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TAXATION

Investment Manager

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*This **Reference Guide** was issued on 30 April 2019 and forms part of the Product Disclosure (PDS) for Merchant Opportunities Fund dated 27 July 2017. This **Reference Guide** should be read in conjunction with the PDS and is not intended to be read as a document in its own right. The **Reference Guide** may be updated at any time. You can download the current PDS or **Reference Guide** from our website www.merchantfunds.com.au or by calling Merchant Funds Management on (08) 6277 0050.*

TAXATION

This section provides a broad summary of the Australian taxation consequences for Unitholders associated with the ownership of Units in the Fund. It does not constitute individual tax advice to Unitholders.

The Australian taxation consequences for Unitholders will depend upon several factors including:

- whether the Unitholders hold their Units on capital account or whether the units are actively traded or otherwise held on revenue account; and
- the tax residency of the Unitholder.

In particular, this overview does not consider the tax consequences to Unitholders who will hold their Units to trade actively or who otherwise hold their Units on revenue account.

Disclaimer

The comments contained in this summary are general in nature and the individual circumstances of each Unitholder may affect the taxation implications of the investment of that Unitholder.

The tax consequences outlined below are based on the relevant Australian taxation laws at the date of the PDS, all of which are subject to change. The tax consequences do not take into account or anticipate any changes in law (by legislation or judicial decision). If there is a change, including a change having retrospective effect, the tax consequences would have to be reconsidered in light of the changes.

In addition, this overview is not exhaustive of all income tax considerations that could apply in all circumstances of any given Unitholder. Special additional rules may apply to particular Unitholders, such as insurance companies, superannuation funds and financial institutions.

It is recommended that all Unitholders consult their own independent tax advisers regarding the income tax, capital gains tax and goods and services tax consequences of owning and disposing of Units, having regard to their particular circumstances.

Assumptions

This summary is based on the following assumptions:

- Unitholders will hold their interest in the Fund on capital account (i.e. Units are held as a passive investment with the intention of generating distribution income and long-term capital growth) and the Units are not actively traded or otherwise held on revenue account;
- it is the intention of the Responsible Entity to distribute all of the Fund's taxable income each year to Unitholders;
- Unitholders will be "presently entitled" to all of the taxable income derived by the Fund and will not be under any legal disability; and
- the Fund will invest in new investments in listed and unlisted securities. The securities will be acquired with the intention of generating distribution income and long-term capital growth.

Taxation of the Fund

Taxation status of the Fund

The Fund should be treated as a trust pursuant to provisions contained in the *Income Tax Assessment Act 1936* and the *Income Tax Assessment Act 1997 (the Tax Act)* based on the above assumptions.

Accordingly, the taxable income of the Fund should be subject to tax in the hands of Unitholders on a "flow through" basis and not the Responsible Entity. Amounts taxed in the hands of Unitholders will retain their character from the Fund. The tax treatment for Australian resident and non-resident Unitholders respectively is outlined below.

To assist Unitholders with the preparation of their income tax returns, the Fund will provide an annual distribution and taxation statement. This statement will generally be provided between July and October (subject to the availability of third party information) of each year and include information such as the different components of their distribution and tax withheld (if any).

Certain public unit trusts may be classified as a public trading trust and taxed as companies where they do not carry on an "eligible investment business". An eligible investment business includes investment in shares in a company, listed or unlisted, or units in a trust. Provided the Fund invests for these purposes and through investing in listed and unlisted securities, as outlined above, it will not be a public trading trust. The activities of the Fund will need to be monitored on an ongoing basis to ensure it continues to carry on an eligible investment business.

Trust losses

To the extent tax losses are incurred by the Fund, these losses remain in the Fund and cannot be distributed to Unitholders. Specific tests must be met for the Fund to utilise any prior year losses in later years.

Investments held by the Fund

Eligible managed investment trusts (MITs) may make an irrevocable election for certain assets of the trust to be dealt with under the capital gains tax provisions, even where gains or losses from the sale of these assets result from trading or would otherwise be on revenue account. Assets eligible for deemed capital account treatment under this election primarily include shares in a company, units in a unit trust, land, and a right or option to acquire any of these assets. The Fund has made this election for deemed capital account treatment. On this basis, gains and losses on the sale of eligible investments should be treated as capital gains or losses.

Controlled Foreign Company (CFC) provisions

The CFC rules apply to tax Australian shareholders on their share of a controlled foreign company's 'tainted income' as it is earned. If the CFC rules apply, assessable income of the Fund may include unrealised gains and undistributed income from overseas investments.

Attribution Managed Investment Trust (AMIT) Regime

In May 2016 legislation was passed for the new Attribution Managed Investment Trust (AMIT) tax regime. The AMIT regime applies from 1 July 2016, with early election permitted from 1 July 2015. The AMIT regime is optional and once the choice is made to enter the regime it is irrevocable. The AMIT regime is intended to reduce complexity and provide certainty on industry practices for calculating and allocating income to Unitholders.

The Fund has not made an election to apply the AMIT regime and the Responsible Entity is considering the impact these rules will have on the Fund and on Unitholders. The Responsible Entity will notify Unitholders if the decision is made to apply the AMIT regime. It is recommended that Unitholders consult their own independent tax advisers in relation to the potential impact of these changes on their tax position if the Fund chooses to apply the new rules.

Taxation of Australian Resident Unitholders

Taxation of distributions

Australian resident Unitholders will be liable for tax on their share of the taxable income of the Fund in the year in which the entitlement arises irrespective of whether the distribution is paid in cash, reinvested or otherwise dealt with on behalf of the Unitholder. This is so even if the distribution is not paid to the investor until after the end of the year to which it relates.

Individual Unitholders will generally be subject to Australian tax on distributions at their marginal tax rate plus the Medicare levy. Company and superannuation fund Unitholders will be subject to Australian tax on distributions at their respective tax rates.

Distribution of income

The Fund may derive distribution, dividend and interest income.

Dividend income derived in relation to Australian investments will be treated as assessable to Unitholders at their applicable tax rate. Distributions received by Unitholders will be grossed up to the extent the distribution comprises of franked dividends. A franking credit will be available to the Unitholder equal to the amount of the gross up.

Distribution of capital gains

The disposal of investments will result in either a capital gain or loss.

If the Fund makes a capital gain from the disposal of an investment that has been held for more than 12 months, the Fund should qualify for the general capital gains tax (CGT) discount in calculating its taxable income.

Any capital gain made by the Fund upon disposal of investments will be distributed to Unitholders and will be assessable in the Unitholder's hands. If the CGT discount is applicable to the capital gain derived by the Fund, the Unitholder will be required to gross up the distribution for the discount. This grossed up amount is then offset against any capital losses (prior or current year) to arrive at a net capital gain. The Unitholder may then apply the relevant CGT discount percentage to their net capital gain, depending on their circumstances.

Should the Fund realise an overall capital loss on the disposal of its investments in a particular year, this loss will remain in the Fund and will not be able to be distributed to Unitholders. Provided the relevant tests are satisfied any such loss can be offset against future capital gains derived by the Fund.

Distribution of tax deferred income

There may be situations where the cash distribution to Unitholders exceeds the taxable amount required to be included in their assessable income. This excess amount is known as "tax deferred" income. This excess is not included in the Unitholder's taxable income. However, this excess or "non-taxable amount" may give rise to a reduction in the cost base of the Unitholder's Units in the Fund for CGT purposes. A reduction will not, however, occur where the excess is due to the application of the general CGT discount.

If the cost base of a Unitholder's units has been reduced to nil as a result of previous tax deferred distributions, any subsequent distributions of tax deferred income will be taxable as capital gains.

Disposal of Units by Australian resident Unitholders

Where a Unitholder disposes of their Units in the Fund to a third party, they may realise a capital gain or capital loss for tax purposes.

The 50% CGT discount may be applied against an individual's or trust's net capital gain provided that the Unitholder has held their Units in the Fund for at least 12 months prior to disposal. Complying superannuation funds should be eligible for a one third discount where they have held their Units in the Fund for at least 12 months prior to disposal. As outlined above, the capital gain is required to be offset against any capital losses prior to applying the CGT discount.

In addition, where tax deferred income has been distributed to Unitholders, the cost base of the Units used in calculating the gain may be reduced by the amount of the tax deferred income.

If a Unitholder realises a capital loss on the disposal of their Units, they may use the capital loss to offset capital gains derived from other sources or it may be carried forward to offset capital gains in future years.

Taxation of non-resident Unitholders

As the Australian tax treatment for non-resident Unitholders is complex, it is recommended that non-resident Unitholders seek their own taxation advice in relation to their specific circumstances. A general summary of the position for non-residents is, however, set out below.

Taxation of distributions

Tax is required to be withheld by the Responsible Entity from certain distributions to non-resident Unitholders. The rules regarding the calculation of the amount of tax to be withheld are complex and depend on whether the Unitholder is an individual, company or trustee. Withholding rates for non-residents vary depending on the type of income distributed. The amount of tax to be withheld may also depend on whether the non-resident Unitholder has provided the Responsible Entity with a tax file number (TFN) or Australian business number (ABN).

The Responsible Entity is required to withhold the appropriate amount from the distributions paid to the non-resident Unitholder, and to remit the amount to the Australian Taxation Office.

Non-resident Unitholders may be entitled to claim a credit for the tax withheld by the Responsible Entity. This entitlement depends on the laws of the country in which the non-resident resides and any Double Tax Agreement between Australia and that country.

Disposal of Units by non-resident Unitholders

Non-resident Unitholders will generally not be subject to Australian tax on capital gains realised on the disposal of their Units in the Fund.

However, non-resident Unitholders may be subject to Australian tax on capital gains realised on the disposal of their Units in the Fund if they and their associates hold, or have the right to hold, 10% or more of the Units in the Fund at the time of the disposal or for a period throughout 12 months that began no earlier than 24 months of the time of the disposal, and the majority of the Fund's assets are attributable to taxable Australian real property.

It is not expected that the Fund will hold taxable Australian real property.

Other tax implications

Goods and services tax (GST)

The transactions undertaken by Unitholders, such as the purchase and sale of Units, are financial supplies and should not be subject to GST.

GST may apply to fees and costs incurred by the Fund. The Fund may be entitled to claim reduced input tax credits in respect of some of the fees and costs incurred.

Tax File Numbers (TFN) and Australian Business Numbers (ABN)

A Unitholder is not required to quote a TFN or ABN when applying for Units. However, if a TFN or ABN is not quoted, or no appropriate TFN exemption information is provided, tax is required to be withheld by the Responsible Entity from any income distribution entitlement at the highest marginal rate plus the Medicare levy (currently 49%). Under the Pay As You Go regime, Unitholders holding their Units as part of a business may quote their ABN instead of their TFN.

Level 1
441 Stirling Highway
Cottesloe WA 6011

P: 08 6277 0050