Submission: Select Committee on the Operation of the Capital Gains Tax Discount

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About the author:

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1 Summary of recommendations

This submission makes recommendations that are designed to be at least revenue neutral over the long term and ensure and ensure budget sustainability. The overarching crux of the submission is that increasing capital taxes creates a significant risk of capital flight to 0% CGT regimes, including New Zealand. This, almost tautologically, would also involve the person leaving to that foreign jurisdiction, also decreasing income tax. Not only that, foreign capital would be deterred, undermining growth. Higher CGT would also create frictions in the market, reducing transaction frequency. This would reduce tax revenue and would stop capital from going to its most efficient use.

This submission is grounded in the idea that Australia should grow the economic pie and the tax base, rather than merely seek to divide a stagnant economic pie. This means that *reducing tax rates* can *increase tax revenue*, as the submission explains below. This operates by attracting, and retaining capital and labor. By contrast, increasing tax rates can reduce total tax revenue. This is because higher tax rates deter new capital from arriving, and cause existing capital to leave, thereby reducing the total tax take. It can also reduce the frequency, or size, of investment, thereby reducing total tax revenue. The main recommendations in this submission are:

1. The focus must be on growing the economy in order to grow the tax base. Increasing taxes in any area will undermine growth, risking a downward spiral via a shrinking tax base.
2. Increasing tax rates will reduce tax revenue: Do not increase capital gains tax in any area, or impose a wealth tax or inheritance tax. Australia operates in an international environment. People, and money, can and will leave. This includes to nearby locations (New Zealand) and more distant locations (UAE, Singapore, Hong Kong, US)
3. Reduce capital gains tax rates. Doing so will attract more capital, drive more investment, and increase economic growth. It will also increase the number and volume of investment transactions (i.e., times the capital gains tax is paid), thereby increasing total revenue. This will grow the economic pie, thereby increasing the tax base. Do not increase capital gains tax as this would undermine investment and result in capital flight.
4. Australia must benchmark its tax rates against economies that attract capital, which include the US, UAE, and Singapore. This is because human and financial capital can and will leave to those locations. Thus, to attract and retain human and financial capital, Australia must be at least as competitive as its competitors. Europe and the

UK are an irrelevancy as capital need not go to either location and being less uncompetitive than Europe does not solve the problem of being less competitive than the US, UAE, or Singapore.

5. In Marxian terms, workers should own the means of production to ensure they are not servants to their employer, meaning they should invest in shares. This also implies people should invest in property. Unlike financial assets, property does not require special expertise, making it the ultimate egalitarian leveler. We should thus encourage more investment, not less.

2 Cutting capital tax rates can increase total tax revenue via economic growth

There is a strong case to *reduce* capital gains taxes rates as this can generate economic growth, ultimately growing the tax base and the total tax take. As will become apparent, there are several key takeaways:

1. Australia must have regard to the tax rates in the next most attractive jurisdictions. These include the UAE, New Zealand, US, Singapore and Hong Kong. Specifically, if an individual can earn a higher after-tax salary in another country, then the individual can move their business, capital, or human capital to that country.
2. Revenue maximization does *not* involve simply increasing taxes. Economic growth and revenue can increase from *reducing* tax rates.
3. Tax rates should *not* increase with talent or with effort.

To see this, we can draw upon the incentive contracting literature. A well-utilized model is that of Holmstrom and Milgrom.[1] This is perfectly adapted to capital investment. Here, we model a situation where the goal is to maximize the value of the State (i.e., Australia's GDP). This would then grow the tax base. The GDP growth itself derives from human and financial capital. After all, capital investment is a core driver of GDP. The State aims to determine how

[1] The model was initially introduced in: Bengt Holmstrom and Paul Milgrom, 'Aggregation and Linearity in the Provision of Intertemporal Incentives' (1987) 55 303. It has been commonly used in the literature. For a recent use, see: Suman Banerjee and others, 'Location Matters: The Impact of Local Air Quality on CEO Compensation Structure' (2024) Working Paper <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4207194> accessed 21 August 2024.

much of the capital returns the investor gets to retain (i.e., how much to tax). The crux of the model is that increasing tax, reduces capital investment, which reduces GDP growth.

The investment, which we denote as e, increases GDP output per year. The contribution to output is proportional to the 'talent', 'skill', or 'productivity' of the person that makes the investment, which we capture with the coefficient ψ. Thus, we have the following value-equation.

$$V(\psi, e) = \psi e + \epsilon \quad (1)$$

Where, e is the investment level, ψ, gives the sensitivity of value to effort (think of this as productivity), and ϵ is a random term, denoting random fluctuations in value. We standardize ϵ such that $\epsilon \sim N(0, \sigma^2)$.

The individuals derive income from the investment. The individual's wage (W) has a flat component (α) plus a share of the contribution to value. Think of this as being akin to the tax free threshold earnings. For practical purposes, $\alpha = 0$. The investor can keep $\beta = 1 - \text{tax}\%$ of the value they create. Thus, the after tax earning is $W = \alpha + \beta V$. The components α and β are endogenously determined and we will discuss their optimal values.

The individual's investment gains must be at least as high as he or she could earn from other outside opportunities and the 'cost' of exerting effort. These outside opportunities are set in an international context. We assume that people and capital are internationally mobile. Thus, people will consider the attractiveness of other jurisdictions, such as New Zealand, the UAE, and Singapore.

The state tries to maximize its net revenue, which is given by:

$$E(Net\ Revenue) = E\big(V(e)\big) - E(W) = \psi e - \alpha - \beta\psi e \quad (2)$$

Similarly, the individual requires that the income earned is at least as great as the 'cost', which includes the opportunity cost of the income forgone with overseas opportunities. That is, if a person could earn more after tax elsewhere (after considering frictions and

information asymmetry), then it is they will move their human or financial capital. This is clear from the capital flight that occurred in Norway following its wealth tax,[2] and in the UK following its increase in capital gains taxes.[3] These tax increases ultimately resulted in less tax revenue due to human and financial capital leaving.[4]

The Cost of Investing thus include (a) the disutility of exerting effort on that investment, (b) a risk premium, and (c) a reservation earning, representing the outside opportunities. In order to model this, we utilize standard functional forms, which are common in the literature [5]. We assume that the individual has an exponential utility function. Thus, the utility of the income earned is $u(W) = -e^{-\rho W}$, where W is the income earned and ρ is the risk aversion coefficient. We also assume the following:

$$\begin{aligned} \text{Disutility of investing (i.e., effort and deferred consumption)} &= \frac{e^2}{2}c \\ \text{Risk Premium} &= \frac{1}{2}\rho\beta^2\sigma^2 \\ \text{Reserveration Income} &= u_0 \end{aligned}$$

Therefore, we know that the compensation $(W = \alpha + \beta V)$ must satisfy the following relationship:

$$\alpha + \beta V \geq \frac{e^2}{2}c + \frac{1}{2}\rho\beta^2\sigma^2 + u_0$$

Rearranging, and noting that $V = \psi e$, this gives us the following relationship:

[2] Gordon Campbell, 'On Wealth Taxes And Capital Flight' *Scoop* (28 May 2025) <https://www.scoop.co.nz/stories/HL2505/S00054/on-wealth-taxes-and-capital-flight.htm> accessed 25 July 2025; Ray de Bono, 'Norway's Tax Experiment: A Costly Exodus' *IM Global Wealth* (23 March 2025) <https://imglobalwealth.com/articles/norways-tax-experiment-a-costly-exodus/> accessed 25 July 2025.

[3] Ian King, 'CNBC UK Exchange CNBC's UK Exchange Newsletter: UK's Millionaire Exodus Spells More Trouble for Labour' *CNBC* (2 July 2025) <https://www.cnbc.com/2025/07/02/uk-exchange-newsletter-millionaire-exodus-spells-trouble-for-labour.html> accessed 25 July 2025; Holly Evans, 'Millionaires to Flee UK in Record Numbers' *The Independent* (24 June 2025) <https://www.independent.co.uk/news/uk/home-news/uk-millionaires-non-dom-tax-rachel-reeves-b2775646.html> accessed 25 July 2025.

[4] Laura Miller, 'Reeves's Capital Gains Tax Changes "Backfire" as Treasury Receipts Fall Sharply' *Money Week* (23 July 2025) <https://moneyweek.com/personal-finance/tax/capital-gains-tax-receipts-changes-backfire> accessed 25 July 2025.

[5] see e.g., Holmstrom and Milgrom (n 1).

$$\alpha + \beta\psi e - \frac{e^2}{2}c - \frac{1}{2}\rho\beta^2\sigma^2 - u_0 \quad \geq \quad 0$$

Now, we should note several factors. First, in equilibrium, the individual will receive an income such that this is satisfied in equality. This is because it would minimize the wage offered, thereby creating the most retained value for the state. Second, that does *not* mean that the state should drive the income towards zero as this would disincentivize investment, as we will see soon. Third, we should recognized that the expression $\alpha + \beta\psi e - \frac{e^2}{2c} - \frac{1}{2}\rho\beta^2\sigma^2 - u_0$, above, is the individual's net earnings less the cost of providing services. Thus, the individual will choose the investment level exerted so as to maximize – or optimize – that level. Therefore, differentiating $\alpha + \beta\psi e - \frac{e^2}{2c} - \frac{1}{2}\rho\beta^2\sigma^2 - u_0$ with respect to e gives us the following optimal level of investment:

$$\begin{aligned} \frac{d}{de}\left(\alpha + \beta\psi e - \frac{e^2}{2}c - \frac{1}{2}\rho\beta^2\sigma^2 - u_0\right) &= \beta\psi - ec \\ \text{Set this to zero find the optimium} & \\ \beta\psi - ec &= 0 \\ e^* &= \frac{\beta\psi}{c} \end{aligned}$$

Therefore, in equilibrium, the person will choose the level of investment (e^*). We can immediately see that this depends on the proportion of value that the individual can keep (β). The state then chooses the level of β having regard to the optimal level of effort. Recall that the value to the state is given by $\psi e - \alpha - \beta\psi e$ (see above). Therefore, we can substitute in the value for e^* to obtain:

$$\begin{aligned} \text{Value to the state} &= \psi e - \alpha - \beta\psi e \\ \text{Substitute } e^* & \\ \text{Value to state} &= \frac{\beta\psi^2}{c} - \alpha - \frac{\beta^2\psi^2}{c} \end{aligned}$$

Now, we can obtain the value for α to substitute into the above equation. Recall that the state would set $\alpha + \beta\psi e - \frac{e^2}{2}c - \frac{1}{2}\rho\beta^2\sigma^2 - u_0 = 0$. Now, if we substitute in $e^* = \frac{\beta\psi}{c}$ we obtain $\alpha + \frac{\beta^2\psi^2}{c} - \frac{\beta^2\psi^2}{2c} - \frac{1}{2}\rho\beta^2\sigma^2 - u_0 = 0$. Collecting terms gives us $\alpha + \frac{\beta^2\psi^2}{2c} - \frac{1}{2}\rho\beta^2\sigma^2 - u_0 = 0$.

Therefore, $\alpha = -\frac{\beta^2\psi^2}{2c} + \frac{1}{2}\rho\beta^2\sigma^2 + u_0 = 0$. We can then substitute into the value for to the state to give:

$$\begin{aligned} \text{Value to the state} &= \frac{\beta\psi^2}{c} - \alpha - \beta^2\psi^2 \\ &= \frac{\beta\psi^2}{c} - \beta^2\psi^2 + \frac{\beta^2\psi^2}{2c} - \frac{1}{2}\rho\beta^2\sigma^2 - u_0 \\ &= \frac{2\beta\psi^2 - \beta^2\psi^2}{2c} - \frac{1}{2}\rho\beta^2\sigma^2 - u_0 \end{aligned}$$

From here, we can obtain the optimal level of β (i.e., the proportion of value that the worker keeps). This gives us:

$$\begin{aligned} \frac{d}{d\beta}\left(\frac{2\beta\psi^2 - \beta^2\psi^2}{2c} - \frac{1}{2}\rho\beta^2\sigma^2 - u_0\right) &= \frac{2\psi^2}{2c} - \frac{2\beta\psi^2}{2c} - \rho\beta\sigma^2 \\ &= \beta\left(-\frac{\psi^2}{c} - \rho\sigma^2\right) + \frac{\psi^2}{c} \end{aligned}$$

$$\begin{aligned} \text{Set equal to zero to optimize} \\ \beta\left(\frac{\psi^2}{c} - \rho\sigma^2\right) + \frac{\psi^2}{c} &= 0 \\ \beta^* &= \frac{\psi^2}{c\rho\sigma^2 + \psi^2} \end{aligned}$$

We can also see how the optimal β^* depends on the skill or ability of the person. We can do this by differentiating with respect to ψ, which simply involves an application of the quotient rule. The germane result is $\frac{d}{d\psi}(\beta^*) \geq 0$. That is, the optimal proportion of value retained increases with talent. Or, phrased differently, tax rates need not automatically increase with the individual's wage (or income) as that same individual might also be especially adept at generating economic growth and it is important to encourage that individual to generate growth. In the investment context, this might imply a lower CGT rate for professional investors. However, that adds complexity.

The foregoing model applies mutatis mutandis to investment and direct work effort. However, the main differences come in areas such as the reservation wage (u_0) and the risk

premium. This is because the capital gains tax rate is zero in many competitor countries. Thus, Australia can charge a higher rate, and expect capital to stay, only to the extent that either (a) it has attractive investment opportunities that are not available elsewhere, or (b) frictions or information asymmetry deter overseas investment.

We can then learn the following from this:

1. Australia must have regard to the tax rates in the next most attractive jurisdictions. These include the UAE, New Zealand, US, Singapore and Hong Kong. Specifically, if an individual can earn a higher after-tax salary in another country, then the individual can move their business, capital, or human capital to that country. This is clear from the fact that the net wage earned in Australia must be at least $\frac{e^2}{2}c + \frac{1}{2}\rho\beta^2\sigma^2 + u_0$, where u_0 represents the reservation wage, which itself represents offshore income.
2. Revenue maximization does *not* involve simply increasing taxes. This is because the optimal level of effort is $e^* = \frac{\beta\psi}{c}$. Thus, the higher the tax take, the lower the effort exerted. And, given that value depends on effort, increasing tax rates can undermine value.
3. Tax rates should *not* increase with talent or with effort. This is clear from the finding that the optimal amount a person should retain *increases* with talent $\left(\frac{d\beta^*}{d\psi}\right) \geq 0$. And, the optimal tax rate is independent of effort.

3 Capital allocation, transactions, and revenue loss

Developers and companies require capital. Investors care about after-tax returns. Increase taxes, and they apply a higher hurdle rate, meaning less investment. This means less growth, including incrementally less housing construction. Less growth means less revenue and a smaller tax base.

Hiking CGT will deter asset sales: Suppose you invest for 10 years at 7 per cent per annum. Your $100 investment will grow to $196.70. You see an opportunity to potentially earn 10 per cent per annum. You are considering selling. On 47 per cent CGT, you are left with only $151.26. You will need to stick with that new investment for 2.8 years just to earn back the

tax. If you get a 50 per cent CGT discount (i.e. pay 23.5 per cent), then it still takes you 1.3 years. If they had stuck with their original investment, they would have been ahead, having $237, while the person who sold is just back where they started.

The impact is clear. First, CGT revenue falls because the individual has less incentive to sell. Second, people do not efficiently reallocate capital, which harms growth and tax revenue over the long term.

4 Tax rate increases will drive capital overseas, reducing tax revenue and growth

Australia must both *retain* and *attract* capital and productive labor. To do this, Australia must resist the temptation to increase capital gains tax or impose wealth or inheritance taxes. This is because Australia exists in an international environment and doing so would result in human and financial capital leaving Australia, thereby undermining economic growth. In so doing, it would reduce Australia's tax base, creating a downward spiral. Specifically: tax rate increases are not revenue neutral, they are revenue negative.

There is clear precedent for the impact of hiking capital taxes:

- United Kingdom: The UK sought to increase capital gains taxes. The consequence is an estimated 16,500 millionaires being set to leave the UK.[6] The increase in tax rates, resulted in capital gains tax receipts falling by 10%.[7] The net result was counterproductive: rates rose but human and financial capital left, ultimately undermining the tax base and economic growth.[8]

[6] Evans (n 3); King (n 3).
[7] Miller (n 4); The Times, 'Capital Gains Tax Receipts Fall 10% as Wealthy Exit UK' (25 April 2025) <https://www.thetimes.com/uk/politics/article/capital-gains-tax-receipts-h78d8tkrh>.
[8] Editorial Board, 'Britain Taxes Away Its Rich' *Wall Street Journal* (23 April 2025) <https://www.wsj.com/opinion/britain-tax-revenue-falls-rachel-reeves-keir-starmer-laffer-curve-b3ba8309> accessed 25 July 2025.

- Norway: A similar effect occurred in Norway when it introduced its wealth tax,[9] ultimately harming tax receipts.[10] Indeed, exit taxes hastened this trend by sending a clear signal of government intent and deterring new capital from entering the country.
- California: California has recently floated the idea of a one-off 5% wealth tax on billionaires. This caused $1 trillion in wealth to leave California before the wealth tax even came into being.[11] That capital exodus causes California to raise less income tax, generate fewer jobs, and will result in less growth.[12]

Australia therefore does not operate in a vacuum. Australia competes with other countries to both *retain* and *attract* capital.

Let us start by considering the case of attracting human or financial capital. If a person is looking to move to, or invest in, a location they will consider the tax rates. If Australia's tax rates are 'too high' relative to other countries , then it simply will not attract capital. Clearly Australia does attract many immigrants. However, Australia attracts relatively few 'high net worth individuals' who could make a significant increase to Australia's tax base and could bring investment capital. Increasing taxes would reduce Australia's access to financial capital.

Australia will clearly not retain capital if it increases capital gains taxes, or imposes inheritance or wealth taxes. Overseas experience is enough to demonstrate this. As indicated above, The UK lost millionaires when it attempted to do so. Australia may lose relatively fewer millionaires due to its geographic distance. However, the UK lost millionaires when it sought to increase CGT to 24%. This implies that Australia could *attract* millionaires if it reduced its CGT which is approximately 23.75% for long term gains (i.e., 47.5%/2 for the long term capital gains rate). Financial capital would also leave Australia if it were to increase such rates

[9] de Bono (n 2).
[10] Rupert Neate, 'Super-Rich Abandoning Norway at Record Rate as Wealth Tax Rises Slightly' *The Guardian* (10 April 2023) <https://www.theguardian.com/world/2023/apr/10/super-rich-abandoning-norway-at-record-rate-as-wealth-tax-rises-slightly> accessed 25 July 2025.
[11] Jing Pan, 'Billionaire "Exodus" Sees $1T in Wealth Exit California, Warns Famed Investor. Build Wealth like the Uber Rich, Anywhere' *Yahoo Finance* (14 January 2026) <https://finance.yahoo.com/news/california-billionaire-exodus-pushed-1t-173300651.html>.
[12] See discussion in Michael Moritz, 'California's Billionaire Tax Plan Will Backfire' *Financial Times* (14 January 2026) <https://www.ft.com/content/122f71b9-bf0f-47c3-a46d-827740d4ce73>.

Australia must therefore have regard to competitive countries when setting its tax rates. If it wishes to attract capital (and generate growth) it must cut capital gains tax. If it wishes to merely maintain the status quo, then it must not increase capital gains tax, or the other pernicious taxes mentioned. If Australia wishes to reduce growth and tax receipts, then it could increase such tax rates. This includes the UAE, Singapore, Hong Kong, and the US. While parts of Europe may have higher tax rates, they are not a counterfactual as human and financial capital would simply move to the most attractive domicile when leaving.

Cutting capital gains tax could therefore raise revenue for Australia. This is because it would attract capital to Australia. In so doing it would (a) increase the volume and number of transactions and investments, and (b) increase the growth generated by those investments.

Furthermore, lower CGT rates would encourage investors to transact more frequently, which raises revenue. For example, at present an investor must wait one year and a day to receive the 50% CGT discount. This is material as it could reduce the CGT rate from around 47% to 23.5%. Notably, the 23.75% rate is only marginally below the level that caused capital flight in the UK, implying that a reduction could attract capital. Furthermore, even at 23.75%, an investor must consider whether to lose 23.75% of their equity by selling or whether to hold. Selling, to invest in another asset, becomes more attractive the lower is the CGT rate as the investor can retain more of their equity. Thus, a lower CGT rate can encourage more transaction volume. In our example, if the CGT rate is lowered to a flat 15%, then we only need to investor to transact twice to generate more net revenue. In this context, reducing the *short term* capital gains tax rate is especially pertinent as it encourages more transaction volume, which raises more tax revenue.

5 Avoid adverse changes to property taxation

The foregoing analysis should make it clear that the government should not make adverse changes to property taxation. A corollary of the forgoing analysis is that individuals will be less likely to invest in property if tax rates increase. This applies to both “negative gearing” and capital gains tax.

Increasing capital gains taxes, or reducing negative gearing, would most likely reduce property prices. This is because they would reduce the after tax cash flows that an investor would expect to receive from a property. It would not impact an owner occupier. However, it would reduce the amount an investor would be willing to bid, thereby reducing the amount that an owner occupier must pay. This would impact different sectors of the market differently. For example, it would be less likely to impact high end properties, whose prices mean that the rental yield is too low to be attractive as a rental investment.

There is a clear issue with reducing the capital gains tax discount: it would result in people being taxed for inflation. This means that the real after tax value of the investment would ultimately decrease. In addition to creating the aforementioned price effects, this would also slow liquidity in the property market as there would be limited incentive to sell. In so doing, it would reduce the stock of available properties to buy, ironically reducing housing supply.

Increasing capital gains taxes on property would risk reducing overall tax revenue. This is for two major reasons:

1. Transaction volume and capital gains receipts: liquidity would reduce in the property market. This is because the after-tax equity left after a sale would be lower. For example, suppose someone bought a property for $1m, which increased to $1.5m over 10 years. Under the current system, the person would pay approximately $118k in tax, leaving $382k in equity. This already deters a sale as the person would have gone from $500k to $382k in equity. But, suppose the CGT discount were eliminated, the equity would fall to $250k. This would deter a sale as the person would now risk not being able to buy another property and their net worth would fall. The net result is that the government would receive less capital gains tax due to fewer transactions.
2. Stamp duty: A corollary of the above is that stamp duty receipts would fall. While these accrue to the states, the fall in stamp duty receipts would ultimately influence the federal government, which would then be required to satisfy the shortfall.

Restricting the capital gains tax discount to new builds, or reducing it for existing dwellings, would not resolve this issue. This is because investors clearly consider the sale price of their property. They will realize that a future buyer will discount the property to reflect their higher capital gains tax rate. Thus, a buyer of a new property will lower the price they are willing to

pay. But, given construction costs, this will reduce the price below the floor necessary for the new build to occur. Furthermore, once the precedent is set, all buyers of newly built properties will consider the sovereign risk of future government changes. Ergo, restricting the capital gains tax discount will result in less supply.

The net result of the foregoing is that increasing capital gains taxes on property will not automatically result in more tax revenue. Indeed, it could stymie investment, reduce the number of sales, and reduce tax revenue.

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