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# Finding opportunities

Vladimir Dolzhikov and Aleksandr Titov of Ashgabat Consulting Team in Turkmenistan give a comprehensive overview of the country's framework for foreign investment

**T**urkmenistan is a country with rich natural resources. It ranks fourth in the world, after Russia, Iran and the United States, for natural gas reserves. The Turkmenistan Natural Gas Company (Türkmengaz), under the auspices of the Ministry of Oil and Gas controls gas extraction in the country. Gas production is the most dynamic and promising sector of the national economy. Turkmenistan's prospecting potential of gas reserves is estimated at up to 21 trillion cubic metres.

In 2010, the country started the policy of diversifying export routes for its raw materials. China is set to become the largest buyer of gas from Turkmenistan over the coming years as a pipeline linking the two countries, through Uzbekistan and Kazakhstan, reaches its full capacity. In addition to supplying Russia, China and Iran, Turkmenistan has taken measures to accelerate progress in the construction of the Turkmenistan-Afghanistan-Pakistan and India pipeline, which had an estimated cost of \$3.3 billion. Turkmenistan intends to build an internal East-West gas pipeline allowing the transfer of gas from the biggest deposits in Turkmenistan (Dovletabad and Yoloten) to the Caspian coast. This pipeline is planned to be around 1,000 km long and have a carrying capacity of 30 billion cubic metres annually, at a cost of between \$1 billion and \$1.5 billion.

Most of Turkmenistan's oil is extracted by the Turkmenistan State Company (Concern) Türkmennebit from fields at Goturdepe, Balkanabat, and near the Caspian Sea, which have a combined estimated reserve of 700 million tons. The oil extraction industry started in Turkmenistan with the exploitation of the fields in Cheleken in 1909 (by the Nobel brothers) and Balkanabat in the 1930s; production then leaped ahead with the discovery of the Gumdag field in 1948 and the Goturdepe field in 1959. Much of the oil produced in Turkmenistan is refined in the Turkmenbashi and Seidi refineries. Oil is exported by tankers through the Caspian Sea to Europe by way of canals.

## Government support for foreign investment

Turkmenistan is a new, rapidly developing country; in 2011 Turkmenistan celebrates 20 years since getting independence. Fast development of the economy and a positive trade balance makes Turkmenistan attractive for foreign investments. One of the main criteria for investors is the country's political stability. Holding neutral status, Turkmenistan belongs to the most politically stable of the CIS countries.

The former President Saparmurat Turkmenbashi announced the policy of attraction of foreign investments and has consistently followed it; for the purpose of monitoring realisation of investment projects he established the State Agency for Foreign Investments under the President of Turkmenistan. This agency develops the national programme for investments that creates the best solutions for foreign capital through defining methods and forms of investment attraction and outlining directions of investment distribution among the sectors of Turkmenistan economy, providing a balance of domestic and foreign investments in accordance with investment policy of the President.

This policy is continued by the new President Gurbanguly Berdimuhamedov, who has declared: "We are always glad to have partners and neighbours who are ready for sincere and effective cooperation." Such motto reflects the attitude of the government to continue the policy supporting international cooperation and attraction of foreign investments due to their important role in economic development of the country.

Enhancing the ability to attract foreign investments to Turkmenistan makes its development more

“Holding neutral status, Turkmenistan belongs to the most politically stable of the CIS countries”

dynamic and innovative therefore it is important to provide favourable conditions for foreign investors to get the effect necessary for the country development. Recent years have demonstrated a significant increase in foreign investment all over the world and Turkmenistan is ready to get its piece of the pie.

In accordance with the Law of Turkmenistan on Foreign Investments in Turkmenistan (the Foreign Investment Law) the development and realisation of the policy of attraction of foreign investment as well as coordination of foreign investment activity in Turkmenistan and assistance to such activity will be provided by the Cabinet of Ministers of Turkmenistan and a duly authorised government body.

### Regulation

The fast development of Turkmenistan requires consistent improvement of the law, therefore Turkmenistan has modernised its legislation regulating attraction of foreign investments and introduced relevant changes. In order to create an investor-friendly regime, the country has also concluded international agreements on elimination of double taxation with more than 20 countries.

Foreign investments in Turkmenistan are regulated by the Constitution of Turkmenistan, the Laws on Investment Activity in Turkmenistan, Foreign Investments in Turkmenistan, Currency Control, Foreign Economic Activity, the Legal Status of Foreign Citizens in Turkmenistan, Property, Foreign Concessions, Economic Zones of Free Enterprises, Hydrocarbon Resources, and Micro-finance Institutions and Micro-financing.

### Special regimes for investments

The legislation of Turkmenistan provides different regimes for foreign investors, one of which is the most popular among investors: the activity within the frame of the Law on Hydrocarbon Resources. This regime offers considerable privileges for foreign investors acting as contractors and sub-contractors on the basis of agreements concluded with the State Agency on Management and Use of Hydrocarbon Resources at the President of Turkmenistan.

A number of foreign companies including large multinational petroleum developers are working on the Turkmen sector of the Caspian Sea developing projects on the basis of production sharing agreements. Developing offshore fields in Turkmenistan enables a

## “Turkmenistan has concluded international agreements on elimination of double taxation with more than 20 countries”

huge potential of hydrocarbon resources of the Turkmen sector of the Caspian Sea and stimulates further increase of oil and gas production in the country. The increased number of foreign partners for the development of Caspian offshore oil and gas fields helps prove a favourable investment climate established in Turkmenistan, that provides mutual benefit and enhances cooperation in the fuel and energy sector.

Another favourable investment regime is provided for foreign investors performing their activity within the territory of the relatively newly-established (in 2007) Awaza National Touristic Zone.

### Definition of foreign investment

In accordance with Turkmenistan legislation, “foreign investments” mean investments of foreign capital into entrepreneurship activity in the territory of Turkmenistan through the following means: cash assets, securities, property, property rights, intellectual property, services and information.

The Foreign Investment Law specifically separates “foreign direct investments” from the general notion of foreign investments. The Law defines foreign direct investments as owning or acquisition by a foreign investor of not less than 10% of the shares in the authorised capital of an established or newly-establishing enterprise in the territory of Turkmenistan, or investments of capital into the fixed assets of the foreign legal entity’s branch office in Turkmenistan.

Regardless of the fact that the notion of foreign direct investments is limited in comparison with foreign investments in general, both enjoy equal benefits and are equally regulated by the norms and rules provided by Turkmenistan legislation.

Foreign investments can be carried out in Turkmenistan in form of:

- (i) shareholding in enterprises together with legal and/or natural persons of Turkmenistan;
- (ii) establishment of enterprises owned in full by foreign investors;
- (iii) establishment of branches of foreign legal entities;
- (iv) purchase of movable or immovable property;
- (v) provision of loans (recently Turkmenistan has adopted the Law on Micro-financing Entities which envisages that investors can create an entity in the form of a closed joint-stock company and provide loans without formation of a bank); and



### About the author

Vladimir Dolzhikov is the managing partner of ACT. He graduated from the International Law Department of Turkmen State University and has practised law since 1994.

Before establishing his private practice he worked in the capacity of consultant for the State Agency for Foreign Investments at the President of Turkmenistan and participated in drafting the Petroleum Law, compiling the Turkmenistan Investment Guide and drafting several other national laws. In June 1999 he was invited by the Know-How Fund of the UK government to participate in the JICAP programme as the president of a law firm from Turkmenistan. He is also the first and only lawyer from the country listed as a Best Lawyer for corporate and M&A.

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(vi) acquisition of property and non-property rights.

### Investment incentives

Attraction of foreign investments in Turkmenistan is promoted by various benefits and exemptions.

Enterprises with foreign investments, branch offices of foreign legal entities have a right to export domestically manufactured goods/ works/services as well as to import goods/works/ services for their own needs without any licence.

Foreign investors and enterprises with foreign investments that act on the territory of the free economic zone have a right to rent the land depending on the term of cost recovery period of their investment projects.

Enterprises with foreign investments, branch offices and representative offices of foreign legal entities that execute construction works and operation of the objects within the free economic zone are free from charges for registration of their investment projects.

Foreign investors and enterprises with foreign investments that act on the territory of the free economic zone are also exempted from payment of:

- (i) any consular and registration fees;
- (ii) fees for the registration of the investment agreements;
- (iii) licence and licence renewal fees;
- (iv) rent for land; and
- (v) contributions to non-budget funds.

Foreign investors, enterprises with foreign investments, their contractors and sub-contractors that execute construction works and operation of the objects within the free economic zone are free from charges for certification of the equipment and materials imported to Turkmenistan.

Enterprises with foreign investments and branch offices of foreign legal entities can determine the prices of the manufactured goods/works/services independently, except for goods/works/services for which prices are subject to state regulation.

Property imported into Turkmenistan to be invested in the statutory fund of an enterprise with foreign investments, or to the permanent assets of the branch office of a foreign legal entity is exempted from the payment of customs duties.

Property imported to Turkmenistan by foreign investors or enterprises with foreign investments on the basis of an international agreement and contract, concluded in accordance with the Decision of the Cabinet of Ministers of Turkmenistan as an investment, shall be exempted from the payment of customs duties within the period of cost recovery of the investment project set by the relevant agreement.

### Tax system

The main taxes applicable in Turkmenistan are income tax, value added tax and property tax.

#### Income tax

Corporate Income Tax (CIT) is 8% for enterprises which are residents of Turkmenistan. This rate does not apply to enterprises performing their activity under the Law on Hydrocarbon Resources.

Branch and representative offices of foreign legal entities are subject to 20% CIT.

Legal entities which are non-residents of Turkmenistan are subject to 15% CIT (withholding tax) in regards to the income received from Turkmenistan sources on condition that the performed activity does not lead to the creation of a permanent establishment.

The income received as dividends or other means relevant to shareholding in other legal entities is subject to 15% CIT.

Natural persons in Turkmenistan are subject to 10% personal income tax.

#### Value Added Tax

The standard rate of VAT in Turkmenistan is 15%; however, there is a reduced rate of 0% that applies to some specific areas outlined in the Tax Code.

#### Property tax

The rate of Property Tax in Turkmenistan is 1% for the fiscal year.

#### Other taxes

There is also a natural resources use tax and for operations with natural and casing-head gas, the rate of which is 22%. For operations with crude oil the rate is 10%; with other mineral resources, the rate varies between 0 and 50% depending on the

level of profitability.

In addition, there are some small special charges for cities, settlements, and rural community's development, advertisement charges and the charge for car park owners.

As well as those special foreign investment regimes mentioned above, Turkmenistan also provides special taxation regimes. Persons acting under the Law of Turkmenistan on Hydrocarbon Resources in relation with petroleum operations are subject only to profit tax.

Any activity within the territory of the Awaza National Touristic Zone is also exempted from VAT, profit tax and property tax payment.

### Legal aspects of foreign investments

The Foreign Investment Law provides regulation for labour relations and social security. Labour relations in enterprises with foreign investments are regulated by Turkmenistan law.

Foreign investors must pay as social security contributions in regards to their employees who are citizens of Turkmenistan the amount of 20% of their payroll. The Foreign Investment Law makes the payment of such contributions optional in regards to employees who are foreign citizens.

The Foreign Investment Law does not stipulate specific requirements in regards to the nationality of management of a company or branch. However, Turkmenistan law provides that the percentage of Turkmenistan citizens shall not be less than 70% of staff and accordingly the number of foreign citizens shall not exceed 30%.

The Foreign Investment Law also provides general requirement for investors on fair competition. In general, local legislation does not provide detailed competition regulation.

The Foreign Investment Law stipulates that foreign investors shall provide accounting in compliance with Turkmenistan accounting regulations. The country is implementing International Accounting Standards.

If foreign are going to perform certain activities in Turkmenistan they must obtain licences. Nevertheless, activities performed in the territory of the free economic zones (including the National Touristic Zone) are exempted from licensing. Oil and gas investors performing activity under the



#### About the author

Aleksandr Titov joined ACT as partner in 2009 having previously worked as a partner and co-founder of GTK Consult, a private legal consulting partnership in Ashgabat. He has many years' experience working as a legal expert for an EU project on international commercial arbitration, and as a legal adviser, specialising in the oil and gas industry, for a number of foreign corporations.

Before that, he provided legal training for civic activists and for entrepreneurs on legal environment for small businesses under the aegis of USAID in Ashgabat. He started his legal career as an adviser in a local Turkmen company, specialising in education and consulting.

Titov holds a degree in law from Saratov State Academy of Law in Russia. In 2005 he participated in the Contemporary Issues Fellowship Program and

conducted research on legal issues of market entry faced by small and medium-size businesses at Maine Business School, USA.

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Law of Turkmenistan on Hydrocarbon Resources are covered by the licence on performance of exploration and/or development that is provided upon signing the agreement with the State Agency on Management and Use of Hydrocarbon Resources at the President of Turkmenistan.

### Registration

Foreign investments in Turkmenistan require registration either:

- as a project (when no entity is created or company share purchased); or
- as an entity (when a new entity is created or company share purchased). Such entity can be created in the form of a representative office, branch office, limited liability company or joint-stock company.

Registration in Turkmenistan is an authorisation-based process. A foreign company that registers its presence in Turkmenistan must have extensive authorised capital and a minimum of five years of corporate existence. Only the company's features matter, not those of the group to which the company may belong.

The registration of an entity is a complicated process that can take several months, therefore it is recommended to hire legal professionals for the registration process.

Some contracts are subject to registration with certain authorities that have specific requirements for such contracts. It would therefore be reasonable, before signing the contract, to find out if it is subject to registration, and if so, to coordinate draft text with relevant registration authority. Only after that the contract should be signed. It is recommended to hire legal professionals for drafting and registration of the contract.

### Investment guarantees

The Foreign Investment Law provides a number of guarantees for foreign investors in Turkmenistan. In particular, the Law provides a national treatment principle, as well as a fair and equitable treatment principle for foreign investors. Moreover, the Law provides guarantees on freedom of entrance to Turkmenistan for foreign investors and members of staff of the investors, guaranteeing long term visas for them. The Law also provides guarantees for foreign investors on access to information, protection of intellectual property and protection from interference of government bodies into foreign investors' economic activities.

The Foreign Investment Law also provides the right to open bank accounts in local and foreign currencies, the right for repatriation of investments, and the right for currency exchange and reinvestment/transfer of revenue/profit. Upon completion of investment activities, a foreign investor has a right to repatriate their assets in cash or in kind.

The transfer of rights and obligations under the investment contract, as well as cession to the investor's state is also provided by the Foreign Investment Law.

A stabilisation of law principle is available among other guarantees to foreign investors: in case the laws provide regulations that deteriorate the conditions for a foreign investor in comparison with the conditions that existed at the moment of registration of the investment, then the law in force at the moment of the investment registration of the investment will be applicable to the

## “Foreign arbitral awards cannot be enforced in Turkmenistan”

investor for 10 years and or for the period of cost recovery of the investments that were made under the permission of the Cabinet of Ministries of Turkmenistan.

The Foreign Investment Law provides a guarantee of compensation to the foreign investor in case of forced alienation of property. The forced alienation is enforced in the form of requisition and applicable only in cases of *force majeure*. The guarantee provides for prompt, adequate and effective compensation. Notwithstanding these provisions, the Foreign Investment Law does not directly provide for prompt, adequate and effective compensation in case of expropriation, nor does it define the public interest.

### Dispute resolution

In regards to dispute resolution, the Foreign Investment Law provides that disputes are to be settled in the arbitration court of Turkmenistan (litigation) or by the agreement of the parties in a commercial (investment) arbitration tribunal. Turkmenistan courts uphold arbitration agreements and choice of foreign law to regulate contracts.

Regardless of the fact that disputes can be settled by arbitral tribunals, it should be mentioned that Turkmenistan is yet not a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the so-called New York Convention). Moreover, there is no mechanism of enforcement of foreign arbitral awards in the legislation of Turkmenistan, which does however provide such mechanism for local arbitral awards. Therefore, foreign arbitral awards cannot be enforced in Turkmenistan.

Nevertheless, Turkmenistan is a party to the ICSID Convention, allowing resolution of investor-state disputes in the ICSID. Turkmenistan has signed more than 20 bilateral investment treaties, allowing investors from party countries to apply to ICSID for dispute resolution.

### Knowledge is key

Investment in Turkmenistan is very efficient and can bring high revenue returns. However, to make it effective, one must have a good knowledge of the legal environment and the orientation of extensive legislative regulations. The question of successful investment in Turkmenistan can, therefore, be resolved only on a specific, individual basis.