ASSET OWNERSHIP AND CAPITAL GAINS
(See also LAND AND HOUSING)

[This Note summarises a number of problems and options for action which have been identified by tax experts, leading community sector organisations and other analysts as needing attention in the Henry report. TaxWatch itself does not express policy views.]

ASSET INCOME ("CAPITAL GAINS")

Some key problems

A 50% tax discount is enjoyed by asset income that is received in the form of capital gains rather than, for example, as bank interest or share dividends. Also, the capital gains tax is levied only on the final sale rather than annually on accrued gains. The combined effect is to distort investment towards property speculation rather than activities which generate recurrent income.

These distortions are aggravated by the complete exemption from capital gains tax for all principal residences and by Australia's uniquely generous deductibility of interest payments on borrowings to buy assets ("negative gearing"). These factors have contributed to the excessive borrowing and asset price inflation which is now causing substantial damage to the general economy.

In a number of European countries "dual income tax" systems seek to tax all forms of asset income in the same way and at substantially lower (often, flat) rate than applies to work income. This approach could "tidy up" the position in Australia, where different forms of asset income are treated very differently. But it could also aggravate current distortions and inequity between taxation of work and assets.

There is no compelling case that the current favourable treatment of asset income, let alone provision of further concessions, is necessary to maintain international competitiveness and attract overseas investment. In any event, most capital gains by overseas investors in Australia are already exempt from our capital gains tax and therefore do not need the 50% discount and other concessions.

The main sources of asset income for low-income Australians are bank and superannuation accounts, neither of which attract significant tax concessions. This contrasts starkly with the treatment of capital gains for high-income people.

Options for Action

- ☐ Remove or reduce the 50% tax discount on capital gains.
- ☐ Remove the exemption from capital gains tax which is enjoyed by property acquired prior to 1985.
- ☐ Tax deemed rates of annual return on assets, analogous to the approach taken in the pension assets test.
- ☐ Reduce the special concessions and exemptions from capital gains tax which have been provided to small businesses in recent years.
- ☐ Provide a low flat-rate exemption for capital gains to simplify compliance, or replace all current exemptions with an exemption for overall gains up to an indexed lifetime limit.
- ☐ Restrict deductibility of interest payments and expenses so that it applies only against income from the same source (eg, from investment properties).

ASSET OWNERSHIP AND TRANSFER

Some key problems

The principal Australian taxes on asset ownership are land taxes and council rates. Many other countries have an annual wealth tax which is intended principally to encourage assets to be used productively or sold, rather than held as a way of avoiding income tax and thereby aggravating inequity. This kind of tax can have efficient and equitable impacts on the ownership and use of assets. It may not raise much revenue directly but can do so indirectly by encouraging use or disposal of assets in ways which generate taxable income.

Unlike almost all OECD countries, Australia no longer has taxes on the transfer of assets by gift or upon death. This lack, together with the tax exemptions for principal residences, greatly aggravates inherited inequity and promotes "hoarding" of assets to avoid tax rather than using and transferring them in an efficient manner. It can also reduce the motivation to make philanthropic donations.

Taxes on these transfers, like taxes on asset ownership, may raise more revenue indirectly by encouraging activities which generate taxable income. As in other countries, they might need to be confined to very high-value transfers in order to avoid undue concern about inequity and discouragement of adequate family provision. They could also enable reductions in some specific taxes on asset transfers, especially stamp duties on residential property.

Options for action

- ☐ Introduce an annual tax at a very low rate on very high levels of total asset ownership.
- ☐ Introduce a national gift and inheritance tax on assets exceeding a high total value.
- ☐ Reduce or remove stamp duties on home purchasers up to, say, median values.
- ☐ Introduce a "deemed realisation" rule that accrued capital gains above a high level are to be taxed when assets are transferred by gift or death.