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TAX & EXCHANGE CONTROL **ALERT**

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Foreign direct investment into South Africa: Some exchange control considerations

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Where a foreign person or entity invests into South Africa by, for example, acquiring shares in a South African entity, the foreign investor would need to consider a number of commercial and legal issues. This would include the tax considerations that may be applicable to investing into and doing business in South Africa, along with any other regulatory requirements that may apply. While the tax considerations are often front of mind, a legal consideration that sometimes does not receive attention is compliance with South Africa's exchange control (Excon) rules, which also apply to FDI's received. In this article we discuss some of the Excon considerations that foreign investors should bear in mind when investing.

Excon legal framework

South Africa's Excon regime is governed mainly by the Exchange Control Regulations, 1961 (Regulations) read with the Currency and Exchanges Manual for Authorised Dealers (AD Manual). The Regulations were published under the Currency and Exchanges Act 9 of 1933 and it was announced in the Minister of Finance's 2021 Budget that the Regulations would be repealed and replaced by a capital flow management framework (New Regulations). It is anticipated that the New Regulations may be less onerous than the current Regulations and AD Manual, although this will only be confirmed once the New Regulations are released.

The Regulations are enforced by the South African Reserve Bank (SARB), which also delegates to authorised dealers, that is, South African banks, the authority to approve certain transactions under the Regulations read with the AD Manual. Those transactions which can be approved by an authorised dealer are detailed in the AD Manual and for any other transaction, SARB approval needs to be obtained.

Acquiring shares

When a foreign investor acquires shares in a South African company, it is a requirement that the shares be endorsed *"non-resident"*. Under the Regulations, shares held by a foreign investor in a South African company are called *"controlled securities"*. In practice, the

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Under South Africa's Excon laws, so-called "*financial transactions*", which include the purchase and sale of unlisted and listed shares, are subject to the so-called 1:1 rule.

physical endorsement will only take place in respect of shares acquired in a private company not listed on a South African exchange. The endorsement must be done by an authorised dealer, that is, a South African bank. In order for the authorised dealer to endorse the shares, the authorised dealer will require that certain supporting documentation and information be provided, along with the relevant share certificates.

In practice, it may appear that the endorsement is merely a formal requirement that needs to be met. However, it has important practical implications. For example, in the event that the South African company declares dividends to its foreign shareholder, those dividends may only be paid if the shares of the foreign investor are endorsed "*non-resident*". If not, the investor would first have to obtain the endorsement. Furthermore, the authorised dealer may be of the view that the failure to endorse the share certificate earlier constituted a contravention of South Africa's Excon laws, which contravention would then need to be regularised before endorsement can take place.

Where a foreign investor disposes of its shares in a South African company, it is also necessary that the shares be endorsed, to avoid complications arising pursuant to the transfer of shares to the new shareholder.

Funding of the share acquisition

Another practical issue to consider is how the foreign investor will fund the shares to be acquired. Under South Africa's Excon laws, so-called "*financial transactions*", which include the purchase and sale of unlisted and listed shares, are subject to the so-called 1:1 rule. In essence, the effect of this rule is that the foreign investor may only borrow funds in the South African market to the extent that it introduces an equivalent amount. For example, if a foreign investor introduces R100,000 into South Africa, it may borrow no more than R100,000 in the South African market to fund the share purchase. The 1:1 rule also applies to South African companies where 75% or more of the voting rights in such companies are held directly or indirectly by foreign persons. Such companies are known as affected persons.

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If a foreign company seeks to acquire the shares in the South African company by means of a share swap, this can only be done if prior approval is obtained from the SARB.

A situation may also arise where a foreign company seeks to acquire the shareholding through alternative means, for example, by offering the existing shareholders in the South African company shares in the foreign company, in exchange for their shares in the South African company. Colloquially, this may be called a share swap. Under South Africa's Excon rules, the foreign entity is required to fund the purchase in one of the following ways:

- Through the introduction of foreign currency;
- By using Rand from a non-resident Rand account held in its name;
- By using Rand from a vostro account held in the books of the authorised dealer; and/or
- By borrowing the funds in the local market, subject to the application of the 1:1 rule discussed above.

As such, if a foreign company seeks to acquire the shares in the South African company by means of a share swap, this can only be done if prior approval is obtained from the SARB. If the share swap takes place without SARB approval, the foreign company will have to regularise the contravention, subject to the payment of an exchange control levy of up to 40%.

A final thought

When making a FDI into South Africa, including through the acquisition of shares in a South African company, a foreign investor must consider all relevant regulatory requirements, including any Excon rules that may apply. While the Excon rules may appear onerous, South Africa's Excon rules also make it possible for South African companies, including those majority owned by foreign investors, to invest and expand their operations into Africa, through the domestic treasury management (DTMC) regime. We discussed the DTMC regime in our Special Edition Budget Speech Alert 2019 and the expansion of the regime in our Tax & Exchange Control Alert of 14 February 2020.

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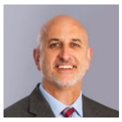

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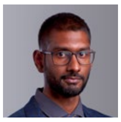

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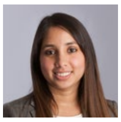

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