MLC Masterkey Unit Trust

MLC-Vanguard Australian Share Index Fund

Important information about your distribution

Background

We advised you on 13 April 2018 that we had decided to opt into a new tax regime – the attribution managed investment trust (AMIT) regime – for all funds in the MLC MasterKey Unit Trust from the funds' 2017/2018 tax year. This included the MLC-Vanguard Australian Share Index Fund (the Fund).

Under the AMIT regime, we're required to 'attribute' the Fund's taxable income to investors on a 'fair and reasonable' basis. The attribution of the Fund's taxable income determines how investors are taxed. Ordinarily, the Fund will attribute taxable income to investors based on the distributions made to investors, in a similar way to how it allocated taxable income before the AMIT regime applied.

However, there may be occasions when the taxable income you're attributed is not based on distributions made to you. For example, in 'exceptional circumstances', such as when withdrawals of money, or 'redemptions' are exceptionally high, we may need to change our approach to attributing the Fund's taxable income. This is explained in more detail below.

How do redemptions impact your distribution?

The Fund's 2017/18 financial year is from 1 June 2017 to 31 May 2018. This year's final distribution was made on 31 May 2018.

The Fund was closed to new investors in 2005. As with many closed funds which permit redemptions but no longer accept applications, the Fund has had a net outflow of money. In the Fund's 2017/18 financial year, the level of redemptions was exceptionally high.

To fund the redemptions we've sold securities, which means the Fund has 'realised' net capital gains. The Fund distributes its net capital gains and other income each financial year.

Under the Fund's Constitution, we had to consider how to make a fair and reasonable attribution to investors of the capital gains and other income generated by redemptions in exceptional circumstances, such as when redemptions were exceptionally high.

The Constitution gives us the ability, in exceptional circumstances, to attribute the capital gains and income that result from selling securities to fund redemptions to the redeeming investors. This is what we've decided to do for the Fund's 2017/18 financial year.

This means investors who have redeemed in the 2017/18 financial year are treated reasonably and investors who haven't redeemed aren't taxed on the increased capital gains and other taxable income resulting from the redemption. This is a fair outcome for all investors.

How are capital gains on redemptions attributed under 'exceptional circumstances'?

The diagrams on the next page provide simple examples of how an investor in a fund may be impacted in two scenarios:

- Scenario 1: a 'normal' year when the level of redemptions isn't exceptionally high (so there aren't 'exceptional circumstances'), and
- Scenario 2: a year (like the Fund's 2017/18 financial year) where there are 'exceptional circumstances' due to an exceptionally high level of redemptions.

The diagrams show how the attribution of taxable income resulting from redemptions may be different in each scenario.

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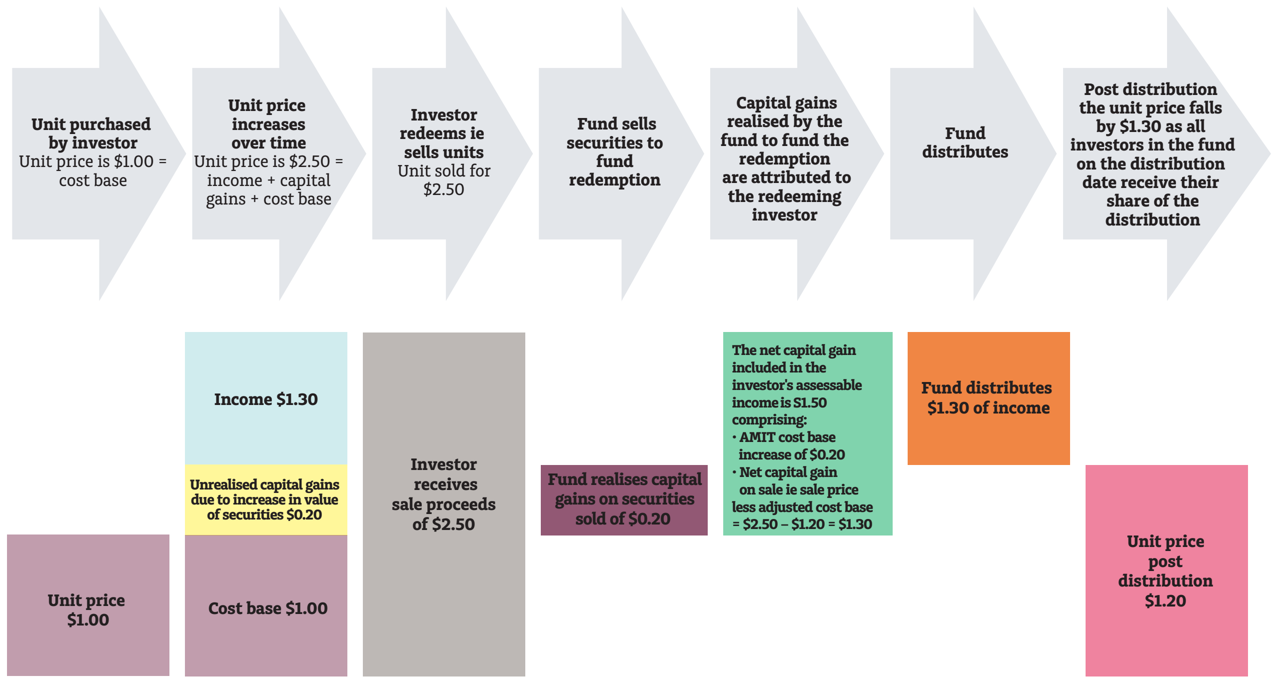
Scenario 1: redemption in a 'normal' year

When the investor in the example redeems their units, they make a capital gain on the disposal, or 'sale', of their units in the fund. This capital gain is included in their assessable income for the financial year.

If securities were sold to fund the redemption and a capital gain was realised, remaining investors in the fund will receive the realised capital gain as a distribution.

Therefore, the redeeming investor is taxed on the net capital gain from the redemption of their units and remaining investors are taxed on the net capital gain that is included in their distribution for that financial year. The taxable income is effectively taxed twice.

Scenario 2: redemption in a year of 'exceptional circumstances'



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In exceptional circumstances, we may decide to attribute taxable income (in the example, the net capital gains), from the securities sold to fund the redemptions to the investor that has redeemed their units.

Therefore, only the redeeming investor is taxed on the taxable income arising from their redemption.

In the example, the redeeming investor's total capital gains and redemption proceeds are the same in both scenarios. However, there are three differences:

- In a year where there are redemptions and exceptional circumstances, the redeeming investor's net capital gains (**green box**) comprises two amounts: the capital gain attributed to them and the capital gain on disposal of the units. The capital gain on the disposal of the investor's units in the fund is reduced by the capital gain attributed to them.
- The fund's distribution (**orange box**) is lower in the year where there are redemptions made and exceptional circumstances. This is because the capital gains are attributed to redeeming investors.
- The unit price for continuing investors (**pink box**) does not decrease as much in the year where there are redemptions made and exceptional circumstances. This is because the fund doesn't make a cash distribution to investors of the capital gains attributed to the redeeming investor.

To keep the example simple, we haven't shown:

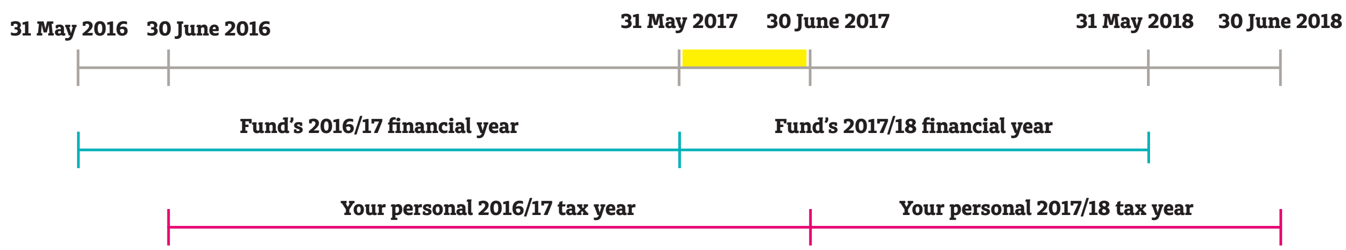
- capital gains resulting from the fund selling securities in the normal course of managing the fund. These capital gains would continue to be included in the fund's distribution (**orange box**) in both scenarios.
- other taxable income that may be attributed to the redeeming investor.
- a situation where either the securities sold or the redeemed units were held for more than 12 months, in which case the capital gains may be discounted.

In these cases, the impact of redeeming units may be different to that shown above.

If you redeem units during June in a year that the Fund has 'exceptional circumstances', you may need to amend your tax return

The Fund pays its final distribution to investors by 31 May each year. This is a month before an investor's personal tax year ends, on 30 June. This mismatch of year ends allows investors to manage and plan their investments during the month of June, before the end of their personal tax year.

If you redeem units in June and the redemption occurs in a year in which the Fund has exceptional circumstances, you may need to amend your tax return for that tax year. The timeline below illustrates the reason for this. It shows the start and end of the Fund's financial year and your personal tax year for 2016/2017 and 2017/2018.



The month of June 2017 (highlighted) is in both the Fund's 2017/18 financial year and your personal 2016/17 tax year.

As redemptions from the Fund were made in exceptional circumstances in the 2017/18 financial year, we have decided to attribute taxable income, such as capital gains, that arise from funding the redemptions. That means we'll also need to adjust the cost base of units for redemptions made from 1 June 2017 to 31 May 2018.

Unfortunately, this means the cost base used to calculate the gain or loss on the sale of units from redemptions made in June 2017 will need to be recalculated for your 2016/17 tax year.

As a result, if you redeemed in June 2017, we'll send you an amended MLC MasterKey Unit Trust Tax Statement for your 2016/17 tax year. It will show a different net capital gain or capital loss from the original tax statement you received from us. We encourage you to seek tax advice as you will need to amend your tax return for the 2016/17 financial year. We'll pay for any reasonable costs of resubmitting your tax return.

While this description deals with redemptions in June during the Fund's 2017/18 financial year, a redemption in June in any future year when the Fund is experiencing 'exceptional circumstances' may have similar implications.

What happens if the level of redemptions in a year is not 'exceptional circumstances'?

In this case, we intend to continue our current practice of attributing the taxable income (including any capital gains) to investors each financial year based on the distributions made to them.

Any questions?

Please speak with your financial adviser or call us on 132 652 between 8am and 6pm (AEST/AEDT), Monday to Friday.

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