Joint Parliamentary Committee on Corporations and Financial Services

Public Hearing Canberra

29 March 2006

Questions taken on notice

Treasury

Question 1

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CHAIRMAN—One of the issues that has been raised with us is the problem of short-termism, for want of a better description, and the conflict between that and trying to get a longer term view taken of the welfare of the corporation. In that context, one of the issues that has been raised with us is that of capital gains tax and how changes to capital gains tax might encourage a longer term view than the current capital gains tax concessions. Perhaps having a capital gains tax regime that reduces over time in terms of the length of ownership of equities as a means of encouraging the corporation to take a longer term view of shareholder benefits.

Mr Murphy—So the question is: if capital gains tax inhibits their investment in certain—

CHAIRMAN—It would perhaps encourage shareholders to hold shares for a longer period of time and thereby encourage their directors to take a longer term view of shareholder value.

Mr Murphy—We could look into that. I am a bit sceptical, but we would have to think about it. We could talk to our tax people.

Treasury response

The appropriate tax treatment of capital gains is a policy matter for the Government.

The following is a description of current policy.

The Review of Business Taxation, chaired by Mr John Ralph, recommended the current treatment of capital gains in 1999. The review followed extensive consultation with industry and the broader community.

Among other things, the review considered a stepped rate for capital gains so that, the longer the investor owned the asset, the lower the rate of CGT would be. The review, however, did not support this proposal and the Government accepted the review's recommendation.

A CGT liability generally arises only when the investor sells an asset or realises it in some other way. This can cause some investors to retain ownership of assets for as long as possible so as not to trigger a CGT liability where they might obtain better returns before tax elsewhere. In other words, they can become 'locked in' to the investment. Lock-in can distort investment decisions to the detriment of both the investor and the Australian economy by limiting economic growth.

The CGT discount reduces lock-in. This is because the taxpayer pays tax on only half the capital gain after 12 months. On the other hand, having a stepped-rate system would significantly increase

the incentive to lock in. This is because some taxpayers would be motivated not to sell their investments until they were CGT-exempt.

Investors would tend to reject opportunities that might arise within the higher-taxable period for fear of incurring a CGT liability. This would be despite the fact that there might be sound commercial reasons for selling.

The CGT discount means that individuals pay tax on only half of any capital gain they make on assets owned for at least 12 months. This ensures that the maximum rate of CGT on these assets is only 23.25 per cent including Medicare levy from 1 July 2006.