



EXCHANGE CONTROL

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Introduction

Exchange controls in South Africa were implemented to regulate the flow of capital out of and into the country. Over time, exchange controls have been relaxed with a view to making South Africa more investment friendly. The stated policy is to gradually relax controls and implement a system to monitor capital flows, rather than exercise controls over the flow of capital into and out of South Africa.

Framework of Exchange Controls

The present control measures were introduced by way of the regulations as promulgated by:

- Government Notice No. R.1111 of 1 December 1961 and amended up to Government Notice No. R.445 in *Government Gazette* No. 35430 of 8 June 2012; and
- Orders and Rules 1961, as published in Government Notice No. R.1112 of 1 December 1961 and amended up to Government Notice No. R.9 in *Government Gazette* No. 33926 of 14 January 2011, issued in terms of the Currency and Exchanges Act, No. 9 of 1933 (the Currency and Exchanges Act).

The legal framework of South African exchange control is based on the premise of a total prohibition to deal in foreign exchange, except with permission of, and on the conditions set out by National Treasury.

Because of its obvious impact on the conduct of normal international trade and payments, the underlying economic policy is not totally prohibitive. The purpose of exchange control in this context is thus:

- to ensure the timeous repatriation into the South African banking system of certain foreign currency acquired by South African residents; and
- to prevent the loss of foreign currency resources through the transfer abroad of real or financial capital assets held in South Africa.

Thus, in essence, the broad ambit of South African exchange control regulations is to prohibit the export of capital from South Africa by South African residents.

The administration of exchange control in South Africa has been delegated to the South African Reserve Bank (SARB) and administratively performed by the Financial Surveillance Department (FinSurv) of the SARB. Certain powers, set out in the Exchange Control Rulings, have been delegated to Authorised Dealers (banks licensed to deal in foreign exchange).

Residents and Non-Residents

The distinction between residents and non-residents of the Common Monetary Area (CMA) is important for exchange control purposes. Non-residents are not directly subject to exchange control as more fully described below. The CMA comprises Lesotho, Namibia, South Africa and Swaziland.

A South African resident is regarded, for exchange control purposes, as a person (that is a natural person or incorporated foundation, trust or partnership), whether of South African or any other nationality, who has taken up residence, is domiciled or registered in South Africa.

A non-resident is a person (that is a natural person or legal entity) whose normal place of residence or domicile registration is outside of the CMA. Although this appears inconsistent, it reflects how the relevant exchange control regulations are drafted.

A review of historical developments is helpful in understanding how exchange control may apply to non-residents. Historically, non-residents were affected directly by South African exchange control regulations in terms of a dual exchange rate system (Financial and Commercial Rand).

This system essentially provided that the local sale or redemption proceeds of South African assets owned by non-residents could not be converted into foreign currency at the Commercial Rand rate of exchange. Instead, it had to be retained in South Africa with authorised dealers in the form of Financial Rand balances. Such balances were transferable between non-residents and eligible for reinvestment in South African-quoted securities and other investments as approved by the exchange control authorities.

As a step along the stated path of the gradual abolishment of exchange control in South Africa, all such controls over non-residents were finally abolished through the termination, on 13 March 1995, of the dual exchange rate system. This also resulted in the disappearance of the Financial Rand. The implication was that, from then on, the local sale proceeds of non-resident-owned South African assets were regarded as freely transferable from South Africa, and that non-residents were not directly subject to exchange control.

Authorised Dealers

In accordance with the exchange control regulations, no person other than an authorised dealer may trade in foreign currency in South Africa. Authorised dealers are appointed by the SARB. A list of the current authorised dealers can be found on the SARB's website.

Exchange Control Rulings (the Rulings) issued by the exchange control authorities detail the general and specific authorities granted to authorised dealers. They also detail the rules and procedures to be followed by authorised dealers in dealing with day-to-day matters relating to exchange control.

The Rulings are compiled in a technical handbook for use by authorised dealers containing authorities, instructions and conditions that apply to the wide range of transactions that they may undertake on behalf of their clients. The Rulings are generally not made available to the public. Instead, an Exchange Control Manual is published and is intended to convey the essence of what is required by the Rulings.

Inbound Investment

General guidelines to South African exchange controls relating to investment in South Africa by non-residents are outlined below.

Capitalisation and shareholders' loans

FinSurv does not prescribe the manner or extent to which foreign-owned companies or entities must be capitalised. The acceptance of foreign loans is, however, subject to prior consent being obtained, as is the payment of interest on such loans. The Income Tax Act, No. 58 of 1962 (Income Tax Act), provides for measures to combat thin capitalisation schemes.

No approval is required from FinSurv for the introduction of the fixed capital of the company (ie share capital and share premium) or the fixed capital of a branch of an external company. Applications of this nature may be approved by an authorised dealer.

The acceptance of all foreign loans and the payment of interest are subject to the prior approval being obtained from an authorised dealer or FinSurv (where the terms of the loan fall outside of the authorised dealer's delegated authority).

The loan(s) may be either denominated in a foreign currency or South African Rand. In terms of policy, the interest rate applicable to shareholder loans is limited to a rate not exceeding the base or prime lending rate applicable to the currency in which the loan is denominated. The interest rate applicable to unrelated third-party loans is limited to a rate not exceeding the base or prime lending rate applicable to the currency in which the loan is denominated plus 2% in respect of foreign currency denominated loans and plus 3% in respect of Rand denominated loans.

The repayment of foreign loans is also subject to approval being obtained from either an authorised dealer or FinSurv. There are no restrictions on the repatriation of capital investments by non-residents.

Local Financial Assistance

In terms of the Exchange Control Regulations, an entity in which there is a 75% or more non-resident interest is defined as an "affected person". In terms of the Exchange Control Regulations and Rulings, the extent to which "affected persons" and non-residents may avail themselves of local financial assistance is restricted.

Financial assistance includes lending currency, granting credit, taking up securities, concluding an instalment and/or hire purchase sale or a lease agreement, financing sales or stocks, discounting, factoring, guaranteeing or accepting credits, guaranteeing or accepting any obligation, suretyships, buy-backs, and lease-backs. It does not include normal trade credits, however.

Authorised dealers are exempted from the provisions of the Regulations and may grant or authorise local financial assistance facilities to affected persons without restriction. Exceptions include financial transactions and the acquisition of residential property, provided a 1:1 ratio applies. Financial transactions include, inter alia, the purchase and sale of any securities (listed or unlisted), repurchase agreements, and any derivative transactions on securities.

Remittance of Dividends and Interest

The remittance of dividends declared from profits, including realised capital profits, to non-resident shareholders/members of non-quoted companies/entities does not require approval from FinSurv and may be approved by authorised dealers. This is provided that the dividend/profit distribution is made from realised profits from normal trading or investment activities.

This applies to companies/entities that are “affected persons” that do not avail themselves of any local financial assistance, as well as “affected persons” that avail themselves of local financial assistance, provided the payment of the dividend/profit distribution will not cause the entity to become “over-borrowed”.

The declaration of a dividend in specie or a special dividend for any purpose requires the prior consent of FinSurv. The remittance of interest on foreign loans is approved when approval is obtained for the acceptance of the loans.

Licensing and Royalties

The remittance of royalties in terms of licensing agreements involving local manufacturing requires the approval of the Department of Trade and Industry (DTI).

The DTI and FinSurv have jointly issued guidelines with regard to the maximum level of royalty that will be approved, namely 4% in respect of retail products and 6% in respect of intermediate and capital goods.

The basis on which the royalties may be calculated is restricted to net ex-factory sales, excluding the in-factory landed cost of imported components and raw-materials directly or indirectly from the licensor, as well as value-added tax.

Licence agreements relating to the use of intellectual property and agreements not involving local manufacture/production require the consent of either an authorised dealer or FinSurv.

Payment for Services Rendered

Authorised dealers may approve payments by residents for services actually rendered by non-residents provided that the fees payable are not calculated on the basis of a percentage of turnover, income, sales or purchases. It is important to note that charges raised must be “arm’s length” and market related. There is also no restriction on the amount of directors’ fees that are paid.

Management and related fees based on an allocation method, or that are percentage based, are not favourably considered by FinSurv. FinSurv will need to be satisfied as to the merit and the basis of calculation in order to consider requests for such payments.

Other Current Payments

Current payments may in general be approved by authorised dealers.

Conclusion

Exchange controls have relaxed significantly and authority to approve a wide range of transactions has been delegated to authorised dealers with a view to streamline and simplify the approval process.

Exchange controls affect all cross-border transactions. Investors and parties to cross-border transactions should consult with an advisor or authorised dealer prior to entering into any transaction, to ensure compliance with exchange controls.