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Dear Sir/Madam

**Income Tax Consolidation Regime: Exposure Draft**

We refer to the above exposure draft and in particular to the proposed amendments to section 705-125 of *Income Tax Assessment Act 1997*.

We have clients who are particularly interested in these provisions because it is desired to partly reconstruct the existing consolidated group by winding up the head entity and distributing shares in subsidiaries to the shareholders in the head entity. All relevant shares and assets are pre-CGT.

We and our clients welcome the proposal to work out the pre-GCT proportion of membership interests by having regard to the market value of membership interests of joining entities which are pre-CGT assets. The proposed abolition of the potential for dilution of the "pre-CGT factor" having regard to assets of leaving entities is welcomed.

However, our clients and we would respectfully suggest that the proposed section 711-70(3) should not be enacted because it would be totally unfair to disregard the single entity rule in potentially applying CGT Event K6 on an entity leaving the group.

For example, one could have the situation where all the shares in the head entity are pre-CGT, and all the shares in subsidiary 1 and all the shares in subsidiary 2 (each wholly owned by the head entity) are pre-CGT. If subsidiary 1 has a major asset, for example land, which is also pre-CGT and subsidiary 1 has transferred the land to subsidiary 2 the single entity rule would mean that the land retained its "pre" status.

However, under the proposal in the Exposure Draft, if the head entity were wound up and the shares in subsidiary 2 were distributed to shareholders, the application of CGT Event K6 to those shares could mean that, because the single entity rule is disregarded for this purpose, all the land is taken to be "post" land in undertaking the CGT Event K6 calculation and therefore a capital gain could arise. This would be the case notwithstanding that all underlying assets and intra-group shareholdings were otherwise pre-CGT assets.

It is submitted that this result would be most inequitable.

We are not aware of the reasons for the proposal to insert proposed section 711-70(3) but would respectfully submit that it could surely not have been intended that the above consequences would apply.

We would be pleased to discuss the above issues further if this is regarded as fruitful for the consultation process.

Yours faithfully

Richard Norton
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