

Iran: “The Last” Frontier Market

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This paved the way for the lifting of a number of international sanctions that had for a number of years crippled the Iranian economy and had imposed a tremendous hardship on the Iranian economy and the country's population. Perhaps it is now an opportune time to look back with hindsight and consider the actual efficacy of the agreement and the measurable results including the trickle-down effects of the agreement on the Iranian economy.

Has Iran actually opened for sustainable business and has the international and regional business community taken sufficient comfort in that frontier market to engage? While the UN report indicated a slide of foreign direct investment in Iran until 2015, a more recent report by the Financial Times reveals that the removal of nuclear-related sanctions in fact made Iran a top destination for foreign investment in the Middle East in the first quarter of 2016. That trend continues in a cross section of industries with regional and international companies seeking to either re-establish their business in Iran or enter and engage with the region's second largest economy for the first time.

There are still key obstacles that must be addressed if the objective of President Rouhani and his current administration can be fully realised. Namely, the curbing of the role of the armed forces in the country's economy and an effective decentralisation of economic power, as well as encouraging an increased transparency in both the regulatory and judicial sectors of the country. Furthermore, notwithstanding the easing of the sanctions regime on Iran, the international financial community, including most financial institutions and banks, are still reluctant to fully engage with Iran. Meaningful cross border business with Iran, without the support of the financial services sector, has therefore been made almost impossible, despite 'creativity' in transacting. Despite all the criticism of President Rouhani, his government has been able to attract a significant amount of foreign investment compared with previous years and is taking new measures to encourage further investment of \$250 billion in a number of key sectors. The recent delivery of the first Airbus passenger aircraft, after almost 4 decades, to Iran's national carrier, Iran Air, is a testament to that success, albeit incremental.

While it will certainly take some time for the trickle-down effects of the changes and for the ordinary Iranians to actually be able to see the impact of these new projects on their daily lives, Iran will likely continue to be the most attractive investment destination in the region, and perhaps one of the few remaining untapped markets that offers a great potential to foreign investment, albeit with certain inherent risks that can only be mitigated. With tens of billions of dollars worth of Iranian assets now unfrozen and many international companies that have been barred from doing business there now able to tap into a market with a young, well-educated population of just under 80 million and some of the world's largest energy reserves, Iran is set to be the biggest economy to rejoin the global trading and financial system since the break-up of the Soviet Union more than two decades ago. The latter will stand true despite the recent 'upset' in the US presidential election and the rhetoric that is heard from certain corners of Washington and Tehran. With the latter in mind, the objective of this article is to provide an overview of the Iranian legal regime and the ways that regional and international entities may enter and establish a presence in Iran. While this note is not intended to be treated as definitive legal advice that may be specific to any particular sector, it should provide certain key guidelines for an optimal market entry.

Setting-up in Iran

In accordance with the Iranian Act on Registration of Companies (ratified in 1932) and the Provision of the Foreign Investment Promotion of Protection Act ('FIPPA') of 2002, foreign corporations are now authorised to set up a business and have economic activities in Iran. It should be noted that, with an exception of certain sectors within the economy, there are largely no restrictions on direct foreign ownership in Iran, whether via the establishment of a limited liability company or a branch on shore. We note here the marked difference between the latter and the prevailing on shore corporate structures in the UAE, where foreign ownership of on shore business is in almost all instances is limited to 49 per cent with the balance held by a UAE national entity in an actual or nominee capacity.

The following are the principle means of market entry:

- Directly (Setting up a new company in the form of fully-owned or partnership);
- Buying existing Iranian companies;
- Having a branch or a representative office;
- Acquiring partnership and have a contractual joint venture;
- Merging or amalgamating companies.

The Commercial Code of Iran enacted on 03 March 1933, provides a number of ways to establish a legal presence in Iran (seven in particular), but most foreign investment in the country adopts the following two corporate structures:

- Private Joint Stock Company (Sherkat-e-Sahami);
- Limited Liability Company (Sherkat ba masouliate mahdoud);

The above-mentioned commercial companies have legal personality and should be represented by a natural person while doing business in Iran. The foreign investor can, of course, appoint a manager for the entity based locally in Iran. As there are no foreign ownership restrictions, with the exception of certain sectors and activities, and most foreign investors likely fall within the exemption, the actual ownership structure of either one of the two above forms can be non-Iranian. The investor can choose to have the shareholders of the Iranian entity as either its current parent entity in the home jurisdiction or to establish a 'de novo' entity solely for the purpose of holding the shares of the Iranian entity and to, in effect, 'ring fence' the new Iranian operation. Alternatively, depending on the structure and certain tax considerations, the investor may consider establishing an offshore shell entity, in jurisdictions such as the BVI, and have that entity act as the shareholder for the Iranian company. However, once formed, either of the two structures will be considered an Iranian entity subject to the Commercial Code of Iran, irrespective of ownership.

Private Joint Stock Company and Limited Liability Company

Under Iranian law, a Private Joint Stock Company is considered a corporate vehicle whose capital is divided into shares, and the liability of shareholders is limited to the par value of their shares. Joint stock companies are divided into two categories: public joint stock companies and private joint stock companies. Between these two types of joint stock companies, the private joint stock company is, in our opinion, the preferred vehicle for most foreign investors, subject to their proposed business model for Iran. In accordance with the Commercial Code of Iran, the minimum capital for establishment of a private joint stock company is IRR 1,000,000 (which at today's current exchange rate, is rather minimal) and the minimum number of shareholders for forming this company is three. There is no maximum share capital. Capital must be fully subscribed to and at least 35 per cent should be paid up at the time of incorporation. Non-monetary assets must be fully contributed prior to formation. If capital contribution is in the form of non-monetary assets, the value of such assets must be assessed by an official appraiser of the Ministry of Justice, or the Organization for Investment and Economic and Technical Assistance of Iran. Shareholders must pay the balance of their subscribed share capital, within five years.

Limited Liability Company

In general, under Iranian Commercial Code, a 'limited liability company' ('LLC') is defined as the company formed for the purpose of trading by a minimum of two persons, and there is no specified maximum limit. In a limited liability company, partners' liabilities are limited. The liability is based on the contribution of shareholders to the company capital. Again, we note that the proposed shareholder of the LLC in Iran can be non-Iranian and the foreign investor should consider the corporate vehicle to use as the shareholder for this onshore entity.

With respect to the initial capital, the Commercial Code of Iran does not require a minimum amount of contribution. The contribution of the shareholders to the limited liability company's capital should be either in cash or in kind. In case of a contribution in kind, the value of such contributions should be specified in the company's articles of association and assessed by one or several experts. Shareholders may choose non-official experts for assessment of contributions. Shareholders in a limited liability company will be jointly and severally responsible for assessment of contributions in kind. A limited liability company is not duly incorporated under Iranian law until all capital in cash has been fully contributed and non-cash contributions have been assessed and delivered by partners.

Comparative assessment of a Joint Stock Company and Limited Liability Company

- One or more managers of the Joint Stock Company ('JSC') are typically appointed from the shareholders. In addition, two directors have to be chosen for this type of company. But, the LLC is managed by one or two directors and they might be appointed either from the shareholders or outside.
- The minimum number of shareholders for forming JSC is three, and for LLC is two.
- In JSC, the general manager is typically appointed for a two year period while, in the case of an LLC, it can be for a limited or unlimited period of time.
- JSC are required to publish their corporate announcements in an official newspaper (Gazette) but no such explicit requirement exists for an LLC.
- Participation in capital increase is optional for shareholders in both companies.

In practical terms, there are no material differences between the two corporate vehicles and the differences are structural in nature and are related to the legal framework and not the efficiency of the business activities they may undertake. The regulatory framework and required corporate filing requirements for a private joint stock company may also be unduly onerous, particularly given the limited nature and scope of the foreign investors' initial activity in Iran. We should note, however, that, historically with respect to public sector tenders, the government has tended to favor JSCs, over LLCs.

Foreign Investment in FZs

Iran does have a number of Free Zones ('FZ') and Special Economic Zones where a foreign investment vehicle can be established. However, given that Iran in most sectors does not have foreign ownership restrictions of the sort that we are familiar with in the rest of the region, the logic, at least for that reason alone, in establishing in a FZ quickly dissipates. Nevertheless, we will briefly outline the differences and likely advantages. With respect to the establishment of a FZ entity in the Kish Free Zone ('KFZ') of Iran the following should be noted. These features of KFZ would be also in common with other seven FZ's in Iran.

- Twenty-year tax exemptions for economic activities from the date of the commencement of the operation;
- Upon approval by the Board of Ministers, importation of goods produced in a FZ to other parts of the country are exempt from payment of all, or a part of, customs duties and commercial benefits tax up to the added value thereof in the FZ;
- Importation of goods produced in a FZ into the other parts of the country, whose raw materials are wholly or partly supplied domestically, are exempt (proportionally) from all or a part of the customs duties and

- commercial benefit tax;
- Goods transported from the rest of the country for use and consumption in a FZ will be constituted as the domestic movement of goods, but their exportation from a FZ abroad will be subject to the general Export-Import Regulations;
- Inflow and outflow of capital and expatriation of profits generated by economic activities in each FZ are permitted;
- Legal guarantee and protection extended to foreign investment: The legal rights of investors, the acceptance of whose capital investment has been decreed by the Board of Ministers, are guaranteed and protected. Should the capital of such investors be nationalised to the favor of the public, or their properties being dispossessed of, a fair compensation is to be paid by the government;
- Renting of land to foreign nationals is permitted, but its sale thereto is strictly forbidden;
- There are no visa requirements for foreign nationals seeking to enter the FZ. Non-Iranian nationals entering the KFZ do not require a pre-arranged entry visa and the entry permit is issued on arrival. Entering the mainland from the KFZ, however, does require an entry visa, unless the individual is a national of the countries exempt from obtaining a pre-arranged visa and can obtain visa on arrival at approved ports of entry (such as Tehran International Airport, IKA). Nationals of 11 countries, including the UK, Canada, and USA, among others, are not exempt from the visa regulations to the main land and must obtain a pre-arranged visa; and
- No limitation on transfer of foreign currency to other Iranian FZ or to other countries and efficient, fast, and a board range of services provided by state/private banks and insurance companies.

Given that KFZ is close to the GCC and a short distance north of Dubai with a well established infrastructure and historical trade relations with Iran and other major commercial hubs of the region, it can be a viable gateway compared to other FZ jurisdictions within Iran. In relative terms, KFZ offers better facilities and more developed infrastructures, such as hotels, flights, and commercial facilities (buildings for offices). The largest Iranian Island in the Gulf, which also operates a FZ, is Qeshm Island and that too is suitable for industrial activities due to the existence of large infrastructures such as pier, tanks, and warehouses.

Alternatively, the foreign investor can also establish a branch of its parent entity in Iran. As in other jurisdictions, the liability of the branch will rest with the parent company. There is a requirement to appoint a general manager for the branch and the general manager can be a non-Iranian national provided he / she is properly employed and has a residency visa.

The regulatory requirements for establishing a branch in Iran are not particularly difficult and the documentation is seamless. The branch can, in some instances, act as an initial incubator type entity with a limited activity scope in Iran.

Regardless of which corporate vehicle is considered to be the optimal one for market entry into Iran, the peculiar nature of that market and the very fact that to most uninitiated foreign investors the seemingly opaque nature of the Iranian business landscape and the existence of inherent risks would mandate that sophisticated local knowledge and expertise is paramount. Our Iran Practice Group, acting as part of a regional integrated practice, is well positioned to provide the local expertise and support for a successful and sustainable market entry into Iran.