

What you should know about the amended South African Exchange Control Rules

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On 4 January 2021, the South African Reserve Bank released Exchange Control Circular No. 1/2021 which provides for the long-awaited relaxation of the South African exchange control rules relating to "loop" structures and investments.



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As background, the Minister of Finance announced in the 2020 Medium Term Budget Policy Statement that the prohibition on "loop" structures for exchange control purposes would be relaxed. As a result, the South African Reserve Bank has advised that from 1 January 2021, the full "loop" structure restriction has been lifted to encourage inward investments into South Africa; subject to the normal criteria applying to inward investments and reporting to the Financial Surveillance Department (FinSurv).

Prior to 1 January 2021, South African individuals, companies, trusts and private equity funds were prohibited from utilising funds or any other authorised foreign assets to enter into a transaction or a series of transactions to, directly or indirectly through any structure or scheme of arrangement, acquire shares or any other assets or interests in the Common Monetary Area (CMA) which consists of South Africa, Eswatini, Lesotho, Namibia and South Africa. (i.e. "loop" structures).

In simplified terms a "loop" structure is a structure where South African residents hold South African assets directly or indirectly through a non-resident entity. An exception to this however applied in that South African residents were permitted to individually or collectively acquire up to 40% equity and/or voting rights, whichever is the higher, in a foreign target entity, which may in turn hold investments and/or make loans into any CMA country.

Amended exchange control rules

The changes to the South African exchange control rules have lifted the "loop" structure restrictions as it relates to individuals, companies and private equity funds, however South African trusts will continue to be prohibited from establishing "loop" structures.

Interestingly, the amendments to the exchange control rules provide that individuals, companies and private equity funds with authorised foreign assets may invest in South Africa through offshore structures, subject to reporting of the transactions through an Authorised Dealer to FinSurv. It would seem, based on the wording of the Circular that the restrictions in terms of "loop" structures have therefore only been lifted to the extent that the relevant exchange control residents already have authorised foreign assets. A South African resident would not be able to create "loop" structure without prior exchange control approval where it does not have authorised foreign assets.

It is also important to note that B.2(C)(i)(f)(ee) of the Currency and Exchanges Manual for Authorised Dealers which provided that a South African company is permitted to acquire up to 40% equity and/or voting rights, whichever is the higher, in a foreign target entity, which may in turn hold investments and/or make loans into any CMA country has been deleted and substituted. Previously it allowed for investment in offshore entities with investments in the CMA.

The substitute wording now states that corporates with authorised foreign assets may invest in South Africa through an offshore structure, subject to reporting of the transactions through an Authorised Dealer to FinSurv. This provides for ambiguity. The interpretation will still be clarified, but it is our view that under the foreign direct investment (FDI) dispensation the corporate may apply through an Authorised Dealer to invest in an offshore company which holds investments and/or makes loans into South Africa without the 40% limitation, but subject to the normal reporting which the Authorised Dealer will do when approving the FDI.

Importantly, the establishment of "loop" structures by the contribution of assets to an offshore entity, such as a joint venture vehicle, remains subject to FinSurv approval.

Currency and Exchanges Manual

These changes are also not industry specific, as is the case with B.2(F)(ii) of the Currency and Exchanges Manual for Authorised Dealers, which provides that unlisted South African technology, media, telecommunications, exploration and other research and development companies may establish an offshore company to raise foreign funding for their operations, subject to certain conditions. Companies established in terms of this dispensation have been permitted to hold investments and/or make loans into South Africa in terms B.2(F)(iii) of the Currency and Exchanges Manual for Authorised Dealers. The changes to the exchange control rules do not affect B.2(F)(ii) and B.2(F)(iii) of the Currency and Exchanges Manual for Authorised Dealers which have not been deleted or amended.

The provisions relating to foreign assets inherited from a resident estate have also been amended and may, on application to FinSurv, be retained abroad provided that the assets were held abroad by the deceased in compliance with the provisions of the South African Exchange Control Regulations. Where it is disclosed that the foreign assets inherited were held by the deceased in a manner contrary to the provisions of the Regulations, including "loop" structures, an application for regularisation of such assets must be submitted via an Authorised Dealer to FinSurv.

The approval of the FinSurv to retain foreign inherited assets abroad will be subject to the condition that the foreign assets may not be placed at the disposal of other South African residents.

FinSurv regulation

It is important to note that existing unauthorised "loop" structures created prior to 1 January 2021 and unauthorised "loop" structures where the 40% shareholding threshold was exceeded will not be automatically regularised as a result of the changes to the exchange control rules. These structures must still be regularised with the FinSurv. Furthermore, where assets are contributed by a South African corporate to an offshore structure FinSurv approval will still be required as this would continue to constitute an externalisation of South African assets. This aspect is of particular relevance to the private equity industry where "dual structures" (South Africa versus rest of world) has become the industry norm to comply with the historic "loop" structure prohibitions.

From a tax perspective, various amendments have been proposed to existing tax legislation (in some instances punitive) to curb any tax leakage arising due to the relaxation of the rules to "loop" structures. It is important to consider these changes once promulgated as it may have negative tax consequences on South African tax residents holding into existing "loop" structures or who consider implementing "loop" structures. In future the difficulties arising in regard to "loop" structure may primarily be the potential tax pitfalls rather than the exchange control rules which have been prohibitive in the past.

The relaxation of "loop" structure prohibitions has perhaps fallen short of what was hoped for. The reason for this is that the changes are limited to South African exchange control residents who already have authorised foreign assets and thereby continues to subject residents without authorised foreign assets to exchange control approval when intent on establishing a "loop" structure.

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