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Exchange control relaxations for Intellectual Property transactions

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INTRODUCTION

In the recent 2017 Budget Review, the National Treasury proposed the relaxation of the exchange control restrictions surrounding certain Intellectual Property ("**IP**") transactions as follows:

"Government proposes that companies and individuals no longer need the Reserve Bank's approval for standard intellectual property transactions. It is also proposed that the "loop structure" restriction for all intellectual property transactions be lifted, provided they are at arm's length and at a fair market price. Loop structure restrictions prohibit residents from holding any South African asset indirectly through a non-resident entity."

To give effect to the above proposals, the Financial Surveillance Department of the South African Reserve Bank ("**FinSurv**") released Exchange Control Circulars No 7 of 2017 and No 8 of 2017.

SALE, TRANSFER, ASSIGNMENT AND LICENSING OF IP

South African residents are currently prevented from selling, transferring or assigning IP to a non-resident without first having obtained prior approval from FinSurv. Circular No 7 of 2017 is aimed at providing relief from this rule to the following extent:

*"Authorised Dealers may, however approve the outright **sale, transfer** and **assignment** of intellectual property by South African residents, excluding mandated state-owned companies as defined in Schedule 2 of the Public Finance Management Act, 1999 (Act No. 1 of 1999), to **unrelated** non-resident parties at an **arm's length and a fair and market related price**, provided that Authorised Dealers view the sale, transfer or assignment agreement and the provision of an auditor's letter or intellectual property valuation certificate confirming the basis for calculating the sale price. The above-mentioned dispensation excludes sale and lease back agreements."* (Emphasis added)

This circular requires all inward funds emanating from such transactions to be repatriated to South Africa within a period of 30 days from the date of the recipient becoming entitled thereto.

This represents a significant policy shift by Treasury and FinSurv, as previously it was not easy to obtain approval to export IP.

The same circular proceeds to provide for relief in relation to the licensing of IP to non-residents, irrespective of whether or not such non-residents are related to the resident, in the following manner:

*"Authorised Dealers may approve the licensing of intellectual property by South African residents to non-resident parties at an **arm's length and a fair and market related price** for the term of the agreement, provided Authorised Dealers view the licence agreement and an auditor's letter confirming the basis for calculating the royalty or licence fee."* (Emphasis added)

The circular also requires that all royalties and/or fees emanating from such transactions must be repatriated to South Africa within a period of 30 days from the date of the licensor becoming entitled thereto.

PERMISSIBLE LOOP STRUCTURES FOR UNLISTED TECHNOLOGY, MEDIA, TELECOMMUNICATIONS, EXPLORATION AND OTHER RESEARCH, AND DEVELOPMENT COMPANIES

Unlisted technology, media, telecommunications, exploration and other research and development companies are currently allowed, with prior FinSurv approval, to obtain a primary listing offshore in order to raise foreign capital and loans for their operations. FinSurv approval in this regard will, however be subject to the following conditions:

- The company must register with FinSurv;
- The company must be incorporated in and have its place of effective management (as the term is contemplated for tax purposes) in South Africa;
- The company's IP must remain registered in South Africa and may be assigned offshore subject to appropriate tax treatment;
- The offshore listed entity must obtain a secondary listing in South Africa within two years after obtaining its primary listing offshore, with a report on the status of its primary listing having to be submitted to FinSurv; and
- An annual report on the operations and offshore funds raised must be submitted to the FinSurv.

Circular No 8 of 2017 expands on the above dispensation by allowing such unlisted companies to establish offshore companies without the need to obtain a primary listing offshore. In this regard, Circular No 8 of 2017 states that:

"(ii) Authorised Dealers are advised that unlisted South African technology, media, telecommunications, exploration and other research and development companies may establish an offshore company to raise foreign funding for their operations, subject to the following conditions:

(a) registration with the Financial Surveillance Department;

(b) the established offshore company must be a tax resident in South Africa;

(c) full details of the percentage shareholding in the offshore company including the group structure must be provided; and

(d) an annual report must be submitted to the Financial Surveillance Department on the operations, including details of funds raised offshore."

Notably, the circular explicitly allows such offshore companies to create so-called "loop transactions" by holding investments in and making loans into South Africa, irrespective of any of the prohibitions on the creation of loop structures.

CONCLUSION

The above changes are welcomed, as they remove some of the red tape associated with international IP transactions. It should however, be noted that there are still various nuances and administrative requirements that must be adhered to in order prevent a breach of the exchange control rules. In this regard, it is advised that you contact your tax and exchange control advisor when dealing with international IP transactions.



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