

A CRITICAL ANALYSIS OF EXCHANGE CONTROL IN A SOUTH AFRICAN CONTEXT

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ABSTRACT

Since the implementation of exchange control, it continues to play a pivotal role in South Africa. In South Africa, exchange control has evolved, specifically there has been a gradual liberalisation in the related rules and regulations.

To this extent, it is crucial to consider the relevance of exchange control in South Africa and the potential consequences of repealing the regulations, including the implications on the collection of taxes by the South African Revenue Service (SARS). This research report seeks to explore this.

While there have been countries that have maintained its exchange control regulations, there have also been others which have abolished the regulations. The evolution of South Africa's exchange control will be compared to Mozambique, Iceland and Venezuela. These countries have been selected based on their economic climates, current exchange control limitations and to gauge an understanding of potential challenges and consequences these countries have experienced and those that South Africa will likely face as a result of repealing its exchange control regulations.

The South African Reserve Bank (SARB) monitors the imposition of exchange control as the current regulations have control over South African's foreign currency reserves, accruals and the spending thereof¹. SARS and SARB jointly ensure that taxpayers are compliant and that there are no contravention of exchange control regulations². A key finding arising from the research is the potential effect that the abolishment of exchange control will have in South Africa. The risks and rewards associated with abolishing exchange control regulations has gone unasked and unanswered in academic literature.

Finally, as part of the critical analysis of exchange control in South Africa this research report aims to provide a recommendation on the continued liberalisation or potential retraction of exchange control regulations in South Africa, and the mitigations against adverse effects on the parties to exchange control.

¹ SARB, 2016, 'Exchange control legislation'.

² National Treasury Republic of South Africa, 2016, 'Special Voluntary Disclosure Programme in respect of offshore assets and income'.

Key words

Authorised Dealer, Authorised Dealer Manual, Common Monetary Area, CMA, Exchange Control, Financial Surveillance Department, FSD, Organisation for Economic Co-operation and Development, OECD, South African Development Community, SADC, South African Revenue Service, SARS, South African Reserve Bank, SARB.

DECLARATION

I declare that this research report is my own unaided work. It is submitted for the degree of Master of Commerce at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination at any other university.



Rushika Valodia

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LIST OF ABBREVIATIONS AND ACRONYMS

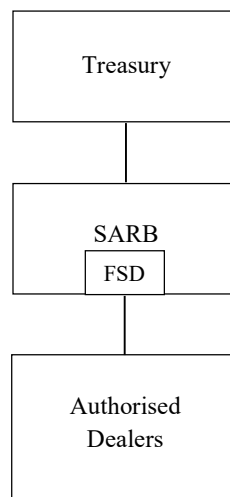
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| BEPS | Base Erosion Profit Shifting |
| CFC | Controlled Foreign Companies |
| CGT | Capital Gains Tax |
| CMA | Common Monetary Area |
| CRS | Common Reporting Standards |
| DTA | Double Tax Agreement |
| DTI | Department of Trade and Industry |
| EOIR | Exchange of information on request |
| FICA | Financial Intelligence Centre Act |
| FSD | Financial Surveillance Department |
| IFWG | FinTech Working Group |
| IMF | International Monetary Fund |
| IN30 | Interpretation Note 30 (Issue 3) |
| ISK | Icelandic Króna |
| JSE | Johannesburg Stock Exchange |
| MCAA | Multilateral Competent Authority Agreement |
| MZN | Mozambican metical |
| NEP | No Exchange Provided |
| OECD | Organisation for Economic Co-operation and Development |
| SADC | South African Development Community |
| SAEFITM | Standard for Automatic Exchange of Financial Information in Tax Matters |
| SARB | South African Reserve Bank |
| SARS | South African Revenue Service |
| SVDP | Special Voluntary Disclosure Programme |
| TAA | Tax Administration Act |
| VAT | Value-Added Tax |

CHAPTER 1: INTRODUCTION

1.1 Exchange control rationale

The Minister of Finance has delegated the Treasury's powers, duties and functions, in terms of the foreign exchange regulations, to the governor of the SARB³. Exchange Control represents exchange operations undertaken by the SARB, specifically the Financial Surveillance Department (FSD) of the SARB, who delegates authority to the Authorised Dealers. The FSD's role is to view contraventions of the exchange control regulations. Further, to circumvent the conditions specified in two manuals, namely: the Currency and Exchange Control Manual for Authorised Dealers in Foreign Exchange (Authorised Dealers Manual) and the Currency and Exchanges Manual for Authorised Dealers in foreign exchange with limited authority (ADLA Manual).

Any request made to the FSD must be channelled through an Authorised Dealer⁴. The Authorised Dealers are not agents of the FSD, however they act on behalf of their customers⁵. Under the circumstances that the Authorised Dealer is not authorised to lend currency in terms of the Authorised Dealers Manual, an official application must be submitted to the FSD⁶. The illustration below displays the organisational structure of the exchange control operations.



³ PKF, 2018, 'Understanding the history and rationale for exchange control'.

⁴ SARB, 2018, 'Currency and Exchanges guidelines for individuals', p. 3 – 9.

⁵ PKF, 2018, 'Understanding the history and rationale for exchange control'.

⁶ SARB, 2018, 'Currency and Exchanges Manual for Authorised Dealers', p. 13.

The authorities in South Africa were concerned with the diminishment of direct foreign investment and capital flight outside of the country, therefore measures were sought to prevent a total economic collapse in South Africa⁷. In essence exchange control regulations were implemented in South Africa in order to protect foreign reserves and exchange rate fluctuations.⁸ The exchange control regulations were introduced in 1933⁹.

The exchange control regulations are an instrument that was designed to achieve effective monetary policy, to again protect the foreign reserves and exchange rate in South Africa.¹⁰

Exchange control is viewed to be a synonym for exchange restrictions as it is the duty of the Central Bank to maintain external stability of the national currency¹¹. Exchange control was viewed to be a form of ‘emergency finance’ in terms of the Emergency Finance Regulations which was first introduced in South Africa at the outset of World War II in 1939¹². A financial emergency is a situation in which a financial crisis may arise, this may be a fiscal and financial problem for which there is no reasonable prospect of resolution¹³.

The exchange control regulations were introduced in 1933¹⁴. In practice, exchange control poses restrictions on individuals, including taxpayers, and various companies in remitting funds offshore, whilst also affecting the flow of funds into South Africa. Specifically, in terms of regulation 10(1)(c) of the South African exchange control regulations:

no person shall, except with permission granted by Treasury and in accordance with such conditions as the Treasury may impose enter into any transaction whereby capital or any right to capital is directly or indirectly exported from the Republic.

There was uncertainty around the meaning of ‘capital’ as stated in the regulations, which was clarified in *Oilwell v Protec*¹⁵.

⁷ PKF, 2018, ‘Understanding the history and rationale for exchange control’.

⁸ SARB, 2011, ‘South African Reserve Bank monetary policy in the decade 1989 to 1999’, p. 42.

⁹ PKF, 2018, ‘Understanding the history and rationale for exchange control’.

¹⁰ SARB, 2011, ‘South African Reserve Bank monetary policy in the decade 1989 to 1999’, p. 42.

¹¹ Einzig, P., 1934, ‘Exchange Control’, p. 9 & 10.

¹² Chait, A., 2018, ‘The Exchange Control Regulations in South Africa’.

¹³ South African Department of Finance, n.d., ‘Policy Framework for municipal borrowing and financial emergencies’, p. 32

¹⁴ PKF, 2018, ‘Understanding the history and rationale for exchange control’.

¹⁵ (295/10) [2011] ZASCA 29 (18 March 2011)

This transfer of funds in and out of South Africa requires any person to obtain approval from exchange control authorities, collectively referred to as Authorised Dealers for purposes of this research report.¹⁶

The current exchange control regulations are issued in terms of the Currency and Exchanges Act, No 9 of 1933, as amended and promulgated by Government Notices.

Initially, Central Banks directly or indirectly aimed at controlling the exchange rates. The measures undertaken are collectively known as general monetary policy, bank rate policy, open market policy and foreign exchange policy. These are viewed to be the normal practices of a Central Bank. While, in later times other factors influencing exchange control were explored by the Central Banks, collectively known to be the intervention, exchange restrictions, gold policy, exchange clearing, import restrictions, encouragement of exports, barter and embargo on foreign loans.¹⁷

During 1960, the Sharpeville shootings caused an increased concern for an economic recession and capital flight from South Africa. The application of exchange control was more stringent during apartheid, specifically during 1985. The factors which affected the economy were disinvestment campaigns, withdrawal of loan funding, international sanctions and trade boycotts. At this stage, any transfer of funds with the exception of normal trade-related transactions, required prior approval from the Authorised Dealers.¹⁸

The financial rand was an alternative currency which was used in conjunction with the commercial rand. It was first introduced in the 1960s and later abolished with effect from 13 March 1995. The financial rand was a currency which was available to foreigners (in other words South African non-residents), which would arise from the sale of their assets and for purposes of investment into South Africa. Accordingly, the financial rand was only available for use by foreigners. A characteristic of the financial rand is that it was viewed as a discounted commercial rand.¹⁹

¹⁶ Chait, A., 2018, 'The Exchange Control Regulations in South Africa'.

¹⁷ Einzig, P., 1934, 'Exchange Control', p. 9 & 10.

¹⁸ Department of Justice and Constitutional Development, n.d., 'Final report of the Commission of Inquiry into the Rapid Depreciation of the Rand and Related Matters', p. 50.

¹⁹ SOHO, 1995, 'South African abolishes financial Rand'.

During 1992, the political affairs in South Africa deteriorated, which caused the financial rand rate to weaken and gave rise to increased volatility in the financial rand rate. Consequently, there was greater pressure placed on individuals and companies to withdraw investments from South Africa. This also caused reluctance in investors to hold on-going investments in South African companies, such as shareholding.²⁰

Accordingly, new exchange control measures were implemented during December 1992. The Authorised Dealer Manual must be read in conjunction with the exchange control regulations. The Authorised Dealer Manual comprises of the conditions and permissions which are applicable to foreign exchange transactions. In terms of exchange control regulation 2(2), the related exchange may be undertaken by Authorised Dealers on behalf of clients. This regulation also explains the administrative responsibilities and the reporting requirements as stipulated by the FSD. Provided that the Authorised Dealer Manual permits the execution of certain transactions by the Authorised Dealers then the FSD's involvement is not required.²¹

Since then exchange control has evolved in South Africa. Following the democratic elections in South Africa in 1994, there has been a gradual liberalisation in exchange control practices, in order to simplify and streamline exchange control regulations²². Furthermore, the relaxation is shown through its less stringent ways which includes the numerous updates made to the Currency and Exchange guidelines, and during 2016 the Exchange Control Rulings were replaced with The Currency and Exchanges Manual for Authorised Dealers²³.

It was decided that exchange control should be maintained as it acts as a cushion in the event of a sudden flight of capital offshore²⁴. As a result of the increased direct foreign investments made by South African companies, the financial rand rate fell by more than 40 per cent during 1992²⁵.

During 2003 the joint tax and exchange control amnesty was introduced. The introduction was to place confidence in the South African economy in times of unfavourable international economic climate. The purpose of the amnesty would allow the regularisation of individual's

²⁰ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 131.

²¹ SARB, n.d., 'Currency and Exchanges documents'.

²² Visser, A., 2017, '#Budget2017: Are exchange controls an issue?'

²³ Chait, A., 2018, 'The Exchange Control Regulations in South Africa'.

²⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 127.

²⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 130.

affairs in relation to their foreign assets. The amnesty proved to be necessary as many South African's had the desire to repatriate their funds offshore due to international co-operation in tax compliance. International tax co-operation involves the offering of lower tax rates with an objective of attracting foreign direct investment.²⁶ International tax co-operation also relates to the transparency and co-operation relating to tax matters. In this regard, the Organisation for Economic Co-operation and Development (OECD) provides key indicators and outcomes of countries which tie in with exchange of information for tax purposes (in other words exchange of information on request (EOIR)) and an inclusive framework of Base Erosion Profit Shifting (BEPS).²⁷

Further, South African's had an interest in repatriating funds to tax havens. Tax havens are typically offshore countries or jurisdictions that impose a minimal tax liability on foreign businesses and/or individuals. These individuals are not required to be a tax resident in the applicable country and the businesses are not required to operate in the country.²⁸

During 2014 and 2015, two cases arose, namely: *South African Reserve Bank and Another v Shuttleworth and Another*²⁹, and *Shuttleworth v South African Reserve Bank*³⁰. These cases are collectively referred to as the *Shuttleworth* cases for purposes of this research report. In the *Shuttleworth* cases, it was established that Exchange Control is not a tax raising mechanism, in other words not a form of taxation in terms of the South African Income Tax Act (Income Tax Act)³¹. Instead it was regarded as a regulatory mechanism to prevent the remittance of capital offshore by imposing an exit charge.³²

If foreign assets or funds were not declared or accounted for in the taxpayers South African income tax return, in terms of the Financial Intelligence Centre Act, 38 of 2001 (FICA), SARS had the power to impose income tax on a calculated amount of foreign-held assets or funds.³³

²⁶ FitzGerald, V., 2012, 'International Tax Cooperation and Innovative Development Finance', p. 1.

²⁷ OECD, n.d., 'International tax co-operation: Key indicators and outcomes'.

²⁸ CFI Education Inc., n.d., 'What is a tax haven?'.

²⁹ [2015] ZACC 17.

³⁰ (864/2013) [2014] ZASCA 157 (1 October 2014).

³¹ No. 58 of 1962.

³² Evans, S., 2015, 'Shuttleworth loses R250m exit charge case in ConCourt', Mail&Gaurdian.

³³ Botha, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4.

In later years, electronic foreign exchange (eForex) was introduced and approved by the SARB. This posed challenges to the ordinary Exchange Control processes, which resulted in an inclusion of eForex into the normal exchange control rulings and regulations.

Currently, uncertainty exists relating to the tax and Exchange Control implications arising from Cryptocurrency transactions, such as Bitcoin³⁴. This virtual currency has been defined by the European Central Bank as follows:

a digital representation of value that is neither issued by a Central Bank or a public authority, nor necessarily attached to a fiat currency, but is accepted by natural or legal persons as a means of payment and can be transferred, stored or traded electronically.³⁵

A Position Paper on Virtual Currencies was issued by the SARB stating that cryptocurrencies are:

a digital representation of value that can be digitally traded and functions as a medium of exchange, a unit of account and/or a store of value, but does not have legal tender status [underlining added for emphasis].³⁶

Therefore, in itself, cryptocurrencies are not subject to regulation by the SARB. Careful consideration should still be made by South Africans when dealing in cryptocurrencies. The SARB has indicated that it intends on releasing a new position paper on the approach to cryptocurrencies.³⁷

Accordingly, South Africa continues to apply exchange control regulations and requires the prior approval from Authorised Dealers to remit funds offshore.

1.2 Problem statement

1.2.1 The research problem

The main research problem is a critical analysis of exchange control in a South African context. This involves understanding its history (in other words the reason it was initially implemented), its evolution since this and as a result, the liberalisation of regulations over

³⁴ Gad, R. et al., 2018, 'The tax and exchange control implications of cryptocurrency transactions'.

³⁵ European Union, 2016, 'Opinion of the European Union of 12 October 2016 on a proposal for a directive of the European Parliament and of the Council amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and amending Directive 2009/101/EC'.

³⁶ SARB, 2014, 'Position Paper on Virtual Currencies'.

³⁷ Gad, R. et al., 2018, 'The tax and exchange control implications of cryptocurrency transactions'.

time. The aim is to conclude on the role of exchange control in South Africa, the continued relevance of exchange control in South Africa and the consequences that may arise post abolishment of the same regulations.

The authors aim is to contribute to global knowledge, by compiling exchange control considerations in association with practical implications and taxation matters, specifically in a South African context.

1.2.2 The sub problem

This research report aims to analyse the exchange control regulations in South Africa and in order to address the main research problem, specified above, the sub-questions set out below will be addressed as part of this research report.

- i. The implications exchange control has had on taxpayers and the SARS. Following this, the potential consequences that may arise from repealing the exchange control regulations in South Africa, for example, the extent of tax collection by the SARS.
- ii. The current exchange control regulations in South Africa compared to Mozambique and Iceland. The purpose is to gauge an understanding of the scope of Exchange Control's movement in South Africa compared to these jurisdictions. As a result, the implications of exchange control in these jurisdictions compared to South Africa and its progress will be considered.
- iii. Since Exchange Control was brought into effect, its rationale, change and evolution to date will be analysed. In assessing the aforementioned, the change in the exchange control policy, all indicators of South Africa repealing exchange control, and its gradual liberation will be reflected upon. In addition, the implications this liberalisation has had on the South African tax base, if any, will be accessed.
- iv. The potential consequences of repealing exchange control in South Africa will be discussed by understanding the consequences another jurisdiction has faced,

namely: Venezuela. This will be applied to a South African context, in discussing the effect on foreign direct investment, expansion of South African companies on a global basis and tax matters.

- v. Finally, the reasons South Africa should or should not abolish the exchange control regulations will be explored. Accordingly, addressing the prevalence of exchange control in South Africa will be considered.

1.3 Research methodology

The research method adopted is of a qualitative, interpretive nature, based on a detailed interpretation and analysis of amongst other things, case law.

An extensive literature review and analysis will be undertaken that includes numerous sources, namely: books, cases, electronic databases, electronic resources – internet, journals, magazine articles, publications, and statutes.

1.4 Chapter outline

The purpose and overview of each of the Chapters going forward in this research report is presented below.

Chapter 1: Introduction

Chapter 1 provides an overview of exchange control and its history which includes what exchange control is, the structure of exchange control reporting, when and why it was introduced, its purpose and what it was designed to prevent. In a South African context, the structure of exchange control and its evolution since it came into effect has been provided. This chapter also explains the research problem and the sub-problems which sets out the premise for the research report.

Chapter 2: Overview of exchange control

Chapter 2 of this report provides a brief overview of exchange control residence and the practical implications of being an exchange control resident. It also presents a general overview of the tax-related matters which are considered as part of exchange control in South

Africa. It addresses South Africa's tax collection by the SARS, which also considers the multiple parties; namely: the SARS, the SARB and a taxpayer. Furthermore within a South African context, it is considered whether exchange control acts a tax or regulatory mechanism, as discussed in the *Shuttleworth* cases. The impact and outcomes of other influential case law in the exchange control and tax space will be considered, namely: *Oilwell v Protec* [2011] and *Krok v CSARS* [2015]. Accordingly, these cases support the view that exchange control and tax are interlinked.

Chapter 3: The evolution of exchange control

Chapter 3 analyses the chosen jurisdictions exchange control regulation and compares this to the South African regulation. The jurisdictions for consideration include Mozambique and Iceland. Mozambique is a part of the Southern African Development Community (SADC), which lead to this being chosen. The access to information and the extent of information available also played a role in the selection Mozambique, as opposed to another SADC country. Further, Iceland, a European country, is in the process of liberalising capital controls, which lead to the selection of this comparative jurisdiction. The Bahamas is also in the process of liberalising exchange control regulations, however this research report has been limited to analysing one other jurisdiction, namely: Iceland. This chapter aims to identify differences between South Africa and the respective jurisdictions, the scope of its movement compared to that of South Africa and assessing South Africa's exchange control. The joint tax and exchange control amnesty is also considered in the evolution of exchange control.

Chapter 4: Indicators of the liberalisation of exchange control in South Africa

Chapter 4 provides further analysis of the indicators of South Africa doing away with exchange control, the gradual liberation and progression of the exchange control policy. This includes exploring SARB's indicators of the 'fairness' of enforcing exchange control in today's time and the practice of Authorised Dealers. For example, the name change from exchange control department to FSD which is indicative of SARB's relaxing intention³⁸.

³⁸ Bridge, N., 2010, 'SARB Exchange control changes name'.

Chapter 5: Consequences of abolishing exchange control in South Africa

Chapter 5 sets out the consequences of doing away with exchange control, specifically considering foreign direct investment, offshore expansion by South African companies, the cost to the country, economic and tax matters. Venezuela has been selected as a jurisdiction which has repealed portion of its exchange control regulations. The reasons that brought about the repeal will be discussed and the consequences thereof will be addressed. Further, reasons why South Africa should or should not abolish the regulations will be explored. Accordingly, the aforementioned addresses the prevalence of exchange control in South Africa.

Chapter 6: Conclusion

Chapter 6 is the final chapter which sets out the conclusion or resolution of the research problem which is drawn from the analysis in the preceding chapters. Maintaining focus on the relevance of exchange control in South Africa and the potential consequences of retracting the regulations. Further, recommendations will be provided on the timing, process and mitigation of adverse effects in abolishing exchange control in South Africa.

CHAPTER 2: OVERVIEW OF EXCHANGE CONTROL

2.1 Introduction

This chapter explores exchange control residency and its applicability in South Africa. It also addresses some of the practical considerations of establishing exchange control residence in South Africa and the related supporting document which is typically required by Authorised Dealers in providing exchange control approval.

Further, in this chapter more focus is placed on considering exchange control in the South African tax region. This takes into account the viewpoint of the SARS, a taxpayer and the SARB. A further review of influential case law in South Africa has been conducted and the precedence these cases have set in the exchange control environment is discussed.

2.2 Exchange control residence and the practical implications

A non-resident is defined by the exchange control regulations as a person whose normal place of residence, domicile or registration is outside of the Common Monetary Area (CMA) being South Africa, Lesotho, Namibia, and Eswatini. An exchange control resident is a person who has taken up permanent residence, domicile or has been registered in South Africa. A non-resident who is also temporarily resident in South Africa is a foreign national for exchange control purposes.

Until such time that the SARB provides an official emigration approval, an individual will sustain his/her title of a South Africa resident for exchange control purposes. This will imply that until a declaration has been submitted to SARS ceasing an individual's South African residency, that individual will continue to be regarded as a South African exchange control resident during the year of assessment in question. Hence, we can conclude within a South African context that numerous actions are required as part of the emigration process, specifically to successfully initiate and achieve emigration. This entails both tax and exchange control considerations, in conjunction both of which attribute to the emigration process.³⁹

³⁹ La Grange, H., 2017, 'Relocating from South Africa'.

The author's view is submitted for the remainder of Chapter 2.2, based on exposure to exchange control in practice and communications with Authorised Dealers, with focus on the practical implications of the exchange control process.

Upon residing in South Africa, a foreign national is required to declare in writing to an Authorised Dealer, as proof of the foreign assets which are held by the same foreign national. In the instance that the foreign national owns foreign assets, they are required to provide an undertaking that they will not dispose of those foreign assets to a third party who is a South African exchange control resident. The foreign nationals will also be required to provide an undertaking that they have not applied for similar facilities, to dispose of foreign assets, through another Authorised Dealer. After making the declaration and undertakings, a foreign national may conduct his/her affairs on the basis set out below.

- i. The ability for a foreign national to dispose of foreign assets without interference from SARB's FSD.
- ii. A foreign national may utilise the banking services in South Africa as an exchange control resident.
- iii. A foreign national may hold non-resident rand accounts or foreign currency accounts with an Authorised Dealer.
- iv. A foreign national may re-transfer capital offshore, provided that he/she can substantiate the original introduction of such funds into South Africa. This may be done by providing proof or supporting documentation.
- v. A foreign national may transfer lump sum amounts and monthly pensions offshore, provided that related supporting documents are provided to an Authorised Dealer prior to the transfer of any such funds.

Based on practice, it is the understanding that the SARB is considering changing its position relating to individuals who have permanent residence in South Africa or individuals who have been present in South Africa for more than a specified period of time, to which the exact

period of time has not been communicated yet. It is understood that SARB intends to treat permanent residents or those present for more than a specified period of time in South Africa as South African exchange control resident even if they do not consider themselves domiciled in South Africa. In terms of the effective date of these proposed new rules, it is undetermined, however it is advised that a circular will be issued by SARB, to which Authorised Dealers will be obliged to comply with.

South African exchange control residents are subject to certain restrictions on foreign exchange transactions, some of which are set out below, this is not a conclusive list.

- i. An annual discretionary allowance has been allocated to each South African exchange control resident, amounting to ZAR1 million.
- ii. An annual foreign capital allowance has been allocated to each South African exchange control resident, amounting to ZAR10 million. This can be approved and utilised through an Authorised Dealer, without the intervention of the SARB and its approval.
- iii. A South African exchange control resident must provide the Authorised Dealer with a South Africa Tax Clearance Certificate, when attempting to attain the foreign capital allowance and utilising the benefit of the ZAR10 million allowance.
- iv. South African residents are not permitted to participate in offshore structures. Specifically, structures which re-invest funds into South Africa by acquiring shares, loan accounts or some other interest in a South African asset or resident company. These types of structures are typically referred to as loop structures.

Upon placing more focus on a company perspective relating to exchange control, there are supporting documents which are required to be submitted to an Authorised Dealer prior to remitting funds from South Africa. The information that is required by an Authorised Dealer from an exchange control perspective, relating to an agreement that has been concluded between companies, such as a management fees agreement between two group companies, has been set out below.

- i. Related party agreements require prior approval from SARB.
- ii. The application should include a background explanation of the South African company's nature of business and this company's related shareholding it has in other companies.
- iii. In terms of the concluded agreement, the management fees must be charged at arm's length and must be market related. If the fees are percentage-based, then the fees charged must be regarded as 'normal' for the trade concerned. Should this not be the case, a supporting motivation must be attached to the application submitted to the Authorised Dealer.
- iv. A detailed description is to be provided relating to the exact services which are to be rendered relating to the management fees. It should be explained what the benefits will be, arising from the services rendered by the said party.
- v. All parties relevant to the agreement should be specified and incorporated into the relative agreement, by providing full details such as name, company registration number and location.
- vi. The Authorised Dealers require a full business motivation of the rationale behind the management fees, such as the assistance with increased turnover of the company and improving business efficiencies. This is required as a recommendation to the application, which will be provided to the SARB.
- vii. The rationale is provided to the Authorised Dealers regarding the reason behind the signed agreements being concluded by the specified companies, however if applicable, if the payment is being made by a different company within the group then the reason behind this must be substantiated. The agreement should be signed between parties making the payment and the one receiving the payment. As advised by the Authorised Dealer, tax efficiencies from an exchange control perspective will not suffice as a motivation and will not be considered.

- viii. All agreements are to be provided to the Authorised Dealers, the copies of all management fees / consultancy fees / assignment fees will be reviewed.
- ix. Confirmation must be provided to the Authorised Dealer that the invoices will provide a full description and/or breakdown of the exact services being invoiced.

The requests which are made by South African residents in order to make royalty and/or management fee payments to offshore related parties, these requests should be made to the FSD for its consideration. A related party is defined as a party to a transaction that has a direct or indirect interest in the other party and has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Alternatively, both parties are under common control. In terms of the Authorised Dealer Manual, this includes transactions between parties that belong to the same group of companies such as parent, subsidiary, fellow subsidiary and/or an associate company.

2.3 Tax and exchange control

The concept of exchange control was challenged when applying the Constitution as it is thought to be an infringement of human rights. Exchange Control was inherently known as discrimination in nature and beneficial to the rich, however in terms of the Constitution, all individuals were deemed to be equal in a non-discriminatory society. In this regard, it was established that once all taxes are paid by individuals, it is argued that all their commitments have been fulfilled and he/she should have the right to transfer money or repatriate their funds as and when they desire.⁴⁰ This view is further explained as part of the *Shuttleworth* case analysis below. Under the circumstances that exchange control was not affected in South Africa, individuals and/or companies would more likely than not exploited the government and taxation in South Africa.⁴¹

⁴⁰ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 157.

⁴¹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

The tax collected by the SARS from taxpayers were in actual fact used to fund the initial capital outlay for the SARB to operate. Therefore, the taxpayer's money was vital for furtherance of SARB's services.⁴²

As an alternative to exchange control, the tightening of fiscal policy was a strategy used to prevent capital inflows to South Africa. During the national budget in March 1997, the business cycle was struggling, therefore it was challenging to further decrease the budget deficit. In addition, the restriction of the fiscal policy caused the domestic rates to decrease and the budget deficits to also decline. A downside to adapting the fiscal policy was that it was time-intensive to implement changes to taxes. As a result, this was not a sustainable tool in resolving the fleeting inflows of capital into South Africa.⁴³ The movement of funds overseas continues to be a favourable thought in the minds of individuals and/or companies due to the crime, political uncertainties, the currency weakness and high tax rates in South Africa.⁴⁴

With effect from 1 July 1997, taxpayers over 18 years of age were permitted to invest a maximum of ZAR200,000 offshore, provided that the taxpayer was classified to be in good standing with SARS⁴⁵. In order to be regarded as compliant with the National Treasury, a Good Standing Tax Clearance Certificate must be obtained to be viewed as tax compliant.⁴⁶ With effect during 1998, provided the taxpayer was regarded to be in good standing, these individuals were permitted to invest in foreign assets valued at a maximum of ZAR400,000. The budget speech during February 1999, increased this maximum to ZAR500,000 and further to ZAR750,000 during the February 2000 budget. Since the permission came into effect from 1 July 1997 to 1 February 1998, these taxpayers, in other words private investors, repatriated capital amounting to ZAR793 million. This is considered a low amount, therefore the lack of reaction from individuals allowed the South African authorities to lift the restrictions and allowed the free outflows of capital from South Africa to offshore jurisdictions subject to certain restrictions.⁴⁷

⁴² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 92.

⁴³ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 173.

⁴⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 156.

⁴⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 177 - 178.

⁴⁶ SARS, n.d., 'frequently asked questions'.

⁴⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 177 - 178.

A downside of holding foreign currency deposits and/or investments through a South African bank was the related bank charges for this particular service. This further decreased the likelihood of individuals making foreign investments, coupled with the related South African taxation imposed on this income earned from the investment. If SARS was of the idea that the intention of the taxpayer was to obtain capital gains, the depreciation in the rand compared to foreign currencies which resulted in capital gains, this is then subject to Capital Gain Tax in South Africa, in terms of the Eighth Schedule to the Income Tax Act. The portion subject to capital gains is the amount by which the investment increased (in other words the appreciation in the investment), in other the words the difference between the amount the investment was sold for less the initial cost of the investment.⁴⁸

Since 1994, South Africa expanded its Double Tax Agreement (DTA) network, which allowed for better exchange of information internationally⁴⁹. As such, this assisted in liberalising exchange control measures as information was easily exchangeable and transparent between South Africa and numerous other countries.

In Article 6 of Multilateral Convention on Mutual Administrative Assistance in Tax Matters, the automatic exchange of information is allowed. Included in this convention is the Multilateral Competent Authority Agreement (MCAA) is a framework which discusses the automatic exchange of information. In this regard, this complies with the Standard for Automatic Exchange of Financial Information in Tax Matters (SAEFITM). In considering exchange control in South Africa, this displays the readily available information as a result of these agreements which are standardised and efficient. Accordingly, there is little need for several bilateral agreements. The MCAA may be tailored such that the signatories have control over the exchange relationship, to which they both agree on what is permitted in this regard. This exchange of information allows for confidentiality and data protection.⁵⁰

South African taxpayers were concerned that they would face large sums of tax penalties. This would have taken place should SARS have discovered that the respective taxpayer illegally held foreign assets⁵¹. The promulgation of the FICA increased the risk of holding

⁴⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 177 – 178.

⁴⁹ Botha, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4.

⁵⁰ OECD, n.d., 'What is the Multilateral Competent Authority Agreement'.

⁵¹ Botha, L and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4.

illegal foreign-held assets. FICA stipulated that SARS had the power to impose income tax on foreign-held assets or funds that were not declared. SARS calculated an amount to be imposed based on their knowledge of the assets or funds which were unaccounted for. This right was provided for the 2003 tax year, ending 28 February 2003, and subsequent tax years. There was a rise in the intolerance of tax haven jurisdictions, particularly relating to exchange of information, which resulted in South Africa enforcing exchange control to prevent illegal money laundering.⁵² The joint tax and exchange control amnesty is fundamental to evolution of exchange control, which is discussed in detail in Chapter 3 below.

Specific to Value-Added Tax (VAT), the SARS Interpretation Note 30 (IN30) deals with the supply of movable goods in terms of section 11(1)(a)(i) read with paragraph (a) of the Value-Added Tax Act, 89 of 1991 (VAT Act) of the definition of 'exported' and the corresponding documentary proof⁵³. The supply of movable goods that are going to be exported, may be zero-rated (in other words VAT charged at a rate of 0%). In order for this to apply, documentary proof is required. The vendor is required to procure certain documentary proof within 90 days from the date on which the movable goods are exported from South Africa. In terms of the aforementioned, Authorised Dealer or SARB exchange control approval is a form of documentary proof that is required. As such, the vendor must enter into a valid written contract detailing the recipient of the payment, for the consideration of supply, which is made after a period exceeding 6 months but less than 12 months, accompanied by the proof of exchange control approval. Similarly, if the supply is made after 12 months, the relevant exchange control approval is still required.⁵⁴ The author submits that this is an administrative intensive process which has to be complied with. The exchange control administrative considerations are discussed in detail in Chapter 5 below.

Based on the above, the author submits that exchange control and tax in South Africa works hand-in-hand and should be considered in conjunction when reviewing exchange control's relevance in today's time.

⁵² Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4.

⁵³ SARS Interpretation Note 30 (Issue 3), p. 1.

⁵⁴ SARS Interpretation Note 30 (Issue 3), p. 10 - 11.

2.3.1 Influential exchange control case law in South Africa

2.3.1.1 The *Shuttleworth* cases

The *Shuttleworth* cases were influential cases in the exchange control and tax sphere in South Africa; namely: *South African Reserve Bank and Another v Shuttleworth and Another*⁵⁵, and *Shuttleworth v South African Reserve Bank*⁵⁶. Mr Shuttleworth had challenged the imposition of a 10% exit charge, from a constitutional point of view, specifically his view was that the exchange control system was unconstitutional in nature, in terms of section 195.⁵⁷ The reason for this thought is that the general public needs to consult the Authorized Dealers, in order to provide permission for transfers, which contradicts the obligations in terms of public administration. In addition to section 195 of the Constitution, it was also seen to be a contravention of section 1 of the Constitution on the basis of foundational values of accountability, responsiveness and openness. Upon consideration of the matters relating to the Constitution, the court concluded that the ‘closed door policy’ was in line with the constitution and was lawful. This was brought about based on the point that the SARB only considered a fraction of the total exchange control applications received. Specifically, during 2010, SARB received 54,000 application from a total of 10,147,090 applications. It was agreed that SARBs’ intervention is only required if it is beyond the scope of Authorised Dealers.⁵⁸

Typically, the 10% exit charge is payable by all South African citizens who are moving amounts in excess of ZAR750,000 offshore⁵⁹. Therefore, based on the courts view that the transaction was constitutional and did not contravene the exchange control circulars, this was a valid transaction on which the 10% exit levy is chargeable. As a result, Mr Shuttleworth was not able to receive a refund of the 10% exit levy which he paid. The court further accepted that the exit levy was imposed to ensure that capital remained in South Africa and this was a method of preventing the export of capital from South Africa to offshore jurisdictions, of which this is valid in terms of the Constitution.⁶⁰

⁵⁵ [2015] ZACC 17.

⁵⁶ (864/2013) [2014] ZASCA 157 (1 October 2014).

⁵⁷ Evans, S., 2015, ‘Shuttleworth loses R250m exit charge case in ConCourt’.

⁵⁸ Croome, B., 2013, ‘Exchange control and the Shuttleworth decision’.

⁵⁹ Evans, S., 2015, ‘Shuttleworth loses R250m exit charge case in ConCourt’.

⁶⁰ Croome, B., 2013, Exchange control and the Shuttleworth decision.

The jurisdiction of implementing any tax regulation lies with the Minister of Finance and not with the SARB, therefore the Minister of Finance was responsible for implementing the 10% exit levy. An argument raised by Mr Shuttleworth was that the imposition of the 10% levy was not reviewed and approved by the parliament. This argument was rejected on the grounds that in terms of section 9(4) of the Currency and Exchanges Act, the promulgation of the same regulation and Act was not implemented with the intention to increase revenue or raises tax in. Instead, the reason for implementing the 10% levy was to protect the South African currency.⁶¹

Mr Shuttleworth applied to the SARB to move ZAR2,5 billion offshore, on which an exit charge of 10% was imposed, amounting to ZAR250 million. In this regard, the crux of the case is that Shuttleworth argued that the exit charge was a form of taxation, while the government argued that the charge was not a tax. The government regarded the exit charge as a disincentive for wealthy individuals to move the inheritance or fortunes offshore. The SARB argued that the exit charge was not a revenue or tax raising mechanism, in other words tax, instead it is a regulatory mechanism. This mechanism was tailored to prevent the moving of capital offshore. The Supreme Court of Appeal agreed with the National Treasury that the exit charge was a regulatory mechanism, not a revenue raising mechanism.⁶²

2.3.1.2 *Oilwell v Protec*

There was uncertainty around the meaning of ‘capital’ as stated in regulations 10(1)(c) of the exchange control regulations, which was clarified in *Oilwell v Protec* [2011]⁶³. This case clarifies that the National Treasury does not have the power to prohibit the export of intellectual property overseas. The National Treasury amended the exchange control regulations to include intellectual property as part of ‘capital’ as defined, in order to exercise control over capital-related matters.⁶⁴

The Court came to the verdict that the validity of the 1998 assignment was apparent and that Oilwell had no claim to the trademark, this was mainly in conjunction to regulation 10(1)(c)

⁶¹ Croome, B., 2013, ‘Exchange control and the Shuttleworth decision’.

⁶² Evans, S., 2015, ‘Shuttleworth loses R250m exit charge case in ConCourt’.

⁶³ Strauss, B., 2011, ‘Tax Alert: "Oilwell" that ends well: exchange control and export on capital’, p. 1.

⁶⁴ Strauss, B., 2017, ‘Tax and exchange control alert: relaxation of exchange controls relating to intellectual property and foreign investment’, p. 2.

which states that trademarks cannot be ‘exported’. A further acknowledgement from the court was that trademarks, just like any other intellectual property rights are jurisdictional and similar to the nature of immovables. The Treasury is focused on preventing the export of intellectual property, similarly The Treasury also sets out to prevent the export of copyrights and trademarks. As a result of the *Oilwell* case, it has been established that The Treasury however has no jurisdiction on putting a hold to offshore assignments relating to intellectual property. In this regard, The Treasury is able to amend the regulations such that the transfer of intellectual property is not allowed. This amendment would potentially be viewed to be contradictory in nature, as according to the state policy of the Treasury, there has been a gradual relaxation of exchange controls over numerous years and limiting the transfer of intellectual property would not be a reflection of this intention.⁶⁵

2.3.1.3 *Krok v CSARS*

Another influential case focused on exchange control and tax is *Krok v CSARS* [2015], which is discussed in detail below.

During 2002, Mr Krok made the decision to emigrate from South Africa to Australia. A trust was previously established for the benefit of Mr Krok, through which assets were granted to him. Accordingly, Capital Gains Tax (CGT) arose in his hands as the beneficiary. The assets were distributed to Mr Krok as it was considered to be tax efficient. In other words, the asset would have been taxed at a lower rate in his hands compared to the high tax rate in the trust. This would also be to his advantage as he has ceased to be a South African tax resident and as such, if the assets are held in his name, the assets will not be subject to CGT. Thereafter he had been directed to a view point that it was less complex for income to be remitted to him under the exchange control rules if the assets were in his name compared to holding the assets in the South African trust. The DTA concluded between Australia and South Africa was affected on and after 21 December 1999. The DTA, specifically Article 25, initially addressed the exchange of information, however did not contain an Article for the gathering of taxes by the revenue authorities.⁶⁶

⁶⁵ Strauss, B., 2011, ‘Tax Alert: “Oilwell” that ends well: exchange control and export on capital’, p. 2 - 3.

⁶⁶ Mazansky, E., 2016, ‘South African Supreme Court of Appeal Confirms Application of Protocol to a Tax Treaty to a Period before Signature Date’.

The decision brought about in the *Krok and Another* case urges the SARS to apply a wide translation to the Mutual Administrative Assistance in Tax Matters. South African courts are therefore liable to adopt a liberal strategy in light of the *Krok and Another* case, in sanctioning aid under the Multilateral Convention with regards to the taxes applying to years going before its date in which it came into effect. The SARS could look to depend on these decisions to convince offshore jurisdictions to aid with gathering charges owed by South African citizens, where they have recognized funds which were offshore and would have given rise to a tax obligation before the Multilateral Convention came into effect.⁶⁷

2.4 Summary remarks

This chapter illustrates the how exchange control and tax are not mutually exclusive. Exchange control has played a fundamental role in South Africa's tax collection by the SARS. It is apparent that the exchange of information amongst the South African authorities; namely the SARB and SARS, have improved and this communication limits illegal activity. It is also vital for taxpayers to remain compliant with the SARS in order to be regarded as an exchange control resident in South Africa and to obtain exchange control approval since the Tax Clearance Certificate is a part of the exchange control approval process. Accordingly, the exchange control regulations and transparency with regards to the exchange of information, assists the SARS in its tax collection.

It is important to establish the difference between tax residency and exchange control residency. A South African exchange control resident may re-transfer capital offshore more freely conduct his/her affairs through a South African bank or Authorised Dealer. Exchange control residents are still required to obtain prior approval for specific transactions. Therefore, the approval attaches the rights to effecting certain transactions.

In support of the view that exchange control and tax are linked, there are numerous influential case law that arose which addresses both exchange control and tax matters in South Africa. These cases provide clarity on the capital as defined (such as the inclusion of intellectual property), the removal of capital from South Africa, the collection of tax by the SARS from individuals who should have been liable for tax in South Africa.

⁶⁷ Mazansky, E., 2016, 'South African Supreme Court of Appeal Confirms Application of Protocol to a Tax Treaty to a Period before Signature Date'.

Consequently, the liberalisation and abolishment of exchange control regulations will likely affect tax in South Africa and potentially affect the tax base and related collection of tax by the SARS.

CHAPTER 3: THE EVOLUTION OF EXCHANGE CONTROL

3.1 Introduction

The progression of exchange control in South Africa is demonstrated by establishing the differences and similarities of exchange control in South Africa against comparative jurisdictions, namely: Mozambique and Iceland. The purpose of this chapter is to assess the movement of exchange control in South Africa compared to an African country and a European country.

A fundamental element to the evolution of exchange control is the joint tax and exchange control amnesty, which gave individuals and entities the opportunity to declare any illegal transfer of funds. This chapter explores the joint tax and exchange control amnesty and the contribution it had to exchange control.

3.2 South Africa compared to the SADC

As discussed previously, individual taxpayers who were in good standing with SARS and over the age of 18, were permitted to move capital offshore, limited to ZAR750,000 during February 2000. In conjunction with this, individuals were allowed to invest in fixed properties, such as farms and holiday homes, in any Southern African Development Community (SADC) country.⁶⁸ The SADC was established in 1992. The purpose is a platform to assist in regional integration and poverty eradication in Southern Africa. A means of eradication is through economic developments and establishing peace and security. The regional economic community comprises of 16 states namely; Angola, Botswana, Comoros, Democratic Republic of Congo, Eswatini, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Tanzania, Zambia and Zimbabwe.⁶⁹ Mozambique is a part of the SADC.

It has been observed that the liberalisation of exchange control matters has progressed more in other SADC countries compared to South Africa, as such there has been slow progress in South Africa in this regard. Consequently, some SADC members have put pressure on South

⁶⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 169.

⁶⁹ SADC, n.d., 'About SADC'.

Africa to further liberalise its exchange control regulations. Focus has been placed on improving investments made by South African residents in the respective SADC member countries. In this way, the SADC members will be assisting in improving its platform and growth for regional integration and poverty eradication in Southern Africa. Accordingly, the SADC showed strong arguments in favour of its proposal that South Africa builds on its investments into the SADC member countries, in which portfolio investments should be made by South African investors into the SADC. The liberalisation of South Africa's exchange control regulations was insinuated by a public relations triumph that the SADC members were focused and dedicated to achieve financial and economic co-operation amongst the SADC member countries.⁷⁰ There was a suggestion to maintain unrestricted capital mobility in the SADC, however a common wall of exchange and capital control among the SADC countries will still remain. As a result, the common currency is not subjected to international capital mobility, this would also be the situation with the CMA rand zone.⁷¹ As defined in the SARB currency and exchanges guidelines, the CMA includes Lesotho, Namibia, South Africa and Eswatini. This being said, prior to any liberalisation of the exchange control regulations in South Africa, the members of the CMA must be considered and consulted, as these jurisdictions shared similar exchange control measures.⁷²

The exchange control measures focused on capital accounts have been liberalised in countries where the domestic savings rate is low, as this will promote the inflow of funds into the SADC member country. The liberalisation of exchange controls also assists in the spread of risks, because the economic climate differs across different countries. Therefore, the cycle differs and the diversification of one's investment portfolio reduces the risk of volatility in their personal inflow of funds. As such, there are great benefits to be reaped from diversifying investments between the local and international markets since the risk the shares are faced are different and take place at different times. This also encourages welfare and improved technology. Please see Appendix 'A' attached hereto for a tabular summary illustration of these costs and benefits associated with liberalising capital account.⁷³

⁷⁰SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 164

⁷¹ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p. 139 - 140.

⁷² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 165.

⁷³ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p. 141 - 142.

Specific to the SADC jurisdictions, the relaxation of exchange control measures relating to the restrictions placed on current accounts will give rise to a positive reflection of the relevant country's policies and economic governance. Accordingly, investors are motivated to invest within the SADC member countries, therefore there will be an increase in the inflow of funds (in other words increased trade) and less outflows of capital in comparison. With a specific focus on service accounts, the prime reason for maintaining exchange control measures is to prevent illegal capital outflow of funds. To the contrary, the liberalisation of current accounts may increase competition and uncontrollable exchange rate fluctuations. Please see Appendix 'B' attached hereto for a tabular summary illustration of these costs and benefits associated with liberalising current account.⁷⁴

The relaxation of both the capital and current account is an indication of the country's commitment to improving economic matters and that country is committed to all-encompassing future management.⁷⁵

Similarly, to South Africa, in Mozambique pre-approval is required from the Central Bank prior to remitting funds to an offshore jurisdiction. The proof of the relevant agreements is required by the Central Bank for their perusal, after which approval is provided. This process is required for every offshore payment that is made, in other words each payment requires pre-approval by the Central Bank to remit the funds. In addition, specific to a company, the company's commercial bank is required to disclose to the Central Bank the company's financial capacity to make a payment of the related magnitude.⁷⁶

The Mozambique revenue authority requires proof of withholding tax compliance that may apply.⁷⁷

The fundamental goal of the new regulation in Mozambique, discussed below, is to enable the Central Bank to police the 'Exchange Control Authority by the Mozambique Central Bank' as put forward under the Constitution of the Republic of Mozambique.⁷⁸

⁷⁴ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141 - 142.

⁷⁵ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141 - 142.

⁷⁶ Harding, C., 2010, 'African exchange controls – almost everywhere you go'.

⁷⁷ Harding, C., 2010, 'African exchange controls – almost everywhere you go'.

⁷⁸ EY, 2017b, 'Mozambique approves new exchange control regulations'.

In Mozambique, an infringement of trade controls regulations is viewed as a criminal offense, which as a result attracts concomitant penalties. On 15 August 2017, Mozambique's Council of Ministers scrapped the exchange control regulations that existed at the time and endorsed the new regulations under the Exchange Control Law. As a result, the Central Bank now regulates the process and sets the terms and conditions that need to be met in order to attain exchange control approval.⁷⁹

It is normal that the Central Bank will supply increasingly versatile and vigorous exchange rules, to be balanced every now and then, as it showcases the market's pre-requisites. The main changes to the regulations have been set out below.

- i. Pre-approval by the Central Bank is required for a rundown of transactions.
- ii. The inflow and outflow of foreign currency will be liable to conditions and confinements, which are dictated by the Central Bank.
- iii. The remittance of fare profits of products, ventures and investment income created abroad will be liable to the terms and conditions which are characterised by the Central Bank.⁸⁰

On 11 December 2017, the Central Bank Issued Notice No. 20/GBM/2017, which has come into effect on its publication as part of the Official Gazette. The changes that arose have been briefly set out below.

- i. The sale of goods or services and the revenue arising from offshore investments are no longer subject to an apportioned local currency, namely Mozambican metical (MZN), conversion of 50%, instead the funds are fully held in the foreign currency. The foreign denominated currency is used to fund any cross-border transactions, while only the funds used for local payments is converted to the local currency. This is known as the repatriation of export earnings regime.

⁷⁹ EY, 2017b, 'Mozambique approves new exchange control regulations'.

⁸⁰ EY, 2017b, 'Mozambique approves new exchange control regulations'.

- ii. The foreign direct investment is only required to be registered with the local bank within 90 days of the entrance of funds, as a result this allows flexibility when there is an inflow of capital into Mozambique.

- iii. Subject to certain requirements, the investments through loans or credit received from related entities received from a non-Mozambique resident no longer require prior approval from the Central Bank and is only subject to the local bank's approval.⁸¹

In considering the above, the changes are mainly focused on the Bank of Mozambique, as an exchange control authority, as more power has been placed in its hands as it has been allocated its own regulatory power. The reason for this change is the influx of transactions and movement of funds between Mozambique and foreign jurisdictions. Other than this, there has not been a substantial change in the fundamentals of the exchange control regime in Mozambique.⁸²

Similarly, to South Africa, Mozambique has liberalised its exchange control regulations. Factors which display this relaxation is the increased flexibility, reduced bureaucracy, the reduced administrative burden on the respective Central Banks and the positive impact on business activity.⁸³

Particularly from a South African perspective, it was essential that the relaxation of exchange control does not defeat the essence of the purpose of the regulations and that the remaining regulations were still sufficient and executed. As an example, SARB has provided the following: If South African investors were allowed to buy shares on the Botswana Stock Exchange, specifically in Gaborone, it is vital to ensure that these investors do not subsequently sell the shares listed on the Botswana Stock Exchange to foreign investors (for example from London).⁸⁴ As such, the author submits that both South Africa and Mozambique have taken the initiative to liberalise exchange control regulations in South Africa and Mozambique. Neither South Africa nor Mozambique are ahead of one another,

⁸¹ PwC, n.d., 'Revision of the Exchange Control Regulation – Notice No. 20/GBM/2017', p. 1.

⁸² Neves, L., 2018, 'Mozambique's new rules on foreign exchange control'.

⁸³ PwC, n.d., 'Revision of the Exchange Control Regulation – Notice No. 20/GBM/2017', p. 1.

⁸⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 165.

instead both have taken the necessary steps in tailoring the exchange control liberalisation to the circumstances apparent in their respective jurisdictions.

3.3 South Africa compared to Iceland

Iceland, a European country, experienced a crisis in which investors needing liquidity, through the form of cash, had tried to remove all their cash reserves out of Iceland. As a result, Iceland experienced a major influx of capital, exploiting the high interest rates paid by the banks, while individuals in Iceland loaned from foreign jurisdictions at a lower interest rate. The currency in Iceland is Icelandic Króna (ISK), and this caused the ISK to deteriorate and collapse. In addition, the banks in Iceland too collapsed. Subsequently, Iceland secured a rescue package from the International Monetary Fund (IMF). In terms of the exchange control regime, investors who held offshore ISK-denominated accounts that yielded high returns, were restricted from bringing the funds back into Iceland. During 2015, the Central Bank of Iceland announced that the exchange controls would be revoked and in this regard, investors had the ability to bring the funds back into Iceland. This was either done by buying ISK currency, which was purchased at a discounted official exchange rate. Alternatively investors had the option to purchase government bonds in Iceland, which is a long-term investment. A significant penalty will be imposed if the long-term investments are sold early, therefore if the government bonds are attained the investors are indirectly 'locked-in'.⁸⁵

From 14 March 2017, new Rules on Foreign Exchange came into effect. In this regard, a prominent portion of the restrictions have been removed for the flow of foreign exchange transactions, particularly in relation to the movement of local and foreign currencies inflow and outflow from Iceland. These changes have largely impacted households and businesses and have had a significant impact since it was first introduced in 2008. The foreign exchange act no longer applied restrictions to households and businesses relating to foreign investment, foreign exchange transactions, hedging and lending activity.⁸⁶

⁸⁵ Kenton, W., n.d., 'Exchange Control'.

⁸⁶ EY, 2017a, 'Iceland removes most restrictions on foreign exchange transactions and cross-border movement of domestic and foreign currency', p. 1.

Previously certain transactions were subject to exemptions, however these transactions which were not authorised, have now become authorised transactions, such as foreign investments made by pension funds or collective investment schemes (known as UCITS).⁸⁷

Cross-border transactions which are denominated in ISK are now authorised to be undertaken. These transactions may be in the form of funds denominated in ISK and financial instruments which have been issued in Iceland in ISK. Accordingly, the transactions may be in an inflow into or outflow outside Iceland. Despite the change in the aforementioned, where the requirements are met in terms of the restrictions detailed in the Treatment of ISK-Denominated Assets Subject to Special Restrictions Act no, 37/2016, known as the offshore ISK assets, there rules remain the same and these assets denominated in ISK require authorisation. In addition, no changes have been made to specified investments, relating to the inflow of foreign currency into Iceland, therefore the special reserve requirements still exist and remain unchanged.⁸⁸

In terms of the Iceland Foreign Exchange Act no. 87/1992, the rules provide for a general exemption on all the limitations, with the exception of the following on which has the restrictions will still be maintained in terms of the rules:

- i. derivatives trading which are held for purposes other than hedging;
- ii. foreign exchange transactions that are carried out between residents and non-residents, without the input of a financial undertaking; and
- iii. foreign-denominated loans made by residents to non-residents, which are assessed based on the specific circumstances.

The Central Bank of Iceland released guidelines which explain the restrictions placed on trade, in relation to the Rules on Special Reserve Requirements on New Foreign Currency Inflows, no. 490/2016. This shows the relaxation of exchange control regulations, in terms of the Foreign Exchange Act, to which a further amendment was made. These changes ensure that there is no undesirable inflow of capital funds into Iceland. These amendments to the

⁸⁷ EY, 2017a, 'Iceland removes most restrictions on foreign exchange transactions and cross-border movement of domestic and foreign currency', p. 1.

⁸⁸ EY, 2017a, 'Iceland removes most restrictions on foreign exchange transactions and cross-border movement of domestic and foreign currency', p. 1.

rules are subjected to special restrictions in terms of the Treatment of ISK-Denominated Assets Subject to Special Restrictions Act no. 37/2016, in which ISK-denominated assets held offshore are not affected. Most of the exchange control measures have been removed from businesses and households, therefore the relevance of exchange control is questionable. The intention of further liberalising exchange control is to focus on offshore ISK-denominated assets. A consideration for Iceland in how to resolve the release of these assets.

Any movement of capital funds still require the Central Bank of Iceland to oversee the transactions. As such, approval is no longer required, however foreign exchange transactions that were previously required to be approved, now it merely needs to be disclosed to the bank (in other words a disclosure requirement). The focal point is to reduce administrative burden and simplifying disclosure requirements. As a result, the Central Bank of Iceland will be able to pay attention to the balance of payments and the financial system. The reason for placing focus on the balance of payments is because there instability here could have adverse effects, such as monetary, exchange rate and financial instability.⁸⁹

The Iceland Foreign Exchange Act was liberalised as the maximum amount of transfers were no longer in effect. As a result, no limitations were placed on individuals and companies in respect of capital transfers. Previously, limitations were placed on the amount of capital transfers that were allowed to take place, as this affected the movement of capital across borders and the foreign exchange market. As mentioned, this maximum was later removed. Subsequently, the Central Bank of Iceland's foreign exchange reserves largely increased, to approximately ISK800 billion. The goal is to maintain the surplus on current accounts, to reduce foreign liabilities and to retain Iceland's related net external position. The aforementioned promotes a stable market. Accordingly, Iceland is in the position where exchange control liberalisation of the capital measures will positively impact its economy, as the conditions of global economy too are favourable.⁹⁰

⁸⁹ EY, 2017a, 'Iceland removes most restrictions on foreign exchange transactions and cross-border movement of domestic and foreign currency', p. 2.

⁹⁰ EY, 2017a, 'Iceland removes most restrictions on foreign exchange transactions and cross-border movement of domestic and foreign currency', p. 2.

Lastly, the Central Bank of Iceland faces lower risk in the long-run when considering the acquisition of offshore ISK-denominated assets from the dominant owners. This will likely enable the abolishment of exchange control.⁹¹

As discussed above the author submits that, Iceland, similarly to South Africa, is in the process of liberalising exchange control measures, with the view of eventually abolishing exchange control regulations. The economic conditions present in South Africa compared to Iceland differ, therefore the mechanisms in which they liberalise exchange control differ. Iceland has experienced positive results from the removal of the cap on the outflow of capital from the country. This is not an aspect that South Africa adopted as there is a limitation in the outflow of capital from the country. Consequently, South Africa is able to consider the liberalisation of its exchange control measures by removing this limitation as this may improve its economy, competitive advantage and be in line with global conditions.

Both South Africa and Iceland are on similar paths as they have both released further guidelines with the intention of further liberalising exchange control, and they consider all risk and rewards present in the economic environment prior to making a drastic removal of exchange controls.

3.4 South Africa's holistic movement in exchange control

In the instance that the macroeconomic and financial policies were more favourable in South Africa, the conversion of capital or capital flight would have been easier to manage. Ideally, these policies should incorporate the conditions of the domestic and international financial markets. South Africa specifically needs to incentivise individuals and/or entities to not move funds offshore by displaying the favourable conditions South Africa has to offer. The reason is that there would be less capital flight if South Africa was marketed as an attractive place for financial investment (in other words making money). As such, South Africa would typically need to limit the levying of tax on financial income, wealth and transactions. The attention of foreign investors was caught based on South Africa's economic conditions which promoted the inflow of capital into South Africa. It was vital that Exchange Control remains in the context of South Africa's economic conditions and policies. South Africa would need

⁹¹ EY, 2017a, 'Iceland removes most restrictions on foreign exchange transactions and cross-border movement of domestic and foreign currency', p. 2.

to build on its domestic financial system and a reduction in the inflation rate would also be beneficial prior to the removal of exchange control.⁹²

As explained above, within the SARB, the exchange control department are the successors of the FSD. The objective of establishing the FSD is to ensure the rand is at all times protected to ensure that the South African economy is balanced and sustainable into the future. The powers allocated to the FSD is granted in terms of the legislature, in which it states that its main purpose is to govern the inflow and outflow of capital. Another layer to the FSD lies an investigation division. This division is responsible for investigating alleged contraventions of the exchange control regulations and to ensure the losses are recovered and the same losses are recouped to the country's foreign currency reserves.⁹³

During 1995, South Africa received large inflows of foreign capital. This assisted South Africa with its integration with the international financial market and hugely beneficial to South Africa since numerous years of huge outflows of capital from South Africa. An increase in the net foreign reserves was facilitated by these inflows of capital, which was more than enough to finance the South African deficit on the current account of the balance of payments. In conjunction, this caused difficulties relating to the management of the South African money market.⁹⁴

The FSD announced amendments to the Authorised Dealer Manual and other guidance documents on 20 April 2017. These amendments granted additional powers to the Authorised Dealers, which resulted in a decrease of the FSD's involvement and the need for approval. This is regarded to be positive progress as conducting business in South Africa and abroad became easier. Examples of the amendments which resulted in a decline in the FSD's involvement and in shifting the responsibility to Authorised Dealers, are the setting up of foreign bank accounts, the approval solely by the Department of Trade and Industry (DTI) of licence agreements involving the local manufacture of goods and miscellaneous transfers such as refunds which now required approval from the Authorised Dealers.⁹⁵

⁹² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 153

⁹³ Croome, B., 2013, 'Exchange control and the Shuttleworth decision'.

⁹⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 172.

⁹⁵ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 2-3.

SARB issued Exchange Control Circular No. 7/2017 and the Currency and Exchanges Manual for Authorised Dealers, which explained that individuals and companies no longer required SARB approval for intellectual property transactions, provided that these transactions were at fair market value and were at arms-length. These changes allowed the Authorised Dealers to provide approval and approval was no longer required from the SARB. This change came with conditions such as the Authorised Dealers are required to review the sale or transfer agreements and the basis of calculation of royalty or licence fee through an auditors letter or the intellectual property valuation certificate. This transfer was required to take place 30 days from approval by the Authorised Dealers and the transfer of the license back to South Africa was not allowed. The transfer of intellectual property is subject to the appropriate tax implications.⁹⁶ The exercise of obtaining an auditor's letter and intellectual property valuation is time-consuming and cost-intensive⁹⁷.

Since South Africa is still subject to exchange control regulations, individuals and/or companies should diversify their savings abroad. As South Africa has become import intensive, this influences the changes in the rand, inflation, credit ratings and interest rates. Therefore, it is vital not to be isolated to South Africa as local income may stagnate while offshore income rises.⁹⁸

A contributing factor to the lack of outflows of capital was high share prices internationally, this hindered foreign investments, and the high interest rates which were imposed in South Africa. Foreign investments made by individuals continued to be low as a result of high indebtedness. In conjunction with this, the income to savings ratio in South Africa was low, which further did not promote foreign investments.⁹⁹ Collectively, this attributed to the lack of increased capital outflows from South Africa to offshore jurisdictions¹⁰⁰.

Currently, if the total value of your baggage exceeds ZAR50 000, you are, for the purposes of exchange control, required to get a No Exchange Provided (NEP) form at any commercial bank before your departure from South Africa.¹⁰¹

⁹⁶ Strauss, B., 2017, 'Tax and exchange control alert: relaxation of exchange controls relating to intellectual property and foreign investment', p. 2.

⁹⁷ Strauss, B., 2017, 'Tax and exchange control alert: relaxation of exchange controls relating to intellectual property and foreign investment', p. 3.

⁹⁸ Smith, C., 2018, 'Managing foreign exchange volatility'.

⁹⁹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 177 – 178.

¹⁰⁰ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 169, 177 – 178.

¹⁰¹ Network migration, 2018, 'SARS notice to people leaving South Africa - May 2018'.

In terms of exchange control residence, a natural person will constitute a resident who has established permanent residence or is domiciled in South Africa. The formal emigration process and approval must be obtained from the SARB, which can be obtained through an Authorised Dealer. Thereafter the individual will be viewed as an emigrant in South Africa. With regards to formal emigration, it is not required to forego South African citizenship, submission of one's passport, or disposing of any immovable property in South Africa.¹⁰²

The emigration application will incorporate a form, titled the MP336(b). Coupled with this form, a Tax Clearance Certificate must be obtained from SARS. This can be generated through the SARS e-filing system. So as to be viewed as an emigrant person of South Africa, a formal migration endorsement must be secured from the SARB through the approved Authorised Dealer at the person's South African commercial bank. The South African authorities also look for the individual's net financial position in South Africa. In other words, the individuals are required to compile a statement of assets and liabilities for the authorities to review. This is required for any spouse who is also emigrating alongside the individual. This is not a conclusive list and the authorities may require further detailed information, which will be requested at their discretion. In terms of exchange control facilities, a foreign capital allowance of ZAR20 million per family unit or ZAR10 million for each individual may be utilised by emigrants during the period of emigration. The process of emigration is a lengthy process, which may take place over a period of 12 months, if not more, prior to the finalisation of the emigration process. This period will depend on the nature of the assets and liabilities and the furnishing of supporting documents which may not be easily accessible.¹⁰³

It is clear that exchange control regulations in South Africa have experienced considerable movement and has not remained unchanged. The author submits that this is of importance as it depicts that with the changing economic environments, exchange control regulations too has evolved. A focal point of liberalisation has been the delegation of powers, specifically that South Africa has placed less focus on the FSD and has allocated a degree of exchange control approval authority to the Authorised Dealers.

¹⁰² La Grange, H., 2017, 'Relocating from South Africa'.

¹⁰³ La Grange, H., 2017, 'Relocating from South Africa'.

Based on the above analysis is noted that the exchange control approval process, specifically the emigration process, is still a lengthily process which is both administrative cost-intensive. This indicates that the exchange control process is not necessarily efficient and may in fact hinder economic growth if transactions and emigration are time consuming.

3.5 Joint tax and exchange control amnesty

The Minister of Finance, Trevor Manuel, announced the introduction of the joint tax and exchange control amnesty on 15 May 2003. He explained that this was a chance to prevail unfavourable economic climate by placing confidence in the South African economy, by allowing individuals to declare their contravention of the Exchange Control Regulations and the South African Tax Acts.¹⁰⁴ The introduction of the joint tax and exchange control amnesty is viewed to be an interesting mechanism in achieving the relaxation of exchange control. The reason for this is that amnesties more likely than not erode government credibility and is known to be ‘deeply destructive of sound public finance’. The reason for considering the tax amnesty was as a result of international success. Specifically applicable to South Africa is the intention to regularise the assets which are held offshore and to correctly include this amount in the South African tax base, this is titled the ‘regularisation of undisclosed offshore investments’.¹⁰⁵

The application of the same amnesty would attain the regularisation, in terms of exchange control and tax, of their affairs in respect of foreign assets held. The timing thereof was also appropriate as there was an increased desire amongst South Africans to voluntarily regularise their personal affairs to attain international co-operation, specifically in relation to tax compliance.¹⁰⁶

In terms of the exchange control regulations, the non-disclosure of foreign-held assets or funds resulted in criminal prosecution. Therefore, South Africans were reluctant to disclose any funds which were illegally held for tax purposes as there was a fear of criminal

¹⁰⁴ Botha, L. and Brunton, L., 2017, ‘Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers’, Cliffe Dekker Hofmeyr, p. 1, 4.

¹⁰⁵ Farrell, G.N. and Todani, K.R., 2004, ‘Capital flows, exchange control regulations and exchange rate policy: The South African experience’, p. 28 – 30.

¹⁰⁶ Botha, L. and Brunton, L., 2017, ‘Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers’, Cliffe Dekker Hofmeyr, p. 1, 4.

prosecution.¹⁰⁷ Despite the fact the fund arising from these investments were legally and legitimately acquired, the issue lies with the way in which these funds were repatriated offshore. This manner in which the funds were transferred puts it into the illegal and criminal bracket.¹⁰⁸

South Africa applies the residence-based tax system, therefore since the investments of the funds offshore were not reported to the SARS, the funds remained outside of the tax system¹⁰⁹. The joint tax amnesty entailed an opportunity to rectify matters which were not previously disclosed. This provided an equitable treatment for previous transgressions. The reason for implementing the tax amnesty was to regularise these transfers of funds by bringing them into the South African tax net, putting it on SARS' radar, and removing the chances of any criminal prosecution.¹¹⁰ This also paved the path for the disclosure of future foreign income earnings or the acquisition of foreign assets. Accordingly, this allowed individuals to retain their offshore assets and allowed for the repatriation of assets.¹¹¹

The key to the success of the joint tax and exchange control amnesty was that with it comes credibility. This relates to credibility with SARS, as taxpayers understand that the investment market will continue to be favourable. A further point of credibility was the government's commitment to de-criminalise the previous non-disclosure of repatriating funds and that no future amnesties will be applied, in other words it's now or never as there is a deadline for submission.¹¹²

In order to obtain the benefits of the joint amnesty, an application needed to be submitted between 1 May 2003 and 31 October 2003.¹¹³

¹⁰⁷ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4.

¹⁰⁸ Farrell, G.N. and Todani, K.R., 2004, 'Capital flows, exchange control regulations and exchange rate policy: The South African experience', p. 28 – 30.

¹⁰⁹ Farrell, G.N. and Todani, K.R., 2004, 'Capital flows, exchange control regulations and exchange rate policy: The South African experience', p. 28 – 30.

¹¹⁰ Farrell, G.N. and Todani, K.R., 2004, 'Capital flows, exchange control regulations and exchange rate policy: The South African experience', p. 28 – 30.

¹¹¹ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4.

¹¹² Farrell, G.N. and Todani, K.R., 2004, 'Capital flows, exchange control regulations and exchange rate policy: The South African experience', p. 28 – 30.

¹¹³ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4.

In order to qualify to utilise the joint amnesty, the applicants may only apply for exchange control amnesty provided that at the time the applicant was not subject to an exchange control investigation by the SARB. Under the circumstance that an application for amnesty was successful, a once-off exchange control levy of 5% was payable on the market value of the foreign assets or funds that were repatriated to South Africa. To the contrary, a once-off levy of 10% was payable on the market value of the foreign assets or funds which the applicant continued to hold offshore. Both of the aforementioned circumstances were only payable to the extent that the value of the foreign assets exceeds the offshore investment allowance of ZAR750,000 less the allowances previously claimed, per natural person. The disclosure in terms of the amnesty released the applicant from any form of criminal charges or civil penalties on or before 28 February 2002, which would have arisen as a result of illegally moving funds which is in contravention of the exchange control regulations.¹¹⁴

While, in order to qualify to utilise the joint amnesty, the applicants may only apply for tax amnesty provided that at the time the applicant was not subject to tax investigations by the SARS. Under the circumstances that an application for amnesty was successful, the taxpayer was required to settle the total taxes due on the foreign income earned during the 2003 tax year, the year ending 28 February 2003. After which foreign income must have been disclosed for all the subsequent years of assessment, in other words from 2003 tax returns onwards. It was not required to re-submit the 2002 income tax return and prior years for foreign income earned, provided that the tax amnesty relief was applied for in the prescribed manner and within the prescribed time. The disclosure in terms of the tax amnesty released the applicant from income tax, interest and penalties arising on or before 28 February 2002, which would have arisen as a result of the failure to disclose foreign-sourced gross income and capital gains.¹¹⁵

In terms of the amnesty, no relief was provided for the wrong-doing in relation to employees' tax and withholding tax on royalties.¹¹⁶

¹¹⁴ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4 - 5.

¹¹⁵ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 4 - 5.

¹¹⁶ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 5.

The amnesty proved to be a success, in considering the statistics that approximately 43,000 applications were received. There was a substantial growth in revenue or tax collection by the SARS, through the submissions of returns, coupled with the registration of thousands of new taxpayers.¹¹⁷

At a similar time that the joint tax and exchange control amnesty was implemented, it was announced that the 'blocked funds' will be unwound. These 'blocked funds' were funds in excess of the emigration allowance held by the SARB. These same blocked funds were held in an 'emigrants blocked accounts'. These funds were withheld from former South African residents that emigrated from South Africa. The 'blocked funds' were redeemed to a maximum amount of ZAR750,000 per former South African resident individual, without implementing a fee for redemption of this amount. Alternatively, up to a maximum of ZAR1,5 million per family unit. The amounts in excess of these specified amounts required exchange control approval from SARB. The amount in excess of ZAR750,000 per individual resident is subject to an exit charge of 10% of this calculated amount, which was not returned to the Republic.¹¹⁸ This was aimed at encouraging the return of capital back into South Africa by reducing the tax burden on investment income.¹¹⁹

As discussed above, the first amnesty arose in 2003 and after two months an exchange control circular D405 was released to the public. Later, during 2010, an amnesty no longer existed, however a combination of the amnesty and the exchange control circular was developed. This resulted in what is known as the Voluntary Disclosure Programme.¹²⁰

Since the imposition of the amnesty, there has been great progression which involve the OECD initiative, Common Reporting Standards (CRS) obligations imposed on financial institutions and the Special Voluntary Disclosure Programme (SVDP). The SVDP for exchange control and/or tax relates to a 'default' as defined in the Income Tax Act, as amended, and was affected during the period 1 October 2016 to 31 August 2017.¹²¹

¹¹⁷ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p.6.

¹¹⁸ Farrell, G.N. and Todani, K.R., 2004, 'Capital flows, exchange control regulations and exchange rate policy: The South African experience', p. 28 – 30.

¹¹⁹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p 71.

¹²⁰ Health, M., 2017, 'Voluntary Disclosure Programme: A very confusing offer that you can refuse', p. 1.

¹²¹ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 5 - 6.

In terms of section 225 the Tax Administration Act (TAA)¹²², a default is defined as:

‘default’ means the submission of inaccurate or incomplete information to SARS, or the failure to submit information or the adoption of a ‘tax position’ where such submission, non-submission or adoption resulted in an understatement.

In addition, the behaviour that led to the ‘default’ is considered in determining the understatement penalty, namely: substantial understatement, reasonable care not taken in completing a return, no reasonable grounds for the ‘tax position’ taken, Impermissible avoidance arrangement, gross negligence and intentional tax evasion.

These processes further assisted in regularising offshore assets and funds from a tax and exchange control perspective¹²³. From a high-level perspective, there are apparent similarities in the amnesty, and the OECD, CRS and SVDP initiatives.¹²⁴ The similarities focus on the fact that taxpayers are given the opportunity to come clean and make a submission of previously undeclared information.

The automatic exchange of information between all tax authorities and the result of the Panama Papers, in all likelihood South Africans would have likely utilised the SVDP procedure to regularise their foreign assets or funds which were not previously disclosed. Accordingly, the SVDP is anticipated to be an efficient revenue-generating mechanism.¹²⁵

The joint tax and exchange control amnesty is a fundamental element to the success of exchange control regulations in South Africa, as this gave individuals and/or companies the opportunity to disclose their funds, which they previous would not have done. As a result, these amounts were traceable and brought back into the South African tax net and generally onto South Africa’s radar.

¹²² No. 28 of 2011.

¹²³ Botha, L. and Brunton, L., 2017, ‘Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers’, Cliffe Dekker Hofmeyr, p. 5 - 6.

¹²⁴ Botha, L. and Brunton, L., 2017, ‘Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers’, Cliffe Dekker Hofmeyr, p. 5 - 6.

¹²⁵ Botha, L. and Brunton, L., 2017, ‘Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers’, Cliffe Dekker Hofmeyr, p. 7.

3.6 Summary remarks

The chapter illustrates that there has been a trend of liberalising exchange control in South Africa, Mozambique and Iceland. The evolution and methods of liberalising exchange control in each of these countries may have similarities and differences, however it is effective for each of their economic conditions.

The exchange control regulations in South Africa has largely evolved since its initial implementation. As explained above, a fundamental step was the implementation of the joint tax and exchange control amnesty, as this assisted with SARS' tax collection and with taxpayer's compliance matters. As a whole, this has assisted South Africa in reviewing all previously undisclosed matters and now including this as part of their records, which assists with future transparency.

CHAPTER 4: INDICATIONS OF THE LIBERALISATION OF EXCHANGE CONTROL IN SOUTH AFRICA

4.1 Introduction

This chapter considers the apparent indications of South Africa's gradual liberalisation of exchange control, including observation of the exchange control policy. There have been numerous changes to exchange control since it came into effect, in terms of what may have been allowable from a remittance of funds perspective, what transactions required SARB approval and the easier access and exchange of information. The liberalisation of exchange control is important in considering South Africa's position and the appropriateness of abolishing exchange control regulations.

4.2 Indicators of liberalisation

During the 1990s, the importance of exchange control was steadily decreasing. Throughout the years various amendments had been made over the governance environment, this became a habit due to variations in the balance-of-payments position. Be that as it may, the governance of the exchange control regulations was continuously being eliminated after the first half of 1990s, and its significance was relentlessly decreasing. The exchange controls imposed on non-resident were eradicated during March 1995. While, during 1995 and 1996, notable liberalisation on exchange control measures for residents were presented and applied going forward.¹²⁶

After March 1995, the liberalising of exchange control needed to be carefully planned. The exchange rates became unified, therefore exchange control over South African residents was considered. There was little information available regarding the susceptibility of South African residents to remit funds offshore. Many factors are considered in liberalising exchange control, such as strengthening the South African fiscal position, the privatisation of state assets and lowering income taxes. Therefore, these factors are structural adjustments that would be necessary to the South African economy.¹²⁷

¹²⁶ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 42.

¹²⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 157

The same structural adjustments would need to be considered, coupled with the effect of the capital inflow of foreign investments into South Africa, as this will affect the abolishment of exchange control in a South African context¹²⁸. This is further discussed in detail, in Chapter 5 below.

The SARB has made available to the public a general guideline that allows for greater understanding of the purpose, scope and operation of the exchange control system in South Africa, named the Exchange Control Manual. A large amount of the exchange control applications which require approval, are filtered through the Authorised Dealers, as this now falls within the duties of the Authorised Dealers in terms of this ruling and manual.¹²⁹

There's very little direction on the most proficient method to deal with customary transactions, foreign inheritance, and foreign investments. Therefore, the SARB provided directives to the Authorised dealers, by means of the exchange control rulings, regarding the mechanisms which was in essence the document to which Authorised Dealers were to make reference to before making any decisions. This assisted the running of exchange control as there was a documented point of reference, as a large number of exchange control staff at the local banks, are not legal specialists. The banks, acting as Authorised Dealers, were explicitly informed that those directives in terms of exchange control regulations, were for their utilisation only and were not to be made accessible to the general public, with the exception of certain extracts. Since, the SARB has changed these orders and has made more information freely available for the benefit of the general public.¹³⁰

As explained above, even though exchange control regulations have been liberalised over recent years, it is still regarded to be relevant that exchange control applies to South African residents. The reason being is that in the instance that South African residents wish to emigrate, their South African assets will be 'blocked' from leaving the country. As such, the assets will be controlled by the local bank, in other words an Authorised Dealer. This does to apply to income earned from assets (such as investments), these residents who decide to emigrate are allowed to remit an unlimited amount of this income abroad.¹³¹

¹²⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 157

¹²⁹ Croome, B., 2013, 'Exchange control and the Shuttleworth decision'.

¹³⁰ Health, M., 2017, 'Voluntary Disclosure Programme: A very confusing offer that you can refuse', p. 2.

¹³¹ Mazansky, E., 2016, 'South African Supreme Court of Appeal Confirms Application of Protocol to a Tax Treaty to a Period before Signature Date'.

Some may argue that there are great benefits attached to the abolishment of exchange controls regulations as this would allude to investor confidence. Undoubtedly foreign investors understood that exchange controls regulations applied to South African residents in isolation post March 1995, in other words were not applicable to these foreign investors as they are non-South African residents. In previous years, exchange control regulations were viewed as a vote of no confidence in the South African economy. The exchange control regulations also created an impression on foreign investors that exchange controls was a tool which was available and allowable to assist with the management of economic matters. As a result, this would now include foreign investors and the allowable exchange of funds by them into South Africa. It was argued that the existence of exchange controls would not deter foreign investment into South Africa, provided that there was confirmation that foreign investors would be able to remit their funds (in other words current income).¹³² The author submits that this is indicative of the liberalisation of exchange control as it expanded its scope to include foreign investors.

The Treasury and the SARB are committed to the strategy of the gradual liberalisation of exchange control measures in South Africa. The radical abolishment was not viewed to be favourable on their behalf and the liberalisation would ultimately depend on the extent of inflows of foreign capital from international jurisdictions and the level and degree of the foreign reserves. As a result, the Treasury and the SARB placed importance on the fundamentals required for an environment in which exchange control regulations can be gradually abolished in totality. The fundamentals consisted of reduced pressure to remove funds from South Africa and to promote or improve the inflow of capital into South Africa. An improved competitive position in the economy such that businesses had less incentive to relocate their operations to offshore jurisdictions, this was envisioned within the correct fundamentals allowing a rise in productivity which would therefore have reduced the desire to shift funds outside of South Africa.¹³³

For numerous years, foreign companies were not permitted to make unlimited dividend payments, there were restrictions in place which specifically related to dividend payments made to its subsidiaries in South Africa. In other words, there were restrictions in place for

¹³²SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150 – 151.

¹³³SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 155.

South African subsidiaries to receive dividend income. These foreign companies were required to obtain exchange control approval for payment of the specified amount of dividends. These same foreign companies had to obtain exchange control prior approval from the SARB or Authorised Dealers to advance new loans to its South African subsidiaries. In addition there were further restrictions placed on foreign companies with regards to loans arising in the South African capital market. This was later gradually removed, after the initial abolishment of the financial rand system in South Africa, such that dividend payments were permitted and loans were advanced.¹³⁴

It was preferable that through the liberalisation of exchange control regulations in South Africa that South African investors make offshore investments through regulated financial institutions that deal in unit trusts and/or insurance companies, as opposed to the individuals directly and independently investing in offshore jurisdictions on their own¹³⁵. The author of this research report submits that the reason behind this recommendation is that the Authorised Dealers are easily able to access information and track the outflow of funds from South Africa.

The SARB ensured that the gradual liberalisation of exchange control was communicated. As the liberalisation is dependent on so many aspects, such as the capital inflows to South Africa from other jurisdictions. Since 1997, the quantum of foreign reserves in the South African market had increased, however regardless of this, the SARB was still of the view that this increase in reserves was not sufficient to substantiate the abolishment of exchange control regulations in South Africa. It was also viewed that the liberalisation of exchange controls was not an easy one and quite complicated as the balance of payments were volatile and the rand was vulnerable.¹³⁶

For the purpose of monitoring and regulating international financial transactions the capital account restrictions and exchange controls remains a popular policy tool and one of choice. The associated costs and benefits analysis were particularly important to the SADC members, as increased financial integration was a forerunner in achieving the liberalisation of exchange controls. On a general basis, it is challenging for one to assess the robust nature of exchange

¹³⁴SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 160.

¹³⁵SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 167.

¹³⁶SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 178.

control regulations and the related potential to liberalise these regulations as information of the South African capital account is not easily accessible. In this regard, there are constraints on accessing data and there are minimal exchange control measures which are legally recognised (in other words the lack of legislated and legally binding exchange control measures).¹³⁷

The exchange control authorities, namely SARB and/or Authorised Dealers, had to approve foreign direct investments made by South African companies. There were specified criteria which needed to be met in order for approval to be obtained for such investments. These companies were required to further obtain permission to utilise the financial rand as a cash medium to finance such investments. This exchange control policy was lifted during the early 1990s.¹³⁸ At this time it was also stated by the treasury that exchanged control will be relaxed over time¹³⁹.

A means of liberalisation is the release of exchange control circulars, as a guideline to Authorised Dealers, which are made available to the general public. The SARB amends and releases these circulars from time-to-time, the date of which is not determined.¹⁴⁰

During the 2017 Budget Speech, it was announced that that certain requirements relating to exchange control would be relaxed by the SARB, as the FSD released Exchange Control Circulars, specifically No. 7/2017, 8/2017 and 09/2017¹⁴¹. The most recent exchange control circular is No. 3/2019¹⁴².

In terms of the Exchange Control Circular 12/2018, the reference to the 'Financial Services Board' in sB.2 of the Authorised Dealer Manual, has been replaced with the 'Financial Sector Conduct Authority'¹⁴³. This is a further indication of the relaxation of exchange control.

¹³⁷ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.139 - 140.

¹³⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 130.

¹³⁹ Strauss, B., 2011, 'Tax Alert: "Oilwell" that ends well: exchange control and export on capital', p. 2.

¹⁴⁰ Croome, B., 2013, 'Exchange control and the Shuttleworth decision.

¹⁴¹ Botha, L. and Brunton, L., 2017, 'Tax and Exchange Control Alert: More exchange, less control – further amendments made to the Currency and Exchanges Manual for Authorised Dealers', Cliffe Dekker Hofmeyr, p. 2.

¹⁴² SARB, 2019d, 'Exchange Control Circulars'.

¹⁴³ Botha, L., 2018, 'Tax alert and exchange control - exchange control: Recent amendments to the Currency and Exchanges Manual for Authorised Dealers', p. 3.

A further indication of the relaxation of exchange control in South Africa was the multiplying of the local lending offices of Controlled Foreign Companies (CFC) working in South Africa. The lending ability was now provided for locally and the lending ability was increased by up to double the amount of what was previously allowed. Confinements on outflows of capital by South African corporates were additionally facilitated and relaxed by permitting the remittance of funds from South Africa amounting to up to ZAR20 million, in regard of any new speculation venture (in other words foreign investment project) in an offshore jurisdiction. Exchange control approval was now provided under such circumstances. Likewise, an administration was made whereby restricted foreign ventures by South African financial organisations could be embraced, while authorisation had been conceded for corporates to counterbalance imported product expenses against the proceeds arising from the exports.¹⁴⁴

The actions apparent from eliminating exchange control regulations may adversely affect the future conduct of monetary policies in South Africa. All the more explicitly, the eliminating of exchange controls would additionally expand the significance of re-negotiating finance policies, and the alternative instruments, for example, varieties in real money or cash reserves and operations within the open-market.¹⁴⁵

When foreign individuals and/or companies were purchasing property situated in South Africa, they were only able to obtain a South African bond valued at 50% of the purchase price or cash investment made into the South Africa property. During July 1996, the 50% restriction placed on the amount foreigners are permitted to invest in South Africa property, by utilising South African bonds, were removed. The SARB announced that foreigners will have the option to buy property in South Africa with a South African bond equivalent to the cash amount they wish to invest into South Africa. The reason for this change was that it was noted that foreign investors were considered a large group of active investors into South African property and this group seemed to be expanding. This was particularly noticeable amongst the wealthier investors and those considered to be at the upper end of the market. During that period flexibility and relaxation was created for a select few controls which were

¹⁴⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 42.

¹⁴⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 42.

placed on South Africa residents, in particular this affected the exemption for foreign investments by the South African corporate and financial institutions.¹⁴⁶

There has been further liberalisation of exchange control over financial institutions, the corporate sector and resident individuals. Therefore, it was evident that there has been a phasing-out action of exchange control. Furthermore, since 1 July 1997 South African taxpayers who were regarded as in 'good standing' with SARS, and over the age of 18, were permitted to invest up to ZAR200,000 offshore.¹⁴⁷

The IMF expressed their views of liberalising capital flows and using capital flow management mechanisms. In liberalising capital outflows, it is important to consider the country at hand and it largely depends on its circumstances and the country's degree of financial development. The process, timing and way in which the liberalisation is achieved is important matter to consider and strategise, particularly in the case of emerging markets. It is understood that the liberalisation of capital accounts will result in world-wide development and growth, however there are results that show that development and growth will be hindered.¹⁴⁸ Accordingly, it was ideal to further liberalise the exchange control regulations such that corporates were able to invest into the South African economics for its growth¹⁴⁹.

Specifically, the desired liberalisation of capital accounts continue to be debated. As recommended by economic theory, the liberalising of capital account provides provision for a more efficient global allocation of resources, increased capital flows for investment purposes, increased opportunities to diversify risk, the increased efficiency within domestic financial sectors, the promotion of financial development, increased growth and productivity, and finally this alludes to good economic policies and the countries commitment in achieving good policy. In combination with the aforementioned, there are considerable costs associated with the short-term capital flows and the related volatility. This volatility will hinder growth and development. This is notably accurate for developing countries which also have financial sectors which are less developed. There is uncertainty around the outcome of countries that establish increased liberalisation as there is likely to be financial disruptions which directly affect development and growth which is also likely to be slow. It is suggested that potential

¹⁴⁶ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 161.

¹⁴⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 42.

¹⁴⁸ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p. 139 - 140.

¹⁴⁹SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 162.

risks involve slow financial integration. Accordingly, it is essential to measure and monitor the development towards external liberalisation.¹⁵⁰

4.3 Summary remarks

It is evident that there have been significant indicators of liberalisation. It is of importance to ensure that funds remain in South Africa for economic growth and development. In this regard, it has been noted that there have been large structural changes to the exchange control regulations, such as the release of exchange control circulars and the segregation of duties to the Authorised Dealers. This has allowed for efficiencies in the process, specifically on the end of the SARB and Authorised Dealers. In addition, there has been liberalisation on the end of the individual and/or company as liberalisation has assisted in both the allowance of capital inflows into and outflows from South Africa. This assists in the allowance of direct foreign investment into South Africa and the offshore capital investments/transfers made by corporates respectively. The quantum of the limit that may be transferred has also been increased which is an indicator of the relaxation of exchange control measures.

Over and above, the author of this research report submits that while exchange control regulations have progressively been liberalised, it continues to be prevalent in a South African context. The SARB may have liberalised exchange control, however the essence of the regime has still been retained. This chapter also further illustrates the importance of the strategic liberalisation as opposed to the sudden abolishment of exchange control in South Africa.

¹⁵⁰ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.149.

CHAPTER 5: CONSEQUENCES OF ABOLISHING EXCHANGE CONTROL IN SOUTH AFRICA

5.1 Introduction

The potential consequences arising from removing the exchange control regulations will be considered in this chapter. There are risks and rewards attached to abolishing exchange control regulations. As a result, this chapter discusses the reasons for and against abolishing the exchange control regulations from a South African perspective. This will be focused on considering foreign direct investment, offshore expansion by South African companies, the cost to the country, economic, tax matters and the effect on taxpayers.

Venezuela is a sample jurisdiction which has considerably liberalised exchange control, therefore the implications which arose from these sudden steps taken to abolish exchange control will be discussed in this chapter.

Accordingly, a holistic view of exchange control will be established and considerations for the future dynamics of the exchange control regime will be discussed, specifically assisting in addressing the prevalence of exchange control in South Africa.

5.2 Analysis of repealing Exchange Control in Venezuela

During 2003, the President of Venezuela, Hugo Chávez, discussed exchange control measures to prevent capital flight to offshore jurisdictions, as the country was under a severe political crisis. It was discovered and assumed that the interest rate was affected by trade on the black market, as the official interest rate differed.¹⁵¹ There was an incentive to buy dollars at a preferred rate and re-sell the dollar at a preferential rate in order to generate a profit on the currency, of which these actions were performed on the black market¹⁵². These exchange control measure were later implemented in 2005 in terms of Foreign Exchange Law. The prime reason for implementing this law was to destroy the foreign exchange market. Any transactions that were not approved by Central Bank of Venezuela were penalised through the exchange control law. As a result, all the power was given to the Central Bank of

¹⁵¹ González C, C., 2018, 'Venezuela: The possibility of buying foreign currency is a ray of sunshine for businesspersons'.

¹⁵² Buitrago, D., 2018, 'Venezuela announces easing of currency controls, economists sceptical'.

Venezuela as all sales and purchases of foreign currency required its approval. Any transactions which took place without the approval of the Central Bank of Venezuela were regarded as a criminal offense.¹⁵³

The Exchange Agreement No. 39 regulates 3 particular transactions, namely:

- i. auctions of foreign currency, conducted through the new system at the supplementary floating market exchange rate (DICOM);
- ii. direct sales of foreign currency; and
- iii. transactions involving the negotiation in the local currency of securities denominated in foreign currency, which are issued by private sector issuers.¹⁵⁴

The DICOM integrates the exchange rate for both the private and public sector. Each person is required to electronically register on the system in order to transact in foreign currency. The applicant is required to hold a foreign currency denominated account with the Venezuelan bank which has a global footprint. The applicant must then provide supporting information, sign a statement confirming their origin, confirm the destination of the funds and must be tax compliant. The Central Bank of Venezuela coupled with the Ministry of Finance have the power to convene all actions jointly.¹⁵⁵ It is submitted that these are stringent measures put in place, as part of the exchange control regime, as all supporting documents are reviewed by a Venezuelan bank prior to remitting any funds and individuals are subjected to providing the information above, without choice. As a result, the Central Bank of Venezuela and any Venezuelan bank would easily be able to access information submitted via the DICOM.

In later years, the exchange control laws drastically changed in Venezuela. A fraction of these laws were repealed in Venezuela which allowed businesses and individuals to trade their funds at designated trading houses which drastically increased access to foreign currency.

¹⁵³ González C, C., 2018, 'Venezuela: The possibility of buying foreign currency is a ray of sunshine for businesspersons'.

¹⁵⁴ Norton Rose Fulbright, 2018, 'Venezuela regulates new system for transactions in foreign currency as part of the exchange control regime, and unifies the official exchange rate at the DICOM exchange rate'.

¹⁵⁵ Norton Rose Fulbright, 2018, 'Venezuela regulates new system for transactions in foreign currency as part of the exchange control regime, and unifies the official exchange rate at the DICOM exchange rate'.

The access to foreign currency was fully restricted in prior years and was regarded to be an extreme change in its exchange control regime. Approximately 16 exchange licenses were granted to trading houses, for purposes of trading between the Venezuelan bolivar and cryptocurrencies.¹⁵⁶

These same changes which were implemented caused a decrease in approximately 5 zeros off the Venezuelan bolivar currency. As it stood prior to the change, the Venezuelan bolivar was nearly worthless, therefore the decrease in approximately 5 zeros further added to the little value the Venezuelan bolivar had. A further impact was the increase in inflation which was up to 1 million percent. In addition, removing the exchange control regulations, which were implemented for a long period of time, left Venezuela residents struggling to attain food and medicine. It was genuinely thought that the impact of the removal of exchange control regulations was not going to be as drastic as it proved to be.¹⁵⁷

After the above took place, during 2003, the president of Venezuela began to limit the exchange of funds in order to prevent capital flight from Venezuela. This was not sufficient to resolve the extent to which the impact of the removal of exchange control measures had. The re-implementation of exchange control measures instead resulted in corruption and the local businesses could not attain funds, denominated in Venezuelan bolivar, which were required for imports and accordingly the running of their businesses.¹⁵⁸

As a result, regulatory burdens were placed on manufacturing businesses in Venezuela. This too significantly affected the smooth-running of their businesses. Foreign exchange control restrictions were placed on these manufacturing businesses, a 30% cap was placed on business profits and the government expropriated companies. These factors resulted in prices that were increased and an uncontrollable price control system. In combination, this affected the business production, the supply chains and the import and export running of the respective companies. Approximately 1,300 companies were expropriated by the Venezuelan government.¹⁵⁹ The sector split of the expropriation is as follows:

- i. the construction sector amounting to 40.5%;

¹⁵⁶ Laya, P., and Rosati, A., 2018, 'Venezuela Eases Currency Controls Amid Economic Meltdown'.

¹⁵⁷ Laya, P., and Rosati, A., 2018, 'Venezuela Eases Currency Controls Amid Economic Meltdown'.

¹⁵⁸ Laya, P., and Rosati, A., 2018, 'Venezuela Eases Currency Controls Amid Economic Meltdown'.

¹⁵⁹ Moya-Ocampos, D., 2018, 'Venezuela foreign exchange controls'.

- ii. the manufacturing sector amounting to 32.3%; and
- iii. a spread across the oil, retail, and service sectors amounting to 27.2%¹⁶⁰.

Since 2007, sectors which have been expropriated in Venezuela are as follows: agribusiness, banking, cement, chemical, construction, food, iron, mining, oil, pharmaceutical, power, steel, telecoms and tourism¹⁶¹.

Specifically, companies which have stopped or paused operations are at risk of expropriation. Alternatively, if companies are accused of price speculation, they too are at risk of expropriation by the government. Large focus was placed on the food sector, which includes basic goods and pharmaceutical products, while little focus was placed on oil, automotive and retail sectors. The government intervention and restrictions on currency allocations, has had drastic impact, which has caused productivity issues and a resultant shortage of goods amongst Venezuelan-based companies.¹⁶²

The re-implementation of exchange control has largely affected the Venezuelan regulatory environment. This will likely get worse if the ambit of the exchange control measures are further widened.¹⁶³

The author submits that the impact that the large-scale removal, or liberalising of exchange control has adverse effects. Venezuela is an example of the risk that lies in this and the resultant adverse implications. This has caused a decrease in the Venezuelan bolivar currency which has also decreased investor confidence. Further, residents of Venezuela have also suffered as they have limited access to basic foodstuff and medical supplies. These factors further illustrate the importance of strategic liberalisation as opposed to the sudden abolishment of exchange control. This alludes to the fact that South Africa may in fact be on the right path in maintaining the essence of what exchange control has been set out to achieve, however allowing for its evolvement such that is changes with the changing economic environment.

¹⁶⁰ Moya-Ocampos, D., 2018, 'Venezuela foreign exchange controls'.

¹⁶¹ Moya-Ocampos, D., 2018, 'Venezuela foreign exchange controls'.

¹⁶² Moya-Ocampos, D., 2018, 'Venezuela foreign exchange controls'.

¹⁶³ Moya-Ocampos, D., 2018, 'Venezuela foreign exchange controls'.

5.3 Potential considerations in South Africa

Approximately 25 years have passed since apartheid ended, followed by the financial crisis and the massive desire to export capital from South Africa to offshore jurisdictions. Therefore, certain critics are of the view that the South African Treasury and the SARB should take the approach of further liberalising exchange control, as what existed 25 years ago may not be relevant in current days. Further, in conjunction with re-considering exchange control matters, policies which are outdated and bureaucratic should be re-assessed. Massive outflows of capital are allowed by individuals in their private capacity, companies and amongst the investment industry. Therefore, the need for time-intensive and administrative procedures, which are attached to exchange control, may not be necessary anymore.¹⁶⁴

Exchange control had also been implemented to decrease money laundering, tax evasion and to achieve the collection of data and tracking of balance of payments. Time has passed since the initial implementation of exchange control and there are more effective, efficient and cost-effective mechanisms of collecting data, some which even include the real-time collection of data by the banks, such as the SARB. It is viewed that a solution to tax evasion does not necessarily need to be achieved through exchange control, instead through the SARS' mechanisms and the TAA. In addition, in later years, money laundering has been addressed through financial intelligence units that ensure that there is no money laundering and the financing of terrorism. In this regard, there may be no need for exchange control regulations and its function to achieve no money laundering.¹⁶⁵

Outflows with minimum relations to the domestic political dilemma, had weakened the balance-of-payments position, dissolved the tax base, and had impaired the scope of the economy to grow. Numerous sources relating to the South African economy indicated that it had endured agony from on-going flights of capital to offshore jurisdictions, by the individual and corporate sectors during approximately 20 years prior to 2011. While, informal evidence recommend that these outflows still persisted thereafter and during the 1990s. Therefore, through greater political stability in South Africa, there has since been decreased pressures on the need for foreign investments and reserves. Accordingly, this has resulted in substantial

¹⁶⁴ Health, M., 2017, 'Voluntary Disclosure Programme: A very confusing offer that you can refuse', p. 2.

¹⁶⁵ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p. 141.

improvement to the extent of eliminating the exchange controls regulations in South Africa.¹⁶⁶

Under the circumstances that no exchange control regime existed prior to 1995, for approximately 30 years prior to this, in all likelihood a fair amount of private and institutional investors would have placed focus on utilising resources to purchase foreign assets. As a result, the economy's dependency on South African sources of income would have been subsequently reduced, while the majority of the earnings from these foreign investments would in all probability have been repatriated. This in succession, would have encouraged service receipts on the balance of payments and as time elapsed, the fraction of the national income which originated from foreign-sourced income should have risen. The invisibles account, relating to imports and exports, of the balances of payments would have too strengthened, while the proportion of foreign currency earnings that arose as a result of the precious metals industries would have declined. Accordingly, the economy would have become more diversified, had the exchange control regime not been implemented, and the above-mentioned predictions had actually occurred.¹⁶⁷

By ignoring international norms set for financial discipline, judicious management, sound government and internal stability was no longer an option for any country that exposed itself to moods and perceptions of international fund investors and financial traders operating in a technologically integrated global market system. The advantage from the integration into the world financial system for South Africa is access to a massive pool of surplus savings in the economies of the world, however this also requires that the country adheres to the discipline urged by the global market economy.¹⁶⁸

The author submits that multiple factors affect the success to exchange control in South Africa. Whilst it may be considered beneficial not to have implemented exchange control, as there are negative connotations associated with such a time-intensive and administrative procedures with exchange control, it is also considered beneficial that exchange control was implemented since there has been political instability in South Africa. In addition, it is believed that as opposed to exchange control, other measures could be implemented to

¹⁶⁶ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 152.

¹⁶⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 149.

¹⁶⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 173.

achieve the goals of exchange control which include preventing money laundering and tax evasion.

The remainder of this chapter explores the potential risks and rewards associated with abolishing exchange control in South Africa, see the detailed analysis below.

5.3.1 Potential risks

The potential risks of abolishing exchange control in a South African context has been set out below.

A select few analysts had challenged the need to abolish exchange control, with a specific focus on the longer-term advantage in South Africa. This considers the initial and then prevailing exchange control regulations, which has since changed, and may not be fit to be abolished.¹⁶⁹

During the 1990s, in considering the abolishment of exchange control, a factor that prevented the removal was that tax rates would strongly remain and high labour costs existed. These risks would have outweighed the benefit of being an attractive country for offshore investors.¹⁷⁰

There is a large corporate tax burden as a result of high rates of tax. The removal of exchange control would lead to foreign companies that are currently operating in South Africa to use debt capital over equity capital for tax reasons, as there will no longer be restrictions on the use of debt capital in South Africa, as a result this is an incentive to abolish exchange control. In order to maintain the hold over tax revenue, exchange control was liberalised but not abolished.¹⁷¹ As such, the author submits that the abolishment of exchange control may give rise to associated illegal transactions which may not have been subject to tax in South Africa. Illegal transactions would arise with or without exchange control regulations, however the abolishment of exchange control regulations is a contributing factor to a rise in illegal transactions. This in turn affects SARS' tax collection which will consequently decrease.

¹⁶⁹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 158.

¹⁷⁰ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

¹⁷¹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 161.

Based on the relatively high burden of corporate tax and the related rates in South Africa, it is likely that the abolishment of exchange control regulations in South Africa will incentivise and build a solid foundation for companies to utilise more foreign debt capital as opposed to equity. In this way, it will alleviate the tax burden on the company. For the purposes of avoiding an undue loss of tax revenue, the South African authorities were of the view that the restrictions placed on the use of debt capital should be more flexible, however the extremity of abolishing exchange control regulations is not necessary. Unfortunately, this consideration had become inferior, as during the budget speech which took place in March 1995, a decision was taken to remove the non-resident shareholders' tax, levied at 15%, therefore the incentive to use equity over debt should have become greater.¹⁷²

Evidence showed that the South African economy suffered from on-going capital flight by both individuals and companies and these outflows persisted. This was attributed to political uncertainties in South Africa, weakness in the balance of payments, the erosion of South African tax base and the hindered economic growth.¹⁷³ The current political and economic uncertainties in South Africa pose a threat to the abolishment of Exchange Control Regulations. Further, the substantial outflow of capital from South Africa could cause the rand currency to significantly drop in value. Accordingly, the inflationary pressures will likely rise.¹⁷⁴ Specifically, with regards to the rand, the monetary and fiscal policies would need to be tailored such that they become more circumscribed¹⁷⁵.

Furthermore, foreign investors may view South African policies as inadequate since the abolishment of exchange control will likely result in authorities implementing stricter limits on policies.¹⁷⁶

Should exchange control be abolished, individuals and/or entities will be able to escape from a particular government and the government's power to exploit them will suffer. Particularly, this will affect the government's power to exploit by means of taxing individuals and/or companies.¹⁷⁷

¹⁷² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 161.

¹⁷³ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 152.

¹⁷⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decades 1989 to 1999', p. 148.

¹⁷⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

¹⁷⁶ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

¹⁷⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

Should there have been appropriate macroeconomic and financial policies, it would have had a pivotal role in fully converting capital accounts in an easier manner. Those policies would have typically involved mechanisms in which the difference or gap between the conditions of the South African financial market and the offshore financial market would have been minimised. South Africa would have been able to retain more capital funds if South Africa had been marketed as an attractive place for investments on which investors are able to generate money. In addition to strengthening the fiscal position, South Africa would also need to consider capping the taxation on financial income, wealth and transactions. This would reduce the risk of capital flight and encourage the retention of funds in South Africa, as opposed to drastically moving funds offshore. The economic policies of South Africa became the focal point of all the multiple foreign investors. Accordingly, this would assist in a desirable South African financial system and related policies, which would also assist in reducing the rate of inflation. These were a more suitable solution, the improvement of South African policies, but possibly not sufficient and to the extent that exchange control may be further liberalised or abolished.¹⁷⁸ This sudden removal of exchange control will likely result in a weaker exchange rate and increasing interest rates, as this change and excessive fiscal expansion would be affected by the change in the market during the short term¹⁷⁹.

Any untimely abolishment of exchange controls in its entirety would have hugely affected the authorities, especially relating to the pressures arising from public opinion, drastic and exponential rises in interest rates, while exchange rates drop and decreases in real wages. This would result in the authorities being forced to re-introduce exchange control regulations. This would result in the SARB's and government's fractured credibility, which affects the viewpoint foreign investors and reduces the intentions of making investments into the South African market.¹⁸⁰ Similarly to the re-introduction of the exchange control regime in Venezuela, in which we have witnessed the negative impact on local currency, inflation and corruption.

It is undetermined as to how South Africa should abolish exchange control measures. Factors under consideration and the SARB's aim is to prevent the deconstruction of the economic upheaval such that it would result in substantially lower exchange rates, an increased inflation

¹⁷⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 153.

¹⁷⁹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

¹⁸⁰ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 151.

rate and increased South African interest rates. Bearing these factors in mind, it is essential to be in a safe position in which exchange control regulations would not need to be re-introduced in South Africa subsequent to its abolishment. The SARB genuinely views the sudden abolishment of exchange control regulations in South Africa will cause a new foreign exchange crisis, this would be more detrimental than beneficial to South Africans and to the interests of investors. It should be acknowledged that while exchange controls are depicted as the only hurdle for many South Africa investors to remit funds offshore, to the contrary it represents one of several obstructions for foreign investors to invest funds in South Africa. Accordingly, after abolishing exchange control regulations, this could have resulted in significant gross outflows of funds from South Africa, however minimal and volatile gross inflows of funds into South Africa. These inflows could have been considerably smaller, which would not assist in South Africa's maintenance of funds within the local market.¹⁸¹

The South African authorities also believed that the exchange control regulations manipulated the exchange rates, interest rates and salaries and wages. This also affected the international competitive advantage of South African producers and their related production. It was preferential that these manipulations be rectified, however it was unlikely that these adjustments would complement social and political matters in a South African context.¹⁸²

In conjunction with the above, another reason against the total abolishment of exchange control, is the South African bank's involvement in the forward rand-dollar market. If the South African banks were to suddenly abolish exchange control regulations, the rand value would have likely fallen against the dollar, and more likely than not immense losses would have incurred on the forward exchange account. A select few of the South African private banks would actively participate in the forward rand-dollar market, as a result the sudden abolishment of exchange controls could have resulted in a volatile forward market and the circumstances under which the market operates. In order to abolish exchange control, it is vital that the South African banks develop a sustainable policy in which to follow, such that a preferable environment is created from which the forward exchange market can be withdrawn and without unduly interfering with the foreign exchange market.¹⁸³

¹⁸¹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 151.

¹⁸² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 151 - 152.

¹⁸³ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 152.

The abolishment of exchange control regulations would have resulted in the imposition of new competition from a foreign market and sector. South Africa may not have been equipped to manage the change and the increased competition. Consequently, the abolishment of exchange control would have given rise to an inequitable playing field between the South African financial institutions and the offshore financial institutions.¹⁸⁴

In terms of the previous legislation, a local unit trust and its related funds could not be managed by a management team outside of the unit trust advisors, nor by an offshore management team. With effect from March 1997 which was during the liberalisation of exchange control regulations, a unit trust may include investments of its foreign assets into foreign securities. In this regard, the unit trust was required to manage the foreign investments itself. The function had to be maintained locally and was not to be undertaken by an offshore manager, even though the delegation of management duties or services to the foreign manager would have allowed for greater efficiencies and the smooth running of the unit trusts. Correspondingly, if exchange controls had been eliminated at that time, South African unit trusts would have been at a disadvantage compared to foreign unit trusts. This would have attracted funds from South African investors for purposes of offshore investments.¹⁸⁵

Potentially, the banking environment and supervision techniques would have needed to be changed such that the methods and frameworks are strengthened. This is essential prior to abolishing exchange control, as the South African banks would not have the means to efficiently provide services. In this regard, the abolishment of exchange control regulations could have resulted in banking problems and the systematic running of the bank. Since South African financial institutions would have been capable of dealing much more frequently in foreign currencies, unless tight restrictions were placed on open positions which remained in force, there was greater risk of system errors. While, on the one hand there would have been increased foreign capital flows, however on the other hand the liberalisation of exchange controls would have resulted in a more volatile liberalised capital account. The liberalised capital account would result in abrupt fluctuations in the money-market and related shortages would arise.¹⁸⁶

¹⁸⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 158.

¹⁸⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 159.

¹⁸⁶ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 159.

It proved to be particularly difficult for South African companies to undertake foreign investments in African countries. In this regard, multiple other foreign investment projects have been forsaken. There were increased risks associated with borrowings taken from international private banks for the purposes of financing such foreign investments, therefore South African banks were hesitant to finance these investments. These restrictions have somewhat dampened the further expansion by South African banks into Africa. In addition, the entry of mining houses as part of the advancement of mining in Africa were also restricted.¹⁸⁷

In the instance that exchange control is abolished, this would give rise to imperfect information or the lack of available transparent information, which would increase the volatility of the capital flows. Consequently, this will cause the taking on of excessive risk and a lack of incentives to protect the capital flows against the risk. Accordingly, these associated risks will likely result in a financial crisis. Completely unregulated capital flows also tend to catalyse the spread of currency crises, which affects a vast number of offshore countries, instead of just one country being South Africa. In addition, the abolishment of exchange control may cause the reversal of short-term capital flows (in other words the need to send the funds back to the originating country). This will result in intensified macroeconomic shock in South Africa, such as reduced productivity in South Africa and reduced interest rates.¹⁸⁸ The free-trading promotes economic growth and development. Consequently, reduced trading could negatively affect South Africa's social welfare¹⁸⁹.

The prime motivation for exchange control regulations is to protect South Africa from any drastic international fluctuations, however the free-floating exchange rate is manipulated by the SARB at times. The abolishment of exchange control may give rise to the increased flow of capital, followed by the decreased flow of capital and vice versa. This does not achieve some sort of stability. Instead, maintaining exchange control regulations on capital flows in South Africa has reduced its risk of financial crisis and will result in lower macroeconomic volatility. As a whole South Africa will be less vulnerable. This vulnerability will affect investor confidence in the South African market which will cause lower investments within

¹⁸⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 162.

¹⁸⁸ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.142.

¹⁸⁹ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141.

South Africa, the real economy, the financial economy and there will be a delay in South Africa's growth. Particular focus is placed on short-term transactions, as these transactions may easily be affected and subsequently reversed.¹⁹⁰

Appendix 'C' attached hereto, shows the measure of the vulnerability of the foreign inflows and outflows placed on a sample of 30 Emerging Market countries. The chart shows that the financing needs of emerging markets countries are less than their foreign exchange reserves. A positive aspect to the chart is that it shows an improvement compared to previous years, specifically relating to the stress that emerging faced during 2008 and 2013.¹⁹¹ Over and above, the author considers the following to be relevant; the chart further shows South Africa as a more vulnerable emerging market compared to many other countries. An essential aspect to note is the progression of South Africa, as from 2008 to 2017 there has been an improvement, and the financing needs as a percentage of foreign exchange reserves has improved.

When purchasing or selling cryptocurrencies or crypto assets, there are currently no regulatory requirements which need to be complied with. This poses a host of risks. Crypto assets may create an environment of risk with unfavourable conditions such as the circumvention of exchange controls, *inter alia*, the undetected illicit flows of monies, money laundering, market manipulation, a threat against consumer and investor protection and tax evasion. In this regard, the Intergovernmental FinTech Working Group (IFWG) and Crypto Assets Regulatory Working Group agreed that the crypto assets regulatory framework will be designed to overcome the contravention and circumvention of the exchange control rules and regulations.¹⁹²

As observed above, the abolishment of exchange control has numerous associated risks and the costs compared to the benefits attainable from this same abolishment must be carefully considered.

¹⁹⁰ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.142.

¹⁹¹ Goldman Sachs Asset Management, 2018, 'Emerging Markets: Blow Up? Or Blow Over?'.
¹⁹² IFWG, 2019, 'Crypto Assets Regulatory Working Group Consultation Paper on Policy Proposals for Crypto Assets', p. 6, 15, 24.

5.3.2 Potential rewards

The potential rewards of abolishing exchange control in a South African context has been set out below.

Since the weakness in the South Africa rand during 1996, some analysts were of the view that mechanisms should be considered and put into place to facilitate the removal of exchange control in South Africa. This was considered as opposed to holding the process back from moving towards an exchange control-free environment. As a result, the privatisation programme was sped up and an exchange control tax amnesty was released. This amnesty allowed South African to disclose their illegal exportation of capital, as discussed in detail in Chapter 3 above.¹⁹³ The author submits that the joint tax and exchange control amnesty has alleviated the rewards associated with the exchange control measures as it was a prime time in which the SARB was notified of the illegal transfer of funds.

Exchange control affects foreign direct investment and the expansion of local companies offshore. Under the circumstance that exchange control is removed, there will likely be increased foreign investment in South Africa and accordingly, a liberalised capital account of the balance of payments.¹⁹⁴ In addition, it is submitted that the convertibility of capital accounts to foreign currency will assist with efficiencies in the financial market.

The abolishment of exchange control will result in an influx of foreign investment in South Africa. As a result, efficiencies may arise and welfare gains from increased production and consumption.¹⁹⁵ The allowance of freely flowing capital will result in efficiency gains for South Africa, as the production of financial services will be strengthened as it becomes specialised. The abolishment of exchange control would have allowed South Africa to tap into the national and international financial markets. This would have too reduced borrowing and/or lending costs.¹⁹⁶

The abolishment of exchange control will push South African financial institutions and producers to become more efficient as a result of increased offshore competition. This will

¹⁹³ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p 71.

¹⁹⁴ Strauss, B., 'Tax Alert: "Oilwell" that ends well: exchange control and export on capital', p. 3.

¹⁹⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 148.

¹⁹⁶ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 149 - 150.

also promote increased productivity and innovation amongst the South African financial institutions and/or producers.¹⁹⁷

On a general basis, the abolishment of exchange control will promote offshore investors to participate in the South African financial market. This will allow the offshore investors to attain liquidity of their funds in South Africa. As a further point, there will be increased offshore investors and South Africa will be able to attain foreign capital at a cheaper rate. The liquidity of the Johannesburg Stock Exchange (JSE) platform will improve, as there will be increased competition as South African investors would also be able to invest in foreign shares and build upon their foreign investment portfolio. The sale of institutional holdings could fund foreign investments. There will also be a decline in local financial institution's on-going accumulation of domestic shares, as this would be more freely traded. Shares of financially sound companies that are also regarded as the market leaders, are able to improve its marketability of its shares. This will encourage offshore investors to build on their share portfolios in leading South African companies.¹⁹⁸

Accordingly, the abolishment of exchange control will result in a competitive economy. This competitive nature will arise as the large multinational companies will attain dominance in the economy, as these entities may have the means to sell their local shareholdings and subsequently invest in the offshore market. As such, these offshore investments are easily attainable and South African residents may now hold diversified investment portfolios. This will allow more stable income streams as monies have been broadly invested.¹⁹⁹

It is important to be mindful that a stable and investor friendly environment is desirable and would attract the inflow of foreign capital into South Africa. As such, structural reform remains a vital mechanism to encourage investments in economic growth and savings in South Africa. These structural reforms include the efficient privatisation and de-regularisation of the labour market and reduction in direct taxes payable. These same reforms will ease the transition to an exchange control-free environment, specifically alleviate pressures for the SARB.²⁰⁰ It will also result in greater foreign investor confidence in the South African market. Other advantages include, the strengthening of balance of payments on

¹⁹⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 149.

¹⁹⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 149.

¹⁹⁹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 149.

²⁰⁰ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 245.

capital account, improvements in the competitive advantage of the South African economy, a decline in interest rates and the reduction on the tax burden to below 25% of the GDP (as recommended by the IMF according to the fiscal norms).²⁰¹

During the 1990s, it was considered that South Africa would have been the international financial centre for Africa, if South Africa had abolished exchange control regulations. In this regard, the lack of controls over the capital account would have allowed economic development in South Africa and Africa, this is considered on a holistic approach as the outflow of capital amongst each other and offshore was allowed. In considering this, it is also important to note that the gross domestic savings would have been rather low as a result of capital flight.²⁰²

There will be increases in importation and this process of importation will also become more efficient. The importation is regarded to be more efficient compared to producing financial services.²⁰³

The imposition of VAT promoted exports by allowing a deduction on the VAT paid on capital and intermediate inputs. Despite the fact that VAT was not charged on the exported final product. This ideally should have increased export competitiveness.²⁰⁴

With regards to exportation, the exchange control regulations which were released during March 1998, allowed South African companies to maintain its currency earnings from exports for a maximum of 180 days from the shipment date or the date on which the services were rendered. This brought about relief for exporter as this allowed for cash flow management from their end, in turn flexibility in the smooth-running of its export businesses and income earned from the receipt of foreign currency. In all likelihood this increased earnings amongst the export companies, with the exception of exporters in the gold-mining industry, as this is generally a cash-strapped exporting business.²⁰⁵ To the contrary, the restrictions placed imports may result in an implicit real exchange rate which results in

²⁰¹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 82

²⁰² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 149.

²⁰³ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 149.

²⁰⁴ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 194.

²⁰⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 175.

exports being less competitive. As a result, in order for exports to recompense from the less competitive environment, labour costs are decreased and productivity is increased.²⁰⁶

From the perspective of a lender, if exchange control regulations were abolished, South Africa may have been put in a position to tighten the exchange control measures or limit the payments in settlement of the loan. As a result, South Africa would abstain from lending. Alternatively, the interest rate would be higher as this would take the risk premium into account which results in a higher rate. The yield on the loan too takes into account any default on the re-payments of the loans and unforeseen disruption.²⁰⁷ It should also be considered that obtaining a foreign loan may prove to be quite an administrative procedure. An easier route may be to use the financial rand market instead. In this regard, the financial rand system has been removed and replaced by the commercial rand market. Consequently, South Africa struggled to borrow due to the overseas borrowing limits.²⁰⁸

As a main point, in order for South Africa to enjoy economic growth, it is vital to gain foreign capital for purposes of this growth, which would only be attainable should exchange control be removed. Without this capital, the economic growth would remain stable or low, however noteworthy growth may not be possible.²⁰⁹

In order to successfully register a business in South Africa, there are strict formalities which a foreign company is required to follow.²¹⁰ This the removal of exchange control measures may be acceptable here, as other procedures are in place to oversee foreign companies in South Africa.

The Central Banks in general argue to maintain exchange control regulations in order to continue to monitor and control the remittance of foreign currencies to offshore jurisdictions, in order to protect the currency. This protection is achieved through preventing any form of abuse and maintaining the fair value of the offshore payments. The Central Banks in Africa have specifically stated that their worth has been proved during the global financial crisis is able to maintain protection of the local currencies. It is also thought that exchange control

²⁰⁶ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141.

²⁰⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

²⁰⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 162.

²⁰⁹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

²¹⁰ Timothy, L., n.d., 'Foreign companies establishing a branch or subsidiary in South Africa'.

negatively affects the running of businesses. Businesses in actual fact assists the economy in growing, however exchange control measures are preventing the related growth.²¹¹

The liberalisation of exchange control in a South African context appeared to be successful and has achieved what it was set out to achieve. Specified industries liberalised exchange control measures over a period of time. For example, exchange control regulations were subsequently removed for South African non-residents. While, the further liberalisation of exchange control on residents continue to be considered, with the intention of potential eradicating all measures in future. Another consideration that lies in the benefits to liberalisation is that the release of funds offshore may also be gradual. Especially considering the fact that restrictions of capital flow has been in place for numerous year (in other words large sums of capital have accumulated and marked to be released/repatriated) that the sudden abolishment could have major adverse effects. Accordingly, this liberalisation is the prudent approach as opposed to a sudden shock to the economic environment, specifically relating to exchange rates and increased interest rates. As a whole this would be summed up as economic disruption and corruption, as we have witnessed with Venezuela. A sudden abolishment may in fact totally defeat purpose of removing exchange control and subsequently actually require even tighter monetary policies or restrictions.²¹² A general point, financial sector development is will likely improve if exchange control measures are liberalised²¹³.

Another observation of a reward that will arise from abolishing exchange control is the increased use of technology and electronic communication, which will also result in increased competition²¹⁴. South Africa will make use of electronic platforms in order to access and observe the financial markets. This will allow for greater integration internationally²¹⁵. The free flow of capital will be viewed as favourable in the eyes of investors as they may exercise their freedom of removing their funds as and when they desire to²¹⁶. It would become challenging to maintain exchange control regulations whilst the integration of electronic trading via e-commerce, financial transactions through which e-payments are made and actual monetary transactions resulting in the exchange of e-money.

²¹¹ Harding, C., 2010, 'African exchange controls – almost everywhere you go'.

²¹² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 155.

²¹³ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.149.

²¹⁴ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141 - 142.

²¹⁵ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 155.

²¹⁶ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141 - 142.

Consequently, exchange control will unlikely achieve what it has been designed to achieve, especially since all offshore transactions may not be traceable by the SARB or Authorised Dealers.²¹⁷

Under the circumstance that international support is provided while South Africa is removing exchange control, this would be beneficial where an international body such as IMF were to provide South Africa with financial support, particularly to achieve balance-of-payments. Furthermore, it is vital that South Africa is on board in the acceptance of assistance from a body such as IMF. With this assistance comes credibility for South Africa and is also viewed as favourable to foreign investors (in other words investor confidence is achieved). Provided that these mechanisms are put in place and foreign investors are convinced that exchange control will not be re-implemented, the liberalisation and final abolishment of exchange control in South Africa may be achieved.²¹⁸

The privatisation of state assets was a method implemented to achieve improved government finances and the restructuring of the same finances. This privatisation allowed for the inflow of foreign capital into South Africa, therefore allowing for the liberalisation of exchange control from this aspect. This assisted in foreign inflows on a small scale. In order for greater benefit to be achieved, the de-nationalisation of entities such as Telkom, Eskom and Transnet would further assist in liberalising exchange control regulations. Telkom previously became slightly privatised. The associated investment has lower risk, which resulted in large inflows of cash. Accordingly, this caught the attention of foreign investors, as a result of the returns.²¹⁹

In the instance that the abolishment of exchange control gave rise to increased interest rates and decreased exchange rate, there would likely be a low level of capital flight from South Africa to offshore jurisdictions, as the South African residents may not have the means and funds to invest offshore. As a result, it may have given rise to increased inward investment into South Africa and the return of previous capital back to South Africa. There is however an opposing view that should be considered, in which case the liberalisation of exchange control may have not created investor confidence as these investors could have had the

²¹⁷ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 155.

²¹⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 154.

²¹⁹ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 153 - 154.

expectation that the exchange control regulations will further be liberalised, at which time they would only invest into South Africa. This delay of inflow of funds into South Africa would have also been caused by the perception that the rand will weaken when the funds are brought into South Africa. The exchange rate risk still existed and did not give investors comfort.²²⁰ In other views, it is considered that exchange control results in an untrue reflection of the exchange rate and economic pricing.²²¹

Exchange control has generally given rise to major administrative burdens for the SARB and Authorised Dealers. Accordingly, the removal of exchange control will be extremely beneficial in the running of the bank's daily activities as the removal of the cumbersome process of exchange control will be removed. The liberalisation of exchange control has resulted in less of an administrative burden and has shown improvement. For example, the administrative burden decreased in line with the removal of some exchange control measures, as the applications submitted to the exchange control department decreased by approximately 48%.²²²

The removal of exchange control would have provided South African residents with the ability to attain offshore capital at a premium currency rate, similarly to the UK-based dollar premium market. This would have been a good assessment of the quantum of funds that would likely be leaving South Africa. Despite the fact there is a shortage of foreign funds in South Africa and related investments, this may be a blessing in disguise as this would have brought about numerous administrative burdens.²²³ This administrative burden poses administrative costs on the public sector therefore it is considered to be an inefficient mechanism due to time it takes to resolve the administrative matters²²⁴.

In the instance that shares are acquired by non-residents in a South African company, the corresponding share certificate must be accompanied by a non-resident endorsement. From an exchange control perspective, the endorsement will enable the free remittance of dividends from the South African resident company to its non-resident shareholder, and will allow the non-resident shareholder to freely repatriate the proceeds received from the sale of the shares

²²⁰ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 154 - 155.

²²¹ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141.

²²² SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 150.

²²³ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 169.

²²⁴ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141.

in the South African resident company.²²⁵ This adds to the administrative burden associated with the exchange control regulations, as the certificate and endorsement would need to be established.

A further means of effectively liberalising exchange control was to allow South African financial institutions to invest offshore, therefore offshore transfers will still be monitored, limited to the financial institutions, as opposed to allowing individuals to repatriate which could go untraced. This was an effective mechanism of improved liquidity in the South African equity or stock market through increased foreign investment into South Africa.²²⁶

The long-standing thought is that the richer countries are prone to lower returns on investments, while countries with capital scarcity will receive higher returns on its investments. Therefore, richer countries would commonly invest in countries with capital scarcity. This would assist the development of the SADC members, its economic environment and consequently the standard of living for residents. A free-tradable capital market also assists in the development of the local financial markets. Once the local financial sector is strengthened and efficient then it is strengthened to allocate capital on a global scale. Again, this increases local investment and a stable consumption.²²⁷

5.4 Summary remarks

Based on the above discussion, it is apparent that the abolishment of exchange control in South Africa has both risk and rewards. Both of which are essential to consider and hold a strong case for and against exchange control regulations. Therefore, the question arises as to whether the costs outweigh the benefits of abolishing exchange control regulations in South Africa, or vice versa. This may not be a conclusion which can be accurately drawn, as in the authors view, both risks and rewards attached to abolishing exchange control regulations in South Africa are prevalent in today's time.

Highlights from a risk perspective is the reduction in the power of government, decreased tax base, increased outflow of funds but decreased inflow of funds, the weakened financial rand,

²²⁵ Timothy, L., n.d., 'Foreign companies establishing a branch or subsidiary in South Africa'.

²²⁶ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 166.

²²⁷ Ellyne, M., and Chater, R., 'A new index for measuring SADC exchange control restrictiveness', p.141 - 142.

increased competition that South Africa may not be able to keep up with, exposure to international fluctuations, consequently reducing South Africa's credibility, weaker exchange rate and increasing interest rates.

Highlights from a reward perspective is the increased foreign investment into South Africa, increased investor confidence, increased innovation in South Africa, increased production and/or consumption, increased global financial integration, decreased borrowing and lending costs and as a result South Africa will become a competitive economy.

Accordingly, the abolishment of exchange control regulations will expose South Africa to adverse effects, which explains the SARB and related parties concerns around abolishing exchange control regulations. This concern is further substantiated by the adverse effects Venezuela was exposed to. According, the re-implementation or new exchange control mechanisms may not work in practice.²²⁸ This may result in decreased investor confidence, increased corruption, the use of a 'black market' and a decrease in the quality of lifestyle as the access to basic foodstuff and medical supplies become limited. This would defeat the purpose of the initial abolishment of exchange control regulations.

An aspect to point out is the administrative burden associated with exchange control regulations. This would have affected the financial markets, potentially resulting in illegal transactions as people try to prevent the process of attaining exchange control approval. Based on the analysis above, Authorised Dealers are required to consider applications in detail (which includes reviewing numerous supporting documents), obtaining records and subsequently providing approval. This is a lengthy process for Authorised Dealers. In addition, the collation of these documents is cost-intensive and time-intensive for individuals and/or companies applying for exchange control approval.

The abolishment of exchange control regulations in South Africa is a controversial matter. Specifically, there is a lot of controversy surround the risks and rewards of the removal of exchange control regulations. In view of this, despite the somewhat equivalent rewards associated with the abolishment, it is beneficial to retain the regulations until such time that there is more clarity. The risks associated with the abolishment of exchange control

²²⁸ SARB, 2011, 'South African Reserve Bank monetary policy in the decade 1989 to 1999', p. 169.

regulations in South Africa are high and South Africa may not be able to recover from the related backlash.

CHAPTER 6: CONCLUSION

6.1 Introduction

This research report explores the essence of exchange control, its liberalisation and relevance in South Africa. The view that exchange control regulations are outdated has been considered by understanding the liberalisation of the regulations since it first came into effect, and the potential risks and rewards of retracting the regulations. Further, in conjunction with a reflection on the research report, this chapter includes recommendations on the timing, process and mitigation of adverse effects if exchange control regulations are abolished in South Africa.

6.2 Overall summary remarks and conclusion

Exchange control proves to still be relevant as it plays a pivotal role in South Africa. Exchange control has a considerable impact on the tax sphere in South Africa, which is clear from the influential case law that arose which has set precedence on the treatment of capital, the exit levy and the collection of tax by SARS. The joint tax and exchange control amnesty was a step taken that was hugely beneficial to both the SARS' tax collection and the SARB's collection of data, as unknown funds were declared. A risk associated with the abolishment of exchange control regulations is the decrease in the South African tax base, as the SARS may not be able to trace funds which are being illegally transferred under its radar. Exchange control regulations ensure that individuals and/or companies are tax compliant by requesting a Tax Clearance Certificate as part of the exchange control approval process.

The liberalisation of exchange control regulations has been largely achieved through the segregation of duties, by the FSD to the Authorised Dealers. Liberalisation is a prudent approach to exchange control, in order to prevent any adverse effects from maintaining outdated regulations and the sudden removal of the regulations in totality. The scope of movement of exchange control in South Africa appears to be on par with Mozambique and Iceland. All countries have taken the path most suited to its economic environment. Accordingly, South Africa has been doing well on the liberalisation point and should

maintain this in order to reap the rewards associated with limited exchange control regulations in South Africa

The short-comings that arose from the abolishment of exchange control regulations in Venezuela are clear and unfavourable. This is not an ideal situation and creates doubts surrounding the abolishment of exchange control regulations, therefore South Africa should prevent its sudden abolishment.

This alludes to the fact that South Africa may in fact be on the right path in maintaining the essence of what exchange control has been set out to achieve, however the liberalisation of the regulations allows for its evolvement such that it changes with the changing economic environment. There are numerous rewards associated with the abolishment of exchange control regulations in South Africa, however the associated risks are high and detrimental to the South African economy. The author submits that the exchange control regulations should not be abolished, however it should continue to be liberalised. This timing and process has been a gradual one and has proved to be successful, without adverse effects.

As evident from the report above, the exchange control process is a cumbersome process. Therefore, it is important to ease the administrative processes for all parties to the process. An efficient and effective mechanism should be established, such as establishing a real-time database, which will be less time and cost-intensive.

At the outset, exchange control regulations were implemented to reduce tax evasion, money laundering, the collection of data and to attain balance of payments. Therefore, these prime areas of concern associated with repealing the exchange control regulations can be mitigated by placing confidence in mechanisms which primarily focus on each of these aspects. The TAA covers tax evasion, therefore SARS can place more focus on this in the absence of exchange control regulations to ensure that the tax base is not affected. While, the financial intelligence units can be utilised for purposes or resolving money laundering. The real-time collection can be strengthened through technology advancements. In addition, the risks can largely be mitigated by approaching the IMF for assistance, this financial support will assist the balance of payments and reflect world-wide investor confidence due to the association with the IMF. Accordingly, the association with the IMF will provide South Africa with credibility, the flow of funds will consequently be somewhat equivalent, therefore the

government will maintain its power. This will assist in stable economic conditions in South Africa, which will promote foreign investor confidence which will in turn promote future economic development and growth.

A recommendation for further research is focused on cryptocurrencies/crypto assets and the related impact of the circumvention of exchange control, specifically establishing a way for these to work hand-in-hand and preventing any undetected illicit flows of money.

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APPENDICES

Appendix 'A'

Table showing the cost and benefits of capital account liberalisation

| Costs | Benefits |
|---|--|
| <ul style="list-style-type: none">● Increases vulnerability to crises Can lead to asset bubbles and misallocation of resources● Reduces freedom to use monetary policies● Causes pressure on currencies to appreciate or depreciate, which has implications for exchange rate competitiveness | <ul style="list-style-type: none">● Increases flows for finance investment and consumption shocks● Improves global allocation of resources and facilitates diversification of risk● Deepens domestic capital markets and generates a more efficient allocation of resources● Improved technology and spill-over effects● Encourages Investment● Mechanism to discipline domestic policies |

Appendix 'B'

Table showing the cost and benefits of current account liberalisation

| Costs | Benefits |
|---|---|
| <ul style="list-style-type: none">● Local industries exposed to international competitors● Less control over exchange rate● May allow indirect capital flight● Less influence over domestic base of foreign reserves | <ul style="list-style-type: none">● Lower cost of goods to consumers● Potential for increased trade with removal of import restrictions● Reduces exchange rate distortions and facilitates competitive pricing● Positive signal of a country's commitment to good policies and economic governance |

Appendix 'C'

Graph showing the emerging market countries that are better positioned to manage risks associated with foreign capital flow

