MLC MasterKey Unit Trust

Important information about distributions when redemptions are made in 'exceptional circumstances'

Background

We advised you in May 2018 of our decision 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.

Under the AMIT regime, we're required to 'attribute' a 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. Most funds will attribute taxable income to investors based on the distributions made to investors, in a similar way to how they 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 a fund's taxable income. This is explained in more detail below.

How do redemptions impact distributions?

Funds can go through periods when redemptions increase, resulting in a net outflow of money. This often happens when a fund is closed to new investors. To fund the redemptions we need to sell securities, which may cause the fund to 'realise' capital gains or other income. The fund distributes its net capital gains and other income each financial year.

If redemptions are exceptionally high in a fund's financial year, the net capital gains could be substantial. Other income may also increase as a result of the redemptions.

Under the MLC MasterKey Unit Trust's Constitution, we need to consider how we 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 are 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.

If we do so, investors who have redeemed 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 and is a benefit of the AMIT regime.

We'll make our decision about the attribution of the capital gains and income at the end of a fund's financial year, when redemptions and capital gains are calculated. The financial year for the MLC MasterKey Unit Trust ends on 31 May.

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

The diagrams on the next page provide a simple example of how investors may be impacted both in a 'normal' year when there aren't redemptions made in exceptional circumstances, and in a year where there are redemptions made in exceptional circumstances. It shows how the attribution of taxable income resulting from redemptions may be different.

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Scenario 1: redemption in a 'normal' year

When an investor redeemed they would make a capital gain on the sale of their units in the fund. This capital gain would be 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 would receive the realised capital gain as a distribution.

Therefore, the redeeming investor would be taxed on the net capital gain from the redemption of their units and remaining investors would be 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'

In exceptional circumstances, the Trustee 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.

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 made in 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 in exceptional circumstances. This is because the capital gains are attributed to redeeming investors.
- The unit price for a continuing investor (**pink box**) does not decrease as much in the year where there are redemptions made in 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:

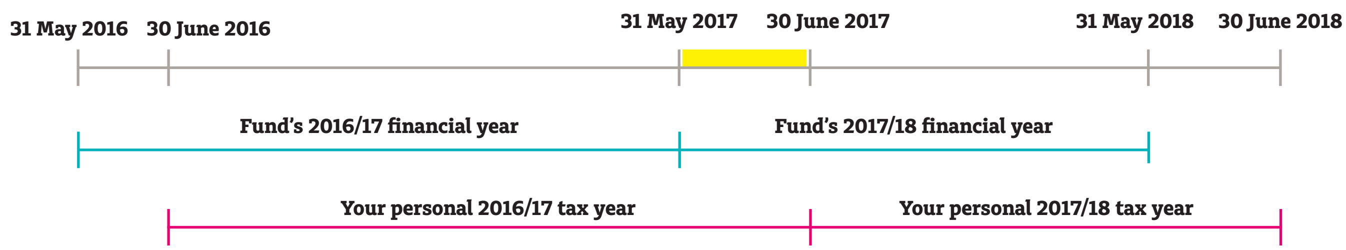
- capital gains resulting from the fund selling securities in the normal course of managing the fund. These capital gains would continue to be included in the fund's distribution (**orange box**) in both scenarios.
- other taxable income that may be attributed to the redeeming investor.
- a situation 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 on page 2.

If you redeem units during June in a year that a fund has 'exceptional circumstances', you may be required 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 investors redeem units in June and the redemption occurs in a year a fund has exceptional circumstances, redeeming investors may need to amend their tax returns 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.

If redemptions are made in exceptional circumstances in the 2017/18 financial year, we may decide to attribute taxable income, such as capital gains, that arise from funding the redemptions. That means we will also need to adjust the cost base of units for redemptions made from 1 June 2017 to 31 May 2018.

Unfortunately, this would mean the cost base used to calculate the gain or loss on the sale of units from redemptions made in June 2017 would need to be recalculated for an investor's 2016/17 tax year. This change would occur after your MLC MasterKey Unit Trust Tax Statement has been sent to you and the details won't be known until the attribution of income for the fund for the year ending 31 May 2018.

If this occurs, we will send investors who redeemed in June 2017 an amended MLC MasterKey Unit Trust Tax Statement for their 2016/17 tax year. It will show a different net capital gain or capital loss from our original advice. If this occurs, we encourage you to seek tax advice and consider amending your tax return for the 2016/17 financial year.

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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