

Investing in Offshore Funds

This factsheet is intended for investors interested in learning about offshore funds in IMA sectors.

WHAT IS AN OFFSHORE FUND?

An offshore fund is a fund domiciled outside the UK.

All the offshore funds in IMA sectors are domiciled in the European Union. The funds must be authorised in their home country and comply with European product legislation, which is called UCITS.

WHY INVEST IN AN OFFSHORE FUND?

Investing offshore may offer you a wider choice of funds and the opportunity to further diversify your investment portfolios. It is important to be aware, however, that an investment in an offshore fund may be:

- Subject to a different investor protection regime than UK funds; this could affect how you make a complaint or seek compensation if things go wrong.
- Taxed differently to investments in UK funds.

DO I NEED INVESTMENT ADVICE?

You have three options:

1. Use a UK financial adviser. You should check that with the FSA the adviser is authorised to sell offshore funds.
2. Use an offshore financial adviser. You should check with the FSA that the adviser is properly authorised by the country's regulatory authority.
3. Buy without taking advice. Either direct from a fund management firm or through the internet.

Note: Buying without advice is commonly referred to as 'execution only.' If you chose this option you are entirely responsible for the investments you make.

KNOW YOUR TAX POSITION

Offshore funds in IMA sectors must have either Distributor status or Reporting Fund status. The Distributor status regime will end by 31 May 2012.

Distributor status

Investors with units in offshore funds that have Distributor status are taxed in the same way as they would be for units in UK funds.

Distributor status is gained retrospectively by the offshore fund manager and requires the fund to distribute annually to investors a minimum of 85% of its profit. If Distributor status is maintained by the fund, then you simply enter the income you have received from the fund on your annual tax return, as you would for any other income received. You will then be taxed at your marginal income tax rate.

When you sell units in the fund you must enter the sale on your tax return and if there is a gain it will be treated as a capital gain but you may not have to pay capital gains tax if the total annual gain from all your investments is £10,600 or less.

Reporting Fund status

Reporting Fund status is gained prospectively by the offshore fund manager and requires the funds to report annually to investors 100% of its profit. The fund may choose to also actually pay out all or some of the income, usually in the form of a dividend. Therefore, an offshore Reporting Fund has three options as to how to deal with the annual income it makes for its investors. It can:

- Pay out all of the income, which is usually distributed by making regular cash payments, probably in the form of a dividend.
- Pay out none of the income in the fund and simply inform (report to) each investor how much they have earned from their investment.
- Pay out part of the income. For example, 60% may be paid in cash and the remaining 40% could be reported to you and reinvested in the fund.

YEARLY TAX LIABILITY

You should establish which method the fund has chosen before you decide to make an investment and ensure it is appropriate for you. Whichever method the fund chooses, the fund management company must tell you how much income your investment has earned in the tax year. You will need this information in order to pay the correct amount of tax.

It is important to be aware that, in all three cases, you will be required to pay tax on the total income earned (i.e. any cash distributions plus any reported income). This means that you may have income tax to pay, even if the fund does not make any cash payments to you.

SELLING YOUR OFFSHORE FUND HOLDING

When you sell your offshore fund holding, whether it has Distributor status or Reporting Fund status you may be required to pay capital gains tax (CGT).

You will not owe CGT if the total annual gain from all your investments (in UK and offshore funds) is £10,600 or less.

- Gains over £10,600 that arise before 22 June 2010 are taxed at 18%.
- Gains over £10,600 that arise on or after 22 June 2010 are taxed at 18% for basic rate tax payers or 28% for higher rate and additional rate tax payers.
- If the proceeds from the sale of all your investments are greater than £42,400 you will have to report them to HMRC even if no tax is due.

All taxable gains must be reported to HM Revenue and Customs (HMRC).

If the offshore fund does not distribute (pay out) all its relevant income to you, but reports it to you instead, there will be one significant difference from selling UK funds. When you sell your fund holding part of the value will be attributable to income on which you have already paid income tax, and part will reflect capital growth. You should ensure that only the part which relates to capital growth is assessed for CGT.

The table below illustrates how this would work:

Proceeds from sales of funds	£1,000
Less: cost of original investment in fund	(£500)
Less: reported income which has not been paid in cash over life of holding	(£200)
Total taxable gain	£300

It is up to you as the investor to check this. Otherwise, you could inadvertently be taxed twice, once under income tax rules, when you report the income annually to HMRC, and again when you dispose of the investment under CGT.

YOU CAN'T AVOID PAYING TAX

For investors, there is little or no tax benefit from choosing to invest in an offshore reporting fund compared to investing in a UK fund. Equally, there is no tax disadvantage. You will still be required to pay tax on money earned from the investment, just as you would if you were investing in a UK-based fund.

WHAT IF I NEED TO MAKE A COMPLAINT?¹

If you are making a complaint about an offshore fund purchased via a UK adviser you need to follow two steps:

1 – Contact the firm or person with whom you have a complaint directly. You MUST always do this as a first step. The company is obliged to respond within 8 weeks of receiving your complaint.

2 - Contact the Financial Ombudsman Service (FOS) if you are unable to reach a satisfactory resolution. This must be done within 6 months of receiving a response from the firm or person you have the grievance with. The Ombudsman is impartial.

If you wish to complain about a fund manager or fund outside the UK you will need to contact the ombudsman in the country where the adviser is based.²

If you have invested without the help of an adviser, you will have access to the complaints procedure of the country in which the fund is domiciled; but your complaint or claim is likely to be limited to any misrepresentations in fund literature, or negligence in handling your investment.

WHAT HAPPENS IF THE UK ADVISER GOES BANKRUPT?

If either the adviser or the fund manager is based in the UK and the Financial Services Compensation Scheme (FSCS) agree you have a valid claim you may be covered by the FSCS, should the firm be unable to pay or goes bankrupt.

The maximum contribution you can receive for investments is £50,000.

If you purchased the fund without a UK adviser and think you may be eligible for compensation, you will have to contact the compensation scheme set up in the country where the fund is domiciled or where your offshore adviser is based. It is unlikely you will be able to make a claim under the FSCS. Although each European Union country has a compensation scheme, it may not be directly equivalent to the UK scheme.

¹ Help is available from the following organisations if you require guidance or clarification on your position before taking matters further. Financial Ombudsman Service, Consumer Helpline – 0300 123 9213. The FSA also has a consumer helpline number – 0845 606 1234.

² Every member country of the European Union and also the European Economic Area (Iceland, Norway and Liechtenstein) is required by EU law to give investors access to a local ombudsman. Within Europe this is called FIN-NET (Financial Dispute Resolution Network). It lists the equivalents of the Financial Ombudsman available in each EU and EEA country.



HELPFUL HINT

Before purchasing offshore funds you may wish to check:

- That the financial adviser or fund management company is authorised by the appropriate regulatory body.
- That the financial adviser or fund management company has permission to sell their services or products to UK investors.
- That the offshore fund itself has been approved for sale to UK-based investors.

Further information

This factsheet is produced by the Investment Management Association, which also publishes a number of other guides and factsheets on investing. These are available free of charge from:

Investment Fact Line

Tel: 0207 831 0898

Web: <http://www.investmentuk.org/investor-centre>

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