Smith & Williamson

Unit trusts and OEICs

A summary of the key features and benefits

Unit trusts and OEICs can offer a flexible investment vehicle which high-net-worth individuals and their families may wish to consider when making investment choices.

An authorised open-ended investment company (OEIC) or an authorised unit trust (AUT) could be a useful approach for wealthier families today.

An OEIC is a regulated investment structure typically used by fund managers for collective investments. There are a number of common features between an OEIC and unit trust, however an OEIC is governed by company law and is single priced, whereas a unit trust is governed by trust law and has a bid/offer spread for units. OEICs are subject to additional regulations designed to protect investors; this includes limits on the types and proportions of different investments that may be held.

We refer to OEICs, although both AUTs and OEICs are included within this description.

Structure

An OEIC can act as a core investment vehicle for wealthy individuals and their families. Typically, investors can hold shares in an OEIC which meets their key investment aims, actively managed alongside it to ensure that each person's specific investment objectives are met. The unique ability of an OEIC to pool like-minded investors' funds can mean that investment management costs are spread and reporting requirements simplified.

The fund

An OEIC can either be standalone or an umbrella fund and can appoint its own investment manager or managers. An investor's share in an OEIC can be bought or sold by the OEIC, thus providing liquidity and flexibility to investors.

Tax considerations

For a UK resident and domiciled investor, gains on shares in a UK OEIC are only taxable when the shares are sold and in-built profits are taxable as gains, unlike some structures where the profit/gain may be taxed as income. Under current UK tax rules, the top rates of tax are 20% for CGT, 45% for Income Tax and 38.1% for dividend income in excess of the annual dividend tax allowance that reduced to £2,000 in 2018/19. The 10% notional tax credit on dividend income has been abolished. From 6 April 2017 interest payments from an OEIC are no longer subject to the deduction of 20% tax at source.

Within the OEIC, UK dividends are not subject to corporation tax, the net income is available for distribution and underlying securities can be bought and sold without tax implications. This means that investors benefit from the management of their assets without triggering a charge to CGT thus enabling gross reinvestment.

Non-UK OEICs will have a different treatment for tax to UK authorised OEICs.

A UK OEIC is not treated as a UK situs asset for inheritance tax purposes, for those who are not domiciled or deemed domiciled in the UK, thereby providing them with an IHT exemption.

OEICs can have tax disadvantages for people from the US.

Administration

In the UK, an OEIC is operated by an authorised corporate director (ACD). The ACD appoints one or more investment managers. Importantly, an investment manager can be removed and another appointed without having to close the structure, appoint a new ACD or create a tax liability. Investors in OEICs can have more than one manager, each looking after separate sub-funds, or even separate portfolios within a single fund.

Fees

Fees vary depending on the provider but can typically have an annual management charge (AMC) of 1.25% per annum for funds of less than £10m and 1% for funds above £10m. This management fee may not attract VAT. Ongoing charge figures are typically slightly higher than the AMC to reflect some further operational costs and VAT. It is usual for OEICs to be launched for sums of at least £10m.

The costs of running the funds, including managing the portfolio, can generally be met from the gross income generated by the investments however capital can be utilised where income levels are lower. This compares with an individual investing in his/her own right, who will suffer income tax on dividends, with only the net amount left to meet investment fees.

There may be other investment costs borne by the fund, for example brokerage, custody fees and transaction charges.

Reporting

There is a regulatory requirement for financial information to be prepared, in accordance with the Statement of Recommended Practice, and made available to shareholders on an annual basis. The investment advisers' report forms part of the annual accounts and provides the shareholder with a comprehensive disclosure regarding investment activities, investment strategy and outlook. The reporting is therefore typically more detailed than investment portfolios held directly. The investment objectives and risk tolerance are included in the prospectus and can be amended if there is a change in circumstances, although this may require approval by the Financial Conduct Authority.

Further information

OEIC funds and Unit trusts can offer a wide range of advantages to wealthy individuals and their families. However, they are not suitable for everyone and the tax treatment of any investor will depend on individual circumstances and may be subject to future changes. It is important therefore to take appropriate advice before proceeding.

Any investment involves risk. The value of investments can go down as well as up and an investor may not receive back the original amount invested.

If you would like further information or to discuss the suitability of such funds, please speak to your usual Smith & Williamson contact or to one of the contacts listed below. If advice is required, they will be able to refer you to an appropriate person within the Smith & Williamson group.

Allan Seldon
Business Development Director,
Smith & Williamson Fund Administration

t: 020 7131 8839
e: allan.seldon@smithandwilliamson.com

Robin Callander
Senior Client Relationship Manager,
Smith & Williamson Fund Administration

t: 0141 222 5034
e: robin.callander@smithandwilliamson.com

Jenny Conniff
Senior Client Relationship Manager,
Smith & Williamson Fund Administration

t: 020 7131 8032
e: jenny.conniff@smithandwilliamson.com