



INVESTMENT FUNDS

If SA wants to foster private equity, it must craft clear, consistent rules for preference shares – and then stick to them.

17 September 2025 6 min read

by Shayne Krige, Director and Head of Investment Funds

First published on CityWire South Africa

South Africa is grappling with a persistent budget shortfall, and National Treasury is under pressure to raise revenue wherever it can. A proposal made on 16 August to reclassify preference share dividends as income was withdrawn on 3 September, but not before it rattled investors and unsettled deal-making. The draft signalled a defensive mindset in government, seeking short-term revenue at the expense of long-term capital formation – precisely when the economy most needs private risk capital.

While the withdrawal was welcomed by private-equity professionals, the damage was done. The mere publication of the proposal – and its subsequent retreat – has eroded confidence and underlined a central weakness in South Africa's investment case: a lack of certainty.

A fragile compact

Lenders and investors perform fundamentally different roles. Lenders provide capital in return for a fixed yield and the promise of repayment. They want their money back, with interest, and as little exposure to uncertainty as possible. Investors, particularly in venture capital and private equity, commit funds without that certainty. They take a residual claim on profits, absorbing both the upside and the downside. Economies require both types of capital to grow.

Tax systems typically mirror this divide. Interest payments on loans are treated as a cost of doing business and deducted before tax, while dividends represent a discretionary share of profits that can only be distributed after tax. The treatment of equity returns is often softened – or exempted – to encourage investment and avoid double taxation.

Preference shares sit uncomfortably between these two poles. They resemble equity in legal form but carry debt-like features such as redemption rights and priority over distributions. Tax authorities across the world have developed tests to determine whether such instruments are genuine risk-bearing capital or simply loans in disguise.

The US applies a 'substance over form' doctrine, asking whether risk has genuinely shifted. The UK uses 'disguised interest' rules to stop abuse while still recognising preference shares as equity if they retain a genuine equity component. Across the European Union, preference shares are generally treated as equity unless they overwhelmingly replicate debt.

What makes South Africa distinct is not the need to police the boundary, but the manner in which rules shift midstream. For professional investors, identifiable risks such as crime, politics or even load-shedding can be modelled and priced. What kills investment is uncertainty – sudden reversals in tax policy, discretionary approvals, or vague drafting that leaves too much to interpretation. These dynamics impose what dealmakers describe as a 'policy-volatility premium'. They push up hurdle rates, complicate cashflow models, and ultimately reduce appetite for deployment.

The recent proposals highlight the choice confronting the National Treasury. A country with a growth agenda sets clear rules, interprets them consistently and keeps channels open for different forms of capital. A country with a defensive agenda writes vague rules that collapse everything into debt, closing loopholes but also closing wallets.

Private equity's language

Preference shares are not a tax dodge. They are the central structuring tool of private equity worldwide. Apple, Google, Uber and Airbnb were all built on successive rounds of preferred stock. In South Africa too, preference shares are the language through which investors negotiate their position between lenders and founders.

By hard-wiring priorities into the capital stack – liquidation preferences, dividend rights, redemption triggers and consent matters – preference shares give early-stage investors confidence that their risk will be rewarded before common equity participates. This makes them indispensable in growth finance.

National Treasury's 2025 Draft Taxation Laws Amendment bill sought to rewrite section 8E of the tax code, replacing the current three-year redemption test with an International Financial Reporting Standards (IFRS)-based approach. Because modern redeemable preference shares are generally classified as liabilities under IFRS, most instruments would have been swept into debt treatment. Dividends would have been taxed as income in the hands of investors, without any offsetting deduction for the issuing company.

For private equity funds, the implications were severe: higher required returns, re-engineered waterfall models, and contractual gross-up clauses that strip cash from growth. The withdrawal of this element of the bill has spared the industry from immediate disruption, but not from lingering unease.

Not all the proposals have been abandoned. Section 8EA, dealing with 'switch-off' guarantees, remains on the table. This would impose a permanent taint: once a guarantee or enforcement right has existed on an instrument, dividends could be reclassified as taxable income forever. National Treasury is also considering tweaks to exchange-control rules that could see certain cross-border preference shares treated as foreign-currency items, dragging them into complex revaluation regimes.

The common thread is a move towards rigidity. Instead of recognising the nuanced role preference shares play in risk-sharing, the reforms risked collapsing the category into a binary test: IFRS equals debt. That oversimplification would have raised hurdle rates for South African private equity at precisely the wrong moment.

Where next?

The episode has left private equity sponsors and corporate CFOs with pressing questions. Existing preference share structures will need to be mapped against IFRS liability tests, past guarantees reviewed and covenant models stress-tested for dividend recharacterisation. Even without section 8E, the spectre of section 8EA means any historic support could contaminate instruments indefinitely.

Yet the bigger issue is not technical but philosophical. In growth finance, stability and clarity are not luxuries – they are prerequisites. The now-withdrawn proposal showed how quickly confidence can unravel when rules change abruptly. Emerging markets compete fiercely for global capital, and even small frictions tip the balance towards Kenya, Nigeria or India.

For South Africa, the cost of this policy volatility will be measured in smaller equity tickets, higher hurdles and tighter covenants. Managers seeking growth capital will find investors less patient and less willing to price long-term upside. That is the opposite of what the government should be encouraging if its priority is jobs and growth.

The withdrawal of the proposal is a step back from the brink, but the warning remains. If South Africa wants to foster private equity, it must craft clear, consistent rules for preference shares – and then stick to them.



Shayne Krige

Head of Investment Funds

[View Profile](#)