



# ICLG

## The International Comparative Legal Guide to: **Project Finance 2019**

**8th edition**

A practical cross-border insight into project finance

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# Iran

Behnam Khatami



Hooman Sabeti



## Sabeti & Khatami

### 1 Overview

#### 1.1 What are the main trends/significant developments in the project finance market in your jurisdiction?

2018 proved to be a volatile year for project finance in Iran. Even prior to the US withdrawal from the Iran nuclear deal (otherwise known as the JCPOA), foreign banks were hesitant to finance Iran projects due to a combination of difficulties in transferring funds, concerns over AML and CTF, and a heightened compliance stance. In addition, many projects present bankability issues and a high commercial risk profile due to, *inter alia*, non-market concession agreements, unattractive output pricing and currency devaluation risk. Following the US withdrawal from the JCPOA and re-imposition of nuclear-related secondary sanctions, international banks generally no longer consider financing Iran projects, fearing US reprisal. In a new environment of constrained financial resources, the prospect of project financing by local commercial banks or the government also remains uncertain.

From a legal perspective, approval of the Public Private Partnership Decree (the **PPP Decree**) by the Council of Ministers has been a major development. The PPP Decree allows the government to provide up to 25% of funding requirements for PPP projects. In each case, the participation arrangement will be documented in an agreement among the parties and in a financing agreement between the private sector counterparty and a local commercial bank. The PPP Decree also provides for a number of assurances in favour of private counterparties such as, where applicable, guaranteed purchase of the project's output by public sector entities (including an undertaking to open foreign currency or Iranian Rial letters of credit for such purchases) and issuance of financial guarantees to cover a minimum annual return. The government may also commit to pay contractual damages and purchase a project's incomplete portions from the private counterparty in the event of *force majeure* or termination of the contract due to the government's breach of its undertakings.

#### 1.2 What are the most significant project financings that have taken place in your jurisdiction in recent years?

Although there is no reliable and complete market information, the directives of the Economic Council and press reports suggest that the most notable project financings have been in the infrastructure (mainly, transportation and hospitals), energy and sewage sectors. In terms of monetary value, Bakhtiari Hydroelectric Power Plant and Dam appears to be one of the largest projects with a value of

EUR 1,683,000,000 according to the Economic Council Directive dated 10 February 2018.

### 2 Security

#### 2.1 Is it possible to give asset security by means of a general security agreement or is an agreement required in relation to each type of asset? Briefly, what is the procedure?

A general security agreement is not possible under Iranian law as security assets or properties must be clearly identified in the grant and the security regime depends on the asset type. A pledge of most movable assets (such as project assets) may, but does not have to, be registered, but this does not apply to certain movable assets such as vessels and aircraft, security over which must be registered. Mortgages over real properties must be registered with a public notary. Security over shares of a listed company must be registered with the Central Securities Depository of Iran. Security over shares of non-listed companies must be recorded in the share register of that company and signed by both pledgor and pledgee. Such registration or recording, as the case may be, of a security interest perfects the rights of the secured party.

#### 2.2 Can security be taken over real property (land), plant, machinery and equipment (e.g. pipeline, whether underground or overground)? Briefly, what is the procedure?

Such security interests may be created. In case of real property, a mortgage is created through registration with a public notary, who will first query the ownership status of the property from the relevant Land Register, and upon confirmation of ownership issue a mortgage document creating security over the property. The security will then be registered in the records of the real property with the Land Register. This security provides a right *in rem* for the secured party as well as priority against unsecured creditors.

#### 2.3 Can security be taken over receivables where the chargor is free to collect the receivables in the absence of a default and the debtors are not notified of the security? Briefly, what is the procedure?

Iranian law does not allow security over receivables because a security asset must be a corporeal thing. While mortgage of a debt or benefit is void, an assignment of receivables is acceptable under

Iranian law and is commonly used. Receivables are assigned through a tripartite agreement among the payor, receiver and assignee.

#### 2.4 Can security be taken over cash deposited in bank accounts? Briefly, what is the procedure?

It is possible to create security over cash deposited in a bank. Such security interest may be created through private agreement and can be perfected by recording it with the concerned bank.

#### 2.5 Can security be taken over shares in companies incorporated in your jurisdiction? Are the shares in certificated form? Briefly, what is the procedure?

Creating security interest over shares of an Iranian company is possible regardless of whether the shares are certificated or not. Security over shares of a listed company must be registered with the Central Securities Depository of Iran. Security over shares of non-listed companies must be recorded in the share register of the company and signed by both pledgor and pledgee. Registration or recording, as the case may be, of a security interest perfects the rights of the secured party.

#### 2.6 What are the notarisation, registration, stamp duty and other fees (whether related to property value or otherwise) in relation to security over different types of assets (in particular, shares, real estate, receivables and chattels)?

To be perfected, security interests over real property and movable assets must be registered with a notary who will charge a registration fee, a notarial fee and value added tax (VAT). The fees are determined by the Judiciary. Currently, the registration fee is fixed at 0.5% of the value of the security asset, while the notarial fee varies depending on the nature of the security asset, up to 4% of the value. VAT is payable at 9% of the notarial fee.

Pledging shares of a non-listed company is free of charge, but pledging shares of a listed company will incur a cost of IRR1 to IRR5 per share.

#### 2.7 Do the filing, notification or registration requirements in relation to security over different types of assets involve a significant amount of time or expense?

Registration of security interests can be done fairly quickly. Creating security over movable assets requires listing the assets, which may take some time. Perhaps most time-consuming is creating security over real property, which normally involves an ownership query by the notary from the relevant Land Register, acknowledgment of ownership by the Land Register, registration of the security with the notary and recording with the Land Register. This process normally takes seven to 21 business days.

#### 2.8 Are any regulatory or similar consents required with respect to the creation of security over real property (land), plant, machinery and equipment (e.g. pipeline, whether underground or overground), etc.?

No regulatory consent would be required if the underlying asset is privately owned. If the underlying asset is public or government-owned, or if the equipment (including pipeline) is located on or passes through or under public or government lands, consent may be

required, from the concerned governmental organisation and, in certain cases, from the Council of Ministers. Practically speaking, security interest over public assets is rarely granted due to the complications involved and the fact that government obligations are usually backed by the Central Bank of Iran (CBI) or a sovereign guarantee.

### 3 Security Trustee

#### 3.1 Regardless of whether your jurisdiction recognises the concept of a “trust”, will it recognise the role of a security trustee or agent and allow the security trustee or agent (rather than each lender acting separately) to enforce the security and to apply the proceeds from the security to the claims of all the lenders?

While Iranian law does not recognise trusts, the rights and responsibilities of a security agent will be recognised if documented and agreed through contractual arrangements among the relevant parties.

#### 3.2 If a security trust is not recognised in your jurisdiction, is an alternative mechanism available (such as a parallel debt or joint and several creditor status) to achieve the effect referred to above which would allow one party (either the security trustee or the facility agent) to enforce claims on behalf of all the lenders so that individual lenders do not need to enforce their security separately?

As mentioned in our response to question 3.1, an alternative mechanism, whereby the parties, by contract and power of attorney, empower a party to take enforcement action on behalf of lenders, is possible.

### 4 Enforcement of Security

#### 4.1 Are there any significant restrictions which may impact the timing and value of enforcement, such as (a) a requirement for a public auction or the availability of court blocking procedures to other creditors/the company (or its trustee in bankruptcy/liquidator), or (b) (in respect of regulated assets) regulatory consents?

Enforcement of security interests perfected with a notary registration must be through a notification procedure and auction process (which includes appraisal by Judiciary experts). If the auction does not result in the sale of the asset, it will be transferred to the secured party. Enforcement of security interests over shares and enforcement of unperfected security interests requires a court order, which can be cumbersome, costly and time-consuming. Any enforcement action may be blocked by a court order in certain circumstances (e.g., absence of ground for enforcement).

#### 4.2 Do restrictions apply to foreign investors or creditors in the event of foreclosure on the project and related companies?

In respect of enforcement actions, Iranian law does not generally differentiate between local and foreign investors or creditors, with the exception that foreigners may not own real property. Therefore, enforcement of foreign creditors' security interests over real

property can either be through receipt of sale proceeds or designating a local agent to take ownership on behalf of the foreign secured party.

## 5 Bankruptcy and Restructuring Proceedings

### 5.1 How does a bankruptcy proceeding in respect of the project company affect the ability of a project lender to enforce its rights as a secured party over the security?

A bankruptcy procedure does not prevent a secured creditor from enforcing its rights against the project company. In a bankruptcy procedure, a secured creditor has priority *vis-à-vis* other creditors with respect to the secured property (but not the project company's general assets, since the concept of a general security interest is not recognised), based on perfection and time of creation of the security interests. Nevertheless, it is possible that a bankruptcy court could delay or block enforcement action by a secured party.

### 5.2 Are there any preference periods, clawback rights or other preferential creditors' rights (e.g. tax debts, employees' claims) with respect to the security?

There is no preference period prior to bankruptcy – transfers during which period may be voidable. There is no clawback under the law that would force a secured creditor to return proceeds of enforcement. There are no special classes of creditors that would override a secured party's interest.

### 5.3 Are there any entities that are excluded from bankruptcy proceedings and, if so, what is the applicable legislation?

All corporate vehicles including governmental companies are subject to bankruptcy proceedings. There is also a narrow judicial reorganisation procedure available under Iranian law, which is not mandatory and cannot prevent a bankruptcy procedure.

### 5.4 Are there any processes other than court proceedings that are available to a creditor to seize the assets of the project company in an enforcement?

Where a security interest is registered with a notary (as required for all real property and for certain movable assets such as vessels and aircraft), enforcement of security by secured parties may be initiated and carried out through a notary with no involvement of courts. Self-help is not available to secured parties.

### 5.5 Are there any processes other than formal insolvency proceedings that are available to a project company to achieve a restructuring of its debts and/or cramdown of dissenting creditors?

A borrower may enter into conciliation agreement with its creditors. If such agreement is consented to by at least three-quarters of the claims value, the borrower does not have to enter a bankruptcy auction process for all of its assets and can continue its business subject to the conciliation agreement. Any creditor rejecting such conciliation agreement can receive proceeds of sale of the assets of the insolvent borrower only in proportion to its claim, but cannot

make a further claim at a later time for proceeds of any sale of property in future, before the creditors who have consented to the conciliation agreement are fully paid.

### 5.6 Please briefly describe the liabilities of directors (if any) for continuing to trade whilst a company is in financial difficulties in your jurisdiction.

A company's directors are required under the law to declare bankruptcy where the company's circumstances so warrant. A failure to do so may result in what is called the company's "negligent bankruptcy", which is a bankruptcy by fault of directors. This would subject the directors to civil and criminal liability, including imprisonment from six months to two years.

## 6 Foreign Investment and Ownership Restrictions

### 6.1 Are there any restrictions, controls, fees and/or taxes on foreign ownership of a project company?

In industries such as power generation, mining, and downstream and mid-stream petroleum which are open to the private sector, there is no foreign ownership restriction and foreign investors can take up to 100% of the project (subject to the sectoral and sub-sectoral limits under FIPPA discussed below). Concession agreements in these sectors often have a BOO structure.

Private investors, whether local or foreign, may not own projects which fall within the exclusively public domain of the economy under the Constitution, as discussed in our response to question 7.3 (e.g., electricity transmission and upstream petroleum projects) and these projects are often structured as BOTs.

Under the Foreign Investment Promotion and Protection Act 2002 (FIPPA), foreign investment must not exceed (i) 25% in each economic sector as a whole, and (ii) 35% in each sub-sector (or field). It is not clear whether and how these aggregate ceilings are enforced.

In general, there are no other controls, fees or taxes arising from foreign ownership of a project company, although Iran has foreign currency control regulations in place which may affect repatriation of foreign investments or dividends therefrom.

### 6.2 Are there any bilateral investment treaties (or other international treaties) that would provide protection from such restrictions?

Iran is party to more than 50 bilateral investment treaties (BITs), which include standard protections such as national treatment, most-favoured nation treatment and compensation in the event of expropriation. Protections under these treaties are subject to obtaining a foreign investment licence under FIPPA.

### 6.3 What laws exist regarding the nationalisation or expropriation of project companies and assets? Are any forms of investment specially protected?

The BITs, FIPPA and FIPPA's implementing regulation provide protection for foreign investors against nationalisation and expropriation. For foreign investments with a FIPPA licence, nationalisation or expropriation is permitted only where: (i) it is necessary for public purposes; (ii) it is carried out pursuant to the

Parliament's decision; and (iii) fair and appropriate compensation equal to the real value of the investment is given prior to the nationalisation or expropriation.

## 7 Government Approvals/Restrictions

### 7.1 What are the relevant government agencies or departments with authority over projects in the typical project sectors?

With respect to government-sponsored projects, the Planning and Budget Organisation (PBO) as well as the Central Bank of Iran play important roles in, respectively, budgeting and foreign currency allocations for the projects.

In both government- and privately-sponsored projects, various governmental authorities with licensing and regulatory powers may become involved. For instance, the Renewable Energy and Energy Efficiency Organization, which is affiliated with the Ministry of Energy, is the main authority for renewable projects and for implementation of guaranteed purchase of the generated electricity from such projects. The National Iranian Oil Company and its subsidiaries (all affiliated with the Ministry of Petroleum) are in charge of upstream projects in the petroleum industry. Road, railway, port and airport projects fall under the authority of the relevant departments within the Ministry of Road and Urban Development. Depending on the location of the project land, various municipalities or the Natural Resources Organisation may have jurisdiction. Finally, the nature of the project may require obtaining certain approvals from the Environmental Protection Organisation.

### 7.2 Must any of the financing or project documents be registered or filed with any government authority or otherwise comply with legal formalities to be valid or enforceable?

Allocation of lands classified as "natural resources" to projects must be done through a notarised lease agreement in a pre-approved form and must be registered with a public notary. Other than the foregoing, there is no specific requirement for registration or filing of the financing or project documents, although the concession agreements (which are usually in pre-approved forms) are usually registered with the relevant government organisation. For projects benefitting from a sovereign guarantee certain formalities such as approval by the Economic Council and the CBI must be followed.

### 7.3 Does ownership of land, natural resources or a pipeline, or undertaking the business of ownership or operation of such assets, require a licence (and if so, can such a licence be held by a foreign entity)?

#### Land

Foreign ownership of land is prohibited in Iran, but foreign nationals can own private land through an Iranian corporate vehicle, which will be considered Iranian even if fully owned by foreign nationals. Ownership of government lands cannot be transferred to private owners (whether local or foreign) but these lands can be leased for specific purposes upon the approval of the relevant government authority. Transfer or lease of private lands do not generally require a government licence and can be done through private agreements (although development, construction and operation of the project may require government licences as discussed before).

#### Natural resources

Under the Constitution of Iran, natural resources such as oil and gas or water are part of the "public wealth", ownership of which as well the right to control, preserve, and manage them have been exclusively vested in the government. The government may grant rights to the private sector subject to relevant laws and regulations for the exploration and exploitation of such "public wealth". In such cases, the government maintains ownership rights with respect to these resources but provides the grantee (whether local or foreign) with exploration and exploitation licences in exchange for royalties. Foreign investment with respect to "public wealth" is usually through service agreements under which remuneration would be limited to the cash flow of the project.

#### Pipeline

Using government-owned pipelines requires a licence from the relevant government authorities. Construction and operating a pipeline for transferring feedstock (such as gas, crude or water) to, or the output from, the project may require a licence from government authorities as well.

### 7.4 Are there any royalties, restrictions, fees and/or taxes payable on the extraction or export of natural resources?

There are various payments to be made to the government in relation to extraction of natural resources, but the nature of these payments depends on the project sector. For instance, "service fees" must be paid in upstream petroleum projects while in mining projects, "royalties" are paid to the government.

The government has an exclusive right to export natural resources, but may exercise this right through marketing and export agreements with private parties (whether local or foreign). The law prohibits the imposition of export duty and charges over non-petroleum goods other than raw and unprocessed minerals, which are subject to export duties and charges.

### 7.5 Are there any restrictions, controls, fees and/or taxes on foreign currency exchange?

Iran currently has a rather complicated multi-rate foreign currency exchange regime in place. With respect to projects, foreign currency exchange services are generally offered by banks and authorised exchange houses through a national platform (the **Sana Platform**) and through an auction procedure. Purchase of foreign currency on the Sana Platform is only allowed for certain uses such as importing equipment and machinery, fulfilling payment obligations to foreign contractors, or repatriation. Sellers of foreign currency on the Sana Platform are generally local exporters who must repatriate their foreign currency earnings.

### 7.6 Are there any restrictions, controls, fees and/or taxes on the remittance and repatriation of investment returns or loan payments to parties in other jurisdictions?

Repatriation of investments from Iran requires approval by an official body called the Investment Board, affiliated with the Ministry of Economic Affairs and Finance. For the purpose of repatriation, foreign currency must be purchased through the Sana Platform and remitted via a bank or authorised exchange house. The only fee applicable to repatriation is the conversion fee, although the rates on the Sana Platform may not necessarily reflect open market rates for retail

transactions. Repayment of loans by government bodies requires approval by the PBO and CBI for budget and foreign currency allocations, respectively. For repayment of interest on loans a withholding tax of 25% applies if the lender is a legal entity (or 15–25% depending on the amount of interest, if the lender is a natural person).

#### 7.7 Can project companies establish and maintain onshore foreign currency accounts and/or offshore accounts in other jurisdictions?

Project companies can have onshore foreign currency accounts, as well as offshore accounts anywhere.

#### 7.8 Is there any restriction (under corporate law, exchange control, other law or binding governmental practice or binding contract) on the payment of dividends from a project company to its parent company where the parent is incorporated in your jurisdiction or abroad?

There is no statutory restriction on payment of dividends by a project company and under general mandatory corporate law, at least 10% of the annual profit of the company must be distributed among the shareholders. Remittance of dividends offshore is subject to the currency conversion regime described, and, for projects with a foreign investment licence, clearance from the Investment Board affiliated with the Ministry of Economic Affairs and Finance.

#### 7.9 Are there any material environmental, health and safety laws or regulations that would impact upon a project financing and which governmental authorities administer those laws or regulations?

There are relevant environmental, health and safety laws and regulations, and all production, infrastructure, mining and civil projects are subject to an environmental impact study (EIS), which must be approved by the Environmental Protection Organisation (the EPO). The EIS requirement applies to almost every industrial sector including petrochemical, oil and gas, power, industrial factories, ports and airports. Upon approval of the EIS for a project, an environmental licence will be issued by the EPO, which is usually valid for one year but extendable with the consent of the EPO.

#### 7.10 Is there any specific legal/statutory framework for procurement by project companies?

The Law on the Manner of Conducting Tenders 2004 (the **Tender Law**) and the Public Accounts Act 1987 set the primary legal framework for public procurement. Tender laws (including the Tender Law) are triggered where the project is owned by the government, and private sector transactions are not subject to public procurement laws. Government-sponsored projects or projects using government financial resources are also subject to local content laws.

## 8 Foreign Insurance

#### 8.1 Are there any restrictions, controls, fees and/or taxes on insurance policies over project assets provided or guaranteed by foreign insurance companies?

From the perspective of a project company, there is no restriction on obtaining insurance coverage from a foreign insurance provider.

#### 8.2 Are insurance policies over project assets payable to foreign (secured) creditors?

Receivables under insurance policies can be assigned to foreign creditors, secured or otherwise.

## 9 Foreign Employee Restrictions

#### 9.1 Are there any restrictions on foreign workers, technicians, engineers or executives being employed by a project company?

In order for a foreign employee to work in Iran, he or she must secure a work visa, residency permit and work permit, which would usually be available for skilled workers. To obtain the foregoing, an Iranian entity usually acts as the employer for the foreign national and sponsors the visa and permits.

## 10 Equipment Import Restrictions

#### 10.1 Are there any restrictions, controls, fees and/or taxes on importing project equipment or equipment used by construction contractors?

To import project or construction equipment, the importer must obtain a commercial card and must register an import application with the Ministry of Industry, Mines and Trade (MIMT). Importation of goods (including equipment) is generally subject to payment of import duties which include a customs tariff and “commercial interest”. The customs tariff is set at 4% of the CIF value of imported goods. Commercial interest is determined from time to time by the Council of Ministers and varies depending on the type of imported goods ranging from 0% to higher rates, such as 75%. Moreover, VAT of 9% applies to imported goods. Despite the foregoing, importation of new equipment and machinery for production lines is exempted from import duties.

Where local content requirements are triggered, the government may further impose restrictions on the types of equipment and machinery that may be imported. Finally, the government may, from time to time, impose *ad hoc* restrictions on the importation of equipment and machinery, for instance via foreign currency or capital control measures.

#### 10.2 If so, what import duties are payable and are exceptions available?

Please see our response to question 10.1.

## 11 Force Majeure

#### 11.1 Are force majeure exclusions available and enforceable?

Iranian law recognises exclusion of liability upon occurrence of a *force majeure* event, provided that such event must be external and beyond the reasonable control of the affected person, unpredictable and actually preventing performance. In addition, contractual agreements with respect to *force majeure* are honoured under Iranian law based on the principle of freedom of contract.

## 12 Corrupt Practices

### 12.1 Are there any rules prohibiting corrupt business practices and bribery (particularly any rules targeting the projects sector)? What are the applicable civil or criminal penalties?

Anti-bribery and anti-corruption laws are mainly set forth in the penal code. Moreover, the Law Prohibiting Intervention by Government Officers prohibits government officials from having an interest in projects. The extent and the type of civil and criminal punishments significantly vary depending on the nature of the underlying offence, but punishments include imprisonment, fines and a ban from public service.

## 13 Applicable Law

### 13.1 What law typically governs project agreements?

Project agreements are typically governed by Iranian law. This is almost invariably the case in government-sponsored projects.

### 13.2 What law typically governs financing agreements?

Local financing agreements are governed by Iranian law. Foreign financing agreements can be governed by foreign laws, among which English law is most common.

### 13.3 What matters are typically governed by domestic law?

Matters pertaining to land lease, operation and maintenance of a project, health, safety and environmental issues (HSE) and product liability are inevitably governed by Iranian law.

## 14 Jurisdiction and Waiver of Immunity

### 14.1 Is a party's submission to a foreign jurisdiction and waiver of immunity legally binding and enforceable?

Submission to the jurisdiction of a foreign court is recognised under the principle of freedom of contract, although exclusive submission may not be enforceable as Iranian courts can assert jurisdiction. A foreign judgment must be recognised by Iranian courts prior to enforcement; this recognition is subject to certain criteria under the law.

Waiver of immunity is legally binding and enforceable. Nonetheless, government properties enjoy some protections under the law against enforcement actions and, therefore, cannot be speedily attached. Following a judgment for enforcement against government property, the property can only be attached in the following fiscal year if the concerned government entity has not voluntarily complied.

## 15 International Arbitration

### 15.1 Are contractual provisions requiring submission of disputes to international arbitration and arbitral awards recognised by local courts?

In general, foreign arbitration is recognised under Iranian law, and a

foreign arbitral award may be enforced by Iranian courts if, *inter alia*: (i) there is a reciprocity with the country in which the award was issued; (ii) the judgment is considered final where it was handed down and a writ of enforcement was issued; (iii) enforcement of the judgment is not considered as contrary to public order or good morals in Iran; and (iv) there is no conflicting judgment handed down in Iran.

Despite the foregoing, arbitration of disputes in relation to public assets or public entities is only allowed if the arbitration agreement has been approved by the Council of Ministers and, in "important cases" (e.g. where the counterparty is a foreign national) by the Parliament. Otherwise, Iranian courts would not recognise or enforce the arbitral award as contrary to public order. The foregoing restriction does not prevent enforcement of an arbitral award outside Iran against government assets in foreign jurisdictions.

### 15.2 Is your jurisdiction a contracting state to the New York Convention or other prominent dispute resolution conventions?

Iran is a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards and passed the Convention into law in 2001. Iran is not a party to other multilateral dispute resolution conventions.

### 15.3 Are any types of disputes not arbitrable under local law?

Disputes concerning bankruptcy are the most notable disputes which are not arbitrable under Iranian law.

### 15.4 Are any types of disputes subject to mandatory domestic arbitration proceedings?

Legal disputes in the capital market, such as disputes amongst brokers, issuers, investors and other market players, disputes relating to contractor agreements with government entities and disputes in relation to government-sponsored projects must go through special domestic arbitration proceedings.

## 16 Change of Law / Political Risk

### 16.1 Has there been any call for political risk protections such as direct agreements with central government or political risk guarantees?

There is a statutory protection mechanism against political risk through FIPPA. Foreign investors receiving FIPPA protections are shielded against the risk of nationalisation and expropriation (although FIPPA offers little protection against creeping expropriation).

Change of law clauses are recognised under the principle of freedom of contract. Therefore, contractual protections against such changes (e.g. by locking taxes, price of feedstock, or purchase price of project output) can be enforced.

## 17 Tax

### 17.1 Are there any requirements to deduct or withhold tax from (a) interest payable on loans made to domestic or foreign lenders, or (b) the proceeds of a claim under a guarantee or the proceeds of enforcing security?

Interest payable to foreign lenders is subject to income tax at the rate of 25% for legal persons and 15% to 25% for natural persons, to be withheld by the borrower upon each interest payment. No tax is incurred with respect to the proceeds of a claim under a guarantee or with respect to proceeds of enforcing security.

### 17.2 What tax incentives or other incentives are provided preferentially to foreign investors or creditors? What taxes apply to foreign investments, loans, mortgages or other security documents, either for the purposes of effectiveness or registration?

“Production operations” (which may include production projects) are subject to zero tax for a specified period of time:

- lesser developed areas, as identified by tax authorities (for 10 years);
- special economic zones and industrial parks (for seven years);
- lesser developed special economic zones and industrial parks (for 13 years); and
- other areas (for five years).

Projects that have attracted foreign investment will enjoy the following tax break after the expiry of the abovementioned exemption period:

- In lesser developed areas: the applicable tax rate will be zero until the cumulative taxable income reaches double the registered and paid-up capital of the project company (up to the foreign investment made).
- In other areas: half of the tax will be calculated at a zero tax rate until the cumulative taxable income reaches the registered and paid-up capital of the project company (up to the foreign investment made).

No incentive is offered to foreign lenders, and no other tax is applied on foreign investment (except for income and withholding tax on interest payments to foreign lenders, mentioned above).

## 18 Other Matters

### 18.1 Are there any other material considerations which should be taken into account by either equity investors or lenders when participating in project financings in your jurisdiction?

Foreign investors should be mindful of the differences between typical financing arrangements in Iran and standard international financing models. In addition to particular practices and expectations in local financing, the absence of a comprehensive, clear and consistent legal regime for financing has complicated project financing in Iran. For instance, the legal framework for public-private partnership (PPP) has only been recently introduced in Iran, but the PPP laws currently in force do not address all aspects of PPP projects. As of now, therefore, PPP schemes in Iran are, compared to other project financing, subject to considerable legal uncertainty when it comes to their structure, procedure, execution,

and tax and accounting implications. Furthermore, it is not clear whether PPP has been introduced as an umbrella scheme covering BOT, BOO, BLT and other models, or whether PPP is a new model supplementary to those already existing.

Proper assessment of bankability of projects, documentation and regulatory risk, and enforceability as well as designing the corporate structure, exit strategies and step-in rights to mitigate project, market and foreign currency risks should also be among the material considerations for foreign investors and lenders.

### 18.2 Are there any legal impositions to project companies issuing bonds or similar capital market instruments? Please briefly describe the local legal and regulatory requirements for the issuance of capital market instruments.

Iranian law does not distinguish between project companies and other types of issuers when it comes to issuing capital market instruments. Under the Securities Market Act (SMA), public offering of securities is subject to compliance with registration and prospectus requirements unless an exception applies (e.g., private placement). In addition, an issuer must comply with the listing requirements of the relevant exchange. Public offering of securities must be carried out within the timeframe stipulated by the Securities and Exchange Organisation of Iran (the SEO), the capital market regulatory and supervisory body. Non-compliance with the requirements under securities laws and regulation (e.g., failure to disclose material information or providing misleading information) can lead to civil and criminal liabilities as well as disciplinary measures administered by the SEO. A number of tax benefits are available to companies that raise finance through the capital market.

Issuance of *sukuk* (or Islamic debt securities) is subject to specific rules and regulations. *Sukuk* must be issued via a special purpose intermediary called *nahad-e vaset* (SPV). The SPV is set up in the form of a new limited liability company, established and managed by the Capital Market Central Asset Management Corporation (CMCAM), a quasi-regulatory body. CMCAM also acts as an asset custodian and is charged with protecting the interests of *sukuk* holders and ensuring the issuer's proper allocation of funds, maintenance of accounts and preparation of financial statements.

## 19 Islamic Finance

### 19.1 Explain how *Istina'a*, *Ijarah*, *Wakala* and *Murabaha* instruments might be used in the structuring of an Islamic project financing in your jurisdiction.

All domestic financing in Iran is Islamic. Common instruments available for project financing are:

*Ijarah* is a lease-based financing facility and *ijarah sukuk* are certificates that evidence a *pro rata* ownership by the holders in assets held by an SPV and leased on their behalf. Under these arrangements, the underlying assets are leased to the ostensible borrower in exchange for rental payments, which are structured to achieve the economics of a financing lease. *Ijarah sukuk* consists of an underlying *ijarah* (lease) agreement and a set of subsidiary agreements (such as agency and *sulh* agreements between the originator and the *sukuk* holders or the SPV on behalf of them). The *sulh* agreement serves two functions: (i) the seller will be bound to supply the underlying asset, and make the payment in due time; and (ii) it brings the relationship between the lessor and the lessee to an end once the project is completed.

*Istina'a* is a made-to-order construction agreement used to finance equipment or plant purchases, and *istina'a sukuk* is an asset-based *sukuk* under which the issuer issues certificates based on a construction agreement. Under the construction agreement, one party requires the other party to manufacture and deliver a specific good within a specific period of time in exchange for a specific payment arrangement, which represents the commercial financing arrangements. The underlying assets may be movable or immovable.

*Murabaha* is a simple financing arrangement whereby a financier purchases goods and sells them to the ostensible borrower on deferred payment terms that reflect the financier's purchase price plus financing costs over time. It can also be structured as a facility whereby a commodity is purchased by the financier on a spot basis and sold to the ostensible borrower on deferred payment terms which reflect the economics of a financing (the borrower sells the commodity to the market on a spot basis to raise immediate cash). *Murabaha sukuk* are certificates that evidence *pro rata* ownership by the holders in underlying assets being purchased through a *murabaha* contract; depending on the particular structure and assets chosen, they can be used to fund a purchase of equipment or raise general purpose financing. The underlying asset could be movable or immovable, and acceptable assets include land, equipment and machinery, buildings, vehicles and commodities.

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**19.2 In what circumstances may *Shari'ah* law become the governing law of a contract or a dispute? Have there been any recent notable cases on jurisdictional issues, the applicability of *Shari'ah* or the conflict of *Shari'ah* and local law relevant to the finance sector?**

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The Iranian civil legal system is wholly *Sharia*-compliant by design, so *Sharia* itself is not chosen or imposed as the governing law of a contract or dispute. Iranian laws are vetted by the Guardian Council, a body in charge of ensuring compatibility of the laws legislated by the Parliament with the Constitution and with *Sharia* principles. If the Guardian Council considers a law passed by the Parliament to be non-compliant with *Sharia* principles, it will not ratify it. In addition, the *Sharia* Board of the SEO is responsible for ensuring that *sukuk* are *Sharia*-compliant. Once an instrument is permitted to be issued in the capital market, it is considered *Sharia*-compliant.

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**19.3 Could the inclusion of an interest payment obligation in a loan agreement affect its validity and/or enforceability in your jurisdiction? If so, what steps could be taken to mitigate this risk?**

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Payment of interest on loans by a domestic borrower to a domestic lender may be considered *riba* (usury), which is prohibited under Iranian law. However, there are a range of domestic financing instruments which replicate the commercial characteristics of a conventional loan without falling foul of *Sharia*, and the restriction does not apply to offshore debt.

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