DOES A CAPITAL GAINS TAX WORK? THE AUSTRALIAN EXPERIENCE ELEVEN YEARS ON

Malaysia does not tax capital gains except, broadly, in relation to real property.[1] There are many policy arguments in favour of taxing capital gains, which will inevitably arise in Malaysia from time to time. It was policy considerations that led Australia to introduce provisions to tax capital gains from 20 September 1985.[2] It is worth exploring the implementation of those policies to determine whether the Australian experience represents a convincing case for Malaysia to introduce a comprehensive capital gains tax.

Part I of this article looks at some of the major arguments that were put forward in Australia for and against the introduction of a capital gains tax. Part II examines design issues that affected its implementation. Part III considers aspects of the Australian experience since the introduction of a tax on capital gains, to determine whether the policy objectives were met. The article concludes by raising the issues that Malaysia should consider before following the majority of OECD and many other countries in introducing a comprehensive tax on capital gains.

1 Real Property Gains Tax Act 1976, replacing the Land Speculation Tax Act 1974.
2 Part IIIA Income Tax Assessment Act 1936 (Cth).

I. CAPITAL GAINS TAX - WE MUST HAVE ONE?

Background

In 1985 Australia embarked upon an ambitious package of tax reforms.[3] The tax system was seen by the Treasury, on the basis of much of the literature in the public finance arena, as being too narrow in its focus. The tax law had developed piecemeal since the introduction of the Income Tax Assessment Act (hereinafter referred to as 'the Act') by the Commonwealth in 1936. Taxpayers had found loopholes to exploit, and lobby groups had managed to obtain a range of arbitrary concessions, which distorted the system further. The result was that individuals were bearing the brunt of revenue collection, with high levels of marginal tax that were said to discourage income-generating savings and investment. It was felt that widespread tax avoidance and the distortions within the tax system were leading to a loss of confidence in the tax system generally and to its fairness in particular.[4] The aim of reform was to correct the distortions and anomalies in the tax system and to implement changes to ensure a more equitable distribution of the tax burden.[5]

One fundamental problem with the existing tax system, particularly because of the high marginal rates of tax on income, was seen to be the tax-free status of capital gains. It was felt that tax avoidance focused on taking advantage of this tax-free status, resulting in an erosion of the tax base.[6] The government had tried to prevent tax avoidance by introducing provisions to tax certain capital profits. The sections were aimed specifically at property transactions and taxed profits arising from the sale of property realised within 12 months of its purchase.[7] Subsequently, a further provision was introduced to tax profits arising from the sale of property that was acquired for the purpose of profit-making by sale.[8]

It was the piecemeal development of the Australian tax system that was a major cause of the resulting imbalances and inequities that the reforms aimed to overcome. The tendency was for the Australian Taxation Office to pursue tax avoidance cases in the courts. During the 1970's it

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3 Refer, the Statement by the Treasurer, *Reform of the Australian Taxation System* (AGPS, 1985).

4 These issues were discussed extensively in Taxation Review Committee, *Full Report* (the Asprey Report) (AGPS, 1975), Taxation Review Committee, *Preliminary Report* (AGPS, 1974) and *Reform of the Australian Tax System*, Draft White Paper (AGPS, 1985).

5 Draft White Paper, *ibid.*

6 *Ibid.*

7 Section 26AAA of the Act.

8 Section 25A of the Act.

faced a High Court that placed increasingly narrow interpretations on the meaning of anti-avoidance legislation.[9] In response, the government amended the tax law to cover the loopholes or avoidance practices that the courts had allowed.[10] This was the background to calls for the reform of what had become increasingly unwieldy legislation in the 1970's[11] and 1980's.[12] Reform was supposed to address the flaws in the system. It was a situation not dissimilar from that which resulted in the introduction of taxation of capital gains in the United Kingdom, Canada and the United States.

The Malaysian economic focus has taken a different approach to that of Australia, in order to encourage strong economic development and investment. This has necessarily impacted on the tax system. The government perspective has been essentially outward looking in order to attract investment and encourage strong economic growth.[13] That growth has provided much of the necessary increase in revenue base for the government, obviating the need to impose extremely high levels of income tax. It has also enabled the government to implement tax changes to cater for planned economic development in a more cohesive fashion. Nonetheless, the government has had to focus on the problems arising from not taxing capital gains.

An example is the introduction of the Land Speculation Tax Act 1974, which provided for a 50% tax on gains arising from the disposal of land and buildings (above a certain value) within two years of acquisition. The aim of the legislation was to reduce speculation in land. The legislation was found to be relatively inequitable and contained several loopholes, so that the Real Property Gains Tax Act 1976 was introduced to correct these anomalies and extended the tax to real property and shares in real property companies. It is important to note that the legislation was introduced for a specific economic purpose and was not intended to impact on efficient economic investment generally. The discrete nature of the Real Property Gains Tax Act 1976 reflects this, as do the rates of tax and the relevant exemptions. How successful this approach has been is worthy of further research.

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9 For an interesting discussion of this period, see J Cleary, "The Evolution of Tax Avoidance" (1995) 5 *Revenue LJ* 219.

10 See Cleary, *ibid* at 231, for a list of the loopholes closed by legislation.

11 For example, the Asprey Report, *supra* n 4.

12 For example, the Draft White Paper, *supra* n 4.

13 This is reflected in the rules governing incentives. See, for example, S Sivalingam, "Current Developments in Tax Incentives for Investment" paper presented at the 8th Asian-Pacific Tax Conference, Singapore, November 1991 and S Sivalingam, "Tax Incentives for Inbound Investment: Towards Greater Selectivity" paper presented at the 8th Asian-Pacific Tax Programme, Singapore, July 1993.

It contrasts with the Australian approach, as discussed above, which seems to focus on revenue raising and management of tax avoidance. Take the introduction by the Australian government of a requirement that a compliance cost impact statement has to accompany the introduction of tax legislation after 1995. The idea was that the economic impact of new legislation would be taken into account.[14] Thus far, the statements provided have shown no evidence of a comprehensive economic basis for the introduction of new tax legislation.[15] This is but one example of the underlying approach to tax reform that seems to be taken by successive Australian governments. The tax system tends to be hijacked by politicians, who are unwilling to integrate it as an essential part of the overall framework for economic development. It is in this context, that I examine the main arguments for the introduction of the Australian capital gains provisions.

A Definition of Income

Both Australia and Malaysia inherited an essentially English system of taxation, reinforced by the English training of much of the early judiciary. Historically, English precedents have had a strong influence on both jurisdictions, although neither jurisdiction now recognises the primacy of the English courts and, in particular, the Privy Council. The result is that both Malaysia and Australia have adopted an approach to taxation based on the historical development of the United Kingdom tax system. This development largely predated serious economic analysis of taxation. Accordingly, the public finance literature suggests that the approach taken is subject to serious distortions. Attempts to correct the distortions in many of the English speaking jurisdictions were reflected in the reports published in those countries, which examined in detail the appropriate basis for taxation.[16]

The main theory put forward in the reports, in relation to the reform of taxation of income, was that of Hague-Simons.[17] Essentially, this theory

14 There is even an ongoing discussion at National Tax Liaison Group meetings between the Commissioner and the professional tax bodies as to what the statement is for and the information it should contain.

15 *1995 Butterworths Weekly Tax Bulletin*, para 304.

16 The Carter Report, published in Canada, has been one of the most influential: Royal Commission on Taxation, Report (Carter Report) (Ottawa 1966). See also, United States Treasury, *Blueprints for Basic Tax Reform* (Washington 1977); United States Treasury, *Tax Reform for Fairness, Simplicity and Economic Growth* (Washington 1984); Irish Commission on Taxation, *First Report: Direct Taxation* (Dublin 1982); P McCaw, *Report of the Task Force on Tax Reform* (Wellington 1982); and the Australian Asprey Report and the Draft White Paper, *supra* n 4.

17 Carter Report, *ibid*. For a very useful discussion, see JG Head, "Capital Gains Tax and Capital Income Taxation" (1987) 4 *Australian Tax Forum* 35.

suggests that all net accretions to wealth should be taxed. It rests on a basic principle that it is important to ensure uniformity of taxation across the tax base. A second principle is that the tax should apply comprehensively. Application of these two principles will ensure that distortions are limited and that, consequently, equity and efficiency within the tax system are possible.[18]

The Malaysian and Australian tax systems historically differentiated between capital and income. Income was taxed and capital was not. This gave rise to voluminous case law on the difference between the two and the development of principles, such as a profit-making purpose, to help in drawing the distinction.[19] The broadening of the interpretation of income has effectively meant that certain capital gains are taxed as income. For example, share or land trading is essentially the buying and selling of capital assets. Yet if a taxpayer is found to be carrying on a business of trading in these capital assets, the proceeds are subject to tax. On the other hand, the sale of land or shares purchased as long-term investments for the derivation of income is generally free from income tax. From a Hague-Simons perspective this means that a significant element of the income tax base is not subject to tax.

However appropriate the economic theory of taxation, policy is governed by the political reality. No country has implemented a 'pure' economic theory designed to produce the 'best' outcomes from an economic perspective. Economists argue that tax policy necessarily becomes concerned with choosing second-best alternatives.[20] Such choices depend upon the information available to decision makers and the strength of interest groups in influencing governments' decision-making.[21] In Australia, the implementation of a tax on capital gains was shaped by politics and led to inconsistencies with a Hague-Simons approach.[22] If Malaysia considers the implementation of a tax on capital gains it will do well to examine the experience of systems such as that in Australia. The question to answer is whether political distortions to a pure taxation of accretions to wealth, as put forward in the Hague-Simons model, prevent a capital gains tax from achieving the objectives of equity and efficiency. If they do, then it may be preferable to achieve revenue gains by other means.

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18 Head, *ibid* at 38. See also, JG Head, "Capital Gains Taxation - An Economist's Perspective" (1984) 1 *Australian Tax Forum* 148.

19 See, for example, *Mamor Sdn Bhd* v *DGIR* [1986] 1 MLJ 1 in Malaysia and *FCT* v *Myer Emporium Ltd* (1987) 163 CLR 199 in Australia.

20 BI Bittker, "A 'Comprehensive Tax Base' as a Goal of Income Tax Reform" (1967) 80 *Harvard Law Review* 925 and, more generally, JG Head, "The Carter Legacy: An International Perspective" (1987) 4 *Australian Tax Forum* 143.

21 M Jones, "The Politics of Tax Reform" (1985) 2 *Australian Tax Forum* 147.

22 *Ibid.*

Equity

A basic principle underlying the design of any income tax system is that it should be based on a person's ability to pay.[23] Income is seen as an appropriate measure of ability to pay, which is why the definition of income is so important. The Canadian Carter Commission was of the view that all additions to economic power, including capital gains, should necessarily be taxed for equity reasons.[24] There are two major requirements for an equitable tax. It should treat people in similar circumstances in the same way: this is horizontal equity. It should ensure that tax is allocated fairly between people in different circumstances: this is vertical equity.

It is argued that a failure to tax capital gains causes a tax system to fail both requirements.[25] Horizontal equity fails, as capital gains represent increases in wealth or the ability to pay. Take two employees earning RM70,000. One of the employees receives a large bonus of RM50,000 from his/her employer. The employee is taxed at the appropriate marginal rates of tax. The other employee receives a capital gain of RM50,000 on realisation of a long-term investment. There is no tax payable. Economists argue that this shows that people in similar positions are not taxed in the same way, which is inequitable.[26]

Vertical equity also fails if capital gains are not taxed. Take two taxpayers. One is a wealthy investor who has substantial capital gains each year and the other is an employee whose only source of income is his/her salary. The wealthy investor pays tax on any income, but not on capital gains. The employee pays tax on all salary. Moreover, it is argued that wealthy investors are likely to make increasing capital gains because of the nature of their wealth, enabling them to become wealthier more quickly as the gains are not taxed. Poorer people, who do not have the capital to invest and who are paying tax on any increase in wealth, are therefore subsidising the wealthy investors who pay tax on only part of their increase in wealth.[27]

The Canadian Carter Report and the Australian Asprey Report reflected the views of most public finance commentators when they stated that they felt that the case for a capital gains tax was overwhelming on

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23 A useful discussion of equity considerations in the design of a tax system is found in S James and C Nobes, *The Economics of Taxation*, 4th ed (Prentice Hall, 1992) ch 5.

24 Carter Report, *supra* n 16 at ch 15.

25 *Ibid* and the Asprey Report, *supra* n 4 at ch 23.

26 *Ibid.*

27 *Ibid.*

equity grounds.[28] Both Malaysia and Australia inherited the distortions arising out of the British schedular system of income taxation. The United Kingdom and Australia have now introduced a tax on capital gains and equity was a major reason.[29] Equity considerations are integral to the Malaysian tax system. For policy-makers, equity considerations are a major ground supporting the introduction of a tax on capital gains, but they have to be placed in the context of the opposing arguments.

Efficiency

There are strong arguments that a failure to tax capital gains is inefficient. Many economists say that it is wrong to treat investment in appreciating capital assets more favourably than other kinds of investment. They say that the result of doing so must be that the rational investor will favour investment in assets that yield low income returns but which appreciate in value. It will be very difficult for any other investment to offer better after tax rates of return. Economic distortion will result.[30] For example, a rational investor would prefer to invest in real estate, where income yields are low, but tax-free capital appreciation is high, than in an exporting or manufacturing business with high income yields but with significantly less capital appreciation.[31] Even more inefficient from an economic development perspective is that 'non-productive' assets become disproportionately attractive.[32] So taxpayers may invest in antiques, paintings and precious stones, simply because their increase in value is not taxed.

A further problem is that, if capital gains are exempt from tax, then taxpayers will try and convert income into capital to take advantage of the exemption. For example, companies may offer bonus shares in place of dividends. The receipt of a bonus share is capital and exempt, whereas the receipt of a dividend is taxable. Most jurisdictions have tried to prevent avoidance measures like this from occurring. In Australia, for example, bonus shares received in place of dividends are taxable in the same way as the dividends they replace. Malaysia does not tax bonus shares in this way,[33] but it does tax dividends used to purchase more shares in the company. The fact that taxpayers take this action, and the revenue

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28 *Ibid* and the Carter Report, *supra* n 16.

29 Statement by the Treasurer, *supra* n 3.

30 *Ibid* and Head, *supra* n 17 at 39.

31 R Mathews, "Some Reflections on the 1985 Tax Reforms (With Special Reference to Business Taxation)" (1985) 2 *Australian Tax Forum* 415 at 421.

32 James and Nobes, *supra* n 23 at 139.

33 Unlike in Australia, legislation has not been used to overcome the decision in *IR Commrs* v *Blott* (1921) 8 TC 101.

authorities act to prevent them, places unnecessary economic costs on both parties and makes the investment process more inefficient.[34]

However, as discussed above, no tax is ever implemented in its pure form to achieve the efficiency advantages that are put forward when it is first proposed. Accordingly, if Malaysia considers introducing a tax on capital gains, it should ensure that such a tax contributes to economic efficiency within the overall economic development framework. Malaysia has a rapidly developing economy and a capital gains tax must be seen in that context. If Malaysia is trying to attract foreign investment, a tax on capital gains may be inappropriate and the lack of such a tax should be seen, perhaps, as a form of incentive to investment.[35] Australia experiences relatively much slower growth and in a stable developed economy, where the revenue base is not expanding, the attraction of taxes on capital to increase revenue is far greater.[36]

Simplicity

Simplicity is usually one of the three requirements (with equity and efficiency) that are looked for in any tax system or new tax.[37] It is generally accepted that this is one of the strongest arguments against the introduction of a tax on capital gains. The Asprey Report stated clearly that,[38]

> It is a tax which, in any administrable form, must be complex and difficult, and produce some anomalies and inequities of its own. There is no doubt whatever that any revenue it raises could be more cheaply and easily raised in other ways. By the criterion of simplicity it fails.

In 1966, Professor Leif Mutén described the then new United Kingdom capital gains tax as 'technically the most advanced tax of its kind the world knows'.[39] Legislation to tax capital gains has traditionally followed in this vein wherever it has been introduced. The complexity arises from attempts to deal with the issues of income definition, equity and efficiency. Political exigencies ensure that any proposals are then made doubly complex.

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34 James and Nobes, *supra* n 23 at 139.

35 See further on the use of incentives to attract investment and their effect, D Bentley, "Tax incentives: should Australia follow Asia's lead?" (1996) 70 *ALJ* 191.

36 For a history of Australian tax collection from capital gains and a comparison with other tax collections, see Commissioner of Taxation, 1994-95 *Annual Report* (AGPS, 1995) Appendix 5.

37 For example, see the Asprey Report, *supra* n 4.

38 *Ibid.*

39 L Mutén, "Some General Problems Concerning the Capital Gains Tax" (1966) *British Tax Review* 138.

However, my reading of the literature suggests that simplicity is a much lauded goal that is seldom achieved in taxation. The complexity of the transactions with which ordinary citizens have to deal in everyday modern life require that the tax law has to be at least as complex in creating an adequate tax framework. That may not be true of traditional salary and wages. It becomes true of claims made against that income when one moves into the realm, for example, of computer and telecommunications equipment, computer software, mobile telephones and home office expenses. The distinctions between private and business use, between capital and revenue, tend to blur, and the tax law has to draw lines in the sand. It becomes true of salary and wages income when benefits are taken instead, when complex commission systems and employee share schemes are introduced, and when contractual arrangements using company and trust structures are put in place to circumvent the traditional employer/ employee relationship. And that is just at the level of the salary and wage earner, without even considering the complexities of what have become common-place business transactions, such as loan arrangements and transactions in different currencies.

My view is that, for many, an argument for simplicity is an argument against taxation, whereas it should rather be taken into account as a design issue. 'Simplicity' has many different meanings and is a relative concept. Professor Cooper, in a seminal article on tax simplification, identified seven different issues that are debated in the context of simplicity: predictability, allowing easy understanding; proportionality, ensuring that reasonable means are used to achieve the stated policy; consistency to avoid arbitrary distinctions; compliance costs kept to a minimum; administration made easy; co-ordination with other tax rules; and clear expression of chosen rules.[40] All of these relate mainly to design. It is efficiency and equity that go to policy, where the decision whether to tax arises in the first place. Any analysis of one tax as against another is not primarily concerned with simplicity, but efficiency, whether it is a consideration of the transaction costs of the tax or the choice of tax base. It is only once the decision to tax has been made that simplicity needs to be considered in determining the design of the new tax regime and the drafting of the laws to implement it.

II. DESIGN ISSUES

The design of a capital gains tax has as much impact on the effectiveness of its operation as the principles that underlie it. However equitable and

40 G Cooper, "Themes and Issues in Tax Simplification" (1993) 10 *Australian Tax Forum* 417 at 424.

efficient it may be at the conceptual stage, these elements can be destroyed in the implementation.[41]

Accruals or realisation?

Economists have long argued for accrual accounting for capital gains and losses. In 1970, Professor Carl Shoup hailed the proposals by the Canadian government to tax gains on shares on an accruals basis as, potentially, 'one of the most significant developments ever, in income taxation'.[42] The basis for his claim is that a large part of any capital gains tax legislation comprises the rules that 'mitigate the distorting pressures that arise under the test of realization of capital gains and losses'.[43]

The Hague-Simons model suggests that all net accretions to wealth should be taxed. The problem with capital accretions is that they generally occur over the life of an asset that is held for a long period of time. Accordingly, taxpayers should be taxed annually on the net increase in value of their assets. Two major problems arise.[44]

First, this would require taxpayers to value their assets annually in order to calculate their tax liability. Practically, this would represent a heavy compliance burden. There is also the associated problem that valuations are notoriously subjective. This has become evident in the calculation of market values under the current Australian provisions. The market value at a given time depends largely upon who is doing the valuation. It is not fatal to accruals taxation of gains, however, as what is lost or gained in one year will inevitably be made up in other years.[45] Valuations are certainly possible within a range. Although, this view is clearly economic. Lawyers prefer precision and invent it, if necessary.[46]

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41 The proposals of the 1949-1950 Shoup Mission to Japan, to introduce a comprehensive income tax system, including the taxation of capital gains, were seen as superior to any tax reform or proposal anywhere in the world at that time. Yet, although relatively intact when they were introduced, they were soon modified substantially. See K Kaizuka, "The Shoup Tax System and the Postwar Development of the Japanese Economy" (1992) 82 *The American Economic Review* 221.

42 CS Shoup, "The White Paper: Accrual Accounting for Capital Gains and Losses" (1970) 18 *Canadian Tax Journal* 96 at 97.

43 *Ibid.*

44 See also, the discussion in the Asprey Report, *supra* n 4 at ch 23 and the Draft White Paper, *supra* n 4 at ch 7.

45 Shoup, *supra* n 42 at 99. See further, R Krever, "Structural Issues In The Taxation Of Capital Gains" (1984) 1 *Australian Tax Forum* 164 at 169.

46 See, for example, Barwick CJ in *Mullens* v *FCT* (1976) 135 CLR 290 at 295, where, in deciding on the application of a particular provision, he said that, "there is no room in this connection for any doctrine of economic equivalence". The Chief Justice was looking for legal precision.

Second, taxpayers could face liquidity problems in paying the tax. Unlike income receipts, such as salary or wages, there would be no cash receipt from which to pay the tax. Payment would have to come from other sources of income. It is only on realisation of an asset that cash becomes available to pay the tax on an asset. This may lead to taxpayers having to borrow money or sell their assets in order to pay tax on the annual increase in value. This may not be so much of a problem as it first appears. From an economic perspective, it is one of the transaction costs of holding an asset, much as is the cost to a business of holding trading stock, for which no deduction is available until realisation.[47] Furthermore, if tax is collected on an accruals basis, logically the rate should be significantly lower, given the much broader annual taxpayer base and the regularity of payments, than would occur in a system based upon realisation.[48]

The Australian and other countries' tax laws are increasingly moving towards an accruals method of taxation in selected areas. Depreciation and trading stock have long reflected economic concepts. The law governing the taxation of income from overseas interests (widely known as controlled foreign corporations and controlled foreign trusts legislation), is usually based on accruals concepts.[49] So too, is the law governing the taxation of financial transactions.[50] Yet, it is interesting to note that, in a joint submission on behalf of various professional bodies to the group rewriting the Australian tax law, it was stated, without reasons, that the taxation of unrealised gains should not be considered.[51] The submission continued:[52]

> Such an approach is clearly inappropriate and there should be no move to an accruals CGT system under current rewrite proposals. The Bodies would strenuously oppose any such move.

This reflects the view of Professor Parsons, who, in 1984, said that he was 'appalled by the administrative and compliance problems' of a tax

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47 Shoup, *supra* n 42 at 99 and the arguments of Krever, *supra* n 45 at 171.

48 R Officer, "Capital Gains and Company Taxation" (1984) 1 *Australian Tax Forum* 281 at 282, Muten, *supra* n 39 at 140 and see below, under the heading "Deferral".

49 In Australia, Parts X and XI of the Act. Broadly, for relevant interests, the net increase in the value of that interest may be taxed each year.

50 Australia has taken over three years to move through various drafts of legislation in an attempt to implement a largely accrual based taxation of financial transactions.

51 Joint Submission to the Tax Law Improvement Project by the Australian Society of Certified Practising Accountants, the Institute of Chartered Accountants in Australia, and the Taxation Institute of Australia on the rewrite of Part IIIA of the Income Tax Assessment Act 1936 ('Joint Submission').

52 *Ibid.*

on unrealised gains.[53] I wonder whether Professor Parsons would still take that view in the light of the 'appalling' administrative and compliance problems with the current Australian system to tax capital gains.[54]

Take, for example, record keeping. Taxpayers are required to retain detailed records of every expenditure relating to every asset until five years after the year of income in which the asset is sold.[55] Death does not constitute a realisation, so where taxpayers inherit assets they have to keep detailed records from the date of acquisition of each asset by the deceased.[56] The same applies where there is a rollover of a capital gain or loss under a concessional provision from one taxpayer to another. The detail required has led tax advisers to ensure that their clients keep asset registers that maintain all appropriate records, which are updated annually. Many taxpayers are blissfully unaware of the legal requirements placed upon them and will probably not be able to produce the appropriate records when required to on disposal of an asset, if they remember to declare the disposal at all. The result will be that if they declare the gain they will pay too much tax, as they will have few or no records of their expenditures in relation to the relevant asset. If they do not declare it, they will pay no tax, until they are audited by the Australian Taxation Office, when they will again pay too much tax and face penalties and interest or prosecution as well.

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53 RW Parsons, "Capital Gains Taxation - A Lawyer's Perspective" (1984) 1 *Australian Tax Forum* 122 at 129. He is not alone in accepting the necessity of using a realisation basis for calculating tax on capital gains. RA Musgrave, "An Evaluation of the Report" (1967) 15 *Canadian Tax Journal* 349 at 352, after arguing convincingly for the principle that "accretion occurs and should be taxed as value rises", performs a volte face and simply accepts without question the recommendation of the Carter Report that "current taxation of accrued gains is not practicable".

54 See, for example, PC Griffin, "Capital Gains: Is CGT The Most Inefficient Tax?" (1995) 4 *Taxation in Australia - Red Edition* 42 and PC Monsted, "The nightmare of record keeping under the capital gains tax provisions" CCH *Australian Federal Tax Reporter* para 987-026. My article does not consider the impact of compliance costs on the choice of tax. Statistics are unavailable on the compliance costs of the capital gains provisions in Australia, but they would undoubtedly have an effect on the simplicity, equity and efficiency of the tax by virtue of the fact that compliance costs are by nature regressive. See CT Sandford, M Godwin and P Hardwick, *Administrative and Compliance Costs of Taxation* (Bath Fiscal Publications, 1989) at 95, 115 and 212. A useful overview of the compliance cost debate in Australia is found in J Pope, "Compliance Costs of Taxation: Policy Implications" (1994) 11 *Australian Tax Forum* 85.

55 Section 160ZZU of the Act. The Commissioner of Taxation has made it clear that records are required in respect of each individual asset and each individual parcel of shares purchased (see Income Tax Ruling IT 2550).

56 The capital gain and loss provisions do not apply to assets acquired prior to 20 September 1985. Assets of a deceased estate are deemed to be acquired by the trustee of the deceased estate, and subsequently by a beneficiary, for market value at the date of death (section 160X).

The effect of the record keeping rules is that Australian taxpayers can be divided broadly into two categories. One category keeps meticulous records and would probably have little trouble adapting to an accruals based system of taxing capital gains. Another category keeps poor or no records. Individuals and small businesses would make up the bulk of this category. Those who keep poor records are ensuring that they will pay too much tax on any capital gain. Those who keep no records, generally out of ignorance, which, of course, is no excuse, are unwittingly being turned by the capital gains system into tax evaders and criminals. The accruals method, at least, would ensure that the declaration and taxation of capital gains is treated as an annual event, along with all other forms of income. If the tax is intended to catch all assets, rather than just those, such as shares and land, that are associated with capital gains, then more thought needs to be given to compliance issues relating to the majority of taxpayers who own assets other than shares and land, such as jewellery and furniture.

A further problem is that there are several provisions in the Act that require a taxpayer to obtain a valuation of an asset. Sometimes it is unclear whether a valuation is required. For example, where the Commissioner of Taxation deems a transaction not to have taken place at arm's length, a market valuation is required.[57] The definition of an arm's length transaction is unclear at law.[58] Accordingly, some years after the event, a taxpayer may be put in the invidious position of having to obtain a retrospective market valuation at the behest of the Commissioner, because the Commissioner decides, on subsequent audit, that the original transaction was not, as the taxpayer had thought, at arm's length.

In light of these problems, and given the successful operation of accruals taxation in other areas, it would seem that accruals taxation of capital gains is at least worthy of serious consideration. Further major advantages of accruals are, the avoidance of the 'lock-in' effect and of 'bunching'.[59]

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57 Sections 160ZD(2) and 160ZH(9).

58 See, for example, *Barnsdall* v *FCT* 88 ATC 4565, *Trustee for the Estate of the late AW Furse No 5 Will Trust* v *FCT* 91 ATC 4007, *Elmslie* v *FCT* 93 ATC 4964 and *Granby Pty Ltd* v *FCT* 95 ATC 4240.

59 For a cursory discussion of these matters, see the Asprey Report and the Draft White Paper, *supra* n 4. See also, Shoup, supra n 42 at 98, Head, *supra* n 17 at 47 and Parsons, *supra* n 53 at 130. Some caution as to the *desirability* of moving to an accruals system is expressed by AJ Auerbach, "On the Design and Reform of Capital-Gains Taxation" (1992) 82 *The American Economic Review* 263 at 264.

The 'lock-in' effect

The 'lock-in' effect occurs where investors retain investments simply because they would have to pay capital gains tax were they to dispose of them. Normally investors consider economic and other factors when deciding whether or not to sell parts of their investment protfolios. Capital gains tax distorts the investment decision and can make it worthwhile to retain otherwise relatively inefficient investments. For example, the owner of a warehouse may decide not to move to newer and better premises because of the capital gains tax cost of disposing of the old warehouse, even though operating from a new warehouse would be much more efficient for the business. An investor may decide to retain shares that perform poorly, simply because it would cost too much in tax to sell them and purchase shares giving a better return.

The problem is exacerbated in the Australian context because the capital gains provisions only apply to assets acquired after 19 September 1985. This provides a tremendous incentive not to dispose of assets acquired before that date. Professor Head called it a 'lock-in' of 'internationally unprecedented proportions'.[60] He went on to say that, as a result:[61]

> any significant benefits, in terms of equity, efficiency and structural anti-avoidance ... of this basic reform will be long delayed and the likely impact must for a considerable period be at best extremely modest and alarmingly uneven.

From the standpoint of both an economist and the government, it would seem clear that, even if an accruals method is not used, a valuation of all assets at a certain date is preferable to the exemption of assets acquired before the date of introduction of the capital gains regime. In the tax planning industry in Australia, pre-capital gains tax assets are regarded almost with awe, and their disposal is seen as to be avoided at almost all costs.

Deferral

The 'lock-in' effect results in tax deferral for extended periods of time and, where the relevant disposal is exempt from the capital gains provisions, as under the Australian legislation for assets acquired prior to the introduction of the legislation, it may result in no tax being payable. Tax deferral occurs, in any event, when capital gains are taxed under the realisation

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60 Head, *ibid* at 57.
61 *Ibid* at 59.

method, and a disposal takes place in a year different from the acquisition of the relevant asset. The effect is that the government is providing an interest-free loan, on the amount of tax payable on the accrued capital gain on each asset, until the asset is disposed of.[62] This exacerbates the 'lock-in' effect, particularly in periods of high interest rates. The government subsidises the holding cost of assets.

The result of tax deferral is fourfold.[63] It delays the receipt of revenue from capital gains. The revenue from the tax is reduced by the effective interest-free loan to asset holders. Tax rates are necessarily higher to achieve the desired revenue take. Economic inefficiencies arise from the distorting impact of negative tax considerations on investment decisions. From a political perspective these issues are relatively unimportant as they cannot be measured accurately. From a design perspective they should carry significant weight.[64]

It is significant that taxation of capital gains on an accruals basis eliminates most of these problems.[65] Deferral is for a maximum of a year, if accruals are taxed annually. Accordingly, receipts need only be delayed to the extent of income tax receipts, and the resultant effective interest-free loan is minimal. Lower rates of tax are required to produce the same revenue as from tax on a realisation basis. Economic distortion still takes place, in that taxation of any kind represents a transaction cost that affects the investment decision. However, there is not the differential between alternative forms of investment to the extent that arises under taxation of capital gains on a realisation basis.

'Bunching' and inflation

Consequences of taxing gains on realisation are that gains can be 'bunched' in the year of realisation and a portion of the gain will reflect inflationary increases in value. Most systems take account of these factors and the Australian system is no exception.[66]

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62 Discussed in the Asprey Report and the Draft White Paper, *supra* n 4.

63 Refer to the discussion in Head, *supra* n 17 at 47.

64 I have sympathy for the arguments of PL Swan, "Capital Gains, Cash Flow Taxes and Corporate Tax Reform" (1984) 1 *Australian Tax Forum* 293 at 296, who argues that distortions in tax system design can produce a worse outcome than the problem the new tax was designed to remedy.

65 See further, Head, *supra* n 17 at 44.

66 Discussed in the Carter Report, the Asprey Report and the Draft White Paper, *supra* n 4. See also, the extensive discussion in J Bossons, "Inflation, Indexation and the Capital Gains Tax" (1985) 2 *Australian Tax Forum* 249.

'Bunching' is only a problem where gains are not taxed at a flat rate. Gains may be taxed at progressive rates to promote equity. Averaging provisions prevent the punitive effect of having a capital gain realised in a tax year added to total income and resulting in the application of far higher marginal rates of tax than if the gain were realised over the period of ownership. Of course, averaging is only of benefit to those taxed below the top marginal rates in the absence of a capital gain. For top rate taxpayers, averaging provides no benefit, as any gain is already taxed at that top rate.

Inflationary increases in assets do not reflect 'real' increases in income. Most commentators argue that, particularly in periods of high inflation, to tax the inflation element of a gain would be punitive.[67] Accordingly, most systems, like the Australian system, provide for indexation of costs incurred in acquiring and maintaining an asset.[68] Australia, unlike the United Kingdom, does not allow indexation of costs to increase a capital loss. This seems illogical and is a decision made on policy grounds. The inequity is seen where a taxpayer has both capital gains and capital losses. Under the Australian system capital losses are offset against capital gains.[69] The result is that an unindexed loss reduces the gain by less than the real amount of the loss, leaving the difference to be made up by the taxpayer.

A design difficulty may arise here from a purely political perspective in relation to taxation on an accruals basis. If the increase in value of an asset is taxed annually, logically there should be provision for indexation for inflation each year, on the same basis as would occur if the tax was on realisation. However, that provision is not made for any other form of taxation on an annual basis. Revenue authorities do not increase assessable income or allowable deductions by an appropriate inflation index factor for the year. Accordingly, revenue authorities may be reluctant to do so for an annual tax on capital gains. This problem is real in Australia, where indexation is only permitted on assets held for more than twelve months.[70] The government has consistently resisted calls to allow indexation for all

67 Compare the views of the Asprey Report and the Draft White Paper, *ibid*, with the conclusion of the Carter Report, *ibid*, that adjustments for inflation would result in inequity, because they could only relieve the effect for some segments of the population.

68 Although there is an anomaly, in that indexation only applies to assets held for more than twelve months, under section 160Z. See further, below.

69 Sections 160ZC and 160ZO of the Act.

70 Section 160Z of the Act.

capital gains, whatever the period of ownership of the asset.[71] Bossons argues that governments should go further and that there should be a comprehensive indexation covering all cash flows in the tax system. As a minimum, however, he supports separate indexation of capital gains (whether they are taxed on a realisation or accruals basis). Although inferior to comprehensive indexation, he argues that it would 'still result in a significant improvement of the tax system'.[72]

Offset

A related problem is whether capital losses should be offset against other income. The Australian approach, based upon trust law, distinguishes between different types of income and, as discussed above, that is why the capital/income distinction is so important. If the rationale for taxing capital gains is because it should be treated in the same way as other accretions to wealth, it does not then make sense for the differentiation to be maintained between the different sources of income. Yet, that is exactly what has happened in Australia, and capital losses are quarantined. They may not be offset against income from other sources, but only against capital gains. If capital gains were taxed at a different rate from other income, there would be good reason for this quarantining. This is not the case and net capital gains are included in the ordinary assessable income of the taxpayer.[73]

III. THE AUSTRALIAN CAPITAL GAINS EXPERIENCE

It is an appropriate time to review the operation of the Australian capital gain and loss provisions. They are currently being re-written as part of the total re-write of the tax law in Australia under the Government's Tax Law Improvement Project. After eleven years in operation the provisions have revealed their benefits and shortcomings. The lessons that Australia has learnt are worth considering for any country contemplating the introduction of a tax on capital gains in any form.

I have already identified several design shortfalls in the Australian legislation. The magnitude of the compliance problem, where there is

71 This approach probably stems from the taxation of speculative gains in Australia under sections 25A, 26(a) and 26AAA prior to the introduction of capital gains legislation. It remains to be seen whether current representations for indexation to be extended to cover all gains and losses will succeed, when the government rewrites the legislation as part of the Tax Law Improvement Project.

72 Bossons, *supra* n 66 at 262.

73 Section 160ZO of the Act.

relatively comprehensive taxation of capital gains, was seriously underestimated by the taxpaying community in Australia. So, too, were the difficulties in obtaining valuations on a range of transactions, often many years after the date at which they are required. Yet, these were the main objections to the introduction of an accruals basis of taxation of capital gains.

Little research appears to have been carried out into the real 'lock-in' effects of the Australian capital gains provisions. Certainly, the theorists would suggest that it would be substantial, given the application of tax only to assets acquired after 19 September 1985, even without the ordinary 'lock-in' effect for taxpayers that do not wish to realise a gain and, with it, substantial tax.[74] The Australian system has at least dealt with the problems of 'bunching' and, in most instances, compensated for inflation in the calculation of capital gains (but not capital losses).

From the beginning, the capital gains provisions aimed to provide a comprehensive coverage of all capital gains, subject to specified exemptions and reliefs. The object was to remove the anomalous treatment of capital gains as compared to income gains.[75] The legislation has, to a large extent succeeded. The opportunities to make significantly greater untaxed gains depending upon the nature of the transaction, whether on revenue or capital account, have largely disappeared. Although, attempts to discover new sources of non-taxable receipts continue,[76] as does the shock at the extent of the scope of a comprehensive tax on capital gains.[77] The reliefs, exemptions and indexation for inflation that are available for capital assets do provide advantages on the realisation of capital assets and, with them, plenty of scope for litigation.[78] However, in broad terms, the introduction of the capital gains provisions has substantially reduced the advantages formerly held by capital investment over revenue investment.

74 Head, *supra* n 17.

75 Refer, for example, the Draft White Paper, *supra* n 4.

76 For example, incentives to enter into a lease were argued to be non-taxable in *FCT* v *Cooling* 90 ATC 4472. The courts have rejected the argument in this and other cases on the same point.

77 The extent of the application of the capital gains provisions to compensation receipts, particularly the Commissioner's view of their application in Taxation Ruling TR 95/35, has caught the tax community by surprise and given rise to a substantial body of literature.

78 For example, the application of a 50% exemption for goodwill on the realisation of a business in *FCT* v *Krakos Investments Pty Ltd* 96 ATC 4063.

Distortions

Politically, some exemptions to a tax on capital gains seem inevitable. The effect, logically, is to make those assets more attractive to investors. It is inequitable, in that it favours investors who choose to invest in exempt assets over those who do not. It may be useful as a policy tool if exempt investments are those that most benefit the economy. However, this is seldom the purpose of *full* exemptions. Reliefs, in the form of *deferral* of payment of tax, or partial exemptions in limited circumstances, are more often used as economic policy tools. It is worth reviewing, briefly, the types of relief and exemption that are available to taxpayers in order to comment on the overall structure of the capital gains framework.

In Australia, the principal residence of a taxpayer is exempt.[79] The arguments in the Asprey Report, proposing this exemption, were based upon the social environment in Australia favouring home ownership.[80] The professional bodies have submitted that there should be a limit on the principal residence exemption, 'to temper taxpayers who may be encouraged to abuse the currently generous' exemption.[81]

Death does not usually realise a gain.[82] The result is deferral of the gain, perhaps indefinitely. The Asprey Report was concerned about such a hole in the capital gains provisions and recommended instead, a threshold level, above which gains realised after the age of 65 would be taxable.[83] Even this concession was politically unacceptable and a potentially indefinite deferral was included in the legislation. The result is a continued discrimination, for individuals, in favour of assets that yield capital gains. To put it another way, the legislation provides legal options for tax avoidance.[84]

Assets kept for personal use are covered by special rules that effectively exempt disposals for less than $10,000. Most individual taxpayers would receive little benefit from this exemption as there are very few personal use assets that go up in value. It is other assets, such as jewellery, art and antiques that would more often result in gains for individuals. For these 'listed' assets, it is only if they cost under $500 that they are exempt. The professional bodies are proposing that the tax law re-write introduce a general annual exemption for small gains of $10,000. They argue that

79 Section 160ZZQ of the Act. The exemption was politically necessary to win public support for the introduction of the capital gains provisions.
80 The Asprey Report, *supra* n 4 at 23.57.
81 Joint Submission, *supra* n 50 at 11.
82 Section 160X of the Act.
83 The Asprey Report, *supra* n 4 at 23.55.
84 See further, Head, *supra* n 17 at 48.

it would reduce compliance costs for individual taxpayers, ensure that unwanted assets are not retained unnecessarily for fear of the capital gains tax liability associated with disposal, and would ensure that the Australian Taxation Office does not have to divert valuable resources to police compliance, in an area that is relatively insignificant from a revenue perspective.[85]

There are numerous rollover provisions in the Australian capital gains legislation and some partial exemptions. The rollovers operate to defer the incidence of tax until a subsequent disposal of the asset, which is no longer covered by a provision granting relief. Some of the rollovers relate to social policy issues, such as the transfer of assets between spouses in the event of a marriage breakdown. The majority relate to the encouragement of business and investment. For example, there are rollovers that cover the transfer of assets: between commonly owned companies, to the new company when a sole trader or partnership incorporates and on a corporate reconstruction. A recently introduced rollover allows the deferral of tax on the sale of a small business, provided the proceeds are reinvested in assets of another business.

Saving for retirement has become a major social issue in Australia, in common with most other countries. The general view is that small business owners tend to reinvest their savings back into their business. So that they are not penalised for doing so, there is a 50% exemption from the tax on the sale of the goodwill of a business in which the net value of the taxpayer's interest is under $2 million. As an alternative, individuals can claim an exemption from up to $500,000 capital gains tax on the sale of a small business where the proceeds are used for retirement.

Partly as a result of the rollovers and exemptions, there is a large number of specific anti-avoidance provisions contained in the capital gains legislation. A further significant element of the provisions is the transitional rules to deal with the fact that the provisions only apply to assets acquired after 19 September 1985, together with a phalanx of associated anti-avoidance provisions. There are also so-called 'catch-all' provisions that have been drafted so broadly that they are intended to apply to any non-revenue transaction that might in any way avoid taxation.

Observations

As with most capital gains taxation around the world, the Australian legislation is exceptionally complex. The level of complexity is made worse

85 Joint Submission, *supra* n 51 at 8.

by the need to include so many rules to deal with the transition of assets purchased prior to 20 September 1985 into the capital gains net. However, the very nature of a comprehensive capital gains system applicable to all taxpayers demands that there should be rules to deal with every kind of capital transaction. There must also be rules to grant the necessary exemptions, partial exemptions and reliefs. These must be carefully surrounded with anti-avoidance provisions to ensure that they target only intended taxpayers and transactions. As I commented above, this does not necessarily mean that it is a bad tax. The nature of modern society is such that, just as our transactions are complex, so too must be the rules governing them. Nonetheless, the complexity must raise questions. If the guiding principle of simplicity, at least in some of its guises, is forfeited, then it is important to consider whether the control of tax avoidance, and the principles of equity and efficiency, are being met.

The differentiation between capital and income in Australia is no longer nearly as important as it was prior to the introduction of the capital gains provisions. There are still advantages in investing in capital assets, as they are indexed for inflation and various reliefs and exemptions can apply. But the extent of the difference is much less. The anti-avoidance provisions have been carefully crafted to cover every possible attempt to circumvent the legislation. The general anti-avoidance provisions in the Act, which apply to any transaction or scheme which has the purpose of avoiding tax, act as a further safety net. In this sense, the provisions are remarkably watertight.

Equity and efficiency are less well served. The 'lock-in' effect and the extent of the exemptions and reliefs ensure that there is some inequity and substantial inefficiency. However, the compliance burden is seldom considered in the literature in this context. Yet, those who are in a position to ensure that they comply with the provisions, larger businesses and high net worth individuals, would also ensure that they pay less tax than those who are unable to fulfil the compliance requirements. As I have observed above, the latter are likely to be small businesses, and the majority of individuals who seldom dispose of capital assets that fall within the capital gains provisions. Furthermore, this very unfamiliarity with the provisions means that taxpayers in this position are likely to breach the rules through omission and, on a tax audit, will be penalised accordingly. Although the Commissioner has the power to remit penalties for non-compliance, remission guidelines do not include ignorance of the law as a basis for doing so.[86]

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86 The Commissioner has set out his policy on remission of penalties in Taxation Rulings TR 94/3, 94/4, 94/5, 94/6 and 94/7.

More assets are now subject to tax on disposal under the capital gains provisions, but there seem to be multiple distortions in the system that would breach the principles of equity and efficiency, just as much as did the previous system, where tax was restricted to speculative gains. For individuals, pre-capital gains assets, personal property, death, the principal residence, small businesses and retirement savings all represent useful legal loopholes in the system. For businesses, pre-capital gains assets, the creation of goodwill, group reorganisations and rollovers of small businesses into like businesses all provide planning opportunities.

IV. CONCLUSIONS

The aim of a capital gains tax is usually to bring gains from capital assets within the tax net. It is done broadly in line with the Hague-Simons definition of taxable income, which includes all net accretions to wealth. The Australian approach was certainly formulated on this basis and, on equity and efficiency grounds, the Asprey Report found the case for a tax on capital gains 'overwhelming'.[87]

However, it is not necessarily appropriate to apply to the final product the arguments for a tax on capital gains found in pre-legislative reports. Such reports are based on certain assumptions that may not be, and in the Australian case were not, reflected in the legislated outcome. Professor Head said of the new capital gains provisions:[88]

> As a result of ... fundamental and deliberate design deficiencies, the reform thrust of the new capital gains tax is seriously blunted if not largely lost.

His remarks were, of course, made before the further anomalies that have been introduced into the capital gains provisions over the past eleven years. Professor Swan, who had been an adviser to the 1981 Campbell Committee Inquiry into the Australian Financial System, was even more pessimistic. He said that:[89]

> implementation difficulties ... are most unlikely to be overcome in any legislation to implement a more fully-fledged CGT. The overall result of implementing a highly imperfect CGT may be to worsen the efficiency of resource allocation rather than the hoped-for improvement.

If the criteria of equity and efficiency are not met in a capital gains

87 *Supra* n 4 at 23.11 and 12.

88 Head, *supra* n 17 at 59. See also, the criticisms of R Mathews, "Some Reflections on the 1985 Tax Reforms" (1985) 2 *Australian Tax Forum* 415.

89 *Supra* n 64.

tax, the arguments for such a tax on these grounds fall away. Other policy objectives come into play. There seems to be a world-wide policy trend towards encouragement of savings. It could be argued that capital gains taxes are a disincentive to savings as they tax accumulated savings, except to the extent that taxpayers take advantage of the 'lock-in' effect.

My discussion has shown that any aspect of income tax tends to be a somewhat blunt policy instrument. This may be one contributing factor to the trend towards consumption taxes, which can impact more rapidly on aggregate consumer demand and are a more buoyant source of revenue in times of resistance to income tax.[90] Governments are constantly looking for ways to expand the tax base, preferably with taxes that are relatively difficult to avoid or evade, and with minimal compliance and administration costs. These are themes which have flowed through my examination of the Australian capital gains provisions, with a largely negative outcome. Capital gains tax design and implementation reflects the conflicts between policy objectives, for example, between simplicity and efficiency in design and between equity and efficiency in its implementation. Even at the equity level, Messere has observed that, although the only way to make the very rich less rich is to tax them heavily on all their income and capital:[91]

> the presence of so many highly paid entertainers and sportsmen in tax haven countries illustrates the difficulty of taxing the mobile rich and many of the immobile rich undoubtedly hide much of their taxable income and capital in other countries.

It is interesting to note that although most OECD countries have adopted capital gains taxes, their contribution to revenue is minimal, in most countries less than 1% of total tax receipts.[92] This is certainly the experience in Australia.[93] Although, it could be argued that the existence of a tax on capital gains increases revenue by preventing the conversion of taxable income into a tax free capital receipt. Australian statistics on the capital gains make-up are scarce, but of particular interest is that in 1990-91 78% of capital gains tax paid by individuals was on shares and real estate, with a further 18% on unidentified trust and partnership distributions, which likely also predominantly related to shares and real estate.[94] If this trend were to continue, it would provide useful information in

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90 K Messere, *Tax Policy in OECD Countries* (IBFD Publications BV, 1993) at 31.

91 *Ibid* at 140.

92 *Ibid* at 291.

93 Australia had a slightly higher collection figure of 2.3% of total revenue collections in 1993-94, but this dropped back to 1% in 1994-95: Commissioner of Taxation, 1995-96 *Annual Report* (AGPS, 1996).

94 Commissioner of Taxation, 1991-92 *Annual Report* (AGPS, 1995) at 204.

targetting a less comprehensive form of capital gains tax.

I suggest that a capital gains tax may fulfil many policy objectives in theory, but is less reliable in practice. Instead of relying on pure theory to determine the tax mix, it is far better to determine the policy objectives first and then to choose the appropriate tax mix, as it will be implemented, in order to achieve those objectives. As concluded by Aaron, Galper and Pechman:[95]

> Tax analysts ... should recognize that recommendations for perfecting pure forms of taxation may well be inferior advice for improving a hybrid tax system. Of equal importance, they may be politically irrelevant.

Before Malaysia follows the OECD example and introduces a capital gains tax, it would do well to consider whether a more targetted tax would better fulfil its policy objectives. The Australian experience suggests that the costs of a tax on capital gains far outweigh the benefits. It also suggests that the original policy objectives expressed in the Asprey Report and the Draft White Paper have not in fact been met. The capital gains provisions have also had significant undesirable effects.[96] The technical and administrative complexity of implementing a 'real world", rather than a purely theoretical capital gains tax, indicate that the principles of equity and efficiency are better served by other means. Given the early Australian statistics, research into the effectiveness of Malaysia's Real Property Gains Tax Act 1976 is merited to determine whether it does not achieve, at far less cost, much of what would in fact be achieved by a comprehensive capital gains tax.[97]

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95 HJ Aaron, HA Galper and JA Pechman, *Uneasy compromise: problems of a hybrid income-consumption tax* (Brookings Institution, 1988), quoted in Messere, *supra* n 90 at 37.

96 C Sandford, *Successful Tax Reform* (Bath Fiscal Publications, 1993) at 5, states that two of the principle criteria by which tax reform can be judged are: how far the tax reforms meet the objectives the reformers set themselves and the extent to which tax reform had desirable or undesirable by-products.

97 Alternatives to a comprehensive capital gains tax are discussed in D Dixon,"Capital Gains and Income Tax Design Alternatives"(1984) 1 *Australian Tax Forum* 185 and Joint Submission, *supra* n 51.