES PAYABLE ON FOREIGN FINANCIAL FACILITIES

In April 2007, Taxation Affairs Organization announced the manner of calculation of taxes payable by foreign banks and entities for the financial facilities granted to Iranian entities. It is noted that prior to this regulation, foreign banks providing financing to Iranian entities were not taxed on their income.

The taxable income of these foreign banks, financial and credit institutes and non-bank instates must be determined based on their deemed profit which is calculated based on received gross interest and fees by the financier. Similar to other legal entities, the payable income tax for these institutes is then determined based on 25% of their income.

Loans and other financial facilities obtained from the international financial institutes (World Bank, Islamic Development Bank and International Monetary Fund) are exempt from the provisions of this regulation, provided that the loan or financial facility is approved by the government of the Islamic Republic of Iran.

Taxation of those banks and financial institutes that their country of nationality has entered into a double taxation treaty with Iran is subject to the provisions of the related treaty.

Considering the existing limitation imposed by the Iranian laws which prevents the Iranians branches of foreign banks to engage in banking activities, these branches are exempt from the requirements of this regulation. Lastly, taxation of branches of foreign banks registered in the Free Trade Zones is subject to the laws and regulations of Free Trade Zones.

OPERATION OF FOREIGN BANKS IN IRAN MIGHT BE IMMINENT

On May 12, 2007, the Monetary and Credit Committee approved submission of the bill on authorization for operation of foreign banks to the Parliament. Although the details of the bill is not yet determined, based on the publicly available information, the government is keen in allowing foreign banks to engage in banking operations in Iran, either through joint investment with Iranian entities or as an independent entity. It is also stated that the bill proposes for authorization to foreign banks to obtain the shares of Iranian state-owned banks.

Although, currently based on the Law on Registration of Corporate Branches and Representative Offices, branches of foreign banks have a presence in the Iranian market, due to legal restrictions these branches and representative offices are not authorized to engage in banking operations and they merely act as the local agent of the main office.

IRAN ONE STEP CLOSER TO VALUE ADDED TAX

To date, 22 articles of the 42-article bill of value added tax (VAT) has been finalized by the Economy Commission of the Parliament. It is anticipated that the Parliament approves the bill into law within the next few months.

RECENT ADHESION TO INTERNATIONAL CONVENTIONS AND TREATIES BETWEEN IRAN AND OTHER COUNTRIES

- Adhesion of Iran to ECO Transit Transport Framework Agreement - Sept 2006
- Bilateral Commercial Treaty between Governments of Islamic Republic of Iran and Republic of Azerbaijan - Nov 2006
- Bilateral Commercial Treaty between Governments of Islamic Republic of Iran and Republic of Kyrgyzstan - Nov 2006
- Bilateral Commercial Treaty between Governments of Islamic Republic of Iran and Republic of Uruguay - Nov 2006

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