

Capital Gains Tax Turns Thirty

Submission to Re:think – Better tax system, better Australia

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Executive Summary

I suggest that we eliminate Capital Gains Tax (CGT) for assets held for a very long time as the perpetual, onerous community regulatory burden of keeping records for decades outweighs the benefit of the tax collected and taxing the profit from short term speculation is no longer relevant for these assets.

Under the current system capital gains tax applies to assets purchased after 1985. This is now thirty years ago. The tax is perpetual and records need to be kept indefinitely. As years go by and assets are inherited or personal circumstances change, the record keeping becomes more and more onerous but the CGT liability is never extinguished.

I suggest that we specify a time limit beyond which CGT no longer applies. At the most this should be twenty five years, but ten years would be more in keeping with normal tax record retention requirements.

There is also a CGT issue for older people who want to subdivide off part of the land surrounding their principal residence. They will generally not have kept records of any improvements and the gain is taxed all in one year although it has been accrued over many years. This can result in a one off very high income year for a pensioner. I suggest that subdivision by an individual of their principal residence is no longer subject to CGT where only one or two new blocks are created and where the residence has been held for some years.

I have also put forward a possible new way to calculate CGT. The current system treats gains for assets held more than one year exactly the same as gains for assets held for decades, with no allowance for the difference in inflation or the fact that the gain may have accrued over several years but is taxed in one year.

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Problems with the current system

The first Capital Gains Tax system introduced in 1985 involved calculations based on quarterly changes to the CPI and was needlessly complex. The new system that replaced it is rather over-simplistic and taxes assets held for one year the same as assets which have been held for decades. Both have the same 50% discount.

A problem with both systems is that the tax is perpetual and receipts and records need to be kept indefinitely, with calculations getting more and more complex as time goes on.

I suggest that we eliminate the perpetual, onerous community regulatory burden of CGT for long held assets where taxing the profit from short term speculation is no longer relevant.

CGT currently covers assets bought since 1985, now thirty years ago, and under current rules this will extend out for ever. As the capital gain can be carried forward by the heirs of a deceased estate there is theoretically no limit to the amount of time an asset can be owned before it is sold and the CGT applied. Currently thirty years, but eventually fifty years, a hundred years, two hundred years...

For share market investments shareholders need to keep original contract notes and, for reinvested dividends and property trusts, every dividend statement. For real property the owner needs to keep every receipt for capital improvements, from major improvements down to buying a picture hook. For assets purchased after 1991 owners can also claim some running costs on properties and records for these also need to be kept. For a holiday house or a rental property the amount of paperwork would fill boxes.

It is difficult and onerous for individuals to keep accurate records for this length of time. As well as space considerations for documentation and the fire hazard of keeping boxes of paper in the attic there is also the likelihood of records being lost in house moves or due to water damage or white ant attack in sheds. Even fading ink could be a problem for records kept for several decades. And what about a retiree owning shares or a holiday house moving to residential aged care – are they to hire a storage unit to keep the paperwork, there would be no room for it at the aged care home.

There is provision for individuals to have their receipts verified by an accountant, but this is costly and I do not see this as a practical solution. The summary of the records signed by the accountant would then need to be kept.

The calculations of capital gain can be daunting for long held share market investments, with reinvested dividends and tax-deferred income to be accounted. After thirty years you could have sixty reinvested dividends to add up for each shareholding, or one hundred and twenty for trusts that pay distributions quarterly. While some taxpayers can use spreadsheets to track their holdings, many retirees with shares do not have computers. Keeping reams of old documents and calculating small tax liability amounts from them, covering decades, is not efficient use of people's time or storage space.

Handling capital gains tax for a deceased estate can be a nightmare. Keeping track of one's own records for several decades is hard enough, sorting out someone else's is sometimes impossible.

If the deceased has not kept excellent records it can be difficult to find the cost base of shares. It is very hard to find records of share prices back more than ten years and the original stock brokers may have long since merged or closed down. The original purchase date for the shares may even be lost, especially where shares have been rolled over in a merger or takeover. The share registries charge a very high fee to provide this sort of information, and they generally can only go back for seven years.

For rental properties owned by a deceased estate, the managing agent may have some records, however estate agents come and go over time and the likelihood of an agent having complete records is slim. There may be no records at all for a holiday home except the original capital cost. Holiday homes are typically improved or added to over their life, so simply using the original purchase cost could considerably understate the cost base.

Another problem occurs where land that is currently part of an individual's principal residence is subdivided and a block sold. The cost base for the new block is generally half of the original cost of the land, plus half of the costs of the subdivision. Any prior costs for the new block, eg fencing, sheds, culverts, bridges, turf or plants would not be claimable unless receipts had been kept. As the land was originally part of a CGT free principal residence, it is highly unlikely that receipts for improvements would be retained.

For land purchased thirty years before, the gain could be a considerable amount, even with the 50% discount. This could result in a one off very high income year for a pensioner, even though the gain in value had in fact accrued over many years. If the gain had been apportioned over those years little or no tax would apply. This could be a disincentive for a pensioner to split a large urban block, thereby releasing land for infill housing. The higher taxable income for the year could affect their government pension amount or their entitlement to a Seniors Health Care card.

Suggested changes

At the very least we need a time limit after which capital gains tax no longer applies. Twenty five years would be a good start. Ten would be better.

A ten year time limit would ensure that taxpayers had to keep records for a maximum of sixteen years (ie five years after the tax return following the sale of the asset) and would simplify calculations to only ten years of data.

Subdivision of the land for a principal residence which had been held for some years could be made CGT free where only one or two new blocks are produced, and the original residence remains. This would encourage pensioners to sell off land that they could no longer care for and release retirement funds for them, reducing the cost to the government of paying their pension and leaving them better able to fund their aged care.

A new way to calculate CGT

Here is my suggestion for a new method to calculate capital gains tax that would be fair to everyone. It is quite easy to understand and far less complex than the original CPI dependent system. It would apply to all individuals and self-managed super funds.

| Assets held for | Taxable % |
|------------------------|------------------|
| Less than 1 year | 100% |
| 1 – 2 years | 90% |
| 2 – 3 years | 80% |
| 3 – 4 years | 70% |
| 4 – 5 years | 60% |
| 5 – 6 years | 50% |
| 6 – 7 years | 40% |
| 7 – 8 years | 30% |
| 8 – 9 years | 20% |
| 9 – 10 years | 10% |
| More than 10 years | 0% |

This linear scale of reduced GST liability with time the asset is held would be revenue neutral, would be more appropriate for taxing short term asset speculation and would eliminate the onerous long term CGT record keeping burden for long held assets.

The current system would stay in place for assets bought before the implementation date, with taxpayers given a choice of either system for these assets. The current system would then naturally phase out after five years when the new system would always give a lower taxable capital gain amount. From this point only the new system would be used.

Capital losses could be carried forward and would be applied as now to the pre-discounted amount of capital gain. Capital losses would expire after ten years, but could be applied so that older losses were used up before more recent ones.