Annual Tax Return Guide 2018

For New Zealand ('NZ') Individual Investors

Vicinity Funds RE Ltd
ABN 33 084 098 180

1. Background

The purpose of this document is to provide a guide as to the potential NZ and Australian income taxation consequences for a NZ Investor who has invested in Retail Direct Property 11 and Retail Direct Property 11 Unit Trust (together, **RDP 11**).

The information contained in this guide relates only to NZ Investors who:

- are individuals
- are residents of NZ for income tax purposes, and
- are not residents of Australia for Australian income tax purposes.

The information contained in this guide is a general outline for NZ Investors and is based on the income tax legislation, rulings and case law in existence as at the date of this guide. In the event that such legislation, rulings or case law changes over time, the position taken may be affected. Further, this guide is not intended to provide an exhaustive or definitive statement as to all the possible tax outcomes for NZ Investors.

Taxation is a complex area of law and tax consequences for a NZ Investor may differ from those detailed in this guide depending on the NZ Investor's particular circumstances. Accordingly, NZ Investors should not rely on this guide as a substitute for professional advice. We recommend investors seek independent professional tax advice particular to their circumstances.

2. General NZ income tax treatment of RDP 11 for NZ Investors

2.1 Classification

The investments in RDP 11 are likely to be characterised as investments in unit trusts and accordingly deemed to be investments in a company for NZ income tax purposes.

The investors will therefore be considered to be shareholders for NZ tax purposes.

We do not anticipate any NZ resident being taxed under the controlled foreign company rules.

2.2 NZ income tax treatment of distributions made by RDP 11

2.2.1 Income tax treatment - foreign investment fund ('FIF')

An investment in a foreign company (including a foreign unit trust) should generally be a FIF under NZ tax legislation and subject to a specific taxation regime.

Assessable income should be calculated under the FIF rules using one of five possible calculation methods, where available.

The most common calculation method applied is the fair dividend rate ('FDR') method. Under the FDR method, assessable income should be calculated as 5% of the market value of the FIF interest at the start of the taxpayer's income year (generally 1 April).

As an alternative, individuals (and some trusts) may choose to apply the comparative value method, which calculates assessable income based on the actual returns (dividends and capital appreciation), less costs incurred in acquiring the foreign shareholding. The amounts are in NZ dollars and, therefore, the method takes into account foreign exchange movements. Note that any loss should be reduced to nil under this method.

Further calculation alternatives are also available in limited circumstances as follows:

- the cost method, being 5% of cost, is available only if the FDR method is permitted but cannot be applied due to an inability to determine the market value of the investment at the start of the income year. A market valuation is required every 5 years under the cost method to reset the cost value to this market value.
- the deemed rate of return method, being the book value of the investment as at the start of the taxpayer's income year (generally 1 April) multiplied by a prescribed rate currently set at 6.28%. This method is available only for certain non-ordinary shares (such as fixed-rate shares) in respect of which the investor cannot determine the market value at the end of their income year.
- the attributable FIF income method, under which an investor pays tax on 'passive' income (such as dividends and interest) if the foreign entity meets certain thresholds. This method is available when the investor holds more than 10% of the entity, can access sufficient information to perform the calculations and their income year commences on or after 1 July 2011.

Calculation of amount included in income and subsequent sale of units under FDR method

We have set out below some further comments in relation to the FDR method as it is the most common method applied. As noted above, under the FDR method assessable income should be calculated as 5% of the market value of the FIF interest at the start of the taxpayer's income year (generally 1 April).

Foreign tax credits should generally be available to credit against assessable income arising under the FDR method where tax has been withheld from distributions by RDP 11 to the NZ Investors. The amount of the foreign tax credits is limited to the amount of NZ tax payable on the FDR income (if lower). A foreign tax credit should not be available for underlying foreign taxes incurred by RDP 11.

Further, as noted below, under the FDR method gains derived from the disposal of a FIF should be excluded from assessable income even where the FIF is held on revenue account. Note that this would not be the case if a sale occurs in the same year as the year of acquisition, which is termed a 'quick sale adjustment' – please see paragraph 2.3.1.

Market value at the start of the income year

Under the FDR and the comparative value methods, the market value of the units would need to be established at the start of the income year. Most individual NZ Investors will have a 31 March income year. In this case, the legislation requires a market value to reflect the amount a willing purchaser would pay to acquire the investment in an arm's length acquisition at the time the value is being measured. Given that RDP 11 has not established the market value of its units, it may be that net assets value **(NAV)** contained in the financial reports is representative of the value at 31 March. Alternatively, the taxpayer may be required to apply the cost method.

Treatment of distributions under FDR method

For NZ income tax purposes, where the FDR method is used any distributions made – whether from capital or current year income – should not impact the tax income calculation (i.e. 5% of the opening market value is taken irrespective of actual receipts in the period).

Exemptions from the FIF regime

The following potential exemptions from the FIF rules are considered likely to be of relevance to individual RDP 11 investors:

- Individuals holding FIF interests (which are not otherwise exempt) with a cost of NZ$50,000 or less should fall outside the FIF regime.[1] There is a very limited exemption for certain trusts also.
- 10% or greater holdings in an Australian company including a unit trust (provided the investor is not a portfolio investment entity, unit trust, life insurer, superannuation fund or a group investment fund), subject to meeting specific criteria.

If a taxpayer is not subject to the FIF regime, the general income calculation rules apply. Broadly this should mean:

- All cash distributed to, or vested absolutely in, the NZ Investors should be taxable at their marginal rate of income tax.
- Australian tax withheld should be creditable to the extent NZ income tax arises on the income.
- On sale or other disposal of units, any gain or loss should be taxable if the investment was held on revenue account. Please see the discussion at paragraph 2.3.2.

2.2.2 Deductions available to the investors

Interest and other borrowing costs (e.g. fees for raising finance) incurred by the NZ Investors in borrowing money to invest in RDP 11 to derive assessable income should be deductible by the NZ Investors, provided the borrowings are directly attributable to the investment.

Brokerage and other fees incurred by the NZ Investors on the sale of units would typically not be deductible (assuming the investment is not on revenue account – see discussion at paragraph 2.3.2).

2.3 NZ income tax treatment on disposal of units

2.3.1 Sale of units in Australian unit trusts for FIF interests

If the investment is taxed under the FIF regime, an additional tax liability should not arise on the sale, or other disposal of the investment.

Please note that where any units are sold in the year in which they are acquired, assessable income may arise as a result of the quick sale adjustment (calculated as the lesser of 5% of the cost of the quick sale FIF interest and the gain realised from the purchase and sale).

2.3.2 Sale of units in Australian unit trusts for non-FIF interests

NZ does not have a capital gains tax regime. However, as can be seen below, a number of instances exist where the capital gain made on an investment should be subject to income tax.

If the FIF regime is not applicable, any disposal gain or loss should be assessable / deductible if the asset was held on revenue account; that is, if the taxpayer carries on a business of dealing in such property, or the investment was acquired with the dominant purpose of sale (assessed at the time of acquisition). Whilst the individual circumstances of the investors would need to be considered, it is noted that the prospectuses reviewed envisage a reasonably long term investment in the units of between five and ten years. Early disposition is not encouraged by the terms of these documents.

2.3.3 Cancellation of units on wind-up of RDP 11

As you are aware, RDP 11 was wound up on 28 February 2018. There may be NZ tax consequences as a result of the wind-up. The wind-up and subsequent cancellation of units should comprise an off-market transaction for NZ tax purposes. The payment would ordinarily give rise to a dividend, which would be exempt from NZ tax if the NZ Investor accounts for their investments using one of the above listed FIF calculation methods.

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[1] This is an automatic exemption for income years commencing prior to 1 July 2011 and an elective exemption for income years commencing on or after 1 July 2011, subject to a four-year consistency requirement.

Alternatively, if a FIF exemption applies then the dividend would be taxable at the NZ Investor's marginal rate. However, the payment on winding up would not constitute a taxable dividend to the extent RDP 11 has 'available subscribed capital' applying for the transaction. This is effectively the amount of capital remaining in RDP 11 which arose from the subscription of the units and has not since been distributed.

Any returns of capital are not taxable in NZ. Therefore, if no FIF exemption applies a NZ Investor should only be taxable to the extent the payment exceeds the amount of capital available to be distributed. NZ Investors who hold their investments on revenue account (as referred to in paragraph 2.3.2) could be taxed on their proceeds less costs.

2.4 Transitional residence exemption

If the NZ Investor qualifies as a transitional resident, further relief would be available.[2]

3. General Australian income tax treatment for NZ Investors

We set out below our comments in relation to the Australian income tax implications for NZ Investors.

There are essentially two circumstances in which NZ Investors, as non-residents of Australia, should be subject to Australian tax.

Firstly, the assessable income (for Australian income tax purposes) of the NZ Investors should include income from sources in Australia. NZ Investors should, however, be entitled to a deduction for deductible expenditure incurred in deriving this income for the purposes of determining their taxable income.

Secondly, NZ Investors may be subject to tax at source under Australia's withholding tax rules in relation to distributions made to the investors from Australian resident unit trusts.

We set out below our comments in relation to the Australian income tax and withholding tax implications associated with a NZ Investor holding an investment in RDP 11.

RDP 11 is structured as investments in Australian unit trusts. As a non-resident of Australia, a NZ Investor may be subject to withholding tax on distributions from an Australian unit trust.

Australian withholding tax should apply to distributions at the applicable Australian non-resident tax rates. There are a variety of different types of withholding which may apply depending on the circumstances.

- *Managed Investment Trust withholding tax* – As RDP 11 is a Managed Investment Trust ('MIT'), all distributions of Australian sourced net income, other than interest, dividends, royalties or exempt capital gains, should be subject to MIT withholding tax.

  MIT withholding is a tax at source and for the 2018 income year, the rate of MIT withholding tax is 15%. The amount of the payment subject to MIT withholding should be treated as non-assessable non-exempt income for Australian income tax purposes. MIT withholding tax should take precedence to Tax File Number ('TFN') withholding tax.

- *Interest withholding tax* – Australian interest withholding tax should be applied to payments of interest by RDP 11, irrespective of whether an Australian TFN has been provided to the Responsible Entity ('RE'). Interest withholding tax is a final tax and is applied to gross interest at the rate of 10%. Interest withholding tax should take precedence to TFN withholding tax.

- *TFN withholding tax* – A NZ Investor may be subject to Australian TFN withholding tax if they do not quote an Australian TFN to the RE. The rate of withholding tax applied to 2018 income year payments was 47%.

2 Transitional NZ residents are new NZ tax residents or returning residents after a period of at least ten years of non-residence. They are not taxable on most foreign sourced income (including FIF income but excluding employment-related income) for the first 4 years of residence unless they have elected not to apply the concession.

Annual Tax Return Guide – NZ Edition

This guide has been prepared to help NZ investors in RDP 11 to complete their 2017-18 NZ income tax return.

What you will need:

You will need the following documentation to assist you to complete your 2018 income tax return:

1. A copy of your 2018 income tax return (IR 3) and income tax return guide (IR 3G).

2. A copy of the relevant return disclosure schedule in order to disclose the value of all your foreign investment fund (FIF) investments, if an exemption from the disclosure requirements is not available.[3] Choose one of the following:
   (a) Interest in a foreign investment fund disclosure schedule for individuals and closely-held entities (fair dividend rate method) – IR 447
   (b) Interest in a foreign investment fund disclosure schedule for individuals and closely-held entities (comparative value method) – IR 448
   (c) Interest in a foreign Investment fund disclosure schedule (cost method) – IR 449

3. Use the rates and tables from the Inland Revenue (IRD) website for overseas currency conversion (keyword search: overseas currencies)

4. Your Australian Annual Taxation Statement for the year ended 30 June 2018

5. A copy of the RDP 11 financial reports as at 28 February 2018 .

The first 3 publications listed above can be downloaded from the NZ Inland Revenue website at www.ird.govt.nz or by calling the NZ Inland Revenue on **0800 227 774**.

Important Information

- This guide assumes you are a NZ resident individual taxpayer with units in RDP 11 holding less than 10% interest in RDP 11. This guide should not be used for other investment income, nor should it be used for other types of taxpayers such as a company, trust, partnership or superannuation fund.
- This guide assumes that you do not have any current year or carried forward ring-fenced FIF losses and that you acquired your units with the intention of holding them rather than as part of a business that trades in these types of investments.
- Your Australian Annual Taxation Statement for the year ended 30 June 2018 summarises the distributions you received in respect of the 12 months ended 30 June 2018. This will provide your taxable income information if you fall outside the FIF regime.
- Unless you qualify for an exemption from the FIF rules, you may determine your FIF income under the FDR method. Alternatively, as an individual you may apply the comparative value method and base your return on actual receipts and capital movements (note that any loss would be reduced to zero).
- This guide assumes that the market values of RDP 11 at 1 April 2017 are equal to the NAV as at 30 June 2017 which can be obtained from the financial reports.

NOTE
The taxation of investment income can be complex. We recommend you seek professional taxation advice from your accountant or taxation adviser. This guide should not be relied on as taxation advice.

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3 A FIF disclosure is not required with regard to an investment in RDP 11 which is incorporated or tax resident in Australia if a NZ Investor holds a direct interest in the syndicate of less than 10% and uses the FDR method or comparative value method.

Steps to complete your NZ 2018 income tax return for your investments in the RDP 11

Step 1: Determine whether you qualify for a FIF exemption

You will qualify for an exemption from the FIF rules if one or more of the following apply:

- The total cost of all your FIF investments (not just your RDP 11 holdings) is NZ$50,000 or less at all times during the year ended 31 March 2018
- You hold a greater than 10% interest in RDP 11 at all times during the year ended 31 March 2018, or
- You are or were a transitional NZ tax resident; that is, the 2018 income year is within four years of your becoming a NZ resident for the first time or after at least 10 years of non-residence.

If you qualify for an exemption under the FIF rules, proceed to step 8. If you do not qualify for an exemption, proceed to step 2.

Step 2: Determine your interest at start of the 2018 income year

Determine your interest (i.e. the total number of units held) in each of the FIFs at the start of the income year (i.e. 1 April 2017).

If you were a transitional resident as at 1 April 2017, your FIF interest at the start of the 2018 year would be nil.

Step 3: Determine the opening market value

Identify the final NAV for RDP 11as at 1 April 2017 (note that the value published is as at 30 June 2017) as published in the financial reports. Determine the value of your holdings by multiplying this value by the number of units held on 1 April 2017.

Step 4: Converting the opening market value to NZ$

Convert the opening market value (disclosed in AU$ – result from step 3) to NZ$ using the conversion table as per the IRD website (search: overseas currencies).

Step 5: Aggregate FIF income

Your FIF income, using the FDR method, is calculated by multiplying the investment value (result from step 4) by 5%.

In regard to RDP 11 units bought and sold during the 2018 income year (i.e. between 1 April 2017 and 31 March 2018), you will also need to include the 'quick-sale adjustment'. This is calculated as the lower of 5% of the average acquisition cost in the period or, alternatively, the sale proceeds less the average acquisition costs in the period (and cannot be lower than zero).

Step 6: Complete the relevant interest in foreign investment fund disclosure schedule (being either form IR 447, IR 448 or IR 449)

Complete the schedule by disclosing your investments in RDP 11as at 1 April 2017, country of incorporation/tax residence (i.e. Australia) and the market value in NZ dollars as at 1 April 2017 (refer step 4).

Note that a FIF disclosure is not required with regard to your investment in RDP 11 which is incorporated or tax resident in Australia if you hold a direct interest of less than 10% and use the FDR method or comparative value method.

Step 7: Disclose whether you have received overseas income

Select 'Yes' for question 17 of your IR 3 return.

Step 8: Enter the income / FIF income in your tax return

If you qualify for an exemption from the FIF rules, enter the gross amount of cash distributions received or vested (i.e. the amounts distributed by RDP 11 before deduction of any taxes) as per your Australian Annual Taxation Statement for the period in Box 17B (‘Total overseas income’).

If you do not qualify for a FIF exemption and you are applying the FDR method, enter the amount calculated at step 5 in Box 17B.

Step 9: Enter the amount of foreign tax paid relating to the overseas income

Enter the total of foreign tax paid (including all Australian tax withheld in respect of RDP 11 distributions) in Box 17A (‘Total overseas tax paid’). A credit for foreign tax paid is limited to your NZ tax liability on this income.

Step 10: Claiming interest and borrowing costs directly attributable to NZ investors

Select ‘Yes’ for question 26 of your IR 3 return.

Enter the total of the interest and borrowing costs which are directly attributable to you and incurred by you in acquiring your interest in RDP 11.

Step 11: Disclosure of interest in foreign companies and unit trusts

If an exemption from the FIF disclosure requirements is not available (as per step 6), select ‘Yes’ for question 36 of your IR 3 return.

Finally, attach the disclosure schedule(s) for all your FIF investments to your income tax return.

For further information, please contact Investor Services:

Telephone:	+61 1800 802 400 (Toll Free within Australia)
Facsimile:	+61 2 9287 0309
Email:	investor.relations@vicinity.com.au
Website:	retaildirectproperty.com.au