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How FundsNetwork™ pays income to investors

This document is for Investment Professionals only, and should not be relied upon by private investors.

Certain classes of shares within funds are designed to pay an income. They are known as “income share classes” and give clients the choice of having income paid out or reinvested back into the fund to buy more shares. This distinguishes them from “accumulation share classes”, which do not generally pay an income and instead retain any dividends or interest they receive, which increases their share price.

This guide looks at the ways FundsNetwork handles the income paid by mutual funds, and how we distribute it to our investors.

Receiving income

Clients can choose to have income reinvested or paid out for each fund they hold – the default is reinvestment but this is easy to change. For example, they could have most of their portfolio set to reinvest income, but specify that particular funds should pay out (as long as the money is invested in an income share class).

In most cases, income will be reinvested into the fund it came from. However, there are a few exceptions.

- If a client with an ISA:
 - completely switches from one fund to another, any income due to be reinvested will be put into the new holding
 - switches from one fund to several, the income will be put into the new holdings in the proportions of the switch
 - redeems a holding, any income waiting to be reinvested will be put into the last fund that has had any dealings
 - sells all the holdings they have with us, we will pay out any remaining income
- If a client with an investment outside an ISA switches out of a fund, or redeems it, any income due to be reinvested will be paid out.

THE INCOME CYCLE

Each fund has an accounting period, such as a month, quarter or a year. This defines how regularly it will make distributions to income investors. The income cycle has four key dates.

- The **accounting date** is the final day of the accounting period. Any investment held in the fund is eligible for the distribution, including any new investments that are awaiting registration (though the distribution from these elements will only be paid or reinvested when the deal is registered). Any holdings that are sold on or before the accounting date are not eligible to receive income
- The **x-dividend date** is when the dividend is declared. It is the first day of the next accounting period. Shares purchased on or after this date will not be eligible for the previous distribution
- The **reinvestment date** is when additional shares are purchased with income that is being reinvested
- The **pay date** is when distributions are paid to clients

There are usually about two or three weeks between the accounting date and the reinvestment or paying out of a distribution.

Income from investments outside the ISA wrapper

An income from our UK-based products can be paid into a UK bank account. Income from Fidelity's offshore SICAV range can be paid into a bank account in any country, in the client's currency of choice, as long as the payment is at least \$50 – any sums below this amount will automatically be reinvested. All currency transactions will be made around five days before payment.

If income is being reinvested, the date when shares are purchased depends on the type of fund.

- Most Fidelity funds reinvest income on the x-dividend date
- The Fidelity Cash Unit Trust reinvests income on the last working day of the month
- All other funds reinvest income about five days before the pay date

The one exception is if a client sells a UK-based investment before the reinvestment deal is placed. In this situation, they will receive an income payment instead.

Income from ISAs

ISAs tend to generate smaller amounts of income, so we consolidate the payments from all income-paying funds and send them out as a single sum each month.

This payment is sent on or around the 15th of the following month and includes all the income that has been generated during the period. Please note that some funds pay income less frequently than others, so clients may notice that their income payments vary. If a client chooses to reinvest income, shares will always be bought on the pay date. This is a regulatory requirement.

A question of tax

Some Fidelity funds have gross share classes, which mean that income is paid without being taxed. These funds are only available to eligible clients, such as ISA investors and Pension Trustees.

In addition, the Fidelity offshore SICAV range of funds and some offshore funds from other companies on FundsNetwork pay gross income. Please contact FundsNetwork on 0800 99 55 11 for more details. Most income distributions on UK-based funds are subject to tax. What a client pays will depend on whether a fund generates its income from interest or dividend payments.

- Interest-based products (which have over 60% of their portfolio in fixed income, such as bonds) are taxed at 20%. In some circumstances this can be reclaimed
- Dividend-based products, which focus their investment on shares, have a tax credit of 10% applied. We used to be able to reclaim this credit for investments inside an ISA, but this is no longer possible

Reclaiming tax on interest

It is possible to reclaim the tax paid on interest-based funds inside an ISA. FundsNetwork reclaims this money for investors on the sixth day of each month, and receives it from HM Revenue & Customs (HMRC) approximately six weeks later. The reclaimed interest is either sent out to investors on the next ISA monthly income pay date, or reinvested back into the fund on the 17th of the month for ISAs. FundsNetwork will deduct any reclaimed tax that has been added to a client's account in error. For example, we may have to do this when we are informed that a client has died, as their ISA holding is no longer entitled to these tax benefits.

A fair approach

If a client invests part-way through a distribution cycle, it is important to make sure they are not unfairly taxed. We do this by applying a process called "equalisation", which splits holdings into shares that have been held for the whole distribution cycle (group 1) and shares that were purchased part-way through the period (group 2). An equalisation rate only applies to group 2 shares and it adjusts the amount of income tax payable or reclaimable (if applicable) by the UK taxpayer on their first distribution.

When a client is re-registering funds to FundsNetwork, we ask their current investment companies for details of whether funds are group 1 or 2. If this information is not provided, all funds will default to group 2. This is because if we defaulted to group 1, we might over-claim from HMRC.

Please note that defaulting to group 2 may mean that HMRC retains more tax than should be paid on the client's funds – reducing the reclaim value. Fidelity simply cannot claim this extra amount until the re-registration is complete. If you think funds may have been classified incorrectly during re-registration, please contact us.

RE-REGISTRATION AND INCOME

After re-registering ISAs, a client may notice some differences in the way income is administered, compared with the way their previous fund providers handled it. This could be because we consolidate payments before sending them out, but it might also be a result of the way we reclaim tax. Some companies send out distributions as if they were gross, so the reclaimed tax does not have to be paid separately. In comparison, we pay the tax, reclaim it later and send it out in a subsequent distribution. Therefore, the client may receive less than they expect during the initial income payments. Tax credit payments usually take up to six weeks to reclaim, after which the income should return to the expected rate.

If you would like any further details regarding income or any feature of FundsNetwork then please contact FundsNetwork on freephone **0800 99 55 11**.