

# 10 CGT MYTHS BUSTED

## Why they should not be used to raise the Capital Gains Tax

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The criticisms and characterisation of the 50% capital gains tax discount over many years have been full of misunderstandings, myths and distortions in the conventional narrative on how the tax works and how it compares with the capital gains tax that it replaced in 1999.

The myths and distortions are biasing the public discussion towards increased taxation.

### **Myth 1: The Howard government halved capital gains tax in 1999**

This could only have been true if nominal capital gains had been taxed in full before the 50% discount for individuals and trusts was introduced in September 1999, but this was not the case.

In fact, the 50% discount replaced an alternative set of capital gains concessions in the form of indexation of the cost base of assets for CPI inflation combined with an averaging provision that limited the impact of lumpy capital gains pushing taxpayers into higher brackets. The old system was discounting by another name.

### **Myth 2: The 50% discount is much more generous than the inflation indexing system**

In fact, the system that the 50% discount replaced delivered substantial relief to taxpayers – probably the equivalent of about a 40% discount at average

rates of inflation and real returns on assets. The averaging provision delivered additional tax relief on top of this effective discount. The previous system resulted in a wide range of effective discounts, smaller at higher real rates of return and larger at lower returns.

### **Myth 3: The 50% discount was intended only as a simpler allowance for inflation, but it over-compensates.**

Simplification was an objective of the discount method, but it was never intended to be only an allowance of inflation. It was meant to serve that purpose but also to provide an incentive for risky, high return investments in Australia in a world of mobile capital. It was expected at the time that in some situations the 50% discount would result in lower taxation than the indexation and averaging system it replaced, and this was deliberate.

### **Myth 4: Inflation is lower now than when the 50% discount was introduced, so the discount is over-compensating for inflation.**

In fact, inflation in Australia had been low for almost 10 years by the time the 50% discount was introduced in 1999. In the 10 years to 1998/99 it averaged 2.5% and in the last 10 years to 2024/25

it was actually higher at 2.8%. So if anything inflation presents a case for a bigger discount now than in 1999.

### **Myth 5: We should go back to the pre-1999 inflation indexation method because it compensates precisely for inflation**

It does compensate precisely for inflation, but at the cost of greater complexity than the simple 50% discount. And the discount was never meant to be only compensation for inflation.

Those urging the government to go back to the indexation method conveniently forget that the averaging provision was part of those arrangements and provided an additional layer of tax relief.

### **Myth 6: The 50% discount has caused house prices to soar and cutting the discount is the solution to high prices**

Real house prices have risen more rapidly on average since 2000 than at least the 20 years prior, but the econometric evidence from several studies is that capital gains tax changes have contributed little to this outcome and that reducing the discount would not have a material, lasting impact in lowering prices.

### **Myth 7: A 25% discount is enough**

This was the policy of the Labor Opposition at the 2016 and 2019 elections and some critics of the 50% discount continue to advocate halving the discount now. However, in many instances 25% would not even compensate for the effect of inflation.

The way the arithmetic works, moving from a 50% discount to a 25% discount results in a 50% increase in capital gain tax paid, which would be a huge tax increase.

### **Myth 8: Capital gains tax policy should be all about housing**

In fact, the majority of taxable capital gains is generated from assets other than housing. Housing

considerations should not determine capital gains tax policy across the board. Even if a cut in the discount is right for housing, it's not right for other assets. Policy should be trying to encourage business investment, not taxing it more.

### **Myth 9: The 50% discount is unfair because most of the tax relief goes to high income individuals**

This assertion is based on Treasury data on the distribution of CGT concessions across taxable income deciles.

But the discount is a policy for economic efficiency, not a social welfare policy. It is hardly surprising that the benefits are skewed towards the taxpayers that own more in assets.

Data on capital gains tax actually paid would show the same skew towards higher incomes. And the data on concessions are misleading in that some taxpayers are pushed into the top income decile temporarily due to lumpy capital gains. The effect of taxation on distribution can only be sensibly assessed for the whole tax system, not for any one tax.

### **Myth 10: The 50% discount is equivalent to \$247 billion of lost tax revenue waiting to be harvested**

This figure is based on estimates of tax revenue foregone over 10 years. It is flawed for a number of reasons.

Summing annual estimates over 10 years is a technique designed to generate a very large number, whereas annual estimates are more meaningful. The estimates are for revenue foregone, not for the revenue that would be gained from increased capital gains tax, which would be much less as taxpayers changed their behaviour in response to the tax change.

The estimate is based on abolishing the discount completely and taxing 100% of nominal capital gains like ordinary income, but nobody is seriously suggesting this.

Any change would be much more modest and existing assets grandfathered, so the extra revenue would be small and not enough to fund meaningful income tax cuts.

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