# PROPOSED EXCHANGE CONTROL REFORMS

MARCH 2020

**This communication aims to provide further context about the proposed exchange control reforms.**

With the outbreak of Covid-19, it is difficult to think beyond all that has transpired over the past few months globally, let alone the past month in South Africa. However, towards the end of February 2020, the Financial Surveillance Department (FinSurv) of the South African Reserve Bank (SARB) issued a host of communications about the proposed exchange control reforms, which we attempt to unpack below.

## BUDGET 2020: THE MINISTER OF FINANCE ANNOUNCED SEVERAL EXCHANGE CONTROL REFORMS

During the 2019 Medium Term Budget Policy Statement the Minister of Finance announced that *'In order to promote investment and reduce unnecessary burdensome approvals, by budget day (26 February 2020) the South African Reserve Bank will propose a more modern, transparent and risk-based approvals framework for cross-border flows.'*

### A new capital flow management framework will replace exchange controls

The following points summarise the main features of the new capital flow management (CFM) framework:

1 A shift from the current 'negative' framework (exchange controls) to a 'positive' framework (CFM measures) where all cross-border transactions will be allowed, except for those that are subject to the control measures below.

2 A more modern, transparent and risk-based approvals framework.

3 Stronger measures to fight illegitimate financial cross-border flows and tax evasion.

4 Stronger cooperation between the Financial Intelligence Centre, SARB, South African Revenue Service and other law enforcement agencies.

5 Enhanced cross-border reporting requirements.

**Capital flow and macroprudential control measures that will remain to ensure financial stability:**

1 South African corporates will not be allowed to shift their primary domicile, except under exceptional circumstances approved by the Minister of Finance.

2 Approval conditions granted by the Minister of Finance for corporates with a primary listing offshore, including dual-listed structures, will be aligned with the current foreign direct investment (FDI) criteria or conditions or both to level the playing field.

3 Cross-border foreign exchange activities will continue to be conducted through dealers authorised and regulated by the SARB.

4 Prudential limits on South African banks and institutional investors (South African banks: 10% of net qualifying capital and reserves; institutional investors – retirement funds: 30% and up to 10% in Africa; institutional investors – collective investment schemes and investment managers: 40% and up to 10% in Africa) will remain, but the limits will be reviewed regularly.

5 The unhedged foreign currency exposures of the banks will remain limited to 10% of liabilities (known as the net open foreign exchange position) and will remain regulated by the Prudential Authority of the SARB.

6 The domestic treasury management company policy, which allows South African companies to establish one subsidiary as a holding company for African and offshore operations without being subject to exchange control restrictions, will remain in place, as will the international headquarter company regime.

7 The export of intellectual property (IP) for fair value to non-related parties will not be subject to approval.

8 The current policy of certain loop structures, which relates to the acquisition of equity or voting rights or both in a foreign company by private individuals, will remain until tax amendments are implemented to address the risks.

The following important points, among others, were noted by the FinSurv branch of the SARB regarding the new CFM framework in a presentation published on 26 February 2020:

1 The Currency and Exchanges Act, 9 of 1933, will remain and new CFM regulations will be issued under this act to replace the current exchange control regulations.

2 The new CFM framework and regulations will be implemented gradually over the next 12 months and **in the interim the current exchange control system and restrictions remain**.

3 A new manual will be issued in line with new regulations and it will include a section outlining the roles and responsibilities of authorised dealers (ADs).

4 Cross-border foreign exchange activities will continue to be conducted through ADs authorised by FinSurv.

5 ADs will continue to rely on presentation of documents to ensure prevention of illicit flows and to determine if transactions do not fall in the category of the CFMs.

## HOW MAY OUR DIFFERENT CLIENTS BE AFFECTED?

| | |
|---|---|
| **1 SOUTH AFRICAN RESIDENT INDIVIDUALS** | Removal of exchange controls, strengthening of the tax treatment and a stricter verification process:<br>1 The distinction between emigrants and residents will fall away and both will be treated identically.<br>2 The inward foreign loan approval process will remain until relevant tax amendments are concluded, at which point the focus will shift to a tax system applicable to foreign loans, with more emphasis on reporting loans through ADs for FinSurv to collect loan statistics.<br>3 The single discretionary allowance of R1 million per calendar year will remain and will be reviewed regularly.<br>4 The foreign capital allowance for investment purposes for individuals of R10 million per calendar year will remain and will be reviewed. Individuals who wish to transfer more than R10 million will be subject to a more stringent verification process, which will trigger a risk management test. This test will include certification of tax status and the source of funds, and assurance that the individual complies with the anti-money-laundering and counterterrorist-financing requirements prescribed by the Financial Intelligence Centre Act, 38 of 2001. |
| **2 SOUTH AFRICAN CORPORATES** | 1 The outward FDI available to South African corporates will remain at R1 billion. Any amount above this limit will be subject to prior notification to FinSurv for verification and reporting purposes.<br>2 The inward foreign loan approval process will remain until relevant tax amendments are concluded, at which point the focus will shift to a tax system applicable to foreign loans, with more emphasis on reporting of loans for FinSurv to collect loan statistics. |
| **3 SOUTH AFRICAN TRUSTS** | Current restrictions disallowing FDI to be held by South African trusts will remain pending changes to tax legislation. (It is unclear at this stage what changes are being referred to. However, this should become clearer when the Taxation Laws Amendment Bill is published in June or July.) |
| **4 CLIENTS WHO WISH TO BUY OR SELL SOUTH AFRICAN-OWNED IP** | ADs may approve the sale of IP by South African residents (excluding mandated state-owned enterprises) to unrelated non-resident parties at an arm’s length and at a fair market-related sale price. |
| **5 LOOP STRUCTURES (WHEN A SOUTH AFRICAN RESIDENT HOLDS SOUTH AFRICAN ASSETS INDIRECTLY THROUGH A NON-RESIDENT ENTITY)** | The current restriction of 40% for:<br>• corporates, for bona fide business investment, growth or expansion transactions; and<br>• private individuals (with effect from 30 October 2019) may individually or collectively acquire equity or voting rights or both in a foreign target entity (excluding a trust) that may invest or make loans in South Africa<br>will remain pending the implementation of the relevant tax amendments. In other words, it is proposed that:<br>• the controlled foreign company legislation be amended to limit the dividend exemption relating to the accrual or receipt of dividends from a resident company to a controlled foreign company; and<br>• the participation exemption for capital gains on disposal of shares in controlled foreign companies by residents should not apply to the extent that the value of those shares is derived from South African assets. |
| **6 INSTITUTIONAL INVESTORS** | Prudential limits (institutional investors – retirement funds: 30% and up to 10% in Africa; institutional investors – collective investment schemes and investment managers: 40% and up to 10% in Africa) will remain and be reviewed regularly. |

## BACKGROUND AND TIMELINE THAT LED TO THE RECENT ANNOUNCEMENTS

**1 The process was initiated in 1995 by the National Treasury and SARB**

They embarked on a process of gradual and sequential relaxation of exchange controls to make it easier to invest internationally, with a shift towards the following:

- **Prudential regulation of foreign exposure for banks**
- **Institutional investors regime**
  All retirement funds, long-term insurers and collective investment scheme management companies are treated as institutional investors, are eligible for the foreign portfolio investment allowance, and must comply with the reporting requirements.
- **Introduction of a cross-border reporting system**

The goal of this system is to ensure accurate and comprehensive reporting of all data by ADs on transactions for balance of payments and other statistical measures about the nature, volume and values of various cross-border flows.

**2 In the 2017 budget the Minister of Finance announced a review of current exchange controls**

In the 2017 budget speech the Minister of Finance announced the review and benchmarking of the current CFM system (exchange controls) against best practices in other developing economies and fast-growing markets. As part of this review the SARB enlisted the services of the Organisation for Economic Cooperation and Development (OECD) to benchmark South Africa's CFM system against the OECD code of Liberalisation of Capital Movements. The code provided a balanced framework for the gradual removal of barriers to capital movement while providing flexibility to cope with situations of economic and financial stability.

**3 In the 2020 budget several exchange control reforms were announced**

As part of the budget proposal documents a document (called 'Annexure E') setting out further exchange control reforms to be implemented over the next 12 months was tabled, along with subsequent other circulars.

**4 A new CFM framework was announced in SARB circular no 2/2020 dated 27 February 2020**

This circular announced that over the next 12 months a new CFM framework will be put in place and all foreign currency transactions will be allowed. However, the capital flow and macroprudential control measures (listed above) will remain to ensure financial stability.

To view the FinSurv presentation, Annexure E and the SARB circular **click** here.

### The removal of exchange controls is a positive development for South African residents.

We will continue to monitor the implementation of the new CFM framework and regulations and will advise as and when any further material information is made available.

### The changes may be finalised over the next 12 few months, so we will stay informed.

It was originally understood that the detail relating to how these reforms will affect South African residents will become clearer over the next 12 months. However, considering the global shift towards tackling the spread of Covid-19, this may take longer. In the meantime, we will stay abreast of the proposals to be able to advise you appropriately.

### We can provide personal, expert advice on how these changes may affect your wealth.

Your wealth manager is well positioned to provide you with expert advice on any actions you must take now and plans you need to put in place for the future relating to your personal wealth management plan.

THE FIDUCIARY SPECIALIST TEAM
**Coastal** Tracy Muller (Head) and Hannelie La Grange
**Central** Devs Moodley and Elana Oosthuizen
**KwaZulu-Natal** Priscilla Reddhi
**Estate Planning Paraplanner** Akhona Modi
**Published** March 2020