

Investing in Offshore Funds

This factsheet is intended for investors who invest in offshore funds admitted to IMA sectors.

WHAT IS AN OFFSHORE FUND?

Offshore funds are usually associated with tax havens like Monaco and the Cayman Islands, but, in fact, the term refers to funds domiciled outside the UK.

However, in this fact sheet **we look only at what may affect investors who have invested in offshore funds admitted to IMA sectors**, which is a small proportion of all the offshore funds available. It aims to help you understand the differences between investing in offshore funds and UK funds populating IMA sectors.

All the offshore funds in IMA sectors are domiciled in the European Union. The funds must be authorised in their home country and must comply with the same European product legislation, which is called UCITS. UK authorised funds, by contrast, will comply either with UCITS rules or with other rules set by the FSA (FSA are the Financial Services Authority, the UK regulator).

WHY INVEST IN AN OFFSHORE FUND?

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

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

WHAT ARE THE IMA SECTORS?

The IMA sectors offer a way of navigating around the large number of funds available for purchase in the UK. The sectors help to identify funds with similar characteristics so that investors can make comparisons between these funds, including performance comparisons. There are over 30 sectors. The IMA develops the definition for each sector and checks to make sure that funds comply with the definition. For example, the UK All Companies sector requires funds to hold a minimum of 80% in UK equities. Funds that do not hold at least that minimum cannot enter the sector.

PROTECTING YOUR INVESTMENT, MAKING A COMPLAINT AND COMPENSATION SCHEMES

Steps to take and who to contact if a problem arises with your offshore fund investment.

CHOOSE AN ADVISER OR A FUND CAREFULLY

You will probably need to consult a professional financial adviser to help you choose a fund. If you are more confident and know what you want, you might choose your own funds without taking advice.

Whichever route you choose, it is important to be aware that the country in which the adviser or fund is located may affect how you can make a complaint and claim compensation if a problem has occurred.

Using an adviser regulated by the FSA

You can use a FSA regulated financial adviser (they are likely to be UK based) when investing in an offshore fund. But first, it is important to check that your adviser is *authorised* to advise on and sell such funds. This will ensure that you remain protected if something goes wrong at a later date.

It also means that you have access to the UK Financial Ombudsman Service (FOS) if you have an unresolved complaint. The FOS can require an FSA regulated firm to compensate you for your loss.

Also if a regulated firm goes out of business the UK's Financial Services Compensation Scheme may step in and provide compensation (see below).

Using an adviser regulated in another European country

If something goes wrong or you are unhappy with any aspect of the advice you receive, you will have access only to the complaints and compensation procedure of the country where the adviser carries out their business. This is the case whether you buy an offshore or UK fund through the adviser.

As with the UK, it is important that you check whether the offshore-based financial adviser has obtained permission from the local regulator to conduct their business. For example, if you have used a local Spanish adviser to invest in a fund, you should make sure the adviser is properly authorised and regulated by the relevant authority in Spain (that is, the equivalent to authorisation in the UK by the Financial Services Authority).

Buying a fund without taking advice

You can buy funds without taking advice, either direct from a fund management firm or perhaps through an internet-based non-advisory sales channel. If something goes wrong or you are unhappy with the product, you will have access to the complaints and compensation procedure of the country in which the fund manager or sales service is based. However, buying a fund without taking advice means that any complaint or claim is likely to be limited to any misrepresentations in fund literature, or negligence in handling your investment.

CAN I MAKE A COMPLAINT?

If you have suffered financial loss and think it is because of bad advice, or perhaps misrepresentation or negligence on the part of the adviser or fund management company, then you can make a complaint and make a claim for your losses. Whether your complaint is upheld may depend on what services you had from the adviser or the fund management company and what information you gave them about yourself. It may also depend on what product information you were given and its accuracy.

I'm still not sure if my complaint is valid

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's Money Made Clear Guide 'Just the facts about making a complaint'** has a useful section, 'Do You Have A Complaint', with examples of common types of complaints. This is not comprehensive list however. The FSA also has a consumer helpline number – 0845 606 1234.

Making a complaint in the UK

You may be able to complain in the UK, for example if you have bought an offshore fund through a UK financial adviser and wish to complain about the advice you received. In summary, this is what you should do:

Step 1 – Contact directly the firm or person with whom you have a complaint

You must always try this method first. Spell out clearly that you are making a complaint and what it is about.

Within 8 weeks of receiving your complaint, the organisation or person must send you either a final response explaining their position or a written response if they have yet to make a final decision.

Step 2 – Contact the Financial Ombudsman Service (FOS)

If you are unable to reach a satisfactory resolution with the financial organisation or person against whom you have a complaint, you can then take the matter to the Financial Ombudsman.

You must take your complaint to the Ombudsman within 6 months of receiving a response from the business you have the grievance with. The Ombudsman will not take sides, but will look at the problem impartially.

UK Financial Services Compensation Scheme

You should only contact the Financial Services Compensation Scheme (FSCS) if the business or person you are making a claim against is unable to pay you compensation. This could be because the business is no longer operating or it has become bankrupt. The FSCS may be able to compensate you instead.

Certain limits apply to the level of compensation you will receive. The maximum you can receive is £50,000.

Making a complaint in another European country

Most countries have schemes equivalent to the UK's Financial Ombudsman. Local ombudsmen should follow up your complaint if it is not satisfactorily dealt with by the adviser or the fund management company which sold the offshore fund to you. However, the rules for handling complaints may differ from country to country. You should consider this before you invest in an offshore fund either directly or based on the advice of a non-UK financial adviser.

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.

Compensation schemes in other countries

If your advisor or the fund is located outside the UK and you think you are eligible for compensation, you will have to contact the scheme set up in their country. It is unlikely you will be able to make a claim under the UK compensation scheme (FSCS). Although each European Union country has a compensation scheme, it may not be directly equivalent to the UK scheme.

You can always choose to take legal advice and make a claim through the courts as with any other claim for poor service.

Helpful Hint

For peace of mind that you are getting the best possible level of protection from your offshore fund, always make sure that:

- Your financial adviser or fund management company is properly authorised and regulated to conduct their business by the appropriate local regulator (for example, the FSA in the UK).
- The financial adviser or fund management company has permission to sell their services or products to UK investors.
- The offshore fund itself has been approved for sale to UK-based investors.

If the above do not apply, you may not be able to make a complaint or seek compensation if things go wrong at a later date.

KNOW YOUR TAX POSITION

Summary of key points about tax differences between offshore and UK funds

Offshore funds in IMA sectors must have either Distributor status or Reporting Fund status. New legislation in 2009 will bring an end to the Distributor regime by 31 May 2012. In the meantime, funds may have either status.

Distributor status

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

Distributor status is gained retrospectively by the offshore fund manager and requires the fund to distribute annually a minimum of 85% of its UK attributed profit in cash to investors. 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 taxed as a capital gain.

Reporting Fund status

An offshore Reporting Fund has three options as to how to deal with the annual income it makes for its investors. It can *either*:

- Pay each investor their full or partial share of the income earned. The income is usually distributed by making regular cash payments to you, probably in the form of a dividend.
or
- Reinvest all the income in the fund and simply inform (report to) each investor how much they have earned from their investment. You won't receive regular cash payments from the fund. If you are familiar with accumulation shares issued by UK funds, this is a similar treatment.
or
- Do a combination of the above two options. For example, 60% of the annual distribution may be paid in cash and the remaining 40% could be reported to you and reinvested in the fund.

You should establish which method the fund has chosen before you decide to make an investment and ensure it meets with your personal circumstances. 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.

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It is important to be aware that you will be required to pay tax from the total income earned (the cash distribution plus the reported income) even if the fund does not make annual cash payments to you.

Selling your offshore fund holding

When you sell your offshore fund holding, whether it has either Distributor status or Reporting Fund status you may be required to pay capital gains tax (CGT), as is the case for selling units in UK funds

You will not owe CGT if the total annual gain from all your investments (including your offshore reporting fund) is £10,100 or less. Any gains over £10,100 are taxed at 18% and must be reported to HM Revenue and Customs (HMRC). Furthermore, if the proceeds from all your investments are greater than £40,400 you will have to report them to HMRC too (even if no tax is due).

There may be one significant difference that can occur when you sell a holding in an offshore Reporting Fund, as compared to many UK funds. This is when the offshore fund does not distribute (pay out) all its relevant income to you, but reports it to you instead. When you come to sell your fund holding, part of the value in it will be attributable to income on which you have already paid income tax, and part will reflect capital growth. You should therefore ensure that you are assessed for CGT *only* on that part of the holding which relates to capital growth, as you would for holdings of accumulation shares in a UK fund. 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

Otherwise, you could inadvertently be taxed twice, once under income tax rules when you reported 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.

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: 020 7269 4639

Web: www.investmentuk.org/about/form.asp

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