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TAX & EXCHANGE CONTROL ALERT

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A silver lining? Relaxation of the exchange control rules regarding loop structures announced in the MTBPS

On 30 October 2019, the Minister of Finance (Minister) tabled the 2019 Medium-Term Budget Policy Statement (MTBPS). In his speech on the MTBPS, the Minister was frank in describing the challenges faced by the South African economy and emphasised that our economy must grow faster. Following the tabling of the MTBPS, ratings agency Moody's indicated that South Africa's credit rating would remain at the lowest investment grade level, but changed its outlook from stable to negative.

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Amongst all the negativity, however, the Minister announced at least one silver lining, from an investment and regulatory perspective – a further relaxation of South Africa’s exchange control rules aimed to “...promote investment and reduce unnecessary burdensome approvals”. To this end, the Minister announced that “rules on active currency hedging, loops, and mortgages for individuals working in South Africa will be reformed. To support regional integration, the HoldCo regime will be extended to all banks.”

On 31 October 2019, the Financial Surveillance Department of the South African Reserve Bank (FinSurv) released several circulars, which give effect to the Minister’s announcement. Five circulars were released and of particular interest was the policy change discussed in Circular 18/2019 (Circular) regarding the creation of loop structures by South African residents investing abroad, which is the main focus of this article.

The rules regarding loop structures before the release of the Circular

In our [Tax and Exchange Control Alert](#) of 17 August 2018, we explained what a loop structure is and why it is unlawful to create a loop structure. As discussed in that article, a loop structure entails the formation by a South African resident of an offshore structure which, by reinvestment into the Republic, acquires shares, loan accounts or some other interest in a South African resident company or a South African asset.

Loop structures contravene, amongst other provisions, Regulation 10(1)(c) of the Exchange Control Regulations (Regulations), which states that no person shall, except with the prior permission of the Treasury, enter into any transaction whereby capital or any right to capital is directly or indirectly exported from the Republic. We also explained that the rules regarding loop structures apply to reinvestment into all countries forming part of the Common Monetary Area (CMA), namely South Africa, Swaziland, Lesotho and Namibia.

Furthermore, we explained in the Alert that there were only three circumstances where a loop structure may be created:

- where a South African resident has created an unintentional loop structure in certain circumstances;

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- where South African technology, media, telecommunications, exploration and other research and development companies obtain FinSurv's prior permission to establish an offshore company to raise foreign funding for their operations, subject to certain conditions; and
- where a South African company acquires up to 40% equity and/or voting rights, whichever is the higher, in a foreign market entity, which in turn holds investments and makes loans into any CMA country. The dispensation only applies where the South African company on its own or collectively with other South African companies hold an equity interest and/or voting rights in the foreign entity that does not exceed 40% in total.

The rules regarding loop structures after the release of the Circular

The Circular amends the rules regarding the creation of loop structures by South African individuals and appears to now be very similar to the rules regarding the creation of loop structures by South African companies.

In terms of the Circular, the rules regarding loop structures, as applicable to South African individuals, have been amended to state the following:

- individuals may not enter into any transactions whereby capital or the right to capital will be directly or indirectly exported from South Africa (e.g. may not enter into a foreign commitment with recourse to South Africa). However, private individuals may raise loans abroad to finance the acquisition of foreign assets without recourse to South Africa;
- private individuals may also not utilise 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/interest in a CMA country ('loop structures');
- as an exception to what is stated in the above two bullet points, private individuals are permitted individually or collectively 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. This dispensation will only apply in respect of loop structures formed after 30 October 2019;

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The amendment of the rules will potentially give South African individuals greater flexibility and may provide them with more options when investing abroad.

- existing loop structures (i.e. created by individuals prior to 30 October 2019) and/or loop structures where the 40% shareholding is exceeded will still have to be regularised with FinSurv; and
- furthermore, unintentional loop structures created with authorised foreign capital invested with non-resident asset or fund managers, who invest in foreign companies that have CMA assets/interests and/or offshore global investment funds that directly or indirectly hold CMA investments over which the South African investor has no control, are permitted.

Observation

Amongst all the negative economic news that South Africans have received recently, the announcement to relax these rules regarding the creation of loop structures by individuals is certainly a welcome

one. The amendment of the rules will potentially give South African individuals greater flexibility and may provide them with more options when investing abroad.

It is important that when a South African individual acquires equity and/or voting rights in a foreign target entity, the individual may also have to establish from the entity whether any other South African residents hold equity and/or voting rights as the collective holding by South African residents may not exceed 40%, unless the residents have obtained prior approval from FinSurv.

South African individuals must also ensure that any income they derive from their investment in the foreign target entity is correctly declared to SARS from a tax perspective.

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