19 December 2025
(Revised February 2026)

SUBMISSION TO SELECT COMMITTEE ON THE OPERATION OF THE CAPITAL GAINS TAX DISCOUNT

Attached is the body of my submission to the above Select Committee on the capital gains tax (CGT) discount. The submission was submitted on 19 December 2025 and accepted by the Committee as Submission 49.

The first complete paragraph on page 4 and its associated attachment on page 5 in the original submission have been updated in this version for purposes of clarity.

The submission focuses on how the CGT discount may influence our pattern of investment and associated productivity. Ideal, "investment-neutral" design for taxing investment income would have little impact on investment decisions and, therefore, have minimal negative impact on productivity and long-term growth.

The submission argues that, only taxing CGT assets on realisation already means CGT assets attract concessional treatment relative to investment-neutral tax design – thus, resulting in a pattern of investment that negatively impacts productivity. The CGT discount provides another layer of concessionality with additional negative impact from its consequent effect on the pattern of investment.

Removal of the discount would at least move our income tax design closer to the investment-neutral ideal.

Such removal should be applied across the board, including to shares subject to CGT treatment which would significantly improve the important interplay between CGT and dividend imputation.

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[1] Formerly of the Commonwealth Treasury, managing the Business Tax Policy Branch during the 1985 tax reform process and having a coordinating role in relation to business income tax policy design in the lead up to, and during, the 1999 Ralph Review of Business Taxation.

CAPITAL GAINS TAX (CGT) DISCOUNT

Shortly put, there is no justification for the CGT discount on economic grounds – that is, in relation to the efficient allocation of investment resources.

Ideal tax design

Ideal design for taxing investment income has tax collected without affecting investment decisions: investment capital and associated resources then go to where they are most productive. The income tax does not get in the way of productivity and long-term growth.

Chapter 19 of the 1985 Draft White Paper (DWP) explains how such ideal design incorporates accrued reductions in value (depreciation) for depreciating assets.[2] That explanation may be extended directly to include in ideal design accrued increases in value (capital gains) for appreciating assets (the mirror image of depreciation).

This ideal design reflects the fact that annual income – or commercial profit – from any investment comprises annual net receipts (gross receipts less current costs all used up in the year) plus the annual change in value – up as well as down – of investment assets (and liabilities). Investment decisions are made on the basis of the potential future annual commercial profit offered by prospective investment alternatives. If the same percentage tax (the investor's tax rate) is taken from the annual profit offered across alternative potential investments, investment decisions should be little affected.

In practice, income tax law may not reflect the ideal of incorporating annual change in value (up, as well as down) of assets and liabilities. But the ideal sets the benchmark against which the quality of existing or proposed tax law might be assessed – that is, how small is the effect of the law on investment decision-making.

All CGT assets

Our income tax law goes to much trouble seeking to have depreciation allowances shadow accruing declining values od depreciating assets – with balancing adjustments made between ultimate disposal value and the then depreciated value. Only for CGT assets held for less than a year (companies aside) does our law accommodate the full capital gains or losses realised on their disposal. If such assets happen to be held for just over a year, suddenly the 50% discount cuts in.

That sudden discount cliff did not arise under the original inflation slice excised from capital gains realised on the sale of CGT assets held for more than a year – design that arose from the DWP[3]. But, ironically, Chapter 18 of the DWP explains how, if inflation adjustments are to be made, they should be applied, in order to maintain investment-neutral design with its productivity benefits. The adjustments should be applied to all investment assets – like depreciating assets, trading stock,

[2] Australian Government, Reform of the Australian Tax System, *Draft White Paper*, AGPS, Canberra, 1985. Table 19C.1, p 229, uses a numerical example to illustrate this ideal design.
[3] Australian Government, above n 2, Chapter 7.

monetary items, CGT assets, and so on – as well as investment liabilities.[4] Annual inflation adjustments applied only to CGT assets distort the pattern of investment. As noted in the DWP:[5]

> "In contrast to a comprehensive set of inflation adjustments……., providing adjustments only for physical assets would impose tax-induced distortions on productive decision-making. For example, investments in physical assets would be favoured, with those on high marginal tax rates particularly being encouraged to 'gear up' these investments with borrowings to take advantage of full nominal interest deductibility."

Such sentiments apply to any form of CGT discount – and, indeed, to design that taxes the full capital gain of assets but only when the gains are realised.[6]

Thus, overall, no form of reduced assessment of capital gains realised on disposal of CGT assets is justified on economic grounds. If the investment-neutral ideal of assessing annual accrued gains/losses of such assets (either immediately or carried forward with interest[7]) cannot be implemented, there is no economic justification for adding another layer of investment distortion to the assessment of the capital gains when they are ultimately realised.

This conclusion applies to CGT assets across the board, including share sales subject to CGT.

Shares subject to CGT

The CGT regime is an important companion of our dividend imputation system.

First, CGT ensures tax is paid by those selling shares year by year even when their company retains all of its income for reinvestment. To illustrate, say, no CGT applies at all to sales of the shares of a company that retains all of its annual income for reinvestment (increasing share value) until the company eventually liquidates. At the extreme, those selling out before liquidation would pay no tax on the income retained during their period of share ownership. But, those holding shares when the company liquidates and distributes all retained income would be assessed on all the company's prior income.[8]

CGT with no discount applying to share sales would do a better job smoothing out shareholder returns than CGT with a discount.

Second, CGT losses are required to ensure there is only one layer of tax over time under imputation. When taxed company income is retained, temporary double taxation may occur: once when company tax is paid; and again if shares subject to CGT acquired prior to income retention are sold

[4] Australian Government, above n 2, pp 206-207.
[5] Australian Government, above n 2, pp 205-206.
[6] For counterarguments in response to a range of typical arguments against taxing accrued gains (like risk, inflation, measurement, no cash to pay tax and lock-in), see Mayo W, *Brad – Tax Policy Advisor Extraordinaire: reforming the taxation of investment income*, Kyscope Publishing, 2025, Chapters 4, pp 14-20. (Available at: www.kyscope.com.au.)
[7] For the mechanics of deferring tax on accrued capital gains/losses until CGT assets are disposed of, see Mayo (2025), above n 6, Ch4, pp 35-38.
[8] For numerical illustration and discussion of such circumstances where no CGT discount applies, see Mayo W, *Taxing investment income: without affecting worldwide investment decisions*, Kyscope Publishing, 2011 (available at: www.kyscope.com.au), pp 179-183.

before that income is distributed. Despite this initial double tax, local taxpayers are prepared to buy the shares post-retentions because, when the company distributes that taxed income, they could attract an offsetting CGT loss. The offsetting capital loss could arise from selling the shares after distribution or on liquidation of the company.[9] [10]

Thus, despite the initial double tax in these circumstances, the access to CGT losses enables achievement of one layer of tax over time on previously retained company income – at the rates of those who held the company's shares while the income was being retained (as illustrated in the submission's attachment). However, as the discounting of CGT losses (and gains) increases, the tax rates applying to the retained income move more to the rates of those selling to realise a CGT loss. Nevertheless, despite CGT discounting, no extra tax revenue should be expected from CGT over the long term, with initial CGT gains balanced by subsequent CGT losses. That is the desired outcome of the interaction of CGT and imputation: all company income (including capital gains) is taxed under imputation at shareholders' tax rates when distributed – both as franked dividends (already taxed in the company) and unfranked dividends. Extra CGT revenue would imply permanent double tax.[11]

Nevertheless, a CGT discount may cause permanent double taxation in specific circumstances. Such circumstances include the situation where a company distributes a level of cash that results in some of the distribution comprising unfranked dividends (to be taxed immediately in the hands of shareholders) because of concessional treatment at the company level. Those distributed concessional amounts may be taxed again (via balancing adjustments) when the company disposes of the associated assets. That double tax is offset by a capital loss available to shareholders when the resulting franked dividends are distributed – but only if that capital loss is not discounted.[12]

In sum, removal of the CGT discount would solidify the balancing of gains on share sales with ultimate CGT losses and, more generally, improve the blending of CGT and dividend imputation. Any removal of the discount should apply across the board, including to shares.

Conclusion

Delaying the assessment of gains/losses of CGT assets until disposal of the assets represents concessional treatment relative to investment-neutral design – thus, distorting the pattern of investment with negative impact on productivity and long-term growth.

Applying a discount to those gains/losses realised on asset disposal adds an additional layer of distortion to the pattern of investment. That additional layer would be excised by complete removal of the current discount across all CGT assets – including share sales subject to CGT, removal from which would see much improved interaction between CGT and dividend imputation.

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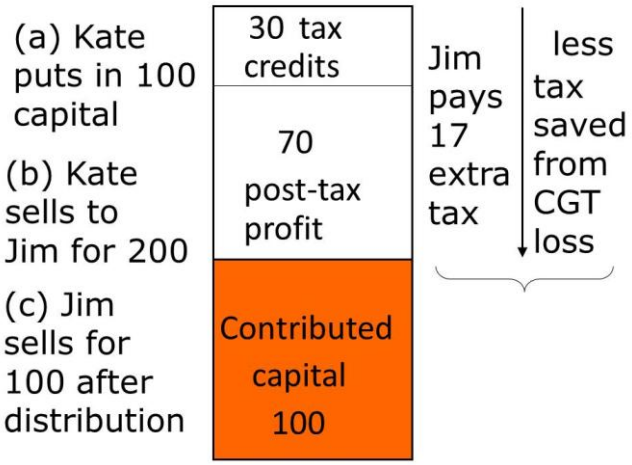
[9] See again Mayo (2011), above n 8, pp 169-183 where capital losses arise on company liquidation.

[10] Prior to recently changed tax treatment, those participating in an off-marker share buy-back (partial liquidation) could also attract offsetting CGT losses – see Mayo (2011),above n 8, pp 242-250 and Mayo (2025), above n 6, Ch7, pp 8-16.

[11] An upgrade to imputation design to a design called integration of taxable income would mean the temporary double tax under imputation would not arise in the first place. See Mayo W, 'Time to upgrade Australia's company tax system from imputation to integration', *Australian Tax Forum*, 33 (4), December, pp 753-803, 2018 (available at: www.kyscope.com.au) and Mayo (2025), above n 6, Chapter 3, Chapter 6 (p 14).

[12] See Mayo (2011), above n 8, pp 175-188. The permanent double taxation is illustrated in Table 39 (p 186), contrasting the single layer of tax resulting in Table 35 (p 175) where no CGT discount applies.

ATTACHMENT: CGT ON SHARE SALES BALANCED BY LATER CGT LOSS



Kate contributes 100 at her company's start.

Over time the company earns 100 of taxable income, retaining post-company tax income of 70, along with 30 of associated franking credits.

Kate (on a 39% tax rate) sells her shares in the company to Jim for 200.

Subsequently, the company distributes all of its retained income and credits and Jim (on a 47% tax rate) immediately sells his shares for 100.

Kate pays CGT on her share sales (temporary double tax then occurring). Jim pays an extra 17 on his 100 of company income (70 franked dividend plus 30 credits) received because of his 47% tax rate. With no discount applying to the CGT loss, in net terms, the 100 of company income is taxed once at Kate's 39% tax rate. As the percentage of discount increases, the tax rate applying to the 100 of company income moves more towards Jim's tax rate (with no CGT at all, his full 47% rate)[13] :

Net tax on 100 income (no CGT discount):
Company 30
Kate(39%) 39
Jim (47%) 17
-47 } **30 + 170 = 200**

39
One layer at Kate's tax rate over time

With no CGT discount, Jim's 47 tax savings from his 100 capital loss (so long as he has capital gains from elsewhere against which to offset the loss) matches his 47 tax on the 100 of company income (30 paid by the company and 17 by him).

Jim receives back 200 cash (30 net tax savings, matching the franking credits, plus 170 cash dividends). The prospect of the CGT loss meant he was prepared to pay 200 initially.

Net tax on 100 income (50% CGT discount):
Company 30
Kate(39%) 19.5
Jim (47%) 17
-23.5 } **6.5+170 = 176.5**

43
More than one layer at Kate's tax rate over time

With 50% CGT discount, Kate only pays tax on 50% of the 100 retained income but Jim only attracts a 50% CGT loss on the sale of his shares.

He only receives a net 176.5 back, less than the 200 he paid initially. While he still pays 47 tax overall on his 100 of distributed company income, his tax savings from the discounted capital loss comes up short of that 47 of tax.

Such effects could be capitalised into share price.

[13] With integration (see n 11), annual taxed company income would always attract current shareholders' rates.