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28 November 2008

PRIVILEGED

Mr Michael Brown
General Manager – Taxation
Perpetual Limited
Level 12
Angel Place
123 Pitt Street
SYDNEY NSW 2000

Dear Michael,

Perpetual Protected Investments - Series 1, 2 and 3 Supplement Investor income tax opinion

We refer to the Perpetual Protected Investments - Series 1, 2 and 3 offered under Product Disclosure Statements (*PDSs*) dated 5 March 2007, 6 September 2007 and 17 March 2008 (collectively referred to as *PPI*). Capitalised undefined terms have the same meaning as in the *PDSs*.

This letter supplements the tax disclosure in the *PDS* for *PPI* - Series 1 and 2 and the tax letter prepared by us in respect of *PPI* - Series 3 (*Tax Opinions*). Specifically, this letter expands on our comments in the *Tax Opinions* under the heading "Negative gearing" regarding the deductibility of interest incurred on money borrowed under an Interest Loan (in the context of *PPI* - 1 and 2), an Annual Interest Loan (in the context of *PPI* - 3) and an Investment Loan (available for *PPI* - 1, 2 and 3).

This letter is based on the law as at 28 November 2008. We have not discussed the tax consequences of this transaction in any other jurisdiction. It is provided solely for the benefit of Perpetual Limited. Parties must seek their own independent tax and general legal advice on this transaction before making any decision to invest in *PPI*. Investors must not rely on this letter.

Baker & McKenzie's instructions are limited to the provision of tax advice. Baker & McKenzie is not involved in the marketing of this transaction and its role should not be interpreted to mean that it encourages any party to participate in this transaction.

1. Facts & Assumptions

- 1.1 We refer to the *PDSs* and our *Tax Opinions*. Our comments below are consistent with the *Tax Opinions*. (Investors still need to refer to these *Tax Opinions* as they provide a more comprehensive review of the deductibility of interest and other tax issues relevant to *PPI*).

2. Deductibility of interest

- 2.1 As a general rule, interest on money borrowed will be deductible under section 8-1(1) of the *Income Tax Assessment Act 1997* to the extent that the money is used for the purpose of deriving assessable income (other than capital gains). Similarly, interest on money borrowed to fund an interest expense will generally be deductible where the underlying loan to which it relates satisfies this purpose test.
- 2.2 We noted in our Tax Opinions that Investors should review the terms of any loans together with the Funds into which they intend to invest to ensure that it is reasonably likely that (in aggregate) the expected assessable trust income (other than capital gains) from their investments will exceed the interest expense. If this is the case, the interest expense should be deductible.
- 2.3 This is a test that needs to be applied at the time the money is borrowed and the investment in PPI is made by the Investor.
- 2.4 We also note in our Tax Opinions that if, on the Protection End Date of the PPI investment, the aggregate deductible expenditure exceeds the trust income derived (excluding capital gains), the Commissioner may focus on the Investor's purpose for undertaking the investment. If the deficit can only be explained by reference to factors such as the reduction of tax or the making of capital gains, the excess expense may not be deductible. However, if the deficit can be explained by reference to changes in market conditions, such as poor investment performance of the Funds or an unexpected increase in the volatility of the Funds, the interest should still be deductible, despite the fact that the interest expense exceeds the assessable income from the investment.
- 2.5 In short, interest does not cease to be deductible simply because an investment does not generate the level of income reasonably expected when the investment was made. As noted in paragraph 9.12 of the Tax Opinion for PPI-3 (a comment which is equally relevant for the earlier products in the PPI series):

In the (we assume) unexpected event that the Fund Units reduce in value to the extent that the Investor's Portfolio consists solely of Call Options and the Cash Account, this should not impact on our analysis. (This is on the assumption that the Investor entered into the PPI with the expectation that the Fund Units would appreciate in value - which would seem to be a reasonable assumption for an Investor.)

- 2.6 We note that the Commissioner of Taxation has also provided some guidance in Income Tax Ruling TR95/33 regarding this issue. We consider that this summary is consistent with this ruling.

If you have any questions with respect to the above, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'JW', with a stylized flourish at the end.

John Walker

Partner

+612 8922 5206

john.walker@bakernet.com