The effect of the 50 per cent CGT discount capital gains realisations – Australian evidence from time series data

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ABSTRACT

This paper reports upon the empirical results of an Australian time series capital gains realisation response study. The motivation for the study is the largely unanswered tax policy question of how responsive capital gains are to capital gains tax (CGT) rate changes. One of the main applications of realisation response estimates is to estimate the revenue effects of CGT rate changes. The CGT rate change contemplated in this study is the introduction of the 50 per cent CGT discount for individuals during the 1999/2000 income year in Australia.

Prima facie, reducing CGT rates leads to a loss of tax revenue for the government. However, proponents of CGT rate cuts have argued that this 'first round effect' on government revenue is more than compensated for by second round or dynamic behavioural effects. Capital gains realisations, it is argued, increase because of the lower tax rates and as a result overall government revenue is enhanced. However, there is considerable debate about the level of responsiveness engendered by such rate cuts. To date, there has been an absence of empirical evidence in the Australian context to support or refute the arguments of either side.

This study uses aggregate time series taxpayer data from *Taxation Statistics* for the years 1995/96 to 2010/11 to establish taxpayer responsiveness to the effective cut in the CGT rate in 1999/2000. The estimating equation in this study regresses the logarithm of real net capital gains on dummy variables for years in which the CGT discount is available (1999/2000 onwards) and the logarithm of each of: the weighted average tax rate, the top marginal tax rate, the real GDP deflator, the real value of household shares and real GDP.

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