Submission to the Senate Select Committee on the Operation of the Capital Gains Tax Discount

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The Centre for Independent Studies (CIS) welcomes the opportunity to provide a submission to the Senate Select Committee on the Operation of the Capital Gains Tax Discount.

The CIS is a leading independent public policy think tank in Australasia. Founded in 1976, its work is driven by a commitment to the principles of a free and open society. The CIS is independent and non-partisan in both its funding and research, does no commissioned research nor takes any government money to support its public policy work.

As a Senior Fellow in the economics program at the CIS, I undertake research into a wide range of public finance issues and regularly comment in the media on taxation and other budget issues. My most recent publication under the CIS banner was *Keeping Budgets on the Rails: Rules for Fiscal Responsibility* (CIS Analysis Paper 94, November 2025).

Before joining the CIS, I was a senior official with the New South Wales Treasury and in that role was responsible for advising the state government on taxation policy and federal/state financial relations. Prior to that I was a senior official with the Australian Treasury in Canberra and both the World Bank and the International Monetary Fund in Washington, DC.

In addition to the attached submission addressing the Inquiry's terms of reference, I attach my CIS Policy Paper of March 2019 titled *Myth vs Reality: The case against increasing capital gains tax*, which I wrote in the context of the then Opposition's policy of halving the capital gains tax discount from 50% to 25%.

I would be happy to expand on the points in the attached submission, or to provide further information, if this would assist the Committee in its inquiry.

Yours sincerely,

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SUBMISSION TO THE SENATE SELECT COMMITTEE ON THE OPERATION OF THE CAPITAL GAINS TAX DISCOUNT

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Introduction

This submission is based on the author's attached CIS Policy Paper No. 18 of March 2019 titled *Myth vs Reality: The Case Against Increasing Capital Gains Tax*, tailored to the Inquiry's terms of reference.

As the Inquiry is considering various aspects of the effects of the capital gains tax (CGT) discount, a basic question for the Committee is the point of comparison for the current 50% discount. Is it no discount at all, a smaller discount, or the pre-1999 system of cost basis adjustment for inflation (which was a form of discount by another name)?

This is not an issue for this submission, as it argues that the 50% discount should be retained, but it is an issue for anyone who believes the 50% discount is excessive. If the 50% discount is assessed against a 0% discount, the effects would obviously be greater than if they are assessed against a smaller discount, which would be more realistic.

Moving from 50% to no discount would be a radical change as Australia has never had such a regime, and other countries also typically tax capital gains at lower rates than other income. A 0% discount would result in a doubling of CGT from the 50% discount.

Alternatives that have sometimes been discussed in Australia include the Henry tax review's proposal for a 40% discount, the then Opposition's policy in the 2019 election of halving the discount to 25%, and the pre-1999 system of adjusting the cost base of assets for inflation.

Another basic issue for the Committee is the extent to which it is influenced by the relationship between CGT and housing. Objections to the CGT discount often arise in the context of housing prices, but the same discount applies to a much wider range of assets and as discussed below housing is not even the largest asset class in the CGT base. Should CGT for all assets be changed solely because of concerns about housing, or should housing be treated differently from other assets?

Yet another issue is what is meant by 'the' CGT discount when there is actually a range of CGT treatments according to entity and asset type. For example, superannuation funds receive a one-third discount, companies receive no discount, owner-occupied housing is exempt from CGT and there are various small business exemptions. The main focus of this submission is on the 50% discount for assets (other than owner-occupied housing) owned by individuals and trusts (other than superannuation funds) for at least 12 months, but many of the comments also apply to the other discounts and exemptions.

Terms of reference (a) and (d).

These terms of reference are addressed jointly as they are closely related. They relate to the effect on after-tax income distribution, asset prices and wealth distribution.

Treasury's Tax Expenditures and Insights Statement[1] indicates that the benefit of the CGT discount (measured as estimated tax revenue foregone) is heavily skewed towards the top two income deciles. However, this is hardly surprising as most assets subject to CGT are owned by higher income earners. If there is a case for the discount, then the uneven distribution of its income effects is unavoidable. The gains taxpayers receive from the discount should not be expected to be distributed evenly or progressively, because the discount does not serve the purpose of a social security or welfare payment.

The effects of taxation on income distribution can only be sensibly considered for the tax system as a whole, not tax by tax. Some taxes (such as the GST and excise duties) are regressive but are accepted because there are other reasons to keep them in the tax system. Likewise for the CGT discount. The tax system as a whole is markedly progressive, and the joint tax/transfer system even more so.

But it should not be accepted that the CGT itself is regressive. The flip side of the skewed distribution of the benefits of the discount is that the CGT actually paid is just as skewed towards the top two income deciles. The CGT is therefore progressive, but a bit less than it would be without the discount.

Another point is that capital gains are not large enough relative to total household income for any form of taxation of capital gains to have any material impact on income distribution. Taxation Statistics produced by the ATO for 2022-23 (latest available) indicate that gross current year capital gains (that is, before the discount) of individual taxpayers were $84 billion whereas total taxable income was $1.2 trillion.[2] That is, gross capital gains were 7% of taxable income, and net capital gains even less. Household gross income from all sources was $2 trillion.[3] The reality is that CGT policy has very little leverage over income distribution either way.

The effect of the CGT discount on asset prices and wealth is difficult to discern from the myriad other influences. While the discount was intended to encourage investment in assets with some risk profile, this does not necessarily mean that it has pushed up asset prices. The prices of shares and business assets are subject to a wide range of influences other than CGT and in many cases are determined in a global market.

In the case of residential real estate, local factors are relatively more important, but there is empirical evidence that tax policies such as negative gearing and the CGT discount – often blamed for high housing prices – in fact account for very little price growth. Supply constraints have been much more important.[4]

Although there are many determinants of income and wealth inequality, it is worth noting that the summary measures – the Gini coefficients – do not provide clear evidence of a rising trend in inequality since the CGT discount was established in 1999. The ABS measure of the Gini coefficient for income has increased slightly since the late 1980s, but very little since 1999. The HILDA measure has not increased at all.[5]

Wealth inequality is significantly higher than income inequality because asset ownership is more concentrated, as is the case in all countries. The ABS measure of the Gini coefficient for wealth did increase somewhat up to the global financial crisis of 2008-09, but not since; and the HILDA measure has not increased at all.

Both income and wealth inequality were disturbed by the pandemic, with some signs of a decline in income inequality initially followed by an increase, and a decline in wealth inequality.[6] It is best to see where these measures settle before coming to any conclusions about trends in the post-pandemic environment.

Australia's income inequality is close to the average for OECD countries and wealth inequality is below average.

Terms of reference (b) and (c).

These terms of reference are addressed jointly as they are both concerned with productivity and the composition of asset purchases by type.

The CGT discount is most often discussed in relation to housing, but it applies to a wide range of assets and housing is not even the main one. Taxation statistics on the composition of current year (gross) capital gains in 2022-23 (latest available, but a representative year) point to real estate transactions accounting for 40% of all CGT events for individual taxpayers and only 5% for superannuation funds. As 'real estate' includes the non-residential type, the proportions for housing would be even lower. Allowing housing to drive CGT policy would therefore overlook the dominance of other asset types.

One appeal of the CGT discount is its uniformity across asset types. This makes it neutral with respect to the choice of asset purchases. In view of this neutrality, it is odd to refer to the discount "funnelling investment into existing housing assets". The discount may tilt household saving away from interest-earning assets — which are taxed at full marginal rates — towards assets that offer the prospect of capital gains, but that advantage does not apply to existing housing alone and says more about the inappropriate taxation of interest than about the CGT discount.

Whether the CGT discount encourages speculative or productive investment is moot. The difference between 'speculative' and 'productive' is not clear-cut. Buying an asset in the expectation that its value will increase may be considered "speculative" by some but to others is the very essence of investment.

Investment in housing, and even existing housing, should not be considered 'unproductive'. All forms of housing generate services that people value. Discouraging investment in existing housing and favouring new construction is like dismissing trading in shares and bonds on the secondary market and only valuing new share or bond issues.

To the extent there is pure speculation, it tends to have a short-term focus. It should not be overlooked, therefore, that the CGT discount does not apply if an asset has been held for less than 12 months.

All things considered, it is difficult to make a case that the CGT discount is inimical to productivity growth. To the contrary, investment and innovation are critical to productivity growth and the CGT discount is meant to encourage investment. Removing or reducing the discount would raise the cost of capital and be detrimental to investment.

Terms of reference (e).

I have no comments on CGT as it applies to trusts, other than to say there is no reason to discriminate against trusts simply because they are a structure favoured by higher income households.

Term of reference (f).

The 50% discount adopted in 1999 replaced the system of cost-base indexation for inflation coupled with an averaging provision that allowed taxpayers to average large capital gains over three years to mitigate the effect of large one-off gains pushing the taxpayer into a higher tax bracket.

The change was in part driven by what was seen as the complexity of the indexation and averaging provisions. However, it is important to understand that the discount was not put forward as simply an alternative way of adjusting for inflation. The Ralph Review of Business Taxation (which recommended the discount) recognised various reasons for discounting capital gains in addition to inflation, such as:

- The disincentive effects of CGT on saving and investment.
- The riskiness of investments giving rise to capital gains.
- The distortionary asset lock-in effect of CGT; and
- The prevalence of lighter CGT burdens in other countries in the context of increased international capital mobility.[7]

Thus, to the extent the 50%t discount gave rise to lighter CGT burdens than an indexation system, that result was seen as being justified by these considerations. In the words of the Ralph Review:

> The Review's recommendations for CGT are designed 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.

The rationale for the discount remains today. Indeed, it is needed more than ever in light of the weakness of business investment and productivity growth. This is not to suggest that the discount alone will spark a revival of entrepreneurship, innovation and investment. The fact that business investment has been weak for a long time even with the discount in place points to the case for another agenda including factors like deregulation to help lift investment.

The housing affordability issue has greater salience today than in 1999, but as discussed above the effect of the discount is easily overstated and Australia has experienced periods of both rapid house price growth, slumps and stagnation in the past under all CGT regimes. As also discussed above, CGT policy should not be driven by housing alone.

When alternatives to the discount are discussed, one popular proposal is to revert to the pre-1999 cost basis adjustment for inflation. However, the reality is that this indexation method results in an effective discount that is probably, on average, not much less than the 50 per cent discount.

Consider this example. Someone 10 years ago bought shares in one company or a bundle of companies that matched the price performance of the overall market as represented by the ASX200 index. They sold the shares after exactly 10 years. The compound average annual price growth rate was 5.8%. Over the same 10 years the CPI increased by 2.9% a year. With cost base adjustment and ignoring transaction costs, the effective discount would have been 43%t.

The results before transaction costs are similar for an average Sydney home (houses and units) price purchase and holding over that period, but as transaction costs for housing are much higher the actual capital gain would be lower and the effective discount under a cost-base indexation regime would be even higher than in the shares example.

In general, the results are sensitive to the real rate of return and the holding period. To take another example, with a lower inflation rate, a higher 4% real rate of return, a five year holding period and again ignoring transaction costs, the effective discount with indexation would be 35%.

These are of course only averages and examples. The results would be different for other time periods and for any time period there would be a wide spread of effective discounts under an indexation regime, well below 50%t for high performance investments and well above for poorly performing ones.

But the point is that on average the 50% discount serves the purpose of simplicity and delivering a better — but not much better — after-tax outcome than the indexation method. For high performing investments it delivers a better outcome, and arguably this is an attractive design feature as it provides a built-in incentive for investors to make their assets work harder.

Terms of reference (g).

Some form of concessional CGT undoubtedly has a role in Australia's future tax mix — that is, concessional relative to full marginal rates of personal income tax -- not only to avoid taxing purely inflationary gains but for the other reasons discussed above. Removing the discount and taxing capital gains (other than short-term) at full marginal rates would be unthinkable because of the damage it would do to saving and investing.

That is not to say the 50% discount is the only form of concession. But given that it is well-established and simple, there need to be strong reasons to change it.

If the sole objective were to adjust for inflation, the most precise way to achieve this would be to revert to the pre-1999 indexation system and accept its greater complexity. However, there are many relevant considerations apart from inflation, which on balance favour some degree of concession in the CGT on real gains in addition to the allowance for inflation.

The 50% discount balances all the relevant considerations in a rough but simple way. While housing could be taxed differently from other assets, this would bring complexity and there is no strong case for doing it.

One more complex alternative across all assets would be to allow cost base adjustment so that only real gains are taxable, but in addition allow a discount — much smaller than the current discount – on the real gains.

If the future brings reform that materially changes the tax system, then there might be a stronger case to review CGT. For example, if personal income tax marginal rates across the board were to be significantly reduced, a smaller discount for capital gains may be appropriate. Alternatively, if taxation of all forms of saving and investing were to be reformed to make it more uniform, there may be a case for a smaller discount. This was the context of the Henry tax review recommendation for a 40 per cent discount of interest income and net rent as well as capital gains.[8]

Terms of reference (h).

Revenue effects are relevant as raising extra tax revenue is often the motivation behind proposals to increase CGT. CGT revenue relative to personal income tax revenue actually increased after the 50 per cent discount was introduced, slumped during and after the global financial crisis, and has risen again since.

It is difficult to disentangle the effects of the tax change from asset market movements. However, one reason CGT revenue has on average been stronger after 1999 is that the discount stimulated asset turnover and realisation of capital gains. The lock-in effect of the tax was loosened and gains that would not have been realised under the indexation regime were realised under the discount regime, thereby offsetting any loss of revenue.

This is relevant to consideration of how much extra revenue a harsher CGT would generate. As the removal or a cut in the discount would tighten the lock-in effect, there is potential for a large reduction in turnover and realisation that would be self-defeating from the viewpoint of revenue gain.

A reduction in asset turnover would not only be a revenue issue. It would also militate against the liquidity and capital mobility that make markets more efficient in allocating capital to its best uses.

Conclusion

There is a very strong case for some form of tax concession for capital gains relative to full marginal rates. This concession should go beyond simply allowing for inflation. While various structures are possible to satisfy this condition, the current 50% discount (and one-third discount for superannuation funds) has the advantage of being simple and well understood and there is no strong case for changing it.

[1] Treasury, *2024-25 Tax Expenditures and Insights Statement* (Australian Government, Canberra, 2024)
[2] Australian Taxation Office, *Taxation Statistics 2022-23* (Australian Government, Canberra, 2025)
[3] Australian Bureau of Statistics, Australian National Accounts: National Income, Expenditure and Product, June 2025 (Australian Government, Canberra, 2025).
[4] Peter Tulip, *Housing Affordability and Supply Restrictions*, Policy Paper 55, February 2024 (The Centre for Independent Studies, Sydney, 2024)
[5] Productivity Commission, *Rising inequality? A stocktake of the evidence*, Commission Research Paper, August 2018 (Australian Government, Canberra, 2018).
[6] Productivity Commission, *A snapshot of inequality in Australia,* Commission Research Paper, May 2024 (Australian Government, Canberra, 2024).
[7] Australian Treasury, Ralph Review of Business Taxation, chapter 18, Incentives for Investing (Australian Government, Canberra, 1999).
[8] Australia's Future Tax System, Report to the Treasurer (Dec 2009), Part 2, Vol 1, p 72.