

Loop structure still exchange control threat

INWARD listings have become a common feature of recent international transactions involving SA.

The recent primary listing of Pallinghurst Resources Guernsey Ltd is a good example, and the announcement that British American Tobacco will obtain an inward secondary listing on the JSE.

However, loop structures remain the biggest exchange control stumbling block for South African-resident investors and has probably scuppered more cross-border transactions contemplated by South African residents, than any other exchange control or tax policy.

A loop structure means that South African residents are pro-

hibited from holding any South African asset indirectly through a non-resident entity. An example would be where South African residents hold all the shares in a company in Mauritius, which owns or acquires South African assets or shares in a South African company. The South African resident shareholders need specific approval to continue to hold their shares in the Mauritius company, despite the loop.

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Approval for a loop structure cannot be approved by the South African Reserve Bank's Exchange Control Division and must be referred to the finance minister.

Approval is only granted in ex-

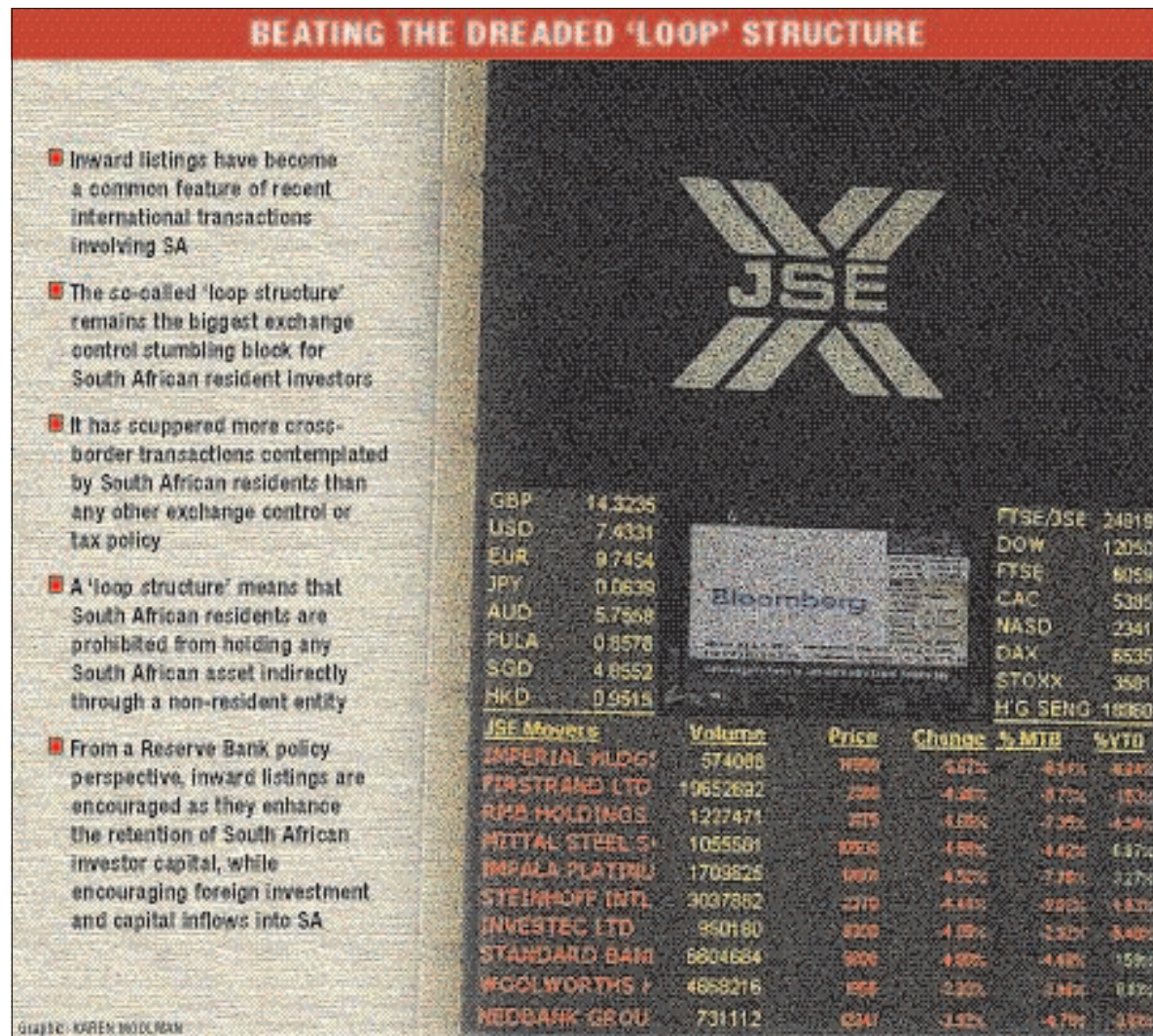
ceptional circumstances, for example to facilitate substantial black economic empowerment (BEE) transactions or where it is regarded in the national interest.

However, an exception to this rule is that the South African resident shareholders will be allowed to continue to hold their shares in the Mauritius company if that entity applies for a listing (primary or secondary) on the JSE and the South African resident shareholders continue to hold their shares on the South African share register. For this reason, an inward listing of a non-resident company is often the only way to obtain the required exchange control approval for a transaction where South African resident shareholders continue to hold their shares in the non-resident company.

From a Reserve Bank policy perspective, inward listings are encouraged as they enhance the retention of South African investor capital, while at the same time encouraging foreign investment and capital inflows into the country. Recent amendments to both exchange control policy and income tax provisions indicate that SA actively seeks to promote inward listings by making it more accessible and attractive to South African shareholders. There are additional incentives where the inward listed entity is an African entity.

Transactions where inward listings are required manifest in a number of ways. Most of these entail the disposal by South African resident shareholders, in exchange for receiving shares in a foreign company as consideration. One example is where a foreign acquirer (Bidco) seeks to make an offer for shares in a South African entity, in exchange for shares.

Another example is where a South African-controlled foreign company acquires a group of com-



panies, which includes South African companies.

In both of these examples the foreign entity through which the South African assets are indirectly held must apply for approval to inwardly list, and to offer their shares as consideration for acquiring shares of the South African residents. The Reserve Bank also requires a maximum of 10% South African resident shareholders at the time of inward listing. This is normally not problematic where the foreign company is a large foreign listed entity with widely held shares, but is problematic where the foreign entity is an unlisted entity, controlled by South African resident shareholders. Based on recent experience, however, the Reserve Bank appears to be amenable to allowing some flexibility in structuring transactions where direct investment into SA will be stimulated.

Practically a South African share register will be opened and all South African shareholders of the foreign entity will be required to hold, or reacquire, their shares in the foreign entity on the South African share register.

Normally this will result in a capital inflow into SA as South

African shareholders will now hold their shares in the country, while they retain the economic hedging benefits of being invested in a non-resident entity. This effectively, from an economic perspective, eliminates the dreaded and restrictive loop structure.

FROM a tax perspective there are a number of important aspects to bear in mind when planning a transaction involving an inward listing. Most importantly, the South African resident shareholders will either have an outright disposal of their shares (especially where an offer is made for shares) in exchange for shares in the foreign Bidco, or will continue to hold shares in the same company (the second example above) but reacquire shares on the South African share register.

Whether an exchange of shares is done as a direct disposal or effected, for example, through the use of derivative instruments the South African resident shareholders must be mindful that they could dispose of their shares for purposes of capital gains tax (CGT) and potentially attract a CGT liability. It is extremely important to determine the disposal and listing

prices in a manner that will ensure maximum tax neutrality.

Any shares traded on the JSE will attract securities transfer tax at 0,25% of their market value, regardless of whether these are shares in a foreign company.

As regards dividends received, these will be exempt from tax in the hands of the South African shareholder if resident shareholders collectively hold more than 10% of the shares in a dual listed company. From January 1 next year this 10% requirement falls away and all dividends received will be exempt from tax in SA provided the company distributing the dividends is dually listed.

Where the foreign entity is not listed in another country the dividend will only be tax exempt if the South African resident shareholders hold more than 20% of the equity shares and voting rights of the foreign entity.

Tax and exchange control structuring of inward listing needs to address complicated challenges but this will most likely become an important element of many cross border acquisition transactions.

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