



18th June 2015

Tax White Paper Task Force
The Treasury
Langton Crescent
PARKES ACT 2600

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Re : BETTER TAX WHITE PAPER SUBMISSION OF CGT DISCOUNT

I have been in public tax practice for over 40 years of which 32 as a principal & consider that the change from indexation to the 50% CGT discount was a huge mistake and to make the tax system fairer and more equitable should be reversed.

Capital Gain Tax ("CGT") was introduced in the September 1995 Budget due to the distortion of capital gains not being taxed whereas income from personal labour and normal investment income itself (rent, interest, dividends etc) were taxed as the various marginal tax rates, depending upon the level of income.

It was correctly considered at the time that it was unfair that capital gains were tax free while labour and investment income were taxed.

The assets cost base was indexed by quarterly movements in CPI to adjust for inflation so that only the "real" capital gain was subject to tax. This system worked fine for years and accounting & tax software was updated to cater for automatic calculation of the indexed cost base, or failing that it was not hard to manually calculate the indexed cost by simply multiplying the cost by the CPI factor for the quarter sold and dividing by the CPI factor for the quarter when purchased.

The indexation of the cost base was preplaced with the flat 50% CGT Discount in December 1999 because the Government / Treasury thought that adjusting the cost base for indexation was too hard. Wee in the tax and accounting industry had learnt to work with indexation and I assure you we considered it pretty basic and simple and certainly not too complicated. I concede that a calculation had to be done to the cost base on every transaction, but was not considered too onerous or costly.

The change to the flat 50% discount in December 1999 flies in the face of why CGT was introduced in 1985. CGT was introduced because it was considered unfair that Capital Gains were tax free. Then in 1999 it was somehow considered fair that 50% of Capital Gains were tax free. It's like the half pregnant argument – can't be half pregnant, but for some reason something that was considered unfair before id OK to be ½ unfair !

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Reverting back to indexation of capital gains would also take some of the heat off the current press for abolishing or quarantining negative gearing on rental properties. One of the driving forces behind the upsurge in negative gearing is that 50% of the Capital Gain will be tax free. If indexation was reinstated this artificial and distorted incentive would be removed. The property investors would have no right to complain as they are only paying Capital Gains Tax on the “real” after inflation gain and the anti-negative gearing brigade would be placated as this unfair distortion would be removed.

On negative gearing, the landlords are paying the costs of holding the rental property such as interest, rates, insurance, agents management fees, repairs & maintenance, and if these exceed the market rental income this loss should be deductible against other income, same as gearing into shares or interest on borrowed fund to buy or fund a business if more than the income in the initial years. Thus removing the artificial 50% CGT Discount would take some of the heat off investing in rental properties, without unduly forcing up rents which was proven to happen when the Keating Government did tinker with removing negative gearing on rental properties.

The small business concessions still could operate on the after indexation Capital Gain.

To further improve the fair taxing of capital gains the averaging of the after indexation “real” capital gain over the period of ownership would result in a even fairer treatment of taxing capital gains. One of the big problems with the way capital gains are taxed is that the taxable portion of the capital gain is all added to the taxpayers taxable income and thus taxed at their highest marginal tax rate in the year of disposal. This is particularly so with say real estate of a business which may have been held for 10+ years and the total taxable capital gain is all taxed at marginal rates in the year of disposal. It would be fairer to average the after indexed capital over the period of ownership and only add this averaged capital gain to other taxable income to work out an average tax rate to be applied to the total capital gain.

Say an asset had been held for 10 years and was sold with a “real” after indexation capital gain of \$100,000. Only 1/10th of the gain would be added to the taxpayers other taxable income to work out an average CGT rate to be applied to the total taxable capital gain. While in theory a little complicated, in practice it would just be another adjunct calculation to determining the after indexation gain based on the years held, and require one more box in the capital gains section of the tax return for the time based average of all capital gains to be added to taxable income to determine the average CGT rate to be applied to the total Capital Gains. I concede this is more complicated than the straight 50% CGT Discount, but would be worth it for the fairer and non-distorted outcome.

Both ideas are not mutually exclusive and could be considered in their own right, but combined would result in the fairest outcome for both taxpayers and revenue collection.

Regards
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