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

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Biography

My name is Cathal Leslie, and I am an economist who has built a career analysing and developing international and domestic economic policy. I have significant experience in tax economics, having worked as an economist in the Centre for Tax Policy at the **Organisation for Economic Co-operation and Development (OECD)**, where my work focused on personal and property tax reform. Prior to the OECD, I worked as an economist in the **Commonwealth Treasury**, where my work covered **financial system** issues and **housing-related policy,** and as an economist at the **Productivity Commission,** where I examined **the effects of the remote area allowances and the zone tax offset**. I am currently an economist working in the **artificial intelligence** sector.

This experience has led me to be particularly concerned with how Australia's capital gains tax settings shape:

- the distribution of wealth between owners and non-owners, and across generations;
- the allocation of capital between speculative investment in existing housing and more productive forms of investment that support long-term growth; and
- the international competitiveness of our capital and labour income taxes.

This submission is provided in a personal capacity. The views expressed herein are my own and should not be taken to represent the views of any past or present employer.

1. Executive summary

As Australia grapples with an ageing population, slowing productivity, rising inequality and worsening housing affordability, the case for examining how capital gains tax (CGT) settings shape investment behaviour has never been stronger. This Senate inquiry into the operation of the CGT discount is both timely and necessary and this submission argues that the current discount is poorly targeted, regressive, and has contributed to capital misallocation away from productive investments. In particular:

- **The CGT discount for investment properties overwhelmingly benefits higher-wealth, older households**. It does little for younger families who face higher entry prices into home ownership but receive none of the tax support.
- **Capital gains on housing largely reflect windfalls on underlying residential land,** driven by factors such as migration, planning, income growth, and public investment in infrastructure and services. Yet, these windfalls attract the same or greater concessions as genuinely risky, productive investments in businesses.
- **The tax system distorts investment towards existing housing.** The combination of full deductibility of interest and other holding costs, light land taxes, and the 50 per cent CGT discount, makes leveraged investment property particularly attractive compared with fully taxed forms of capital income or investing in productive businesses.

Considering these concerns, this submission recommends:

1. **Reducing the CGT discount for residential investment property**.
    - Reducing the CGT discount (e.g. to 33%) would limit investor demand while maintaining a buffer against inflationary gains in asset prices.
2. **Undertaking reforms with the broader tax ecosystem in mind,** recognising that the discount interacts with other tax measures. Some areas to consider:
    - moving towards a dual income tax system (i.e. treating labour income and capital income separately for tax purposes), where ring fencing of rental losses means they are only deductible against other capital income;
    - removing the CGT discount may worsen housing turnover, which could be counteracted with reforms to stamp duty and land taxes; and
    - whether bequeathing assets should be counted as a taxable CGT event.
3. **Reducing barriers that discourage renting of spare bedrooms**
    - Retirees face compliance and tax burdens when renting out spare rooms, along with welfare policy barriers that reinforce housing underutilisation.
4. **Re-allocating the savings from smaller housing concessions** towards tax cuts on business investment and labour income.

Together, these changes would better align Australia's CGT system with fairness, housing affordability, and long-run productivity. To support these findings and recommendations, the remainder of this submission details some of the key issues with current CGT arrangements, as outlined in the Senate Committee's Terms of Reference. These include the distributional effects and productivity-sapping impacts of CGT settings (Section 2), as well as reform options, such as treating housing investments, business investments, and primary residences differently for tax purposes (Section 3). The submission then canvasses other related issues that could improve the functioning of the tax system, including a discussion of how CGT rules discourage the utilisation of spare bedrooms (Section 4), introducing deemed CGT realisation at death (Section 5), and a conclusion (Section 6).

2. Distributional and productivity impacts

2.1 How have capital gains in the housing sector been generated?

Capital gains on housing can arise from two different sources:

1. **The building (the structure)** – investment in the physical dwelling: bricks, mortar, fixtures and fittings.
2. **The land** – the underlying site, the bundle of location-specific amenities and planning rights attached to it.

This distinction matters for tax design because it tells us whether the concessions benefit new housing investments or landholding. The Australian evidence points to the latter. In the early 1950s, land at the urban fringe accounted for well under 10 per cent of the value of a typical new house. By the early 1970s, land shares had risen to around 50 per cent of the dwelling's value[1]. Since then, land has become the dominant component of dwelling values in Sydney and other major cities. Recent decompositions of house values into land and structure components find that by the mid-2010s, roughly two-thirds of the average house value in Sydney was land rather than the building.[2] Recent price appreciation would imply this share has risen further. In other words, the "capital gain" realised when an investment property is sold is predominantly a land gain, not a return to the owner's investments in the quantity or quality of the physical dwellings on the land.

2.2 Why housing gains are different: land windfalls rather than rewards for effort

For business equity, capital gains more closely resemble a reward for taking on commercial risk, innovating, and creating new products or services. When an investor backs a firm that grows, hires staff and raises productivity, the resulting capital gain reflects genuine value creation. One can reasonably argue that tax relief for such gains encourages socially beneficial risk-taking that expands our productive capacity. By contrast, **most long-run gains on residential property – particularly in established urban areas – are not of this character**. These gains primarily arise because:

- planning decisions restrict or shape the supply of housing in desirable locations;
- publicly funded infrastructure and services (transport, schools, hospitals, parks) raise the value of nearby land; and
- population growth alongside rising incomes increases competition for a relatively fixed quantity of well-located sites.

Individual owners do not design the transport network, determine migration policy, or set zoning rules (or at least they shouldn't – and there are zoning windfall tax solutions to discourage rent-seeking in this manner). Yet when these factors drive up land prices, the private owner receives a private benefit.

[1] Stapledon (2009)
[2] Kendall and Tulip (2018)

2.3 Tax incentives encourage housing speculation

Residential property investment has several distinct features:

- banks are willing to extend loans at far higher loan-to-value ratios than on alternative investments (i.e. 80% LVR);
- there are no margin calls if the price of the underlying asset falls in value;
- full deductibility of interest and many holding costs against other income; and
- the expectation of sustained capital gains, particularly in major cities, is driven by factors such as planning, income growth and migration.

As noted by several economists, including Ken Henry[3], together these settings make **leveraged investment in existing housing** highly attractive on an after-tax basis, and for high-income investors, can allow them to effectively access very low, or even negative effective marginal tax rates (see stylised example in Table 1 where it is compared with a dual-tax system with a flat capital income). A typical pattern for a geared investor is to accept a **negative cash flow**, use those cash losses to reduce tax on labour income, and then rely on a **tax-favoured capital gain** on eventual sale. In this way, the CGT discount effectively "completes the circuit" for speculative property investment.

The combined effect is that the CGT discount turns publicly created increases in land values into private, lightly taxed windfalls. This is very different from how the tax system treats, for example, a worker who saves in a fully taxed interest-bearing account, or a small business owner whose profits are fully taxed as they are earned. Therefore, it is not difficult to understand why so many investors choose to invest in residential property.

Table 1: The combination of negative gearing and CGT discounts can create negative effective marginal tax rates

	Current system	**Dual-income-tax system**
Tax on labour income	Top marginal rate 47%	Top marginal rate 47%
Tax on capital gains	50% CGT discount; gains taxed at marginal rate (47%) = 23.5%	All nominal capital income is taxed at a flat 23.5%
Interest deductibility	Nominal interest is fully deductible against labour income	Nominal interest is deductible only against capital income
Initial loan	$100	$100
Property value after 1 year	$107	$107
Debt after 1 year	$105	$105
Pre-tax profit	$2	$2
Tax on capital gain	Nominal gain $7 × 50% discount = $3.5 taxable × 47% = $1.65	Nominal gain $7 × 23.5% = $1.65
Tax savings from interest	Interest $5 × 47% = $2.35	Interest $5 × 23.5% = $1.18
Net effect of tax	$1.65 (CGT) − $2.35 (saving) = −$0.70	$1.65 (CGT) − $1.18 (saving) = +$0.47
Post-tax profit	$2 − (−$0.70) = $2.70	$2 − $0.47 = $1.53
Effective tax rate	(2−2.70)/2 ≈ **−35%** (tax system subsidises the return)	(2−1.53)/2 ≈ **23.5%** (effective rate ≈ capital-income rate)

[3]Treasury (2009)

2.4 The opportunity cost: less capital going to productive investments

Capital is not unlimited. To the extent our tax system encourages highly leveraged trading of existing dwellings rather than new investment, it increases the share of savings tied up in bidding for the same stock of housing rather than expanding the productive capital stock – new machinery, technology, intellectual property, skills, and genuinely additional housing. This has significant consequences:

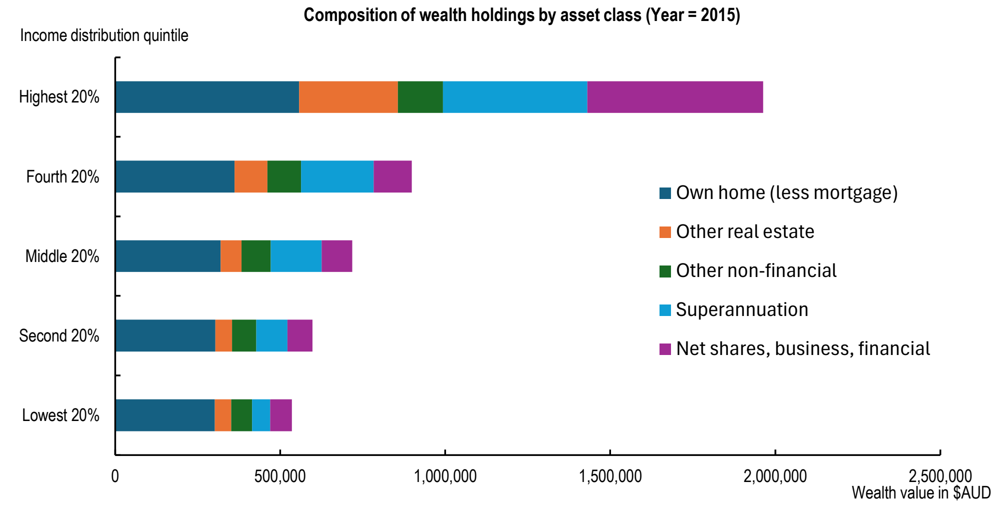
- **Lower business investment**: projects that might have been financed may miss out because capital is earning tax-advantaged returns in residential land instead. This is worsened by the fact that tax concessions must be balanced through taxes elsewhere. Australia's headline corporate and top personal income tax rates are relatively high by OECD standards, which can reduce the number of profitable investments opportunities in the country.
- **Weaker productivity growth**: while some investment in housing is desirable, sustained real house price appreciation driven by land scarcity and pro-demand-side policies does little to raise output per hour worked. By contrast, investment in technology, equipment, and skills has much larger productivity pay-offs.

2.5 Who benefits from the CGT discount?

A helpful starting point for assessing the equity of the CGT discount is the distribution of assets subject to it. CGT-exposed assets – investment properties, shares, and businesses – are disproportionately held by higher-income (Figure 1), higher-wealth and older households (Figure 2). Naturally, this is what we would expect: asset ownership skewed towards those with greater ability to save (i.e., those with higher incomes), those who have been working for longer (i.e., older people), and those who are wealthier.

Figure 1. High-income households disproportionately hold CGT-eligible assets

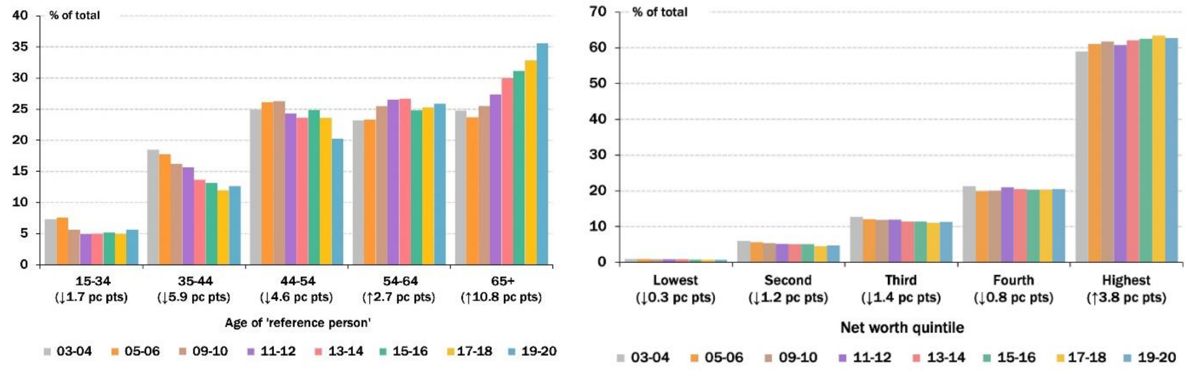
Composition and stock of wealth by household income, 2015



Source: [ACOSS]

Figure 2. Wealth distribution is skewed and disproportionately held by older households

Share of Australian wealth by age group and share of wealth by quintile



Source: [Inside story]

Within housing specifically, ownership of multiple properties (and therefore exposure to taxable capital gains on property) is heavily concentrated among the top end of the income, age and wealth distributions. CGT-exempt residential housing, while still disproportionately held by higher-wealth, higher-income, and older households, is more evenly distributed by income and is typically the largest form of wealth owned by most households. Younger households, renters, and those without access to parental wealth are less likely to hold assets that realise capital gains.

2.6 How the CGT discount on housing worsens wealth and intergenerational inequality

As mentioned earlier, gains from housing primarily derive from underlying land windfalls rather than individual effort. Given this, the distribution of these windfalls raises equity issues in a way that gains from business investment do not. Discounted (and exempt) gains on housing – especially those with multiple properties – are distributed highly unequally. I see two main issues:

- **The owner vs non-owner divide**: The more house prices rise, the larger the untaxed or lightly taxed gains are for current owners, and the more difficult it becomes for non-owners to buy in. The CGT discount increases the after-tax return to housing investment, encouraging additional demand and supporting higher prices than would otherwise prevail. This widens the wealth gap between owners and renters and helps explain why Australians are entering home ownership later in life (if ever).
- **Intergenerational transmission of untaxed windfalls:** Due to rapidly increasing property values, long-held properties in desirable suburbs can deliver substantial tax-exempt (owner-occupied property) or tax-deferred (investment property) transfers to heirs, conferring significant advantages unrelated to effort or merit. Consequently, inheritances and parental gifts are becoming a growing determinant of homeownership, diminishing the role of personal earning capacity (i.e., merit). Meanwhile, the fiscal cost of these concessions is borne by the broader tax system, including younger workers who have not benefited from asset appreciation.

3. Housing: distinguishing the primary residence from investment property

The serious economic and distributional consequences of current CGT settings outlined above underline the importance of reform. Based on previous policy proposals and likely impacts on various asset types, this section outlines how Australia's CGT discount should apply to different forms of housing and makes specific reform recommendations. It distinguishes between:

- Leveraged residential property investment;
- new housing that expands supply vs existing housing; and
- owner-occupied housing (the primary residence).

I argue that the CGT discount should be reduced for all investment properties, while preserving at least some CGT preference for the family home and avoiding changes that would further discourage downsizing or mobility. Savings from these changes should be redirected towards broader cuts to labour and capital income taxes. My focus is on reforms that improve how well the housing stock is used, who benefits from housing windfalls, and how capital is allocated between housing and more productive investment.

3.1 Why investment property should be treated differently

Several features of investment property mean it should be treated differently from both primary residences and business investment:

- it is commonly acquired with the expectation of a tax-advantaged capital gain on the underlying land;
- ownership is concentrated among older, higher-wealth, higher-income households with the borrowing capacity to take on leveraged positions in residential land;
- it competes directly with would-be owner-occupiers for the same stock of dwellings, particularly in established suburbs where new supply is constrained; and
- unlike in business investment, where capital gains more often reflect risk-taking, innovation and additions to the productive capacity of the economy, capital gains in housing largely reflect windfall increases in land values.

A CGT regime that recognises these distinctions would scale back concessions for leveraged investment in existing housing, while maintaining core protections for owner-occupiers and more targeted support for productive capital formation.

3.2 Housing investment that adds supply vs trading existing dwellings

In principle, one might wish to favour genuinely supply-adding investment over pure trading of existing dwellings. In practice, however, drawing a clean line in legislation between "new supply" and "existing stock" is difficult. Knock-down rebuilds that replace one house with another, substantial renovations that make previously uninhabitable dwellings usable, subdivisions and secondary dwellings would all sit in grey areas. Designing separate CGT regimes for each category would add complexity and invite boundary-pushing. I am not aware of any other OECD country that operates such a system.

Accordingly, I am sceptical of the practicality of CGT reform proposals such as those suggested by the McKell Institute[4]. Applying a much higher discount rate to new attached dwellings (70 per cent, compared with 35 per cent for existing houses and 50 per cent for other investments, as McKell proposes) could deliver substantial untaxed windfalls to speculators who benefit from planning rule changes. It would also be a marked deviation from how CGT usually operates. We generally do not discriminate between income-generating assets based on whether they are new or pre-existing. For example, when we buy shares on the stock exchange, we are rarely 'investing' new capital in a company; we are purchasing someone else's existing ownership rights. This is for good reason: in aggregate, purchases of pre-existing assets free up capital for sellers to re-invest. By offering more attractive CGT treatment to current owners than to prospective buyers, the proposal would make the asset more valuable to the seller than the buyer. Ironically, a reform designed to favour new attached dwellings may, in practice, worsen liquidity and reinvestment.[5]

Lastly, the other main reason is that the supply of new dwelling construction in Australia is inelastic – it does not grow significantly in response to higher prices. Elsewhere, I've suggested that this may be because we are already constructing new dwellings at close to our economic capacity; many have cited planning constraints[6], as well as productivity and insurance market gaps. Whatever it may be, or even a combination of these factors, tax reform, when prices have increased so much over the past two decades, does not seem to be the way forward on new construction. Notably, studies have shown that the existing CGT discount and negative gearing settings have had only modest impacts on prices (i.e. between 1-4%).

3.3 Suggested options for reforming CGT on investment housing

The following reforms aim to improve fairness and productivity, and to tilt the investment balance towards greater density and more owner-occupiers.

- **Reduce the CGT discount for residential investment property**
  - Reduce the CGT discount rate;
  - Redirect concessions towards income tax cuts, which would increase the post-tax incomes of renters, while boosting the after-tax return to rental income.
- **Tightening the interaction with negative gearing**
  - Most OECD countries do not allow the full deductibility of investment losses against labour income.[7] While this submission focuses on the CGT discount itself, its interaction with interest deductibility and easy access to credit strongly shapes investor behaviour. Ring-fencing investment losses from labour income (i.e., through a dual income tax system) would reduce the relative demand for investment properties compared with other investments. One study found that the removal of negative gearing could boost homeownership rates by 5.5 percentage points[8].

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[4] McKell Institute (2025).
[5] Grattan (2016) made similar points about liquidity problems on CGT reforms where old CGT rules are grandfathered in. McKell's suggested reform (which also includes grandfathering), has similar effects, except rather than being a transitional feature, it would make them permanent.
[6] Centre for Independent Studies (2021)
[7] C. Gillitzer (2025)
[8] Cho et al (2017)

- **Interactions with state-level stamp duty and land taxes**
  - CGT and stamp duty are both triggered on sale and, when layered together, can significantly discourage housing turnover. Stamp duty is a pure transaction tax on property values, while CGT taxes only the gain. In practice, an investor selling a property that has appreciated substantially in value can face a large tax impost at the point of sale. Ideally, any reduction in the CGT discount on housing would be alongside broader reforms to abolish stamp duty.
  - In parallel with any move away from stamp duty, the Committee should consider measures to introduce or expand broad-based land taxes. By taxing the underlying land value, rather than the value of the structures on top of it, a land tax would:
    - encourage more efficient land use and greater housing density where it is desirable; and
    - ensure that more of the economic rent from rising land values is captured on a current basis, reducing the extent to which large land windfalls remain untaxed and then benefit from the CGT discount.

3.4 Reducing investor housing concessions would increase the cost of tax concessions on owner-occupied properties

The Commonwealth's fiscal position is generally more favourable when a greater share of housing is held as investment properties. Both rent and gains on sale are taxable, whereas for owner-occupiers the imputed rent (i.e., the hypothetical rent one would have paid for an equivalent property) is untaxed, and any capital gains are exempt. The recommendations above are likely to increase the share of housing stock held by owner-occupiers rather than investors. That is, more housing will be tax-exempt. Consequently, revenue gains that we might expect may not be as large once increased tax expenditures on owner-occupied housing are accounted for.

Owner-occupied dwellings occupy this special place in the tax system and in social expectations because they provide:
- shelter and security;
- a form of saving over the life cycle; and
- stability for families and communities.

For these reasons, the primary residence has enjoyed generous tax treatment in Australia (as in most OECD countries). While certainly not immune from being used as a speculative vehicle to generate fully exempt capital gains (i.e. by encouraging the purchase of larger, more desirable plots than an individual would otherwise choose), the economic and social reasons to maintain its tax-preferred status are compelling. This submission does not propose a wholesale removal of the primary residence exemption. However, it is essential to recognise that this status has helped make residential property a tax-favoured asset class. That is not a neutral setting, and it has substantial distributional and efficiency consequences.

3.5 Pitfalls to avoid on CGT reform for owner-occupied properties

If, in the future, Australia were to place limits on the CGT exemption for primary residences – i.e., by introducing a cap or applying tax above a threshold – it is important that investments by owner-occupiers in their own property are included in the cost base, so as not to penalise investment. It is also crucial not to penalise mobility when it is otherwise efficient to do so. One concern is that taxing gains on the primary residence, even only above a threshold, could:

- discourage households from **moving for work** (e.g. relocating to a different city);
- make it harder for families to **adjust their housing** as circumstances change (forming couples, having children, separation); and
- reduce older households' willingness to downsize or right-size, even when doing so would free up larger homes for families and better match their needs.

To mitigate these concerns, the Committee could explore generous **rollover relief for owner-occupiers**, such as:

- allowing homeowners who sell their primary residence to **defer CGT liability** on gains when they re-invest the proceeds into another main residence; and
- only crystallising CGT when the reinvestment chain is broken (for example, when the household permanently exits owner-occupation or when the household’s constituent members pass away).

4. Lifecycle housing patterns and the "empty-nest CGT penalty"

While not explicitly addressed in the Committee's Terms of Reference, several other inefficiencies are borne out by Australia's CGT settings. One distortion arising from the current treatment of capital gains on housing is the way it interacts with owner-occupiers who wish to rent out spare rooms. Australia has one of the highest numbers of bedrooms per person in the OECD[9]. Unfortunately, the tax system effectively penalises the group who are best placed to ease pressure in the rental market – older "empty-nest" owner-occupiers in well-located family homes.

4.1 Who actually has spare bedrooms?

Spare bedrooms are not distributed evenly across the population. Stylised facts from census data and housing surveys point in the same direction:

- Young adults in their 20s and 30s are disproportionately:
  - renting, often in small apartments or share houses; or
  - recent mortgagors in relatively modest dwellings, with limited surplus space.
- Couples with children tend to **fill** any additional bedrooms as their family grows.
- The typical household with **one or more unused bedrooms**, particularly in well-located detached houses, is an **older owner-occupier**:
  - children have left home (85% of over 55s have at least 1 spare bedroom);
  - the mortgage may be fully or largely repaid; and
  - the household is firmly attached to the neighbourhood and reluctant to move.

From the perspective of housing utilisation, older owner-occupiers are exactly the cohort with the greatest potential to provide extra rooms in the areas where renters most want to live: established suburbs with good access to jobs, transport and services. But the tax system punishes a more efficient usage of existing housing, even acting against the wishes of older owner-occupiers themselves.

4.2 The tax status of a primary residence when spare bedrooms are rented out

Australian real estate has enjoyed massive capital gains over the last three decades, with residential wealth now totalling $11.5tn. As a result, the primary residence CGT exemption has yielded significant tax savings for many homeowners. However, once an owner decides to rent out spare rooms, the tax treatment changes in three important ways:

1. **Rental income becomes assessable**.
2. **Deductions are allowed, but apportioned**.
   The owner can claim a share of interest, rates, insurance and other costs, typically based on floor area and time used to produce income.
3. **The main-residence CGT exemption becomes partial**.
   A proportion of any future capital gain on the dwelling are taxable, pro-rated by:
   - the share of the property used to produce income; and
   - the fraction of the ownership period during which it was used that way.

[9] OECD (2016)

In effect, the decision to rent out rooms converts part of the home from a tax-privileged, fully exempt asset into a quasi-investment property for CGT purposes.

4.3 Renting spare bedrooms: a poor trade-off for older owners

This transition matters differently at different stages of the life cycle. For a high-income household in mid-career, renting out rooms involves a clear trade-off:

- On the one hand, **deductions** for the rental share of mortgage interest and other costs are valuable because they reduce tax at a relatively high marginal rate.
- On the other, they accept that a proportion of future capital gains will be taxable.

For older "empty-nest" households, the calculus is much less favourable. Many retirees have low taxable income, do not have mortgage interest to deduct, and other deductions, such as maintenance, are only deductible at low or zero marginal rates. They therefore receive **little income tax benefit**, despite taking on the compliance burden of record-keeping and apportionment. By contrast, the **CGT consequences** are much less affected, because CGT is realised in large single instalments (and therefore likely taxed above the tax-free threshold).

Taken together, these features amount to an implicit **"empty-nest penalty"** in the tax system:

- An older couple in a three- or four-bedroom home in an inner or middle-ring suburb faces a choice between:
  - preserving full main-residence CGT exemption; or
  - taking in renters, paying tax on modest rental income, and converting part of their future capital gains into taxable income, adding complexity.
- For many, the rational response is to **leave the spare rooms empty**.

This is inefficient. The existing stock of dwellings in well-located areas is **underused**, older people who want to rent out spare bedrooms are discouraged for tax reasons, and younger renters are pushed into **cramped or peripheral accommodation**.

4.4 Reform needs to be holistic

Seniors Australia, in arguing for tax reform on retirees renting out spare bedrooms, noted that "older people report home sharing arrangements fulfil several needs. These include addressing loneliness, feeling safer, stronger social connections, and affordability"[10]. However, any response to the "empty-nest penalty" needs to start from a sober assessment of what taxes can and cannot do. The reluctance of older Australians to rent out spare rooms has many drivers:

- the desire to maintain spare bedrooms for visiting relatives and friends;
- practical concerns about privacy, safety and hassle in sharing a home;
- the design of Age Pension assets and income tests;
- the fact that many older owner-occupiers are, by global standards, relatively asset-rich and under little day-to-day financial pressure.

Therefore, new CGT tax concessions targeting spare bedrooms on their own are unlikely to improve housing utilisation dramatically. As such, policymakers should strive to remove disincentives for older owner-occupiers improving the utilisation of their homes.

[10] Seniors Australia 2025

Simply extending the CGT exemption to households who wish to rent out spare bedrooms would likely encourage tax minimisation strategies and discourage downsizing, muting the economic benefits that might be gained from better utilisation of spare bedrooms. CGT reform could be more potent if complementary reforms are made elsewhere, thereby avoiding providing another concession that worsens already severe intergenerational wealth inequality. With that in mind, reforms should be guided by three principles:

1. **Remove unnecessary penalties on the efficient use of existing stock.**
   Older owner-occupiers willing to share under-occupied homes should not face disproportionate tax penalties or complexity for doing so.
2. **Reducing and avoiding concessions that encourage underutilisation.**
   Tax relief for older homeowners should be tightly targeted at genuine increases in housing supply and utilisation, and should avoid discouraging downsizing.
3. **Coordinate with retirement income and housing policy.**
   Tax changes need to be complemented by reforms to retirement income and support for downsizing.

5. The penalisation of in-life giving over bequests

5.1 Australia's CGT system discourages gifting during life

When individuals gift an asset, such as an investment property or shares, to a relative, they trigger CGT. This amounts to **an unrealised capital gains tax on the asset**. The asset is 'deemed' to have been sold at market value when it is gifted, with a CGT liability triggered by the gifter.

In contrast, if those same assets are gifted through a bequest, they pass through estates **without triggering a CGT event**. The net effect of the deemed disposal rule for gifts but not for bequests is that the tax system effectively encourages people to hold onto assets until they die. It is hard to justify why the tax system should encourage holding assets until death rather than giving them in life.

5.2 CGT Carry-over rules enable tax minimisation inheritance strategies

The carry-over of CGT liabilities on investment properties through bequests generates opportunities for parents to make tax-deferred inheritances to their children. In 2021, 2.2 million individuals owned an investment property, while 1.8% of Australians[11] (approx. 460,000) had a landlord who was a parent or other relative. Like any other investment property, as long as they declare market rent to their children, rental losses are deductible against their labour income. This means many could be employing a strategy of deducting what is, in all but name, effectively their child's or grandchild's mortgage. Nothing stops people from separately providing in-life cash gifts to family members outside rental arrangements.

Because mortgage deductions are unavailable to owner-occupiers, this puts prospective owner-occupiers at a tax disadvantage compared to high-income parents who choose this inheritance strategy for their children. It also means that, upon the parent's death, the property's ownership transfers and becomes eligible for the CGT exemption on a pro rata basis.

5.3 The CGT wedge between gifting and bequests drags on productivity.

When the cost base of an inherited asset, including investment properties, is carried over, it creates what is known as the 'lock-in effect'. Bequest recipients are left with an accrued tax liability on their property. For an inherited investment property intended to be owner-occupied by the inheritor, this is like another stamp duty if they later want to sell the asset, impeding their mobility if their work or personal situation changes (e.g., divorce, children leaving home). For other assets, like shares, this means portfolio investment decisions are influenced by the accrued tax liability rather than returns alone, which discourages people from moving away from underperforming assets.

5.4 International practice: the treatment of unrealised gains at death

Australia is unusual among advanced economies in allowing large, unrealised capital gains to pass at death without being taxed in any form. Most comparable countries ensure that, in one way or another, **unrealised gains are brought into the tax base when wealth is bequeathed**

[11] Australian Pasifika Education Network (2023)

at death. These approaches, when combined with a step-up in cost basis, can reduce capital lock-in by resetting cost bases for heirs – meaning that heirs don't face an additional tax burden if they immediately choose to sell the inherited property – thereby encouraging them to allocate inherited capital based on potential returns rather than tax liabilities.

Countries tax unrealised capital gains at death through one (or a combination) of approaches (see table 2 for a complete breakdown):

- **Inheritance or estate taxes** — In many OECD countries, inheritances or estates are taxed on the full value of assets transferred. While the form differs – with some countries taxing the estate and others taxing the recipient – the practical effect is that unrealised gains embedded in the assets are subject to tax as part of the transfer.
- **Deemed realisation of capital gains at death** — Some countries instead treat death as a deemed disposal for capital gains purposes. Unrealised gains are calculated and taxed as if the asset had been sold at market value immediately before death.

As Australia does neither, substantial capital gains – including on long-held residential properties – can be deferred indefinitely. Australia also does not apply a step-up in the cost basis of inherited assets, which means investor capital can be locked into underperforming assets with large unrealised capital gains to avoid a large tax bill. In considering reforms, the Committee therefore starts from an international position in which **some form of taxation of unrealised gains at death is the norm rather than the exception**.

Table 2: Treatment of unrealised capital gains at death

Countries where treatment applies to most assets		
	Countries that levy inheritance or estate taxes	**Countries that do not levy inheritance or estate taxes**
Unrealised capital gains are taxed at death	Denmark, Hungary	Canada
Unrealised capital gains pass to heirs on a carry-over basis	Denmark, Finland, Germany, Ireland, Italy, Japan, Luxembourg, Switzerland,	Australia, Austria, Estonia, Israel, Mexico, Norway, Sweden
Unrealised capital gains are exempt upon death and transferred with a step-up in basis	Chile[1], Denmark, Finland, France, Hungary, Korea, Lithuania, Portugal, Slovenia, Spain, United Kingdom, United States	Latvia[2]

1. This is considered a non-taxed event, not an exemption.

2. Taxes gifts through personal income taxes, does not levy a separate gift tax or an inheritance tax.

Note: Countries may appear multiple times in the table if different treatment applies to different assets. Missing information from Poland and, the Slovak Republic. This table does not consider ordinary exemptions for certain asset classes, low-value capital gains, or capital gains on long-held assets. There is no capital gains tax in Belgium, Greece, and the Netherlands (levy inheritance or estate taxes) or in Czech Republic and New Zealand (do not levy inheritance or estate taxes). There is no capital gains tax on privately held movable property in Switzerland, except when individuals are judged to be trader.

Source: Reproduced from OECD 2021.

5.5 The case for deemed realisation at death

Between inheritance taxes and deemed realisation, deemed realisation is arguably a more efficient and fairer tax rule. This ensures that large, accumulated gains are taxed at least once over the asset holder's lifetime, while still allowing heirs to retain the underlying asset if they choose. In Canada, where such a system already operates, it is estimated that deemed disposal at death makes up approximately 20 per cent of the capital gains tax base[12]. Under such a regime:

- the asset is deemed to have been sold at its market value at the time of death;
- CGT is assessed on the accrued gain;
- the heir receives the asset with a new cost base equal to that market value;
- the underlying wealth is not taxed again;
- the inheritor is not burdened with an unrealised CGT liability that distorts capital allocation

However, moving to this system would create some fairness and liquidity concerns. A deemed realisation regime could introduce deferral and relief options, for example:

- providing specific deferrals or exemptions where a surviving spouse or dependent continues to live in the primary residence;
- allowing tax to be deferred, with interest, until the property is sold, where an immediate payment would cause hardship;
- offer specific exemptions and rollover rights for certain assets that are illiquid or have certain social value (e.g. farms), and
- applying thresholds so that only substantial gains are subject to deemed realisation.

The key point is that deemed realisation at death prevents indefinite deferral of CGT on the CGT base and reduces lock-in, without requiring an annual wealth tax, inheritance tax, or frequent revaluation of assets, as in an unrealised CGT system.

[12] Policy Options (2024)

6. Concluding remarks

Australia's CGT rules do little to support genuinely productivity-enhancing investment and too much to deliver unearned windfalls on residential land. It widens the gap between owners and non-owners, entrenches intergenerational inequality, worsens the utilisation of housing stock, and diverts scarce capital towards bidding up the price of existing dwellings rather than expanding the productive capital stock.

A better-designed regime would draw more precise distinctions between:

- windfall gains on scarce urban land and returns to productive business risk-taking;
- investment properties and primary residences; and
- capital and labour income, within a more coherent dual-income-tax framework.

In practical terms, this points towards a package that would:

- reduce the discount rate on residential property investment;
- implement more favourable treatment for genuinely risky, productivity-enhancing investments and work, for example, through a more generous CGT discount, lower personal income tax or a lower corporate tax rate;
- move towards a dual-income-tax structure, with separate schedules for labour and capital income, ring-fencing of rental and other investment losses, and lower but flatter tax rates on capital income;
- complement any CGT changes with broader reform – phasing out stamp duty on housing transactions in favour of broader land taxes; and
- introduce deemed realisation of capital gains at death (with appropriate thresholds, deferrals and protections) so large windfalls cannot escape the tax base indefinitely.

Taken together, these reforms would rebalance Australia's tax concessions away from lightly taxed windfalls on housing and towards work, entrepreneurship and productive investment. They would improve fairness between owners and non-owners, between younger and older Australians, and between capital and labour, while strengthening the foundations for long-run growth.