ATIEH ASSOCIATES

Legal Newsletter

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NEXT IRANIAN BUDGET SUBMITTED TO PARLIAMENT

President Khatami submitted the draft of budget for the next Iranian fiscal year (starting 20 March 2002) to the Parliament. The Parliament has spent most of the recent weeks on debating the particularities of the budget.

Next year's budget has drastic changes compared to the years before including the inclusion of a unified exchange rate. Below, are some of the highlights of the budget as presented to the Parliament:

- The budget for next year is estimated at US$86.2 Billion reflecting a 45% increase compared to the previous year's budget
- Next year's budget is based on a unified foreign exchange rate of about 7,700 Rials to the US$
- Next year's inflation is predicted at about 12-14%
- Subsidies will become more targeted as opposed to providing for a blanket subsidy to the population
- Domestic energy prices will see a modest increase
- Price per barrel of crude oil is estimated at $18
- Various ministries to issue participation certificates (bonds) as means of generating needed revenue
- Job creation is one of the top priorities of the budget
- Use of oil revenue will be limited to infrastructure investments as sale of oil is deemed to be sale of national assets
- Budget deficit is defined for the first time according to internationally accepted principals
- The government is permitted to borrow up to US$2 Billion from foreign sources to cover any major drops in the predicted oil price
- Exports are promoted in non oil and gas areas
- Financial facilities will be available for job creation and promotion of exports

As the parliament debates the budget various provisions will be ratified line by line and put before the entire parliament for vote and ratification. Finally, the budget will be presented to the Guardian Council for review. As of the writing of the newsletter, the following items have been agreed to by the Parliament:

- Unification of Foreign Exchange Rate
- 10% raise in the price of energy for domestic use

NEW TAX LAW APPROVED

Towards the end of last year, the Iranian Parliament ratified a new tax law making significant changes to the old legislation. This draft was subsequently rejected by the Guardian Council ("GC") which found some of the articles unconstitutional and sent back to the Parliament. In January 2002, the Parliament made certain changes as suggested by the GC. The changes were approved by the GC in February 2002 and as such Iran now has a new tax code.

The new tax code provides for many changes which are more taxpayer friendly. Among others, these changes include:

- The elimination of the 10% corporate tax
- Corporate income being taxed at a flat rate of 25%. Under the previous law, companies would be subject to both a 10% corporate tax plus their dividends being taxed at levels of up to 54% (beyond $35,000 of profit).
- The reduction of the top tax rate on salary income from 54% to 35%
- Creation of a central tax authority (as provided for under the Third Five Year Development Plan)
- Tax exemption of income of up to 1,300,000 Rials
- Possible cancellation of the tax exemption of foundations with the leaders approval
- Introduction of new tax holidays in areas such as manufacturing.
- Creating incentives for voluntary reporting

Such change is very good news to foreign investors since profits will be taxed at very favorable rates. This should encourage all taxpayers to be transparent and report their income while lowering their tax exposure. Ultimately, the government believes that lower tax rates would encourage self reporting of all income and as such increase government tax revenues. The government estimates tax evasion at about 40-50% under the old law.

LAPFI REJECTED AGAIN

As previously reported, the Iranian Parliament passed a new Law on Attraction and Protection of Foreign Investment. What followed was a number of rejections by the Guardian Council ("GC") (Iran's version of an upper house). The first bill was ratified by Parliament in June 2001 and subsequently rejected by the GC based on about 8 objections. In November 2001 another version was ratified by the Parliament. This was again rejected by the GC based on over 18 objections. Another version was ratified in January 2002. This version has again been rejected by the GC in February 2002.

There has been no public disclosure yet as to the reasons of the rejection by the GC. Given the fact that the Parliament is currently debating the national budget bill, no further action has been taken until these debates are concluded. Given the ongoing disagreements between the two, it is likely that the foreign investment law will finally be resolved by the Expediency Council as the final arbiter between the GC and Parliament.

SPECIAL ECONOMIC ZONES REGULATIONS TO BE MODIFIED

In 1989 Iran ratified legislation enabling the creation of Special Economic Zones ('SEZ'). Until recently, the primary attraction of these zones were to provide customs exemptions and to facilitate the re-export of goods from these zones. SEZs are very diverse including zones for energy, petrochemicals and textiles. Unlike the Free Trade Zones of Iran, the SEZs have no separate legal regime (other than customs) and for the most part are under the jurisdiction of mainland laws.

However, as foreign and domestic investment in Iran has risen considerably from the time the SEZs were established, a new set of regulations have been submitted to the Parliament. The purpose of the bill is to facilitate regulations that would make investments in the SEZs more attractive and under specific rules and procedures. It is expected that the Parliament would review and possibly ratify a new law in the coming months. As such, favorable changes to the current regulations should be expected in the near future.

NIOC PERMITTED TO PLEDGE OIL CONTRACTS TO SECURE FINANCING

The National Iranian Oil Company has been permitted -- through a cabinet decree -- to guarantee its foreign loans through its crude oil export contracts. Under this decree, the Central Bank of Iran and NIOC can raise financing of up to USD 1,000,000,000 from foreign sources and secure such debt by means of pledging NIOCs crude oil sale contracts.

This is a very important development in creating enforceable security against state entities such as NIOC which enjoy a number of domestic immunities. Under such immunities, very limited property could be pledged as collateral against financing. With this decree, foreign banks and other providers of finance would be able to have recourse to NIOCs oil contracts with foreign parties as opposed to looking for security inside Iran which most often was impossible. This should pave the way for other large state owned entities to provide such securities in the future.

INTERNATIONAL AGREEMENTS

The Iranian Parliament has ratified a number of international agreements in the past months. These include:

- Bilateral Investment Treaty between Iran and Turkey
- Agreement between Iran and India for Trade and Economic Cooperation
- Bilateral Investment Treaty between Iran and Macedonia
- Decree on International Road Transportation Agreement between Iran and Jordan
- Commercial Agreement between Iran and Nigeria
- Bilateral Investment Treaty between Iran and Morocco

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