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Standard of treatment of foreign investments in Iran

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**Comp. Law. 347* Introduction

This article outlines the Iranian laws and regulations on the standards of treatment of foreign investments in Iran. It will provide an overview of the treatment standards that foreign investors expect to receive once they establish their investment in Iran in terms of the guarantees and protections available to them under Iranian laws. These include the privileges and incentives provided by the Government to foreign investors who invest in the free economic zones. The evaluation of the treatment standards is to determine the level of protection that is offered by the Iranian Government to foreign investors when undertaking investments in Iran.

General standard of treatment under Iranian laws

Once foreign investors enter and establish their investments in Iran they become subject to the exclusive jurisdiction of Iranian laws. Generally, the standards of treatment of foreign investment are contained in the Foreign Investment Promotion and Protection Act 2002 (FIPPA). However, foreign investors should comply with domestic laws governing: residence visa and work permits, employment issues, payment of social security and insurance premiums, taxation and capital transfer requirements. The national laws and regulations also set forth the process and procedures for issuance of permits required by the investor to make investments in a specific industry or economic sector. Foreign investors are required to obtain an investment licence to receive the protections available under the FIPPA provisions including guarantees for non-discriminatory treatment, non-expropriation and non-nationalisation, currency transfers and access to dispute resolution procedure. The Iranian Civil Code provides in art.961 that “foreign nationals are also entitled to the enjoyment of civil rights …”.[1] This means that foreign investors can exercise all the rights that are enjoyed by Iranian nationals when undertaking economic activities in Iran provided that they comply with all the applicable laws and regulations.

Standard of treatment of foreign investors under FIPPA

National treatment standard

FIPPA contains provisions on the standard of treatment of foreign investments. Article 8 provides that “foreign investments under FIPPA shall equally enjoy all rights, protections, and facilities available to local investments”. FIPPA qualifies provision of the national treatment standard to foreign investments by guaranteeing them equal and non-discriminatory treatment without any exceptions.[2] This means that foreign investments are entitled to receive the national treatment standard in all the fields of activities. The provision of national treatment standard is guaranteed to both foreign investors and their investments. According to the Regulations, “foreign investors enjoy the same treatment as accorded to domestic investors”.[3]

Investment guarantees

The common features under the FIPPA include:

• entry of foreign capital whether cash or non-cash is only subject to the investment licence and does not require any other permit;

• volume of investment in each individual case is not restricted in any way;

• foreign capital is protected against expropriation and nationalisation, in the occurrence of which the foreign investor is entitled to receive compensation;

• transfer of the principal capital, profits and capital gains shall be in the form of foreign currency or in the form of goods as stipulated in the investment licence;

• free export of produced goods is guaranteed and where there are prohibitions on export, the goods can be sold locally the proceeds of which shall be transferred abroad in the form of foreign currency and through the country's official monetary system.[4]

Specific guarantees

There are also specific features and advantages for different types of investments, foreign direct investment (FDI) and non-equity based (contractual) investments. In the case of FDI projects:

• investments can be made all areas in which the activities of the private sector is authorised; and

• there is no restriction on the percentage of foreign shareholding.[5]

With regard to investments that are undertaken within the framework of contractual arrangements:

• The Government guarantees the payment of compensation for losses incurred by foreign investment resulting from the prohibition or interruption of the implementation of the financial agreements caused by enactment of laws or government decisions up to the ceiling of the due instalments.

• In BOT and civil partnership schemes, where the state entity is the sole purchaser and/or supplier of the goods and services at subsidised prices, the purchase of the produced goods and services by the state entity party to the contract, is guaranteed within the framework of the laws and regulations.[6]

Employment of foreigners

The regulation of employment relations in Iran is governed by the Labour Law approved on November 20, 2006. Foreign nationals are not authorised to engage in employment in Iran unless, first, they hold an entry visa with the right to specific employment and, secondly, obtain a work permit under the relevant laws and byelaws.[7] The Ministry of Labour and Social Affairs is the responsible body to issue visas with the right to specific employment for foreign nationals and approves work permit.[8] In the instances where the interest of the country's industry require the immediate employment of a foreign national on an exceptional basis, the minister concerned shall notify the Ministry of Labour and Social ***Comp. Law. 348** Affairs accordingly with whose approval a temporary work permit will be issued for the foreign national without requiring compliance with the formalities for issuing the visa with the right to specific employment.[9] FIPPA guarantees the issuance of the residence visa, work and employment permit for the foreign investors, managers and experts including their close families.[10]

Benefits of investment in the free trade zones (FTZs)

Dispute settlement

The Law on the Administration of Free Trade Zones approved on August 29, 1993 authorises foreign investment in the FTZs. Article 8 stipulates that:

"… [T]he Authority and its affiliated companies are permitted to conclude the necessary contracts with natural or legal persons, whether foreign or domestic, and to participate with domestic or foreign investors for the implementation of development and productive projects, in compliance with the due provisions of the Constitution. Disputes and claims arising out of the concluded contracts shall be examined and settled in accordance with the mutual agreements and the contractual commitments of both parties concerned."

According to Hadizonooz:

"…it seems that here the legislature somehow desired to avoid the [application] of article 139 of the Constitution concerning the requirement for [obtaining] the parliament's approval for distribution of [disputes]."[11]

Exemptions from payment of social security insurance, taxation and customs duties

The FTZ regime exempts foreign investors from the requirements of labour law, the payment of the social security and insurance premium, issuance of residence and work permits and taxation of investment income. Article 12 provides that:

"… [R]egulations governing the employment of workforce, social insurance and security and the issuance of entry visa to foreign nationals, shall be based on rules which are to be approved by the Board of Ministers."

All economic activities in the free zones enjoy total exemption from the payment of income and property taxes subject to the Direct Taxation Law for a period of 15 years.[12] With the approval of the Board of Ministers the importation of goods produced in the free zones to the mainland are exempt from payment of all or part of customs duties and commercial profit tax up to the added value thereof in the zones.[13] The importation to the mainland of the goods which are produced in the free zones from raw materials that are partly and wholly supplied domestically are exempt (proportionally) from all or partial customs duties and commercial profit tax.[14]

Credit guarantee and repatriation of capital

Article 19 provides that:

"… [U]pon approval by the Board of Ministers, the Authority is empowered, within the framework of its approved plan and budget, to obtain and guarantee credits from domestic and foreign sources for the purpose of implementing of infrastructures and productive projects. Repayment of these credits shall take place only through drawing on revenues of the Zone concerned."

Article 20 states that:

"… [I]nflow and outflow of capital and repatriation of profits generated by economic activities in each Zone are permitted. The required regulation for attraction and protection of investment in each Zone and the modality and participation of foreigners in activities in each Zone shall be approved by the Board of Ministers."

The authority of each zone can take measures with the approval of the Board of Ministers and from its financial resources or by entering into agreements with the banks, credit institutions or insurances companies to guarantee the foreign capitals against losses resulting from expropriation and nationalisations up to the extent of the undertakings stipulated in the relevant contract.[15]

Registration of companies and use of land]

Registration of companies, intellectual and industrial property rights, as well as registration of ships, vessels and the aircraft in the Zones, shall comply with art.81 of the Constitution.[16] According to art.81 of the Constitution the grant of concessions to foreigners for the establishment of companies for commercial, industrial, agricultural and mining and services is absolutely forbidden. Ownership of land in the zones by foreigners is strictly prohibited and foreigners are only allowed to rent property.[17]

The Regulations on Investments in the FTZs

The Regulations on Investments in the Free Trade Zones (FTZs) was approved on June 16, 1994. Article 2 provides that:

"… [A]ll natural and legal persons and institutes, both Iranian and foreign, as well as international organizations, may either separately or jointly with the Authority and affiliates thereof or jointly with each other invest in the Free Zones in accordance with these Regulations; their accepted capital shall be subject to these Regulations."

Foreign investors are authorised to participate in the economic activities of the zones up to any amount.[18] The capitals of foreign investors that are imported in to the zones are protected by this Regulation and shall enjoy its facilities and privileges.[19] In the case of nationalisation of the foreign capital for the public purpose or where the foreign investor is deprived of his ownership rights, the government shall pay fair compensation to the investor.[20] The repatriation of net profits, sums relating to principal capital and gains from the economic activities of the foreign investment and the foreign currency capital of Iranian as well as the proceeds of sale and transfer of these types of capitals out

of the zones are permitted.[21] Article 13 provides that:

"… [P]ayments of instalments of the principal of loans and related expenses, as well as payments pursuant to patent, technical know-how, technical assistance and engineering, trademark, management and similar contracts are authorized if the authority is informed and if they are made within the framework of investment projects based on relevant contracts and financial statements."

Transfer of funds under Iranian law

The Central Bank of Iran (CBI) lays down the regulations containing the procedures for foreign currency transfers. According to the regulations of the CBI all foreign exchange transactions should be conducted through the official ***Comp. Law. 349** banking system although a free market for foreign currency purchase is also available. The rate of foreign exchange in the free market is not substantially different compared with the official banking rate. The CBI sets out the regulations on the exchange of Rials against foreign currencies by the Iranian banks. The CBI has authorised the repatriation of the principal and profits of the foreign investment as well as the repayment of the loan instalments with the approval of the Organisation for Investment, Economic and Technical Assistance of Iran (OIETAI). In addition foreign investors can stipulate in their contract with state entities, an express provision to ensure the transferability and convertibility of foreign currency. The CBI authorises the convertibility of Rials and the transfer of foreign currency for international transactions provided that the supporting documents for the transfer are submitted by the foreign investor. The banks also guarantee convertibility of Rials through the unofficial currency market.

Transfer of funds under FIPPA

Importation of capital

The transfer of funds in and out of Iran by foreign investors are governed by the provisions of FIPPA and its Implementing Regulations (the Regulation). The methods of transfer of foreign capital into Iran include: (a) the conversion of cash into Rials; (b) cash used directly for purchases related to the foreign investment project and noncash items[22] and (c) non-cash items are defined as:

• machinery and equipment;

• tools and spare parts, CKD parts and raw, addable and auxiliary materials;

• patent rights, technical know-how, trade marks and names, and specialised services; and

• other permissible items approved by the Council of Ministers (the Cabinet).[23]

The Regulations set forth the procedures for importation, valuation and registration of the foreign capital. The foreign capital that enters the country in the form of cash will be converted into Rials and registered in the name foreign investor.[24] The foreign capital that enters the country in the form of cash but not converted into Rials will be deposited in the foreign currency account to be used for foreign payments and registered in the name of the project company.[25] Customs shall determine the valuation of foreign capital that is imported in the form of non-cash.[26] According to commentators:

"… [T]he requirement of registration shows the desire of the government to closely monitor, if not control, the flow of foreign currency in and out of the country."[27]

Foreign currency exchange rate

The applicable foreign currency exchange rate at the time of entry or exit of the foreign capital as well as all foreign currency transfers shall be the rate prevailing in the official banking system in case of unified exchange rates otherwise the free market rate as recognised by the CBI will be the basis for the exchange rate.[28] It has been stated that:

"… [T]he single rate normally closely follows the open market rate. If there are multiple rates in place, which usually include subsidy rates for certain purposes, the applicable rate will be the free market rate as determined by the Central Bank. In other words, the foreign company will not receive the benefit of the subsidy rates that the government may want to provide for specific purposes, i.e. protection of new domestic industries or import of basic foods."[29]

Transferability

The principal foreign capital and its revenues or what is remaining from the original investment in the country can be transferred abroad after the fulfilment of all obligations and payment of legal dues by giving a three-month notice to the Board[30] and with the approval of the Minister for Economic and Financial Affairs.[31] The profits of the foreign investment may be transferred abroad after deduction of taxations, duties and statutory reserves with the confirmation of the Board and the approval of the Minister of Economic and Financial Affairs.[32] The payments related to the instalments of the principal of the financial facilities of foreign investors and the related costs, contracts for patent rights, know-how, engineering and technical assistance, trade marks and brand names, management and similar contracts within the framework of foreign investment may be transferred abroad according to the approval of the Board and confirmation of the Minister of Economic and Financial Affairs.[33] Transfers referred to in arts 13, 14 and 15 (principal, profit and instalment payments) should comply with art.3(b) of FIPPA, which states that joint venture, buyback and build, operate and transfer (BOT) contracts should not depend on any guarantee by the government, banks or state entities[34] :

“In other words, the government does not guarantee a certain rate of return for the investment project. The only thing that the government guarantees is the damages, if any, that may result from a governmental action.”[35]

Convertibility

The foreign currency required for the transfer of the principal, profits and the instalments payments can be obtained by the purchase of foreign currency from: (a) the banking system; (b) from the proceeds of the export of manufactured products and/or (c) from the provision of goods and services.[36] The CBI is under the obligation to provide and make available to the foreign investor the equivalent of the foreign currency for the transferable funds required for the purchases of foreign currency from the bank by the approval of OIETAI and confirmation of the Minister for Economic and Financial Affairs.[37] The transfer abroad of any part of the foreign capital admitted into the country within the framework of the investment licence that is unused is exempt from all the foreign exchange and export and import laws and regulations.[38] The ability of the foreign investor to transfer funds overseas will depend on the approval of the Board and the Ministry of Economic and Financial Affairs, which does not make it clear how long it will take for it to grant the approval. The legislation also fails to state the grounds under which the approval for the transfer may be refused by the authorities. According to Sabahi:

“… [F]or all types of transfer, approval of the Board and the confirmation of the Minister of Economic Affairs and Finance are required … this scheme, although providing for the freedom of convertibility and transferability of foreign capital, is heavily bureaucratic, and the government's hand is visible in every step of the transaction, which can make the foreign investors wary and suspicious. The Act, however, by providing ***Comp. Law. 350** for a guarantee against the political risk of adverse legislation, offers assurance to foreign investors about the transferability of foreign currency.”[39]

Government guarantees

Guarantee against non-commercial risks

The Government only guarantees foreign investment projects against non-commercial risks. FIPPA protections are only available to investments that do not depend on government payment guarantees. Under art.3(b) of FIPPA the return of capital and profits in civil partnership, buyback and BOT contracts should not be guaranteed by the government, state banks or entities. Therefore non-equity based investments such as BOT contracts can either have the FIPPA protection or the government payment guarantees but not both.[40] The purpose of this provision is to make sure that the foreign investors bears all the commercial risks in undertaking the investment by requiring it to recover capital and profits from the project revenues. Therefore the investment is not covered against project failures to generate the expected revenues due to changes in market prices or demands for the goods or services produced by it.[41] Effectively the Government and its instruments are prohibited from guaranteeing a fixed rate of return for the investment described above. The reason for the unavailability of the government guarantee is to reduce the commitment of the public funds and reliance on other public resources for the construction and implementation of infrastructure projects. By doing so the Government intends to transfer the associated risks of undertaking such investment

projects to the private sector. The Cabinet Decree[42] on Foreign Investment, the Regulation Governing Contracts, Civil Partnership, Buyback and BOT approved on July 30, 2003 stipulates in art.3 that the guarantees of the Government do not include the following:

• the damages caused by the failure of the investor in fulfilling its contractual obligations;

• the responsibilities of the investor in operating and managing the investment; and

• the damages caused to the investor as result of force majeure.

Off-take guarantee

In certain projects the exclusive purchaser of the goods and services is the government monopoly who resells it to the ultimate consumer often at subsidies rates. Therefore the inclusion of the off-take guarantee in the investment contract provides foreign investors with assurances that the Government will remain as customer of the goods and services for the duration of the project for an agreed rate. The Regulations have authorised the Government to guarantee the purchase of the goods and services produced by the project. The Government may, within the framework of the law, guarantee the purchase of produced goods and services at a rate and quantity determined in the contract, where the Government is the exclusive purchaser of the goods and services as well as cases, where the goods and services produced by the investment are supplied at subsidised rates.[43]

Guarantee against adverse changes of the laws

Foreign investments conducted in the form of non-equity based and project finance agreements are protected against adverse legislative changes. Where the implementation of the approved financial agreements in the context of civil partnership, buyback and BOT schemes is interrupted or prohibited as a result of the enactment of laws or government decrees, the Government guarantees the payments of compensation for incurred losses up to the maximum ceiling of the amount of the matured instalments.[44] In the words of Sabahi, “this is a reassuring guarantee against ‘creeping expropriation’, and practically, works as a stabilization clause for the investment licenses”.[45]

The protection against adverse alteration of the laws is only available to foreign investments undertaken through non-equity based and contractual arrangements covered by art.3(b) of FIPPA, meaning that FDI projects are not entitled to receive compensation.[46] According to Shiravi:

“… [B]y limiting the compensation to the amounts due instalments, the legislation fails to provide adequate compensation in this respect. In addition, it provides no compensation for other adverse consequences that such changes may have for business, like the impact of such changes on the construction or operation costs and price or demand for the products of the project.”[47]

The member ministers of the High Council for Investment have the authority to determine the scope of the government obligations and the Board determines the extent of incurred losses.[48]

Ownership of assets and assignment of security interest

Generally under the Iranian laws foreigners are prohibited from acquiring land. According to FIPPA, the project company is authorised to purchase and own land for the purpose of the investment project.[49] The investors may retain ownership rights over the imported equipment and materials. The FIPPA provisions grant foreign investors limited ownership rights over intangible assets that can be used as security interest for lenders. The foreign investor is authorised to exercise ownership right over the remaining capital in the economic entity in which the investment is made, so long as the investment and accrued profits in the BOT schemes are not amortised.[50] In BOT contracts the proprietary rights of foreign investors can be transferred to the institution providing financial facilities to the investment project upon the confirmation of the Board.[51] The Board consists of the Deputy Minister of Financial and Economic Affairs, Deputy Minister of Foreign Affairs, Deputy of the Management and Planning Organisation, Deputy of the Central Bank and deputies from other relevant ministries whomay be invited on a case-by-case basis. Once the project is completed the foreign investor has to transfer all the assets including plant and machinery to the state entity in compliance with the terms of the contract. The assignment of proprietary rights to the Iranian party designated in the BOT contracts may, on the basis of the agreement of the parties to the contract, be effected by way of gradual assignment during the contract period or single assignment of the acquired rights at the end of contract period.[52]

Investment insurance

In May 2003 Iran acceded to the World Bank Convention on the Multilateral Investment Guarantee Agency (MIGA) adopted in 1985.[53] Foreign investors can obtain guarantees for their investments in Iran against non-commercial and political risks. The risks covered by the guarantee of the Agency include expropriation, currency transfer, breach ***Comp. Law. 351** of contract and war and civil disturbance.[54] In addition, the Cabinet Decree on Foreign Investment authorises foreign investors to procure insurance services of local, foreign insurance companies or methods of reinsurance services offered by foreign insurance companies for their investments.[55] The availability of additional guarantees to foreign investors to cover their investment with private insurance will improve the investment climate and promote the flow of investment into Iran.

Privatisation of state entity

The guarantees provided by the Government prior to privatisation of the state entity remain valid and binding after acquisition of the state entity by private shareholders. The Government guarantees to transfer the obligation of the state entities to purchase the goods and services of the project company to the new shareholders to whom the state entity has been sold.[56] The Cabinet Decree on Foreign Investment provides that the privatisation of state entities is regarded as a government act and therefore the state entities continue to benefit from the guarantees provided by the Government.[57] Foreign investors can also stipulate in the investment contract that, in the event of privatisation of the state entity, all it obligations will be transferred to the new shareholders. An express provision in the contract will guarantee that the owners of privatised entity will continue to honour the existing contractual commitments of the state entity.

Transparency

FIPPA contains provisions on transparency and disclosure requirements. The OIETAI is under an obligation to allow public access to all information concerning investments and foreign investors, investment opportunities and Iranian partners, the field of activity and other information available to it.[58] To facilitate this all the ministries, state companies and organisations and public institutions subject-matter of the law are under an obligation to provide the OIETAI with all the information required for foreign investment and the reports on the foreign investment implemented.[59] The Minister of Economic and Financial Affairs is under an obligation to provide the relevant parliamentary commissions with the report on the performance of the OIETAI with respect to foreign investments every six months.[60] The law fails to mention the publication and disclosure of laws and regulations affecting foreign investments. It does not mention the requirement for the availability of government policies, administrative decisions and procedural rules to private investors.

Disposal of the investment project

Once the foreign investor completes its tasks it can dispose the investment project by transferring it to either a local or another foreign investor who is qualified to replace the original investor. The assignment of the whole or a part of the foreign capital to a local investor and/or upon the approval of the Board and confirmation by the Minister of Economic and Financial Affairs to other foreign investor is authorised.[61] In the case of assignment to another foreign investor, the assignee who shall have, at least, the same qualification as the initial investor, shall replace and/or become a partner to the former investor from the standpoint of FIPPA.[62] The foreign investor can insert an express provision in the investment contract to ensure the assignment of their rights and obligations in the investment project to a third party. The investor may also liquidate its investment by winding down the company in which it invested and transfer abroad its capital after payment of taxation.

Conclusion

The Iranian laws guarantee foreign investors non-discriminatory and national treatment standards in compliance with international law. Generally, by investing in the free economic zones foreign investors benefit from a set of privileges and incentives designed to facilitate the importation of capital without the bureaucratic and administrative rules on registration requirements. Foreign investors are guaranteed the free and unrestricted transfer of funds overseas including capital, profit and instalment payments. The standards of treatment extend to both direct investments and non-equity based (contractual) investments. This means that project finance agreements are protected against

non-commercial and political risks and the guarantees for payment of compensation to foreign investors for losses resulting from expropriation and nationalisation, alteration of the laws, and currency transfer restrictions.

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4. FIPPA 2002 (Implementing Regulations) art.4(a)(2)-6.
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10. FIPPA 2002 art.20.
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16. Law on the Administration of Free Trade Zones 1993 art.22.
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19. Regulations on Investment in the Free Trade Zones 1994 art.10.
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21. Regulations on Investment in the Free Trade Zones 1994 art.12.
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48. FIPPA 2002 (Implementing Regulations) art.30.

49. FIPPA 2002 (Implementing Regulations) art.34

50. FIPPA 2002 art.3 Note.

51. FIPPA 2002 (Implementing Regulations) art.10.

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53. The Parliament passed a Single Article Act to authorise the Government to join MIGA with 1,659 shares with a maximum payment of $17.5 million.

54. MIGA art.11.

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56. Shiravi, "The Legal and Regulatory Framework for BOT Projects in Iran" (2008) 2 Int'l Business L.J. 165, 174.

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59. FIPPA 2002 art.22.

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