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BOT Contracts

A Path to Increased Infrastructure Foreign Investment in Iran

Introduction

With a view to attraction and promotion of foreign investment and improving engagement of private sector in economic activities, the Iranian government has in the last two decades adopted Build-Operate-Transfer (BOT) methods to obtain infrastructure facilities with a greater efficiency and speed, without the state undertaking financial responsibility.

Due to economic sanctions, BOT methods have not always succeeded in promoting foreign investment. Nonetheless, upon changes in economic trends in Iran BOTs are becoming increasingly important and used in various industries such as roads & railroads, airports, ports, power plants, dams & irrigation networks, downstream oil & gas.

Although Article 44 of the Iranian constitution seems to put an encompassing limitation on the involvement of private sector in most industries such as large scale and mother industries, major minerals, energy sources, navigation, aviation, etc., this general rule has been made subject to various exceptions and constraints by the Iranian legislator in the course of time. The "Law On General Policies Pertaining To Principle 44 Of The Constitution " of 2008 has permitted investment, ownership and management by private sector in the majority of industries listed in principle 44 of constitution.

In line with this general permission, BOT was introduced in article 3.B of the "Foreign Investment Promotion and Protection Act " of 2002("FIPPA"), as a method among others for foreign investment in all fields, including private and state-owned sectors.

Legislation

There is no specific set of rules governing exclusively BOT contracts under the Iranian law. Thus, in order to find the legal sources of rights and duties arising therefrom, reference has to be made to the following general laws and regulations:

- Foreign Investment Promotion and Protection Act " of 2002 ("FIPPA") and its implementing regulations
- Five-Year Development Plan Laws, currently in force the "Law on the Sixth Five-Year Economic, Cultural, and Social Development Plan for 1396-1400 (2016 – 2021)" (the "Sixth Development Plan)
- Annual Budget Laws
- Bilateral Investment Treaties
- 1988 Direct Taxes Act ("DTA") and its following amendments
- Sectorial laws and regulations in transportation, power, water and sewage, oil & gas

Basic Structure

Based on the original BOT concept, diverse variations such as, Build-Operate- Ownership (BOO), Build-Own-Operate Transfer (BOOT) and Build-Transfer-Operate (BTO) have evolved in many countries. Ownership and transfer to government may not exist in some of these arrangements as the case with BOOs, or may be affected at a different stage such as in BOOTs. However, these differences are not so significant as to require a separate study and the same regulations govern all these arrangements. The following general characteristics differentiate BOTs from other investment schemes:

- Performance based: Pursuant to article 3.b of FIPPA, the return of capital and profit accrued is solely emanated from the economic performance of the project. Being a performance-based contract, such return and profit shall not be guaranteed by the government or government companies and/or banks.
- Exercising ownership rights by foreign investors: As long as the investment in BOT schemes and its accrued profits are not amortized, the foreign investor is permitted to exercise ownership rights over the remaining capital. Thus, if for instance an operation period is 20 years, in the first year of operation the foreign investor has ownership rights over the entire project while after 5 years; it could only exercise ownership rights over $\frac{3}{4}$ of the project.
- Assignment of the Project to the government: Unlike transfer of ownership rights to the government which, above shall be effected by way of gradual assignment during the contract period, depending on the contract terms assignment of the right to operate the project to the government may be effected either through gradual assignment or a single assignment at the end of the contract term.

Advantages

Some advantages and incentives provided by Iranian laws for foreign investment in BOT contracts

- **Guaranteed Purchase of Products:** As per article 4.b.2.2 of Implementing Regulation of FIPPA, in BOT schemes where a government agency is the exclusive purchaser and/or supplier of goods and services at subsidized price, the purchase of produced goods and services shall be guaranteed by the government agency. In this case, failing to produce goods and services due to the investor's failure may entail fines.
- **General protections offered by FIPPA:** Specified in FIPPA article 3 as a form of investment through contractual arrangements for foreign investment, BOTs are covered and protected by FIPPA, enjoying thus the benefits and advantages provided therein for foreign investment including national treatment, payment of appropriate compensation on the basis of the real value of the investment in cases of expropriation, transferability of the principal of the foreign capital and the profits therefrom, etc.
- **Assignment of ownership rights to other investors:** In order to facilitate the provision of finance for BOT projects, Article 10 of the Implementing Regulations allows assignment of the whole or part of the foreign capital to other foreign investors upon approval of the FIPPA board and confirmation of Ministry of Economic affairs and Finance. Assignment to local investors is permitted without the need to obtain such approval.
- **Tax Incentives:** One of the main tax incentives applicable to BOT projects is provided by Article 138 of DTA as amended in 2015, granting an income tax exemption equal to the minimum interest expected from partnership contracts for those contributing in cash to the financing of projects and the provision of the working capital of production enterprises in the form of partnership contracts. The article further provides that the interests paid shall be deemed as deductible expenses for tax purposes for the payer of the interest.
- **Stabilization Provision:** To help mitigate the financial risks resulting from change of regulations, Article 17. Note 2 of the Implementing Regulations of FIPPA provides for the provision and payment of losses resulting from prohibition or interruption of execution of a BOT project by the government up to a maximum of installments as maturity, if such prohibition or interruption occurs due to enactment of new legislation.

Concluding Remarks

Insufficiency of state finance resources in Iran is increasingly improving the significance of BOT methods as an effective tool to promote economic and infrastructure projects. Government awareness of this importance has been illustrated in different laws and regulations attempting to provide incentives and cover certain political, legal and financial risks for foreign investors using BOT schemes. Notwithstanding the flaws and gaps in the existing regulations, subject to recognizing associated risks and taking into account all considerations BOTs can provide an acceptably effective mechanism to benefit from the huge investment potential of Iran.

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