TR 7

Facts

An offshore company proposes to issue non-voting redeemable fixed rate preference shares to a group entity and intends to account for the transaction as a short term loan rather than equity and accordingly treat dividends payable as interest under the Financial Reporting Standard 5 (FRS 5).

Point at issue

Whether the tax treatment should follow the accounting treatment i.e a transaction should be based upon its economic substance where it differs from its legal form.

Ruling

The preference shares cannot be considered as a short term loan for tax purposes. The terms and conditions on which the preference shares will be issued may entitle them to be reclassified as a short term loan according to accounting standard. However, for tax purposes, any distribution will be treated as dividends and not as interest.