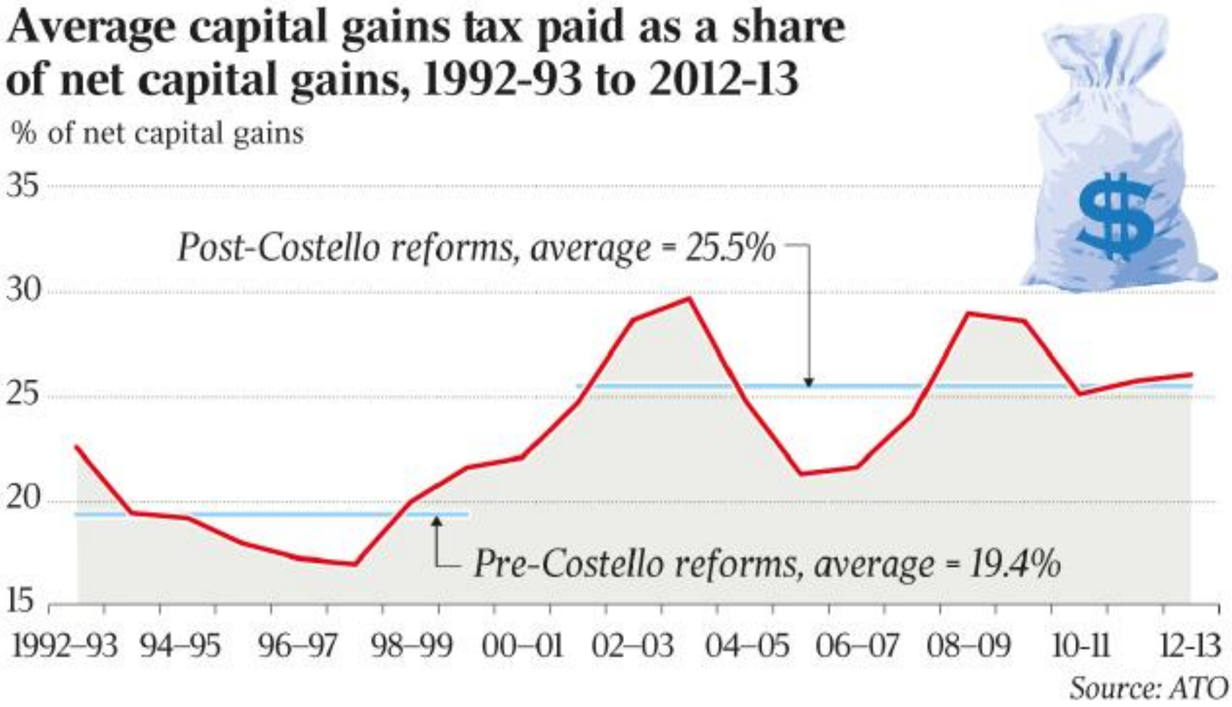
THE AUSTRALIAN

Tax reform: Australia could do without a CGT

THE AUSTRALIAN AUGUST 31, 2015 12:00AM HENRY ERGAS



Capital gains tax share

If there is an iron law of Australian public policy, it is that you can’t keep a bad idea down. And never was that clearer than in the National Reform Summit’s discussion of capital gains tax.

From ACOSS to the ACTU, the Grattan Institute to the Australia Institute, the chorus was the same: the arrangements Peter Costello introduced in 1999, under which individuals can generally discount a capital gain by 50 per cent in calculating their taxable income, are cripplingly costly, eroding public revenue while benefiting the wealthy. They are, in other words, yet another example of the Howard government’s fiscal vandalism: and one that in the Left’s great tax grab, cries out for reversing.

Completely overlooked, in the tidal wave of rhetoric, was the reality: far from shrinking, CGT revenues rose substantially after the Costello reforms, with the share of net capital gains the CGT collects climbing from 19 to over 25 per cent. That increased burden has fallen mainly on higher-income earners, partly because capital gains themselves propel taxpayers into the top tax brackets.

Those increases were not unintended consequences. On report, on which Costello's reforms were based, predicted CGT revenues would rise, not only from abolishing indexation (that discounted realised gains for inflation) but also from removing the averaging provisions, which until then helped prevent capital gains from pushing investors up the income tax scales merely because they had recently sold an investment property or disposed of shares.

Instead of favouring the well-off, the Costello reforms therefore ensured that capital gains are taxed relatively heavily in Australia, with the Tax Foundation calculating that our marginal CGT rate is 7 percentage points above the advanced economies' average. Moreover, the effective rate of CGT has been rising and will continue to rise, as increases in income tax rates and bracket creep jack up the tax payable on each dollar of gain made.

Unfortunately, those high rates of CGT are anything but costless. To begin with, the CGT can tax investment income that has been taxed several times, compounding the tax rate on savings. And as the tax rate on savings is already high, the additional economic harm is material.

It is true that Treasury's "Re: Think" paper on tax reform suggests otherwise. Because taxes don't have much impact on the level of savings, it argues, taxes on savings, such as the CGT, may do little damage to efficiency, assuming they are imposed uniformly.

However, Treasury's argument is confused. After all, saving is merely a way of using income today to "buy" consumption tomorrow; and just as the economic harm a tax on oranges causes does not depend on how it affects spending on oranges but on whether it materially reduces the number of oranges consumed, so the economic harm from taxes on savings depends not on what happens to the level of savings but to the impact on how much future consumption savers buy.

That impact is typically large: for example, at an unchanged level of savings, a tax that cuts the average inflation-adjusted annual rate of return by just 5 percentage points reduces the value of savings in 30 years by over 75 per cent. Instead of such punitive tax rates, it would be far better to tax savers' current consumption a bit more heavily, collecting the same amount of revenue while allowing them to invest the remainder of their income at the higher, tax-free, return.

But the distortions due to the CGT are even greater than those caused by other taxes on savings. In effect, as gains are only taxed when they are realised, the higher the CGT, the greater the incentive to postpone realisation. By thus locking in investors, high rates of CGT make asset markets less efficient while inducing investors to carry more risk (in the form of unrealised gains) than th

At the same time, because the CGT can be avoided by postponing realisation, rate increases may yield little revenue for the harm they cause. And with both the US Treasury and Congress' bipartisan tax committee calculating that the CGT tax take falls once its effective rate rises above 30 per cent, we may be at that tipping point, and for individual taxpayers, beyond it.

The fact inflation rates are not as high as they were at the time of the Costello reforms diminishes those efficiency losses but hardly eliminates them. That is all the truer as even very low inflation rates can drive effective tax rates far above their statutory counterparts.

Consider, for example, a $100 asset that when it is sold in a year will yield $107. If the inflation rate is 3 per cent, the investor's real gain will be of only $4; so even taxing the nominal gain of $7 at 33 per cent (the average individuals pay on net capital gains) amounts to a 59 per cent effective tax rate on the actual increase in wealth.

Little wonder then the New Zealand tax review, which covered much the same ground as the Henry report, found "even low rates of inflation can significantly distort effective tax rates". And as it also found capital gains taxes "make the tax system complex and costly", it concluded that a CGT would not lead to a "fairer or more efficient tax system, lower avoidance or raise substantial revenue".

New Zealand therefore benefits from not having a CGT, as do numerous other countries. And we would too, or at least from lower rates. But the sack-and-pillage crowd want to increase the CGT. Their goal is neither efficiency nor prosperity; it is to tax and spend, soaking the rich along the way. With Labor well ahead, they may soon have their way.

jayess 6 MINUTES AGO

In other words, the determined pressing for higher outcomes, is just another expression of the politics of envy.

LIKE REPLY

Terry 17 MINUTES AGO

This is another part of a broken "Tax System"

These articles whilst full of merit don't help because you are " preaching to the converted ".

Unless the "Tax System" gets a full revamp perhaps based on Singapore's model or even New Zealand's for that matter we will continue on a downward Greek style trajectory.

LIKE REPLY

Terence 23 MINUTES AGO

What's the matter with Smokin' Joe that he can't get with the program and implement some smart changes such as the ones you suggest here re CGT. Why not make things better rather than worse? All those soft targets that he says are in his sights - the wealthy, super, people's houses, Internet purchases - the mind boggles.

Terence M2

2 LIKE REPLY

Guy 28 MINUTES AGO

Thanks Henry. In lay terms why advise you children to invest in very expensive property if they are going to be taxed as Labor wants near 100% on your investment.

LIKE REPLY

Christine 53 MINUTES AGO

Good job Henry... that's what I was looking for: the Effective rates. This applies across CGT, Super and PAYG (when combined with welfare withdrawal).
When I was starting out the rule of thumb for real estate gains over the long term ((more than 15 years) was 2%p.a. averaged over that time after inflation.
But inflation was/has been at least double that, so a tax that allows a 50% discount on gains when inflation is 4% and gain is 1 New Comment

gain is fully taxed at your maximum PAYG rate PLUS 25% of the inflation also being taxed. In many cases this would among to an EFFECTIVE tax impost of 60% (+/- 5%).

Could you now do an article on the measurement of inflation please? The "CPI" is a basket that applies to no one and everyone but as we have kids I can assure you that education and health care are far exceeding the CPI in their annual increases. This applies also to council rates, government taxes and charges etc. We are a frugal household investing in our kids. OUR CPI is much higher than 3%.

The same applies to retirees...

Finally... a real issue here is the lack of understanding of effective rates of tax both in the community and the Treasury. Clearly Costello know what he was doing. He seduced an entire nation into thinking that the CGT was an attractive "rort" when in fact the 50% discount when used with a high PAYG income and high (4% or higher) inflation means that capital gains are very heavily taxed.

1 LIKE REPLY

Tony 16 MINUTES AGO

@Christine Not just Capital Gains but all savings interest paid. When was the last time you could get a bank account paying interest at higher than the cpi, but every $ of interest earned is taxed at the marginal tax rate. Where is the inflation indexation for this efective loss of value in the savings account. Tax on anything other than consumption is a blend of paradoxes and hypocrisy with a large slather of envy thrown in for good measure.

LIKE REPLY

Phil D 1 HOUR AGO

If you make an inflation adjusted gain on the sale of an asset then thats an income stream & should be taxed as for any other income. If you roll the gains into the same sort of business you dont pay capital gains tax until you opt out of the industry.

The family home should be treated the same as any other asset & attract capital gains tax. The present exemption allows investors in capital city markets to make untaxed income by turning over their principal place of residence in a rising market.

1 New Comment

LIKE REPLY

Robert 1 HOUR AGO

An excellent analysis. Unfortunately, with only a political choice between a far-left dominated Labor Party and a Liberal Party that under the current PM and Treasurer continues to drift towards the centre, there seems little chance that the tax and spend express will be slowing any time soon.

Maybe its time for us to dust off that passport?

2 LIKE REPLY

Andrew 33 MINUTES AGO

@Robert Continues to drift towards the centre? I think not! Drift way off to the right alienating those of us with solid prudent economic views but a touch more social justice than is currently being shown.

LIKE REPLY

Richard 1 HOUR AGO

What it boils down to is the government is already too big, and getting bigger. As this wasteful dead hand expands, it becomes hungrier for ever more taxation to consume.

The answer is to expect less from government and to do more for ourselves, and to control our governments from expanding. In fact, to go on a campaign to shrink government back to essentials only. A national target could be to shrink all government from 38% back to below 30% of the economy. There is little government can do for us ..... that we cannot do better, more effectively and with greater efficiency by doing it for ourselves.

5 LIKE REPLY

tom 1 HOUR AGO

There's also an in-principle difference between taxing the capital gain on passive investments like shares that increase in value through no effort on the part of the shareholder, and taxing the capital gain on, say, a small business. The idea that the owner of such a business, having worked hard, taken serious risks, provided employment and paid consumption and income taxes should have to pay additional tax on the realisation of that asset, is an idea so stupid, selfish and greedy that it could only have been devised by navel-gazing politicians and apparatchiks whose pay packet miraculously appears in their bank account, and who have never created any wealth in their lives.

3 LIKE REPLY

Christine 50 MINUTES AGO

@tom Look up Section 154D of the Taxati

1 New Comment

There is/was an exemption there whereby an "active business asset" is untaxed when a gain is realised if the gain is transferred within 5 days of receipt of the payment to your super.

Search "ATO Active asset Concession". And give thanks to Peter Costello.

1 LIKE REPLY

sydneyman 2 HOURS AGO

I think some allowance should be made for the impact of the Consumer Price Index on the Capital Gain itself.

Otherwise we are being taxed on an illusory gain & not a real one.

Contrary to Labor/Greens,ABC/SBS I think the CGT should be reduced as well & taxes raised elsewhere perhaps GST to make up the shortfall.

My wife & I mortgaged our home to start a small business & are entitled to a reasonable after tax capital gain, considering we risked the roof over our heads for our old age.

The biggest problem in Australia is Govt.SPENDING especially welfare.Plus the new Rudd/Gillard schemes NDIS,NBN,Gonski etc.etc. are unaffordable & the NDIS in particular will lead to hundreds of thousands of questionable "disability pensioners".

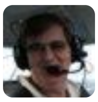
LIKE REPLY

Jason 1 HOUR AGO

@sydneyman Ironically, pretty much all the revenue raising and cost saving measures introduced by the current government were to reverse Howard era changes.

As for the likes of Gonski being unaffordable - do you really think that school education is a less worthy place to spend money than other areas which you haven't described as unaffordable?

LIKE REPLY



Raymond C 57 MINUTES AGO

@Jason @sydneyman Gonski is unaffordable. But not because we can't find the money - but because there is, at least in this country, an inverse relation between increased spending and academic outcomes. Until we work out why the ever increasing amounts

1 New Comment

producing better academic outcomes then all increased funding, ie Gonski, is likely to be wasted.

LIKE REPLY

Jo-nathan 23 MINUTES AGO

@Jason @sydneyman What Howard era changes are you referring to? Was it tax cuts? Bracket creep was in issue then as it is becoming now. One should bear in mind that this country has some of the highest marginal income tax rates in the world.

Yes, spend money on education, but the crucial question is how well the money is spent. Can something be managed better without necessarily throwing more money at it? We have governments almost glibly announcing that they will spend money on this or on that, but with precious little information regarding how it will be spent. Currently all levels of government are spending 38% of GDP, and still manage to run deficits. Is the taxpayer getting value for money? Where is the focus of governments attempting to do more with less and cutting waste? The annual $500,000,000 bill that taxpayers are footing for travel and office expenses of parliamentarians is a glaring example of government's lack of spending discipline. How Tony Burke can claim $1.2 million for his office over two years is beyond me.

LIKE REPLY

Charles (DCC) 16 MINUTES AGO

@Jason @sydneyman

More money does not equate to better education.

I believe school education is poor because school heads in the state systems do not have control of their schools, not because of "lack of funding".

The pursuit of Excellence has been abandoned to the pursuit of mediocrity, and political interference in schools - operationally and in the curriculum - has become the norm.

Reduce the education spend, curtail the unions, give headmasters fiscal and disciplinary control over their staff, scrap the national curriculum and the imposition of Greenie philosophy, "sustainability" "global warming" "aboriginal culture through mathematics" and the rest of the loony fringe ideas, and educational standards will rocket while costs go down.

1 New Comment

LIKE REPLY

Christine 46 MINUTES AGO

@sydneyman See my comment above re small business.

LIKE REPLY

Geoffrey 2 HOURS AGO

Excellent article, Henry. How times have changed. Back in the 1980s, Keating's introduction of CGT and Fringe Benefits taxes looked like payback or envy against small and large business, who, the meme went, were rorting while the typical Labor identity was doin' it tough and the workers were on subsistence wages.

Before the "consensus" period under Hawke/Keating, it was good for your average get ahead type to go into a small business, as you could do well, one way and another. It was still hard work. Fast forward to the present, and we see small business struggling to make it pay, while the legions of Labor appointees to all manner of positions, be they quangos, commissions of all sorts, superannuation boards, you name it, getting salaries most of us can only dream of plus expenses to boot. While businesses have to endure the onerous accounting for FBT, pollies have expenses waved through with no trouble at all until someone decides to make a fuss over Bronny.

Capital gains tax should go. Expenses are a legitimate business cost.

3 LIKE REPLY

NICOLE 2 HOURS AGO

Unfortunately, as usual, Henry's 'analysis' is very partial, theoretical and ignores the community's will as expressed through the Parliament (yes, both Houses comprise the Parliament).

While a CGT to GST switch would lower the inefficiency costs of raising tax in a textbook, any Senate is very unlikely to pass it due to legitimate concerns about increasing inequity.

Henry could, for example, analyse the impact of fixing some holes in the CGT/income tax base, then there might be a chance of successfully arguing for a reduction in income tax rates/indexing thresholds . Such as switch would, effectively, increase the proportion of tax raised from the GST and other indirect taxes.

1 New Comment

LIKE REPLY

Charles (DCC) 1 HOUR AGO

@NICOLE Ignores the community's will? You have to be in the PS. Since when did the "community's will" enter into the thought process of either a politician or a public servant?

LIKE REPLY

K 1 HOUR AGO

@NICOLE Absolute twaddle Nicole. You demonstrate that unlike Henry you know nothing of the tax system that applies in the real world. You state that Henry should "analyse the impact of fixing some holes in the CGT/Income Tax base". These so called holes do not exist in the way that the fairness lobby likes to portray. Henry understands that fact. You do not.

This generalised claim to "legitimate concerns about increasing inequity" that has become the fallback position of those arguing for tax increases has gone too far. It needs to be seen for what it is. A socialist grab for increasing unearned handouts and denial of each individuals personal responsibility for looking after themselves.

LIKE REPLY

Peter 56 MINUTES AGO

@K @NICOLE Your clinical retort to Nicole was undermined by your comment about "A socialist grab ..." suggesting that you are just as ideological as those whom you oppose.

LIKE REPLY

Angela 3 HOURS AGO

A property investor will have paid stamp duty, interest on the borrowings and more than likely land-tax depending on the value of property. That amounts to tens of thousands of dollars in tax revenue. In addition the rental return on an investment property relative to the value of the property is very low. Often around 2.0 to 2.5 per cent. When a property is sold, the capital gains tax concession offers some compensation for the outlays and the financial shortfall over the years. The 50 per cent discount offers from compensation. If capital gains on property is increased to 100 per cent the s

1 New Comment

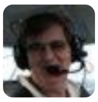
compensated for compounding inflation over the years which would make the calculations more complicated.

LIKE REPLY

Jason 1 HOUR AGO

@Angela COmplication isn't an issue in the day of smartphones.

LIKE REPLY



Charles (DCC) 54 MINUTES AGO

@Angela Capital gains tax when he sells, and then there's the stamp duty etc, including on loans, to be levied from his next purchase, along with all of the compliance, legal and many other costs.

I looked at selling an existing business and buy another but I won't do it because I'll be setting myself up set myself up to be ripped off on capital gain on the way out, and stamp duty etc on the way in to another business.

I would end up with a business worth half a million less than the one I have now, and the only winner would be the bureaucracy.

I can't be the only one to do these sums. I wonder what this is costing the country in lost opportunity?

LIKE REPLY

Jeff 3 HOURS AGO

Well well well... Last week I sold the very last of property that I purchased in Launceston Tasmania in the late 1980s. Before that I had sold some Industrial property that I had in Melbourne and also high quality machinery that i used in my manufacturing business. All the property was to provide me with an income when I retired. I had to sell all that stuff in 1990s to liquidate my assets to pay for Paul Keatings Recession we had to have. When selling all of that then as the my company was in liquidation I had to pay capital gains tax which added to the losses. It was a bad tax when it came in and still stultifies the economy from free trade. Its a tax that is applied only if one make a profit, or a financial gain. That is considered bad among the Labor Party specialists. The other side of the coin if one sells at a loss then you cannot claim a capital loss against income. The Sack and pillage crowd when they fet in will complete the job of the socialsts to destroy and disrupt the economys of the world. Because I was self sufficient even after that collapse of my business due to Labor Government policies, I retired t Tasmania and have never had the full pension which I have never wanted but the drama of just getting the health card so i can get medication at the same rate as most other people of my age are e

1 New Comment

sold it all and that money has been invested in my private home. So I will own and operate zip, nothing, I will still not get the pension because my wife earns too much as a graduate engineer. Hold on to you hats folks when Labor gets in we will have the mother of all recessions. It will be very long and protracted and we may need to get some African Nations to send money to us. I do hope the Greens and the ALP are aware of this and will make sure we are all fed and looked after?

14 LIKE REPLY

Jason 1 HOUR AGO

@Jeff When ALP were in last time we didn't hit recession although the rest of the world did. The LNP are in now and we are far closer to recession while the US and others seem to be booming.

LIKE REPLY

Ron 54 MINUTES AGO

@Jason @Jeff Rudd blew a bundle trying to "protect us" from the GFC. RGR also introduced many long term, yet completely unfunded, pipe dreams. This has left the country in a very unstable economic position. You can't blame the LNP for that. They tried to fix it in Budget #1 but once again it was Labor and the Greens that blocked key areas of that.

As for that GFC stimulus - look around the world at countries that started in a LOT worse position than Australia and DID NOT blow a bundle on Keynesian stimulus packages. They are all emerging with great growth rates. New Zealand is moving along great with their NP government. Exports up, Australian businesses relocating jobs over to NZ weekly. Even the basket case of the UK is in good solid recovery with lower unemployment than Australia. That is on the back of "the bad" Austerity measures introduced by their Conservative government to fix their problems. You need to look more broadly than just what Bill and his union puppets say or release.

1 LIKE REPLY

Andrew 30 MINUTES AGO

@Jason @Jeff Pretty hard to be in recession when your #1 export commodity nearly trebles in price over two years. That Rudd bloke must have been a genius to engineer that....

1 New Comment

LIKE REPLY

Janis 1 HOUR AGO

@Jeff Life's tough with choices we make. You made your bed you lie in it. and Keating made your road much rougher . Just remember Keating way caught big fish Skase, Bond, etc

LIKE REPLY

Manfred 1 HOUR AGO

@Jeff You made a capital gain on post 1986 capital purchases when forced to sell in the early 1990s recession?

You do understand, don't you, why I think your story might be more than slightly embellished to drive an idealogical point.

LIKE REPLY

Paul 7 HOURS AGO

My concern with there being no capital gains tax is inflation of property prices. We have some of the highest property prices in the world. We have trillions locked up in property that should be in industry adding to GDP income. Our inflated property values must be reducing our GDP per capita by 10-20%.

Also part of the problem with property prices is tax. 10 years ago the average tax on a new house in Qld was $130k. So must be pushing $170k by now. That's come about by lack of foresight with infrastructure development and green policies in local govt. Prices can never come down when the tax is so high.

2 LIKE REPLY

Lee 2 HOURS AGO

@Paul But There was a time when we had no CGT at all, within living memory, and prices weren't skyrocketing then.

2 LIKE REPLY

Jason 1 HOUR AGO

@Lee @Paul That was a different world, before banking deregulation.

LIKE REPLY

LUCAS 20 MINUTES AGO

@Paul Where do you get these figures from?

1 New Comment

LIKE REPLY

Paul 7 HOURS AGO

What ever happened to the principle of all income being taxed the same … so that investment moved to areas or best return?

Inflation is always a problem. It creates scope for tax on inflation as profit.

Taxes are too high. half the people pay no significant net tax. That is, 50% of Australians are viewed as incompetent and unable to contribute to the nation. That really is ridiculous. A reasonable welfare level needs to be established and taxes worked out from that. I can't see why welfare should cover more than 10-20% of the population over 20 years of age.

If we had low taxes, then they could be flatter and less susceptible to distortional effects like inflation impacts.

8 LIKE REPLY

Jeff 3 HOURS AGO

@Paul Labor Party Greed and stupidity syndrome it's called. Equality for all. It's designed to make every Australian equally poor!

10 LIKE REPLY

John 8 HOURS AGO

I don 't object to a CGT because without it you have people turning taxabke income into a non taxable form that is unfair to working people.

The current CGT formula however creates a roadblock to urban consolidation if you have a home on a large enough block to build two homes, keeping one for yourself.

If you demolish the existing home and sell one block you lose the 50% CGT discount on the capital gain for the block you have sold and must pay tax on the whole capital gain for the block. If you have lived in the same place for 10-20 years that can amount to several hundreds of thousands of dollars extra.

As it stands the existing home must be retained to keep the 50% CGT concession. Without it funding a new home to live in on the second block is prohibitive especially for older home owners.

This CGT quirk can create planning issues with the local council if the existing home is acoss the new common boundary. This all makes it hard for many people to downsize and free up land for more homes.

2 LIKE REPLY

Jeff 3 HOURS AGO

@John Yep you are right it is and always h

1 New Comment

development and of course yet another Labor party blunder with intended consequences. I fully understand all of that as I have been in the thick of it. I spoke to an accountant a couple of years ago and asked him if there was any chance that the liberals would remove the tax at any time? When he stopped laughing he said no way. It's too good a money earner and the government does not have to do anything for it.

3 LIKE REPLY

Robyn 2 HOURS AGO

@Jeff @John Yes guys, it is just like the cash cow called stamp duty on property.

This is a diabolical tax, is the main cause of raising property prices because sellers price it in to the sale price. i.e if a buyer has paid $xyz in stamp duty to purchase a property then that tax is added somewhere along the line to the selling price. I did once myself.

LIKE REPLY

Benjamin 8 HOURS AGO

You'd be better off spreading CGT to the principal place of residence and removing stamp duty.

LIKE REPLY

Jason 8 HOURS AGO

The reason the CGT take went up in the 00s was because of the share market boom. Since then, it's been pretty minor as investors have spent the last several years recovering their capital losses.

You clearly need a CGT - the opportunity for tax avoidance is too great (as it is in NZ). I think the current rate is too distortionary and that we should revert to the previous indexation + averaging regime. This may be more or less tax than currently payable under the 50% discount regime but it would be fairer and less distortionary (the current system encourages investors to seek short term capital gains).

LIKE REPLY

Chris 2 HOURS AGO

@Jason CGT "profits" to the Government have risen not just because of the share market boom but because of our increasing population growth. With one of the highest (per capita) population growths in the G20 countries, we see an increasing shortage of

1 New Comment

is generally controlled by state and local governments. Land shortages will attract higher selling prices. Depending on the state or territory, the fees and charges can be as low as 30% of the land price and rise to over 65% of the land price. The site development costs are relatively per land parcel and only change relative with inflation. The buyer does not see a breakdown of the purchase price. We have the then Planning Minister, Mr Frank Sartor, in 2007 to provide the breakdown in a reply letter in the Sydney Morning Herald. NSW Section 94 Certificates, when introduced, had a rate of $7,000 for Liverpool Council but $130,000 for Baulkham Hills Council to do exactly the same thing.

Whilst our population continues to rise, get used to increasing land prices.

LIKE REPLY

1 New Comment