Submission of the National Foundation for Australian Women to the Select Committee on the Operation of the Capital Gains Tax Discount

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Authorisation

This submission has been authorised by the NFAW Board

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National Foundation for Australian Women

This submission is being made by The National Foundation for Australian Women (NFAW).

NFAW is dedicated to promoting and protecting the interests of Australian women, including intellectual, cultural, political, social, economic, legal, industrial and domestic spheres, and ensuring that the aims and ideals of the women's movement and its collective wisdom are handed on to new generations of women. NFAW is a feminist organisation, independent of party politics and working in partnership with other women's organisations.

The taxation of capital gains affects women and men in different ways; it is not gender neutral. This submission responds to the terms of reference through a gender lens.

Why is the taxation of capital gains an issue for women?

The taxation of capital gains, as set out in the terms of reference of the Committee affects women in two domains: firstly, whether men and women are affected equitably through the effect of the discount, and secondly, through the effect on the housing market.

Australia is overall a low taxing economy. The Australia Institute estimates that if Australia raised revenue at the OECD average rate, the federal Budget would have increased by around $140 billion in 2023-24. Compared to OECD averages, Australia's rate of income tax is relatively low. While the OECD tax wedge data reflect some difficulties in comparisons, these tend to emphasise the point about Australia's tax take being low.

Nevertheless, our reliance on income tax is high - about 50 per cent of tax collections. Within income tax we have an overreliance on tax from labour due to the tax concessions available on investment income, including capital gains tax concessions and franked dividends. Women are less likely to benefit from these tax expenditures as they are less likely than men to accumulate investment assets, including superannuation.

There is room to broaden the tax base to include more focus on wealth or inheritance taxes, taxes on resources and to remove subsidies and deductions for wealthier and older Australians at the expense of poorer and younger people. These changes would deliver for intergenerational equality, as well as making room for better services and programs to support all Australians, and particularly women and families.

Women are the beneficiaries of a progressive and redistributive taxation system. Taxation data shows that women are underrepresented in the highest income tax brackets and overrepresented in the lowest income tax brackets. Women are also the beneficiaries of increased spending on income support payments and social services. Unsustainable tax expenditures limit funding to government funded services, with the potential to reduce jobs. Women are over-represented at lower income levels, therefore changes to government benefits and services affect them disproportionally.

Women are also significantly affected by housing insecurity and homelessness, which is increasing in Australia amongst women. The 2021 Census showed a 10 per cent increase in the number of women who are homeless since 2016, compared to a 2 percent increase in the number of men who are homeless.

Single women households make up 51% of households that are eligible for the maximum rate of Commonwealth Rent Assistance. Over 80 per cent of single parent families, 77 per cent of which are headed by women, receive the maximum rate of CRA. They face increasingly expensive housing markets nationally and cannot compete for quality housing. When households struggle to afford rent, they cut back on essential items including food, education and healthcare with consequences for health and wellbeing. .

A more comprehensive tax base would not only reduce gender wealth inequality but would enable the allocation of more funds to housing and other services that women access.

Recommendations:

1. The CGT discount is poorly targeted with high income men receiving the largest benefit. The discount should be reduced by at least half to 25%.
2. The CGT discount has contributed to the high cost of housing. The discount on properties made available for rent should be phased in over 5 years based on the length of time that a landlord has made the property available for rent:
   - Less than one year no discount (as is currently the case)
   - 1-2 years 5%
   - 2-3 years 10%
   - 3-4 years 15%
   - 4-5 years 20%
   - Over 5 years 25%
3. Additional funds made available from the reduction of the CGT discount should be allocated to the housing portfolio to build affordable housing for key workers and other low income renters.
4. Division 6 of Part III of the *Income Tax Assessment Act 1936* should be rewritten to remove the anomalies that arise when a trust makes a capital gain.
5. The rewrite should include a review of the CGT provisions that apply to private discretionary trusts in Sub-Division 104E of the *Income Tax Assessment Act 1997* to tax the value of increases in the value of the assets of the trust.

Discussion

The introduction of the Capital Gains Tax was based on the premise that in a comprehensive tax system all forms of earnings should be taxed, whether from capital gains or from earned income. The initial provision for an indexation adjustment was consistent with this principle, but later amendments to provide a tax incentive for capital gains have distorted the tax base.

The housing market is particularly vulnerable due to its dual role as a store of wealth and a consumption good. Housing is a necessity, and lack of housing has impacts not only on the economy but also on the wellbeing of Australians.

In this submission we will principally address terms of reference a; b&f; d and e.

a. the contribution of the capital gains tax (CGT) discount to inequality in Australia, particularly in relation to housing;
b. the role of the CGT discount in suppressing Australia's productivity potential by funnelling investment into existing housing assets;
c. how the CGT discount influences the types of assets purchased and whether these classes of investments are productive or speculative;
d. the distributional effects of the CGT discount;
e. the use of the CGT discount by trusts;
f. whether this tax discount is fulfilling its original intended purpose;
g. whether the CGT discount has a role in Australia's future tax mix; and
h. any other related matters.

a. the contribution of the capital gains tax (CGT) discount to inequality in Australia, particularly in relation to housing

The CGT discount contributes to inequality in Australia by distorting the return on assets. In respect of the housing market, this affects affordability for those seeking to purchase a home as well as renters.

This has a particular impact on women who are more reliant on renting in the private market as they are less likely to have the financial capacity to purchase a home or to invest in other assets.

Recommendation 1: NFAW recommends that the discount should be reduced by at least half to 25%.

There are two mechanisms by which the Capital Gains Tax (CGT) affects housing in Australia.

The first is the 100% Main Residence Exemption from CGT for owner occupied housing, which has the effect of encouraging overinvestment in a person's main residence. This exemption is identified in the Treasury Tax Expenditures and Insights Statement as costing the revenue approximately $51,500 m in 2024-25 made up of $27,000 million for the discount component and $24,500 million for the exemption. It has increased by 18% since 2020-21.

The main residence exemption distorts the housing market as owner-occupiers regard their residence as a store of wealth instead of a consumer good. Owner-occupiers benefit from housing price increases as the gains are free of tax; albeit locked away until the residence is sold. This price spiral allows owner-occupiers to outbid new entrants to the housing market, locking them out of home ownership. ABS data shows that home ownership has declined from 71% in 1999-2000 to 66% in 2019-20, while the proportion of homeowners with a mortgage has increased by 5%.

The second mechanism, and the issue that this inquiry is principally concerned with, is the discount that ensures that only 50% of a net capital gain is included in assessable income. The discount cost the revenue $22,730 m in 2024-25, an increase of 27% since 2020-21. Note that this is not segregated into housing and other assets.

The CGT discount affects the rental market as it applies to reduce the taxable gain on investment properties.

The effect of the CGT discount on the rental market is based on the interaction with negative gearing. Although negative gearing is not the focus of this inquiry, the ability to borrow significant sums against the value of the purchased property allows investors to make substantial capital gains that are taxed at a concessional rate relative to other forms of income. As noted in the Henry Review (Chart 4.4) the different rates of tax that are applied to different classes of assets results in market distortions. Although other forms of investment may also be funded by borrowing, the ability to use the property as security for the loan makes the residential property market particularly attractive to investors. The ability to claim the interest as a deduction while the property is rented offsets the holding costs until the investor makes the capital gain on the sale of the property.

Recent AHURI research found that landlords with access to alternative financial resources are less likely to sell rental properties within five years, which increases the capital return on their investment. It also found that reducing the discount would have a bigger impact on high income landlords but would have little impact on rental affordability as the primary consideration for landlords is the rental yield.

b. *the role of the CGT discount in suppressing Australia's productivity potential by funnelling investment into existing housing assets*

f. *whether this tax discount is fulfilling its original intended purpose*

The capital gain on a negatively geared rental property is likely to be higher than the gain on an investment of the same amount in shares. This encourages investment in the rental market over shares in a productive enterprise for investors seeking a short term gain.

Recommendation 2: The CGT discount has contributed to the high cost of housing. The discount on properties made available for rent should be phased in over 5 years based on the length of time that a landlord has made the property available for rent:
- Less than one year no discount (as is currently the case)
- 1-2 years 5%
- 2-3 years 10%
- 3-4 years 15%
- 4-5 years 20%
- Over 5 years 25%

Recommendation 3: Additional funds made available from the reduction of the CGT discount should be allocated to the housing portfolio to build affordable housing for key workers and other low-income renters.

The CGT discount was introduced following the Ralph Review of Business Taxation with two main goals:

- To "enliven and invigorate the Australian equities markets, to stimulate greater participation by individuals, and to achieve a better allocation of the nation's capital resources" (Final Report, Chapter 18).
- To replace the indexation method of calculating net capital gains and replace it with a simpler method of calculation.

Notably the application of the change to residential property was not discussed in the Ralph Review, which was tasked with reviewing business taxation. The report anticipated that investors would respond to the changes by realising equities that they held, making more efficient investment decisions.

In fact, the introduction of the discount had a significant influence on the housing market, with rental investment becoming the investment of choice for small investors. The percentage of rental investors has increased from 7% of the population in 2001 to 9% in 2021. Investors under 35 were more likely to purchase a rental property, but also more likely to sell that property within 2 years, perhaps reflecting the practice known as "rentvesting" where a less desirable investment property is purchased with the intention of making a quick capital gain to fund a more desirable property. This speculative investment destabilises the rental market.

Notably the purchase of shares also has a tax preference through the franking system, encouraging investment in shares known to pay dividends. The effective marginal tax rate on domestic shares is lower than rental properties as set out in the 2010 The Henry Review (Chart 4.4), and again in the 2020 TTPI Policy Paper 01-2020 (Figure 5) however the gain on disposal of a negatively geared rental property is likely to be higher than the gain on the disposal of shares as the value of the property is higher.

d. the distributional effects of the CGT discount

The distribution of the CGT discount is inequitable. The concession favours high income men over 50:

82% of the benefit goes to taxpayers in the highest income decile;

58% of the value of the benefit goes to men; and

Around 70% of the benefit goes to taxpayers over the age of 50. (TEIS, 2024)

Refer to Recommendation 1: The discount should be reduced by at least half to 25%.

The distribution of the discount to older, wealthy, men reflects the capacity to invest in capital assets. Treasury has estimated that 82% of the discount was distributed to the top income decile (TEIS, Chart 2.6). The TEIS further notes that 58% of the benefits went to men while women received 42% of the benefits, and that the majority of the benefit went to taxpayers aged over 50 with 13.6% going to people over 64.

It is worth noting that the number of men and women receiving the CGT discount is more evenly split at 52% men to 48% women, but the value of the discount was considerably lower for women as they generally have lower income. Where an asset is held as a joint ownership with a spouse, as is frequently the case with investment property, the benefit of the discount will be lower for the lower income earner; but crucially the tax payable is also lower due to the lower tax bracket. Studies of intra-household finances show that this arrangement does not always benefit the lower income spouse as the actual distribution of the net gain on the sale of the property is influenced by intra-household power dynamics, which is associated with the financial contribution that each person makes to the household, often without any reference to non-fiscal contributions made by women, such as caring for children, despite the fact that such contributions free the man to engage in remunerated labor.

e. *the use of the CGT discount by trusts*

Division 6 of the Income Tax Assessment Act 1936 and the associated CGT provisions in Subdivision 104-E of Part 3-1 of the Income Tax Assessment Act 1997 are no longer fit for purpose. The rewrite that was proposed by Treasury in 2011 should proceed as a priority.

Recommendation 4: Division 6 of Part III of the *Income Tax Assessment Act 1936* should be rewritten to remove the anomalies that arise when a trust makes a capital gain.

Recommendation 5: The rewrite should include a review of the CGT provisions that apply to private discretionary trusts in Sub-Division 104E of the *Income Tax Assessment Act 1997* to tax the value of increases in the value of the assets of the trust.

The application of the CGT discount to trusts is conceptually a consequence of the interest that beneficiaries hold in a trust. Unlike a company, the trust is not a legal entity but rights held by beneficiaries in trust property. The modern discretionary trust has evolved in a way that allows entitlements to capital and income to be determined by the trustee from time to time, which gives scope for manipulation.

The discount itself is not the issue: it is based on the allocation of capital gains, and calculated by reference to the net capital gain of the beneficiary as if they had received it themselves. This calculation is complex but applies the "look-through" principle to aggregate the gain, or loss, with those derived personally.

Following the decisions in the Bamford and Cajkusic cases, provisions were included in the law to ensure that the beneficiaries have the financial benefit of the capital gain formally conferred on them as part of the distribution process. This attempts to address the issue of the manipulation of distributions. However, enforcement of the entitlement is not a taxation matter, but a matter for the Courts.

There are still areas of statutory interpretation that allow loopholes: specifically the definition of net income of the trust could allow the beneficiaries of a trust with no income as defined by the trust deed to avoid paying tax on a net capital gain.

More concerning is the lack of symmetry between a share in a company and the treatment of an entitlement in a discretionary trust. SubDiv 104E attempts to ensure that an interest in a discretionary trust is liable for CGT if disposed of. However the fundamental flaw is that the legislation refers to an interest in a trust, which is problematic in relation to discretionary trusts. As the law stands, if the trust is established without payment by the beneficiary the provisions relating to trust property, Event E5 and Event E7, do not operate. The transfer of an income stream may be caught by Event E6, but such a transfer is unlikely as an entitlement under a discretionary trust would have a very limited market as distributions are at the discretion of the trustee.

In contrast, shares in a family company are subject to CGT based on the market value rule.

It is worth noting that the Ralph Review (Chapter 16) also proposed significant changes to the taxation of trusts and companies that would address the asymmetry between the taxation of these entities particularly when used to operate a business. The issues relating to the discount for trusts would not be a concern if this proposal had proceeded.

There is little information available about the gendered impact of the use of trusts and the CGT discount. However, we would make the observation that as our understanding of coercive control and economic abuse is developing it is likely that women and minors are liable for tax on trust distributions without actually receiving the benefit of those distributions. Unlike company dividends, the allocation of trust income does not require payment but can be made through an appropriate minute and supporting accounting entries.

The ATO has stepped up its scrutiny of family arrangements that may be classified as a reimbursement agreement, however a beneficiary that does not receive their entitlement from a trust must apply to the court to enforce their rights. Beneficiaries may not have the capacity to take this course of action – even if they are aware of their entitlements and distributions under the trust.

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Income Tax Assessment Act 1936

Income Tax Assessment Act 1997