

# Iran

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## Taxation of loans granted to Iranian entities by foreign banks

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The taxation of income arising from the grant of foreign loan facilities has for some years been a contentious issue, the established position being that income earned therefrom was not subject to tax. A recent circular issued by the director-general of the Taxation Affairs Organisation, however, changed the position in that it provided, among other things:

“... given that the income earned by foreign entities in the form of interest and commission charges must be regarded as to include their activity in Iran and an instance of exploitation of capital in Iran, therefore, the grant of loan and credit facilities by foreign investors and banks who carry out their activity by means *other than* a permanent establishment, branch, representative office, agency and the like, shall be subject to taxation on income as the case may be in accordance with the provisions of the Direct Taxation Act.”

The language of the circular is clear and confirms that the income of foreign lending banks, being earned in Iran, will be made subject to tax. This could have significant repercussions on agreements entered into by foreign banks and Iranian borrowers.

### Reasoning

The legality of the imposition of this tax is arguable. Given that Principal 51 of the Iranian Constitution unequivocally provides that “no tax shall be imposed unless by law”, the legality of any tax imposed on such income must be specifically provided for in a law enacted by Parliament. The Direct Taxation Act 1988, as amended (the DTA) is the only item of parliamentary legislation dealing with taxation. The only provision of the DTA imposing an obliga-

tion on foreign entities to pay tax is Article 107. The wording of the circular clearly relates to paragraph (c) of the Article, which provides:

“The taxable income of foreign legal entities and organisations domiciled outside of Iran shall be assessed in the following manner...

...(c) In the case of exploitation of capital and other activities that the legal entities and the said organisations perform in Iran *through* representation such as a branch, representative, agency and the like in accordance with Article 106 of this Law.”

It would seem that the reasoning behind the circular is fundamentally flawed. Whereas the DTA provides for income derived *through* representation, etc, the circular seems to take a diametrically opposite view and speaks of income derived by means *other than* representation, etc.

### A question of origin

Further, a previous decision made by the High Council of Taxation confirmed that:

“... pursuant to... Article 107(b) of the [DTA]... any non-Iranian person (whether real or legal) shall be subject to taxation in Iran on their income in Iran... but in the case of income earned from Iran, on the basis of the said authorities, the intention of the legislator was that this related solely to income derived from the transfer of licenses and other rights and/or the provision of training and technical assistance and/or film rights and apart from these, other income derived from Iran shall not form part of the matters mentioned, including profits related to credits and facilities granted by foreign credit institutions domiciled abroad who, having no operational activities in Iran, shall not be liable to pay tax to the government of the Islamic Republic of Iran.”

The decision confirms that income derived from the grant of loans and facilities by foreign banks, being income derived “from Iran” (as distinct from income earned “in Iran”), is not subject to tax, given the absence of specific provision for this in the DTA.

The decision is a confirmed interpretation of the DTA, and as the DTA is a higher form of law than a circular, it would seem likely that the contents of the circular may be found to be contrary to the DTA.

On the basis of the circular however, from the date of its issuance, the practice would be such that the income of foreign lending banks will be made subject to tax (deducted at source). This practice will continue until the circular is set aside as a result of judicial review.

It is the experience of the author that in all cases where financial facilities are granted by foreign banks to Iranian entities (which are almost invariably government companies in any case), the relevant facility agreement contains provisions whereby any payment made to the foreign bank shall be grossed up by the amount of tax attributable to it. Given this, it would seem that it will ultimately be the Iranian borrower who will suffer the consequences of the director-general’s circular.

## Financial and corporate

Recommended firms	
<b>Tier 1</b>	Atieh Associates Tavakoli & Shahabi Torossian Avanessian & Associates
<b>Tier 2</b>	Dr Akhlaghi & Associates Dr Jamal Seifi & Associates
<b>Tier 3</b>	AA Atai & Associates Adib Law Firm Hossein Lotfi IRCLS (Hendizadeh & Associates)

While the world around it continues to change dramatically, Iran’s legal market remains stable.

A lack of substantial foreign investment continues to be the main barrier to expansion both in the number of law firms and their individual size. International sanctions are one of the key reasons for this, as one partner explains: “Since last year they haven’t notched up the sanctions but the sanctions do put people off investing in Iran.” The US presidential election was highlighted by some partners as a reason for a slight increase in investor interest. “Over the last month or so, we have been getting a lot of instructions from companies that didn’t want to invest a year ago,” says a partner.

Some firms see potential for work coming from investors based in emerging jurisdictions. As one partner says: “We’re seeing a shift towards the eastern side of our borders, creating links with China, India and the Middle East.”

Another possible source of work is the privatisation of companies through the use of Iranian legal doctrine Principle 44 – although up to now progress has not been as fast as many would have liked. “The government was reluctant to give up these cash cows; also there are not many companies to privatise,” explains a partner. Other reasons the lawyer cites are, “inefficiency ... the companies are basically insolvent; and the credit crisis.”

Some have a sense this is changing however. “There has been progress,” says another practitioner: “We have seen it in the last few months and weeks – Iranian banks being listed on the stock exchange.”

Lingering political uncertainty makes any long-term trends impossible to predict but many firms feel that a more liberal economic policy would help their cause. “We would like to see the government adopting less radical policies. If the government put less emphasis on nuclear and other things the economy would improve,” says a lawyer.

### **Atieh Associates**

The practice at Atieh continues to be dominated by work coming from international clients and it is one of the most visible Iranian firms in terms of foreign exposure. “We had numerous references from US and UK law firms about Atieh, so we decided to go with them,” says one client.

Leading partner Babak Namazi is one of the market’s leading figures and has a strong reputation among peers and clients. “Babak is a practical lawyer,” says a client, adding: “Practical in the sense that he can resolve conflicts in an intense negotiation.”

Last year the firm advised a number of foreign vendors and lenders over the financing of a telecoms transaction and counselled another foreign lender over the financing of crude oil carriers.

In M&A, Babak Namazi led the team advising foreign purchasers on an acquisition in the food and beverage sector, while the firm also acted for another foreign client over a joint venture in the automotive sector.

#### **Leading lawyers**

Babak Namazi

### **Tavakoli & Shahabi**

A leading figure at Tavakoli & Shahabi is Cyrus Shafizadeh, whose peers recognise the qualities he brings to the firm. “Shafizadeh is a young dynamic lawyer who has given a fresh feeling to their firm,” says a rival partner.

This status is further reinforced by Shafizadeh’s leading role on most of the firm’s key transactions last year, including advising a multinational railway components manufacturer over the acquisition of shares in an Iranian company and a joint venture with another.

Another highlight saw the firm acting for an international steel company in the acquisition of mines in the country.

#### **Leading lawyers**

Ahman Ehtesham

Cyrus Shafizadeh

### **Other ranked firms**

**Dr Akhlaghi & Associates** added to its practice last year with the hire of Behazin Hasibi, who represents the firm at the Organisation of Investment and Economic Technical Assistance.

*Leading lawyers:* Behrooz Akhlaghi