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Relaxation of the exchange control rules pertaining to loop structures

On 4 January 2021, the Financial Surveillance Department of the South African Reserve Bank (Finsurv) issued [Exchange Control Circular No. 1/2021](#) (Circular) which *inter alia*, and with effect from 1 January 2021:

- lifts loop structure restrictions in respect of South African exchange control residents that are tax resident in South Africa
- removes certain restrictions in respect of inward loans received from foreign lenders.^[1]

Prior to the circular being issued:

- certain South African exchange control residents, namely South African companies and individuals, were permitted to acquire up to 40% equity and/or voting rights, whichever is the higher, in a foreign entity, which foreign entity could in turn hold investments and/or advance loans into any Common Monetary Area (CMA) (which includes South Africa, Eswatini, Lesotho and Namibia) (regardless of the extent of reinvestment by the foreign entity in South Africa), without requiring Finsurv's prior approval, while any loop structure above this prescribed threshold required prior Finsurv approval;
- inward foreign loans received from foreign lenders were also subject to the following restrictions:
 - the loan funds may not have represented or have been sourced from a South African exchange control resident's authorised foreign asset
 - direct/indirect South African interest in the foreign lender was prohibited.

While the relaxation of the rules is generally welcome, South African exchange control residents should take note of the additional reporting obligations to Finsurv, which are also effective from 1 January 2021. These rules may create an additional administrative burden as previously the only reporting obligation was for unauthorised transactions.

All existing unauthorised loop structures, created prior to 1 January 2021 and exceeding the 40% shareholding limitation, must be regularised with Finsurv.

Related tax amendments

In order to address potential tax leakage which may result from the relaxation of the exchange control rules, certain amendments have been made to the taxation of income earned by controlled foreign companies (CFCs) in terms of the Taxation Laws Amendment Act No. 23 of 2020, promulgated on 20 January 2021.

The amendments come into operation on 1 January 2021 and apply in respect of dividends received or accrued to, or, any net capital gain of, any CFC on or after that date.

The amendment applicable to dividends will apply if a CFC holds shares in a South African resident company (a loop structure). In this instance, a portion of the dividends received by the CFC will now be included in the CFC's net income (i.e. become taxable). The portion to be included is determined in terms of a formula, which, simply, aims to prevent arbitrage in dividends tax rates that the loop structure facilitates.

The amendment applicable to net capital gains has been made to the participation exemption on capital gains arising from the disposal of equity share capital in a foreign company to a non-resident. In future, the participation exemption on capital gains will not apply to the disposal of any share in a CFC to the extent that the value of the assets of that CFC is attributable to assets directly or indirectly located, issued or registered in South Africa.

South African exchange control residents should carefully consider the impact of these tax amendments when planning any increased shareholding in foreign companies which create loop structures.

The relaxation of the exchange control rules relating to loop structures, and the related amendments to the tax rules, create both opportunities and risks for financial, tax and estate planning. The below Deloitte Tax & Legal professionals would be happy to assist you in investigating as well as navigating these opportunities and risks in further detail.

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^[1] Exchange Control Circular No. 1/2021.

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