Foreign exchange rules OK?

For many years, foreign exchange was not a consideration in most transfers of intellectual property from a South African owner to a foreigner. Intellectual property (like trade marks and patents) was simply transferred in the ordinary course of events, the only factor being compliance with the relevant recordal obligations at, for example, the relevant registers of trade marks and patents in terms of the relevant intellectual property legislation.

The 2004 case of Couve v Reddot International threw the cat amongst the pigeons, with the court in that case holding that intellectual property constituted capital and therefore fell within the net of regulation 10(1)(c) of the Currency and Exchanges Act. This regulation required that, effectively, all transfers of capital (including intellectual property, according to the Reddot case) to foreigners from South Africans are subject to prior approval by the relevant foreign exchange authorities or else the transfer would be void. This had generally not been done for many years.

Many worries were laid to rest following the 2011 case of Oilwell v Protec International Limited, where the Supreme Court of Appeal held that intellectual property was not capital for the purposes of the (by then notorious) regulation 10(1)(c) and were not subject to foreign exchange requirements. Effectively, this case ratified the traditional approach taken, namely not thinking foreign exchange requirements were applicable when a South African assigned intellectual property to a foreigner. In turn many intellectual property assignments were in safe waters again, and affected intellectual property owners heaved a collective sigh of relief. At least to the extent that they may have been aware of the perils they had been facing.

This period did however attract the attention of influential persons determined to ensure that intellectual property did in fact fall within the ambit of these foreign exchange requirements (particularly regulation 10(1)(c)) and on 8 June 2012, the definitions to the regulations were amended specifically to include intellectual property in the definition of capital. Curiously, only intellectual property was included by this amendment and not other asset classes. Intellectual property has been widely defined and covers a wide variety of transactions, including “a transfer of any intellectual property right”, to the full extent of whatever that may encompass. Intellectual property enjoys the dubious distinction of gaining prominence for exchange control purposes.

What this means is that any transfer of any intellectual property from a South African to a foreigner now falls directly within the ambit of regulation 10(1)(c) and needs prior approval from the foreign exchange authorities to be a valid transfer. Generally this will be given if the South African can show that fair value has been paid for the intellectual property and various tax and transfer pricing issues have been tested. It does however present a hurdle that must be overcome before the transfer is effective.

It is not only transfers of intellectual property that are affected by South Africa's foreign exchange regime. Payments of royalties to a foreigner are also subject to various restrictions (in terms of regulation 3(1)(c)). Doubtless many potential franchisees or master franchisors have discovered this when getting their franchise agreements vetted by an experienced intellectual property lawyer. The foreign exchange authorities have for some time had a set of guidelines, the DTP001 guidelines, which lay down what is acceptable. While these guidelines are not legally binding, in practice they are very persuasive and are generally followed unless there is good cause for them not to be. They may contain some surprises for the uninitiated. For example, upfront payments are disallowed. Royalty rates above six percent are probably not going to be allowed. Minimum payments or annual payments are, as a rule, not acceptable. And so on. Potential licensees need to be very aware of these requirements and should be getting appropriate advice.

The South African government has stated that it has a policy of relaxing exchange controls, but the above developments regarding transfers of intellectual property seem rather to be a tightening of the net. Furthermore, there is no sign that there is likely to be any relaxing of the royalty payment restrictions. Perhaps due to the above story involving transfers of intellectual property, all foreign transactions involving intellectual property are being carefully monitored and scrutinised. The old approach of using a basic deed of assignment to transfer intellectual property is no longer effective with cross border transactions. It would be very prudent to ensure that proper advice is sought whenever contemplating any transaction involving a South African, a foreigner and intellectual property.

Bruce Lister

2013