

### Implementing Regulations of FIPPA Ratified

The Foreign Investment Promotion and Protection Act (FIPPA or Act) was ratified May 2002 and published July 2002. According to Article 25 of the Act, the Regulations implementing it were to be prepared within two months from the ratification date.

In late September, the Council of Ministers duly ratified the "Implementing Regulations" consisting a total of 38 articles. These Regulations were published on 15 October 2002 and with FIPPA are now in full force.

Although the Regulations are not much more extensively detailed than the Act itself, a few provisions should be highlighted.

#### Investments Covered

Similar to FIPPA, the Regulations stipulate two types of investments subject to

coverage:

1) Foreign Direct Investments: these are permitted in all fields open to private Iranian sector participation.

2) "Non-equity investments": This is an umbrella term covering investments under the schemes of "build, operate and transfer", "buy-back", and "civil partnership." Such investments are permitted in all fields including those reserved exclusively for the state and not just within the private sector activity.

#### Coverage Provided

The Regulations provide that regardless of the type of acceptable mechanism used for foreign investment – i.e. direct or non-equity – the coverage provided them entails the following features:

- Foreign investors shall enjoy the same treatment as

domestic investors, equally and without prejudice.

- The entry of foreign capital will be regulated exclusively by an investment license. Hence, no other permit or permission is necessary.
- There is no limitation on the amount of foreign investment entitled to coverage.
- There is no set ceiling limiting the percentage of foreign investment in each project and/or investment.
- In case of nationalization or expropriation, the foreign investor will be entitled to compensation by the government.
- Repatriation of capital and profits in the form of foreign currency is guaranteed.

## Regulations Afford Special Coverage for BOT Investments

FIPPA and Regulations grant specific incentives and coverage to "non-equity investments" (i.e. BOT, buy back, and civil partnership projects). Appertaining to such investments, the government will additionally provide the following benefits to the foreign investor:

- If the government causes a business disruption, then it will pay the loans of the project as the loans become due.
- The sponsors of BOT projects may assign their rights to lenders subject to the approval of the Foreign Investment Board.
- In cases where transfer of ownership to an Iranian party is mandated by law (e.g. in state owned projects), such transfer must be either gradual or at the end of the contract period.
- If the BOT project is producing either 1) goods and services that can only

be purchased by the government or 2) goods or services subsidized by the government, then the government will guarantee the purchase price of those products as specified in agreements between the parties.

## Application Procedure

Unlike its predecessor (i.e. Law and Regulations Concerning the Attraction and Protection of Foreign Investments in Iran--LAPFI), this recent legislation delegates the approval of foreign investment to the Foreign Investment Board, not to the Council of Ministers. This should result in less bureaucracy and a much swifter response time. Furthermore, in an effort to increase efficiency, a note accompanying Article 6 of FIPPA requires that administrative decisions regarding completed applications received for FIPPA coverage must be made within 45 days of receipt. Although neither the Act nor Regulations provide any direct remedy if the government fails to meet this deadline the Regulations require the related ministries to respond to inquiries of the Foreign

Investment Board within 10 days. Otherwise, the investment will be deemed approved by that ministry. The purpose of this deadline is to inadvertently produce incentive for the ministries to comply with the deadline.

The above scenario is not applicable where the Foreign Investment Board itself does not approve the application for protection within the subscribed period.

## Registration of Capital

Foreign capital can enter Iran through one of two forms, either in cash or "in-kind."

**Cash:** Where the foreign investor imports cash into Iran with the intention of converting the cash into Rials the capital will be registered under the name of the foreign investor and will fall under the ambit of FIPPA subsequent to the date of exchange. Foreign investors are also permitted to import and maintain hard currency without the need for conversion to Rials. Such amounts are usually held in foreign currency for foreign purchases. It is important to note that the Regulations recognize and protect such amounts that have

been deposited in accounts of the project company. There were no similar provisions under LAPFI, the former investment law.

**In Kind:** In-kind capital refers to machinery, equipment, spare parts, CKD, raw material, additives, and supportive materials. These are to be recognized and registered as foreign capital upon approval of the Foreign Investment Board and The Ministry of Commerce. The Customs Office directs the evaluation and clearance of imported items. Generally, the evaluation made by the Customs Office will form the basis for the amount of protection to be registered under the Act. The costs of transportation as well as insurance may be added to the evaluation for protection purposes.

Additionally, in cases where there are inconsistencies between the valuations submitted by the Foreign Investment Board and that of the Customs Office, the Customs Office's valuation will prevail.

## Repatriation of Capital and Profit

The Regulations duly reflect the repatriation provisions of the Act for the most part.

The profits and accrued proceeds of foreign investments may be repatriated in the manner specified as per the investment license. These refer to repatriation in the form of cash and/or exports of own or other Iranian produced products. The Foreign Investment Board must approve such repatriation and the Minister of Economic Affairs and Finance must provide his consent.

The Regulations permit the utilization of profits from a foreign investment to increase the foreign capital of that registered investment. In such instances, the capital registered and protected will be modified to reflect such increase.

Finally, the regulations contain a specific reference to circumstances where an insurance company steps into the place of a foreign investor. The Regulations explicitly recognize such substitution by the insurance company and grant the same rights to the insurer for repatriation purposes.

## Other Provisions

Besides the articles highlighted above, a number of other noteworthy provisions are provided for in the Regulations. These include:

- Although not mentioned in the Act, Iranians who want to benefit from FIPPA must demonstrate that they are engaged in business activity outside of Iran.
- Where foreign investment results in the establishment of an Iranian company, ownership of land is permissible—albeit it must be through the newly established company.
- It is now possible to provide pre-FIPPA investments coverage under the Act. One criterion is an increase in capital.
- Upon approval of the investment license, the foreign investor must import the capital within the time frame prescribed in the license. Failure to do so will result in cancellation of the license.
- Accounting records of foreign investors (similar to Iranian

investors) must be audited by government certified accountants.

- If a foreign investor does not repatriate the approved dividends or capital within six months following the date of approval, the remaining sums will be excluded from protection. However, an exception does apply where the foreign investment board grants an extension.
- The specific sectors and sub-sectors referred to in Article 2 of FIPPA have been listed in detail.
- Details of the operation and duties of the Foreign Investment Services Center are explained in detail in the Regulations.

## **BOT's to be Taxed on Profit and Loss Basis**

The Ministry of Economic Affairs and Finance in September 2002 announced to the Taxation Affairs Organization the list of those expenses incurred in or out of Iran for the purpose of executing investment projects such as power plant projects in the BOT scheme.

This decree has finally clarified the method of taxation for BOT projects – which have no legal precedence -- on a profit and loss basis. Prior to this release, it was unclear whether BOT's were to be taxed on a deemed profit basis (similar to the buy back agreements) or on a profit and loss basis.

The decree has established as acceptable (i.e. tax deductible) for BOT projects the following expenses:

- Expenses related to the procuring of financial facilities outside of Iran which are allocated for the execution of the investment projects. These include profit, loan commission, commitment expenses, guarantees, and loan management.
- Expenses incurred from the insurance of these financial facilities obtained outside of Iran.
- Expenses related to the insurance of equipment and possible damages regarding the activities engaged.
- Expenses related to primary work or work commenced prior to exploitation of the project. To clarify, these are

the expenses which are paid before the foreign company's registration of a branch office in Iran. They include expenses such as primary studies, design, technical and engineering, arranging contracts.

- Expenses of capital wear and tear capped at the amount needed for the primary work. The duration is to be determined by the time frame cited in the contract. The method utilized for the calculation of this wear and tear must be the direct method.

There are several requirements that must be met for this tax deduction to apply. First, the primary expenses must be confirmed by the governmental organization that is a party to the BOT contract. Second, it is required a branch office of the foreign company involved be registered in Iran. This branch office's financial list must be approved by one of the members of the "Iran Official Accountants Association".

- All other expenses related to the projects that were accrued outside of Iran. However, these must be done with the approval of one of the international

accounting institutes and must be confirmable to an accounting institute member of "Iran Official Accountants Association", which is the accountant of the branch office in Iran. Note: this approval procedure does not apply to the expenses highlighted in the above bullet points.

## **Government Authorized to Pay Hard Currency for Domestically Produced Electricity**

Based on a decree of Council of Ministers dated August 26, 2002, the Ministry of Energy is authorized to enter into electricity purchase agreements with Iranian companies or foreign-Iranian joint ventures. In case of purchases from the latter, the ministry may tender part of the payment in hard currency. Upon request by the Ministry of Energy the Central Bank of Iran is then required to timely deposit the necessary foreign currencies into the account of electricity producers.

Foreign investors have been permitted to participate in the electricity sector under the Third Economic Development Plan (2000). This decree covers those

foreign-Iranian joint ventures that have started or will start their activity pursuant to the mentioned law and that are under the coverage of Foreign Investment Protection and Promotion Act (FIPPA).

## **Government Authorized to Guarantee up to Two Billion USD of Foreign Financial Facilities**

Note 21-M of the Budget Bill 1381 (2002-2003) authorized the government to obtain and/or guarantee financial facilities from foreign sources for the implementation of national infrastructure projects. Hence, pursuant to the current fiscal budget, the Iranian Government recently issued an executive by-law regarding the use of up to 2 billion US dollars of foreign financial facilities. This executive by-law, dated May 25, 2002, authorizes the Ministry of Economic Affairs and Finance to sign loan agreements and/or guarantees in order to obtain foreign financial facilities on behalf of the government. The following list is a sample of a few methods that may be utilized:

- Pledge of the oil sale contracts;

- Issuance of foreign exchange bonds (directly or through the Central Bank);
- Pledge of the shares of the government in Privatization Organization;
- Pledge of the assets of Iranian Foreign Investments Company;
- Other legal methods.

The Minister of Economic Affairs and Finance must approve terms and conditions of the loans. In addition, the Management and Planning Organization, Central Bank, and National Iranian Oil Company are all required to cooperate with the Minister of Economic Affairs and Finance for acquisition and repayment of the facilities.

## **Recent International Agreements and Treaties**

The following agreements and treaties have been recently stipulated by the Iranian government but have not yet been ratified by the Parliament:

- 1) Bilateral Investment Treaty between Iran and Tunisia.
- 2) Economic, Trade, and Banking Agreement between Iran and Bahrain.
- 3) Bilateral Investment Treaty between Iran and South Korea.
- 4) Trade Agreement between Iran and Ukraine.

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