KPMG

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The next frontier

INVESTING IN IRAN

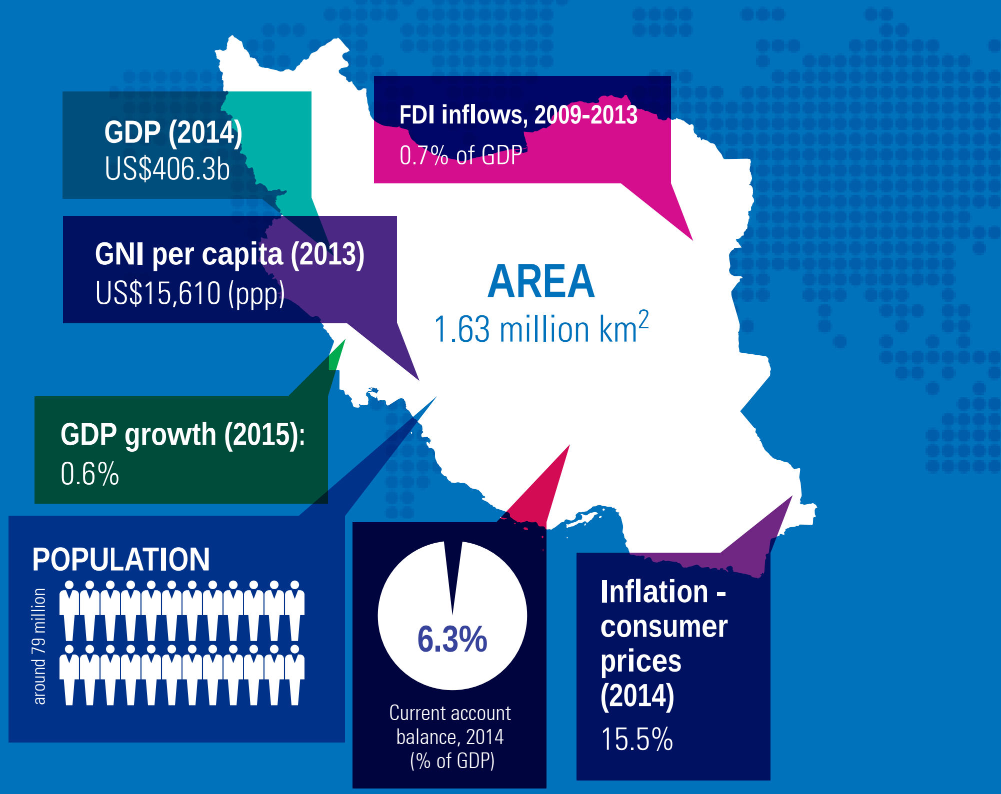
KPMG, Iran-focused investment firm Griffon Capital and international law firm Freshfields Bruckhaus Deringer recently held a seminar on investment opportunities in Iran to share insights on what to be aware of when approaching the Iranian market.

January 2016

Deal Advisory

IRAN

Iran benefits from an **advantageous geographical location** with established export routes into Central Asia, the Middle East and beyond which makes it an attractive location for doing business in the region. With a population of approximately **80 million people**, the **world's largest gas reserves**, the **region's second largest economy** and **trade** and **investment opportunities** across all of Iran's economic sectors – energy, petrochemicals, mining, financial services, hospitality and tourism, fast moving consumer goods, food and beverages, retail, automotive, aviation and manufacturing – Iran has the **potential to quickly become the region's largest economy** once sanctions are lifted. Almost 64% of Iran's population is under the age of 35 – many of whom are **highly educated** - making it an attractive market for global investors.



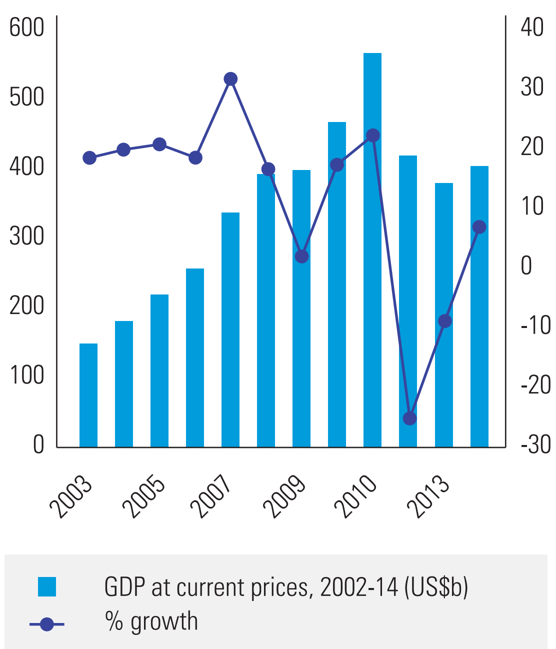
Source: CBI, IMF and World Bank

Investment landscape

Easing of sanctions will lead to liberalisation of trade and direct foreign investment. The IMF is confident that the required investment in infrastructure and productive capacity will be met from an expected inflow of foreign direct investment, in conjunction with accumulated government and private sector savings and domestic financial resources. Now that a majority of EU and US secondary sanctions have been lifted, the Iranian economy may grow quickly, driven by exports of oil, gas, petrochemicals and other manufactured goods. Furthermore, direct foreign investment could lead to a rise in size and importance of capital markets and result in Iran being added to the MSCI Frontier or Emerging markets index.

Iran has an established industrial base and is the largest exporter of cement in the world alongside commodity and energy reserves. It has the largest natural gas reserves and the 4th largest oil reserves in the world. In terms of infrastructure, Iran is comparatively highly-developed with 54 airports and over 10,000 kilometers of railway. It is a diversified and resilient economy, and despite years of war and sanctions it has continued to grow consistently, with the oil sector accounting for only 10% of GDP. In addition, the government's involvement has decreased significantly after a decade of privatisation with potential for further re-privatisation due to weak management and corporate governance of semi-state institutions.

Iran's recent GDP



Source: World Bank

Tax considerations

Iran follows a territorial tax system - Iranian companies are taxed on their worldwide income and non-resident companies are taxed on their income derived from Iran. Iran has a competitive corporate income tax (CIT) regime with a CIT rate of 25%. There is no withholding tax on dividends so this is considered the final tax. The withholding tax on interest is low at 5%.

Iran is an attractive investment location from a tax perspective as tax exemptions are granted for certain types of activities, mainly manufacturing and mining operations. There are also a number of free trade zones which grant tax exemptions for 15 years from inception.

With tax efficient cash repatriation, a comprehensive double tax treaty and investment protection agreement network (covering in excess of 40 countries) and no capital gains tax on non-residents disposing of shares in Iranian companies, investments can be structured in a tax efficient manner.

Legal considerations

Given the absence of substantial foreign direct investment for over a generation, Iran's legal system remains largely untested by foreign investors. It remains to be seen how Iranian courts will address complex commercial disputes involving foreign parties. Legal, political and commercial risks mean that careful thought will need to be given to planning investments.

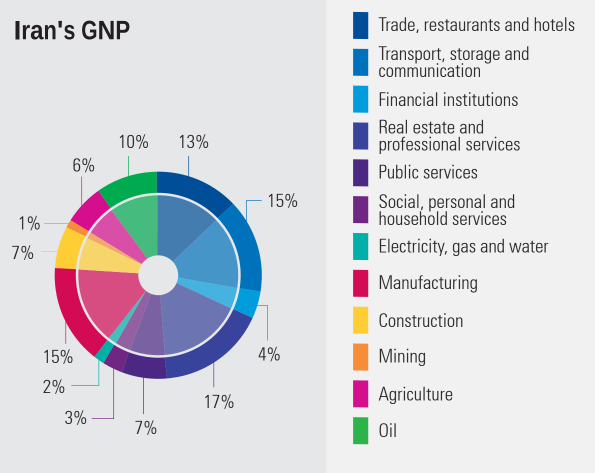
To benefit from protections under Iran's Foreign Investment Promotion and Protection Act (FIPPA), investors need to obtain a licence from the Organization for Investment, Economic and Technical Assistance of Iran (OIETAI). An OIETAI license is also required to benefit from many Iranian investment protection treaties. FIPPA provides important substantive protections, although these are generally less extensive than those found in Iranian bilateral investment treaties. However, under FIPPA, investment disputes must be resolved before Iranian courts. Investors may therefore wish to consider structuring investments to bring them within the scope of a bilateral investment protection treaty to benefit from more robust protections and the ability to enforce those protections through international arbitration. Opting for arbitration outside Iran when agreeing commercial contracts can also help to mitigate risks. However, investors contracting with the state or state entities need to be aware that parliamentary approvals may be required for such entities to agree to international arbitration. See here for further information.

On 16 January 2016 (Implementation Day), the EU terminated the provisions of nuclear-related economic and financial sanctions, although restrictions remain in place in relation to certain persons and entities on EU sanctions lists and other activities. Most US secondary sanctions were also suspended on Implementation Day, meaning that a broad range of US secondary sanctions no longer apply to non-US persons. Non-US entities owned or controlled by US persons can, if licensed by the US Treasury Department's Office of Foreign Assets Control, engage in certain Iranian business, provided that US persons are not involved in facilitating or approving such entities' actions. However, important restrictions remain, including the continuing prohibition on US individuals and entities doing business in Iran without a licence; the inability to use US dollars for Iranian business, given continuing restrictions on the transfer of funds through US correspondent banks; and the continuing ban on the export or re-export of controlled US-origin goods, technology and software. See here for further information.

Challenges

Iran faces a number of severe structural and macroeconomic challenges, including lower oil prices (and the likelihood that increasing Iranian supply might further depress global prices), significant non-performing assets in the banking sector (with interest rates well above global averages), stagnant credit, inflation (as high as 35% in 2013), unemployment and exchange rate depreciation.

Iran's GNP



Developed infrastructure

54 airports

15 ports

215,157km roads

10,407km railway

*GNP data is provided for the latest available period and include indirect taxes and other factors.
Source: CBI and Griffon Capital.

The "snap back" provision - the possibility that sanctions could be re-imposed following a breach of the carefully negotiated Joint Comprehensive Plan of Action - appeared to be one of the major concessions by Iranian negotiators in Vienna and is a commercial risk that any company interested in investing in Iran will have to face. Other risks that investors should consider include hyperinflation and a new wave of currency depreciation. A serious deterioration in regional stability - Iraq, Syria, Afghanistan and Yemen which are all nearby – could significantly impact the conditions for growth. Investors will also need to assess how any recent developments in the local Iranian legal and regulatory environment might affect their business in Iran.

Finally, historical performance impacted by sanctions may not be a reliable guide to the future. Moreover, legal complications, the risks of association with still-sanctioned entities, and monetary transfer challenges mean that initial decisions on foreign investment are likely to be taken with care. The support of advisors with strong local knowledge and on-the-ground experience will be invaluable.

Summary

Iran is one of the last unexplored frontier for international investors. Despite its current challenges, Iran's favorable demographics, significant private sector, resilient diversified economy, established infrastructure and encouraging tax environment present rich opportunities.

Doing business on the ground in Iran requires a good understanding of its regulatory environment, culture and particular business nuances. We believe that the key to success will be finding the correct local partner, thorough due diligence to understand the opportunities and careful structuring to ensure legal protection alongside commercial efficiency.

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