



## Permission at a Price: The Loop Paradox and Navigating Technical Traps of Post-Relaxation Structures

### I. Introduction

Within the evolving architecture of South Africa's financial regulations, the "loop structure" has transitioned from a forbidden relic of an isolationist past to a sophisticated, albeit fiscally hazardous, instrument of modern international finance. On 1 January 2021, the South African cross-border investment landscape underwent a fundamental paradigm shift. According to the South African Reserve Bank (SARB), the regulatory body formally dismantled decades-old prohibitions that had restricted residents from holding domestic assets through offshore structures. This move is part of the broader modernization of the exchange control regime and seeks *inter alia* to position South Africa as the pre-eminent investment hub for Africa.

However, this regulatory relaxation created a punitive dichotomy. While the Financial Surveillance Department (FinSurv) of the SARB signalled a new era of conditional permission, the National Treasury and the South African Revenue Service (SARS) concurrently fortified the tax ramparts. In terms of the overall fiscal policy, the exchange control relaxation was not accompanied by a corresponding easing of the tax burden; instead, it served as the catalyst for the introduction of specific anti-avoidance measures designed to prevent the erosion of the domestic tax base. This has birthed the "Loop Paradox" - a structure compliant with exchange control regulations yet potentially profoundly tax inefficient.

In this article, we aim to dismantle this paradox on a high level by highlighting the specific tax anti-avoidance traps in Section 9D and paragraph 64B of the Eighth Schedule. In so doing we seek to equip investors and practitioners with the foresight to distinguish between structures that are merely legally possible and those that are commercially viable.

### II. The Foundation: Defining the Mechanics and Relevant Terminology

A robust understanding of the current regime requires a grasp of both the mechanics of a loop structure and the relevant statutory definitions.

#### 1. The Mechanics

A loop structure represents a circular flow of capital where a South African resident – be it a natural person, corporate entity, or private equity fund – externalises capital to establish or acquire an interest in a non-resident vehicle. This offshore entity then reinvests those funds back into the Common Monetary Area (CMA) by acquiring South African assets. In terms of the Currency and Exchanges Manual for Authorised Dealers (the Manual), these assets typically manifest as equity shares in a domestic operating company, commercial immovable property, or the extension of loan funding to South African residents. The "loop" is completed when value is accumulated offshore from assets located physically within South Africa.

#### 2. Foundational Definitions

For the purposes of this discussion, the following definitions are paramount:

- **Controlled Foreign Company (CFC):** According to Section 9D(1) of the Income Tax Act (the Act), any foreign company where more than 50 per cent of the total participation rights are directly or indirectly held, or more than 50 per cent of the voting rights are directly or indirectly exercisable, by one or more persons who are residents.
- **Participation Rights:** In terms of Section 9D(1), the right to participate in all or part of the benefits of the rights (other than voting rights) attaching to a share, such as dividends or capital distributions.

- **Common Monetary Area (CMA):** According to SARB regulations, the area comprising South Africa, Namibia, Lesotho, and eSwatini.
- **Authorised Foreign Assets:** In terms of the Manual, funds held offshore by residents that were externalised through permissible channels, such as the Single Discretionary Allowance (SDA) or Foreign Capital Allowance (FCA).
- **Foreign Business Establishment (FBE):** Per Section 9D(1), a FBE is essentially a fixed place of business located outside South Africa used for carrying on the business of a CFC for not less than one year, suitably staffed and equipped to conduct its primary operations.

Phase of the Loop	Traditional Mechanism	Regulatory Concerns include
Outward Leg	Externalisation via SDA or FCA	Indirect export of capital rights.  Base erosion and profit shifting (BEPS).
The Accumulator	Offshore Holding Company/Trust	
Inward Leg	Acquisition of SA OpCo shares/Loans	

### III. Historical Overview: The 40% Administrative Safe Harbour

Historically, Regulation 10(1)(c) of the Exchange Control Regulations, 1961, stood as an absolute bar to loop structures, viewing them as a mechanism for capital flight. Despite this, a limited administrative practice emerged. According to SARB policy, an informal "40% threshold" was historically applied. If South African residents collectively held less than 40% of the equity or voting rights in a foreign company that held CMA assets, the structure was generally not classified as a prohibited loop. While this specific marker was superseded on 1 January 2021, any legacy structure created before 2021 that exceeded this threshold without specific authorization is still considered unauthorised and must be regularised with FinSurv.

### IV. The Watershed: Exchange Control Circular No. 1/2021

Effective 1 January 2021, Exchange Control Circular No. 1/2021 (the Circular) implemented the decision to lift the full loop structure restriction to encourage inward investments into South Africa. This dispensation applies to residents holding "authorised foreign assets".

#### 1. Eligible Parties

In terms of the Circular, the relaxation applies specifically to resident individuals, South African companies, and private equity funds.

### 2. Mandatory Reporting and the 30-Day Endorsement Rule

The new regime replaced prior approval with a stringent post-transaction reporting requirement. In terms of the Manual, residents must provide the Authorised Dealer with the legal identity of foreign investors and a description of the CMA assets acquired. A failure to adhere to these obligations renders the structure unauthorised. Furthermore, an important mechanical requirement is the "Non-Resident" endorsement of share certificates. Failure to have shares endorsed by an Authorised Dealer within 30 days of acquisition is a breach of regulations and non-endorsement prevents *inter alia* the legal distribution of future dividends offshore.

### V. Technical Analysis

#### 1. The Accrual-Based Imputation of CFC Net Income

The primary instrument of tax stringency here is Section 9D of the Act, which governs CFCs. For a detailed analysis of the complexities involved in determining CFC status and attribution, refer to our October 2025 tax flash: [The Participation Puzzle: A Guide to Calculating CFC Rights under Section 9D](#)

The core mechanism is the potential annual imputation of the CFC's "net income" to its South African shareholders. This net income is calculated in terms of the provisions of the Act and as if the CFC were a South African resident. In essence, the resident shareholder may be taxed even if the CFC does not distribute a dividend.

## 2. The Character Trap: Loss of "Look-Through" Nature for Individuals

With effect from 1 January 2021, the "look-through" rule for capital gains in proviso (f) to section 9D(2A) was specifically removed for natural persons and special trusts. This effectively ensures that capital gains imputed from a CFC in a loop do not retain their capital nature in the hands of the individual shareholder. In other words, the capital gain is included at the 80% corporate inclusion rate in the net income of the CFC and then imputed to the individual, resulting in a maximum effective tax rate of 36% (80% x 45%), rather than the lower effective Capital Gains Tax (CGT) rate of 18%.

## 3. Dividend exemption denied in loop structures

Section 10(1)(k)(i) exempts dividends received by a shareholder from a South African company from normal tax, provided none of the provisos to the section apply. Ordinarily, this exemption should apply to a CFC receiving dividends from a resident subsidiary when calculating the CFC's "net income" under Section 9D(2A). However, proviso (d) to Section 9D(2A) restricts this exemption, employing a formula designed to ensure that the total effective South African tax - comprising Dividends Tax withheld at source and the tax on the imputed net income - equals 20% of the gross dividend.

In the context of a loop structure, this ensures the dividend is effectively taxed at 20%. For a South African corporate shareholder, this results in significant tax inefficiency; whereas a direct dividend between resident companies is entirely exempt, the loop interposition triggers a 20% tax cost.

Furthermore, while the inclusion ratio in the formula (20/27) is calibrated to achieve a 20% effective rate for corporates ( $20/27 * 27\% = 20\%$ ), the ITA fails to differentiate for individuals. For a natural person in the 45% bracket, the imputed amount is taxed at their top marginal rate, resulting in a maximum total effective tax rate of approximately 33.33%. This is substantially higher than the 20% statutory Dividends Tax rate for direct investments, confirming that loop structures can lead to punitive outcomes for both corporate and individual shareholders.

## 4. Section 9H Exit Trap

Further tax inefficiencies manifest should a foreign company cease to constitute a CFC or should a South African resident company cease to be a resident. According to Section 9H of the Act, a deemed disposal of assets at market value occurs upon such events, amongst other potential consequences. To the extent that the market value of the assets exceeds the base cost thereof, an exit charge would arise, which frustrates efforts to 'de-loop' such structures in a tax efficient manner.

## 5. Foreign capital gain exemption denied in loop structures

Paragraph 64B(1) of the Eighth Schedule provides for a foreign capital gain participation exemption regime to encourage South African tax residents to make meaningful investments in foreign companies. However, paragraph 64B(6) provides that the foreign capital gain participation exemption must not apply in respect of any capital gain or loss determined in respect of the disposal of any share in a CFC to the extent that the value of the assets of that CFC is attributable to assets directly or indirectly located, issued or registered in South Africa. It follows that, where a loop is present, the South African tax resident will be taxed on any capital gain realised upon the disposal of its shares in the CFC, to the extent that the CFC's value is derived from South African assets.

## 6. Secondary Technical Traps

- **Section 8G (CTC Step-Up):** Should a loop structure involve two or more South African companies below the CFC-level, Section 8G could apply to prevent the artificial inflation of "Contributed Tax Capital" in the structure. See our August 2025 Tax flash: [Collateral Damage: Navigating the Punitive Reach of Section 8G Beyond its Anti-Avoidance Mandate](#)
- **Section 10B(4) and Deductible Payments:** In terms of Section 10B(4), the foreign dividend participation exemption is denied if the dividend arises from an amount that was deductible from the income of any person.
- **Section 31 Transfer Pricing:** In terms of Section 31 of the Act, any funding within the loop must be on an arm's length basis. Excessive interest on "thinly capitalized" loans may be disallowed and re-characterized as a "deemed dividend *in specie*", triggering additional Dividends Tax.

## VI. Strategic Use Cases: When do Loop Structures still make sense?

Despite technical traps, loop structures remain strategically relevant in at least four primary scenarios:

### 1. Multinational Group Architecture:

For companies with a strong international presence, a foreign Holding Company (HoldCo) can own the shares in a South African Operating Company (OpCo) alongside investments in other foreign OpCos, streamlining treasury management and capital allocation across jurisdictions.

### 2. Accessing International Equity Markets:

Major corporates use loop components to facilitate listings on global exchanges to access deeper capital pools and create a global "acquisition currency" for international M&A.

### 3. Strategic IP Holdings:

Strategically, jurisdictions with no local exchange control restrictions could be suitable for Intellectual Property (IP) holding purposes.

### 4. Global Asset Consolidation:

Wealthy individuals may use loop structures to consolidate their global wealth, including South African assets, under a single offshore vehicle for various commercial reasons, including administrative simplicity, succession planning etc.

## VII. Regulatory Context: South Africa's exit from the FATF Grey List

A significant regulatory milestone was reached on 24 October 2025 when South Africa was formally removed from the FATF's "grey list" of jurisdictions under increased monitoring. This follows the successful implementation of 22 action items addressing systemic AML/CFT weaknesses. While this strengthens the credibility of the financial system, SARS has indicated that it will continue to utilize data-driven insights and sophisticated technology to counter illicit financial flows.

### VIII. Conclusion: No free lunch

The freedoms granted by the SARB are certainly not a "free lunch." In terms of the overall fiscal framework, a loop structure should rarely be implemented for tax efficiency. It should only be utilized where there is a compelling, non-tax commercial driver. It should furthermore be borne in mind that every loop structure is a sure candidate for a SARS audit. While the SARB may now say "yes" to these structures, SARS continues to reply with a very expensive "at a price."

### Disclaimer

The above information is intended to provide general guidance with respect to the subject matter. This general guidance should not be relied on as a basis for undertaking any transaction or business decision, but rather the advice of a qualified tax consultant should be obtained based on a taxpayer's individual circumstances. Although our articles are carefully reviewed, we accept no responsibility in the event of any inaccuracy or omission. For further information please refer to the author.

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