SMART INVEST IRAN

Business & Investment Services Provider

SMART Business Guides

Doing Business in Iran

Methods of Foreign Investment

Introduction

According to article 3 of the Iran's Foreign Investment Promotion and Protection Act (FIPPA), methods of investment are: (i) Foreign Direct Investment (FDI) where the activity of the private sector is permitted; (ii) foreign investment in all sectors within the framework of "Joint-Venture", "Buy-Back" and "Build-Operate-Transfer (BOT)" schemes where the returning the capital and profits accrued is solely emanated from the economic performance of the project in which the investment is made and such return of capital and profit shall not be dependent upon a guarantee by the government, state-owned companies or banks.

1. Foreign Direct Investment (FDI)

Foreign direct investment is a kind of cross-border investment in a business enterprise by a natural person or a legal entity based in another country with the aim of achieving long-term profit. In this type of investment, control and management of the enterprise as a whole or in part will often be in the hands of the foreign investor. Based on FIPPA, foreign direct investment attained in the following ways:

1. Through the use of foreign investment in a new Iranian company or through the purchase of an already-established company's shares by the foreign investor.

2. Through contractual arrangements between the parties with or without formation of the company

Needless to say, foreign direct investment in the private sector will only be allowed in accordance with the procedures prescribed by the Act. Furthermore, it can be construed from the article 3 of FIPPA and related regulations that Foreign investment in economic sectors that are monopolized by the government will only be permitted where the returning the capital and its profits is solely through the economic activity of the same investment project and does not rely on any guarantee by the government or government companies or banks. In fact, this article states the criteria for foreign investment in the public and private sectors of the Iran's economic system.
Under the article 44 of The Constitution of the Islamic Republic of Iran:
"The economy of the Islamic Republic of Iran consists of three sectors: state, cooperative and private, and it is based on systematic and sound planning.

1. The state sector includes all large scales and mother industries, foreign trade, major minerals, banking, insurance, power generation, dams, large scale irrigation networks, radio and television, post, telegraph and telephone services, aviation, shipping, roads, railroads etc. which all will be publicly owned and administered by the State.

2. The cooperative sector includes cooperative companies and enterprises concerned with production and distribution in urban and rural areas in accordance with Islamic criteria.

3. The private sector consists of activities concerning agriculture, animal husbandry, industry, trade and services that supplement the economic activities of the state and cooperative sectors.

Ownership of each of these three sectors is protected by the laws of the Islamic Republic. In so far as this ownership is in conformity with the other articles of this chapter, it does not go beyond the bounds of Islamic law, contributes to the economic growth and progress of the country and does not harm society. The scope of each of these sectors as well as the regulations and conditions governing their operation will be specified by law."

Based on section "A" of the General policies of the Article 44 of the Constitution of the Islamic Republic of Iran: "Investment, management and ownership of those sectors that mentioned in Article 44 are permissible by the non-state enterprises and public institutions.

...

The cooperative and private sectors as described below:

(i) Large-scale industries, mother industries (including large downstream oil and gas industries) and large mines (except oil and gas)

(ii) Foreign trade activities in the framework of trade and foreign currency policies of the country

(iii) Banking operations by non-state public enterprises and institutions, publicly-held cooperatives and Joint-Stock companies and provided maximum shareholding of each shareholder is determined by law

(iv) Insurance

(v) Power supply, generation and importation of electricity for domestic consumption and export

(vi) All postal and telecommunication activities except the main telecommunication grid, assigning frequencies and main networks of postal exchanges, routing and management of distribution of mails and basic postal services

(vii) Roads and railways

(viii) Aviation (air transport) and shipping (marine transport)

The optimal share of the State and non-State sectors in the economic activities covered under the preamble of Article 44 will be determined by law by taking into view the sovereignty and independence of the country, social justice and economic development and growth."

Considering the above-mentioned General Policies of the Article 44 which has been instructed by Supreme Leader of Iran the private sector can invest, manage and own economic activities specified in this instruction. As a result, foreign direct investment is allowed in these eight grounds by the foreign investors.

2. Foreign Direct Investment (FDI)

Regarding paragraph (b) of the article 3 of FIPPA, foreign investment is possible in all sectors within the framework of "Joint Venture", "Buy-Back" and "Build-Operate-Transfer (BOT)" schemes. These schemes are briefly discussed below.

2.1 Joint Ventures

The term "Joint Venture" is frequently used in the field of foreign investment as it is employed by investors in many legal systems for investment. The Joint Venture model as a favorable contract which decrease risks and costs of investing has always been of interest to the investors. However, the application of this type of contract will be required to obey the laws and regulations governing the contract.

Considering the laws and regulations of a host country and the subject matter of the project as well as its performance requirements, it is advisable to build a Joint Venture in the form of a company which has a separate legal entity from its members which often called "Corporative Joint Venture". In some other cases, partnership without establishing a company and through concluding a contract is a safer choice for investment which is known as "Contractual Joint Venture". Partnership as a kind of contract is not the purpose of investment, but it is a method by which the foreign investors achieve their investment objectives as specified in their business plan.

In various legal systems, this form of investment has different names such as "joint venture" "partnership" "consortium" and sometimes "shareholders' agreement". In some other legal systems these titles differ in some aspects which analyzing them is beyond our brief discussion. In Iran's legal literature the legal form of partnership is mentioned in Civil Law (article 606-501), the Commercial Code (companies' section) and also it is implied in Interest-Free Banking regulation (article 18). Article 3 of FIPPA also states civil partnership as a method of investing which can be established in the form of a joint venture. In the corporative joint venture, partners establish a company known as a joint venture company (JVC) which is a kind of business companies with an independent legal entity and each of them possesses specific percent of its shares. In this case, partners are known as shareholders and it is the company which is responsible for implementation of the project which is the subject of the joint venture. On the other hand, in the contractual joint venture partners who decided not to establish a company directly implement the investment scheme based on their contract.

...

2.2 Buy-back Agreement

The second method of investment which is expressed in article 3 of FIPPA is the "Buy-Back" contract. In recent years, buy-back contracts as a contractual investment technique have had a prominent role in Iran's economy. This type of contract is mainly known for its use in the development of discovered oil and gas fields. In addition, buy-back contract is usable in other industries.

Buy-back contract is a kind of counter-trade arrangements which is also classified as a hybrid contract. It is often defined as a contract between a purchaser and a vendor in which the vendor agrees to repurchase the property from the purchaser if a certain event occurs within a specified period of time. The buy-back price is usually set out in the agreement. However, the buy-back transaction has acquired a broader meaning under the Iranian law. As defined by Article 2 of the Executive Rules approved by the Council of Ministers, a buy-back transaction refers to a deal in which the supplier, wholly or partially puts the needed goods and services for the establishment, expansion, reconstruction, improvement or continued production of manufacturing enterprises of the country at the disposal of the producer.

The price of the mentioned goods and services, after deducting the amount of down payments plus the related costs dispersed on the basis of the concluded contract is paid to the supplier or buyer through the delivery of goods or services of the producer and/or through delivery of other industrial and mineral goods and services produced in Iran. Due to some requirements in Iran's Constitution and Petroleum Act, buy-back contracts are usually employed in the development of oil and gas fields in Iran.

2.3 Build-Operate-Transfer Contract (BOT)

According to the FIPPA, another contractual framework for investment is "Build- Operate-Transfer" (BOT) Contract. This method of investment often used for building infrastructures such as power plants, telecommunications, airports and highways. Nevertheless, it can also be used in the recreational projects such as building cable cars. In BOT contracts, a government organization confers the concession of building and operation of a specific project to the private sector and in return the private sector is responsible for financing, designing, supplying materials, building, testing and managing the project. During the operation period, the private sector recovers its costs and interest of its investment by selling the project's output. At the end of operation period, ownership of the facility is transferred to the government organization free of charge.

BOT contract is a kind of public-private partnership in which the government or a public sector decides to build an infrastructure project by with the partnership of the private sector. Experience has proven that it is much faster and cost-effective when governments build necessary facilities and infrastructures by partnership with the private sector. Choosing an appropriate company from the private sector (which is usually is a consortium) is done through a tendering process after which the state or public sector sign a BOT contract with the selected company.

3. Foreign Portfolio Investment (FPI)

3.1 Iran's Stock Exchange

Tehran Stock Exchange was established in 1968 and has been the primary equities market in Iran. In 2005 the new Capital Market Law of Iran approved by the parliament and in 2006, according to this Act, TSE was demutualized and established as a Joint-Stock company with over 6000 shareholders. TSE has enjoyed a reputation for having maintained an orderly market and a cost-effective trading capability since its inception. The fully computerized trading system has helped boost the trading capacity and efficiency of the stock market. In 1994, the electronic trading systems was launched. In 2007, TSE moved to the powerful trading system (powered by Atos Euronext) in order to meet the high trading volume. TSE has been awarded quality system certificate of ISO9001 in 2009 and planned to obtain ISO27001 certification for its IT Security Management System.

TSE has implemented many reform measures in the past few years in order to bring it in line with international practice and to better reflect investors' diversified needs. TSE is set to continue making progress towards liberalization and internationalization. The Tehran Stock Exchange, with its fully automated trading systems and book entry mechanisms is known as one of the most active exchanges in the Middle East region.

At the end of June 2016, the total market capitalization of 509 companies listed on the Tehran Stock Exchange (TSE) amounted as US105$ billion. The ratio of total market capitalization to GDP was about %25 in 2016. In this year, the total trading value was US19$ billion representing a market turnover rate of %22.5. The market P/E ratio of the Tehran market was 6.7, lowest among primary WFE1 exchanges, making it an attractive marketplace for investors. In order to enhance the core competitiveness of the Tehran Stock Exchange and to make faster progress towards liberalization and internationalization the authorities have also promoted the introduction of new financial products, new financial institutions and implemented many reform measures such as making a list of Single Stock Futures (SSF), relaxing limitations on foreign investment, streamlining foreign registration procedures and adjusting various trading system and mechanisms so that they are more in line with international standards.

3.2 Foreign Investments in the Tehran Stock Exchange

As with several emerging stock markets, the Tehran Stock market historically set several limitations on foreign investment. With the growth of Iran's stock market and development of the economy the Stock Market Authorities have gradually relaxed these limitations on foreign investors.

Since April 2010 the process for investment by foreign investors in the stock markets has been changed from the 'permit' system to the 'repatriation' system. On April 18th ,2010 Upon the recommendation of the Ministry of Economic Affairs and Finance and by virtue of the paragraph 3 of article 4 of the Securities Market Law of I.R.I ratified in 2005, the Council of Ministers approved "The Regulations Governing the Foreign Investment in the Exchanges and OTC Markets". This has consequently simplified the application procedures for foreign investment in the Tehran Stock Exchange.

According to the Article 7 of this "Regulations", the restrictions imposed on the possession of shares by the non-strategic foreign investors on every exchange or OTC market are set forth as follows: The number of shares owned by the total foreign investors shall not exceed twenty (%20) percent of the total shares number of the companies listed on the exchange or on the OTC market or twenty percent (%20) of the shares number of any company listed on the exchange or on the OTC market.

The number of shares owned by each foreign investor in any companies listed on the exchange or on the OTC market shall not exceed ten percent (%10) of the shares number of such companies. Based on the Article 4 the foreigners/ foreign entities have to submit the required information and documents to the organization along with an application based on the forms prescribed by the organization so as to obtain a license for trading in securities on every exchange or OTC market.

For more information about procedure and rules related to Iran capital market read here (stock market)

Typical Transactional Structures

Types of operation

Depending on the nature and type of investment and economic sector, foreign investors can undertake investment projects either jointly with an Iranian partner or independently.
To implement investment projects, the foreign investor is required to establish an Iranian company as special purpose vehicle to own and manage the project. The Iranian Commercial Code envisages several types of commercial companies. The most suitable vehicles for structuring investment are the private joint-stock company (PJSC) and the limited liability company (LLC).

PJSC

Iranian law allows foreign investors to establish a wholly-owned Iranian company to engage in commercial activities including investment projects. The most common form of commercial enterprise for investment is the PJSC. The liability of shareholders in a PJSC is limited to the amount of their respective shareholdings in the company

LLC

A foreign company may establish a wholly owned LLC. An LLC is a simple form of Iranian company with limited liability and may be formed by two partners with a minimum capital of US1,000$. LLCs do not issue share certificates21. The founding partners may act as directors one of whom could take the position of the managing director.

Joint Ventures

In cases where the foreign investor decides to undertake an investment project jointly with an Iranian partner, it may enter into a joint venture agreement with the partner. The joint venture agreement contains the parties' intention to establish the joint venture company, the terms and conditions for their cooperation, the limits of their financial liabilities, the management and the extent of contribution of each partner.

Branch Office

Foreign companies may register a branch office in Iran for the purpose of carrying out marketing, trade and business activities. A branch office is a simple form of business entity that does not require share capital or an Iranian partner. A chief representative (general manager), who will be in charge of operating the branch, is nominated by a board resolution of the parent company.

The Differences Between the Agency, the Representative and the Branch of a Foreign Company in Iran

In case that the office of the company shall engaged in carrying out the works undertaken by the head office of the company such as executing the works under a contract concluded by and between the head office of the company outside ban and a client in ban, the registered office shall be known as a Branch Office.
In cases where the office's responsibilities include representing its head office before its clients and selling the products of its head office in Iran, carrying out after sales services and negotiation of the terms of agreements to be concluded by and between the company and its clients in Iran and concluding agreements with those clients the office shall be known as a Representative Office.
The office shall be called a Liaison Office in cases where the office of a company should be solely engaged in conducting market research activity on behalf of its head office, reporting the business opportunities available for the company to its head office in order present the relevant proposals (Performa Invoices) which shall be made directly by the head office to the clients in Iran. Therefore the office shall not be in a position to generate any income of its own in Iran and its expenses shall be covered by transfer of funds by its head office from outside of Iran.

To know about legal issues related to different kinds of Iranian company you can read Here (legal system)