

**A study on whether the Australian regime
of income tax on capital gains
causes widespread violation of horizontal equity**

Maheswaran Sridaran

CA, Master of Taxation (UNSW)

(Student number: 40029255)

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I confirm that this doctoral thesis of mine has not been submitted by me for a higher degree to
any other university or institution.

Maheswaran Sridaran

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Publications based on my thesis

Most principal elements of this thesis have already been published by me, as follows:

Articles published in refereed journals

- “Taxation of capital gains and horizontal equity: a review of the Australian perception”, (2005) *Australian Tax Forum* Volume 20 No 1, p 41
- “An evaluation of whether the Australian regime of income tax on capital gains satisfies the policy objective of horizontal equity”, (2007) *Macquarie Journal of Business Law* Volume 4, p 213
- “What reasons could (in theory) cause the CGT regime to produce outcomes that fail to satisfy horizontal equity”, (2009) *International Journal of Liability and Social Enquiry*, Volume 2, No 3, p 332

Articles published in non-refereed tax journals

- “Is Australian currency property for CGT purposes?” (9 January 2003) *CCH Tax Week*, Issue 1, p 1
- “CGT: Is confidential information of a business property?” (1 May 2003) *CCH Tax Week*, Issue 16, p 269

- “Some arguments for not having a flat personal income tax” (9 December 2004)

CCH Tax Week, Issue 48, p 793

Abbreviations used and definitions

In this thesis:

- the Income Tax Assessment Act 1936 (Cth) is referred to as “the 1936 Act”;
- the Income Tax Assessment Act 1997 (Cth) is referred to as “the 1997 Act”;
- all legislative provisions referred to are those of the 1997 Act, unless otherwise stated;
- the (Federal) Commissioner of Taxation is referred to as “the Commissioner”;
- Taxation Rulings, Taxation Determinations, Interpretative Decisions, and Law Administration Practice Statements issued by the Commissioner are collectively referred to as “rulings”, though Interpretative Decisions and Law Administration Practice Statements strictly do not represent rulings which are binding on the Commissioner;
- “horizontal equity” means taxpayers in an equal economic situation being taxed equally, and, by extension, taxpayers not in an equal economic situation not being taxed equally;
- “economic efficiency” means a state that pertains where scarce resource use occurs such that there is no possibility of making a change (of scarce resource use) which helps one person without hurting anyone else;

- “significant” or cognate expressions mean “of consequence”;
- “widespread” means “occurring in many situations”;
- the system in Australia for subjecting capital gains to income tax is referred to as “the CGT regime”; and
- the Australian income tax on capital gains is referred to as “CGT”.

Abstract

The research problem addressed in this thesis is:

Does the Australian regime of income tax on capital gains cause widespread violation of horizontal equity?

The conclusion drawn in this thesis is that there is reason to expect that the Australian regime of income tax on capital gains (“the CGT regime”) can cause widespread violation of horizontal equity. That conclusion is reached by seeking answers to five questions:

Question 1

- Was the enactment of the CGT regime, and the continuance of it after enactment, actuated by a perception (of respectively the government which enacted it, and subsequent governments which yielded to its continuance) that the regime will satisfy the policy objective of horizontal equity?, and, if it was,

Question 2

- Is that perception largely correct?, and, if it is,

Question 3

- What reasons could (in theory) cause the CGT regime to produce outcomes that fail to satisfy horizontal equity (that is, outcomes that violate horizontal equity)?, and, if such reasons exist,

Question 4

- Do those reasons (or any other) in practice cause the CGT regime to produce outcomes that violate horizontal equity?, and, if they do,

Question 5

- Is there reason to expect those outcomes to be widespread?

This thesis argues that only any one of four reasons can (in theory) cause the CGT regime to potentially produce outcomes that violate horizontal equity. Those four reasons (designated as respectively Reason A, Reason B, Reason C and Reason D) are:

Reason A

- The best interpretation (pursuant to the current approach of the Australian judiciary) of relevant legislative provisions can result in outcomes that violate horizontal equity.

Reason B

- Though the best interpretation (pursuant to the current approach of the Australian judiciary) of relevant legislative provisions does not result in outcomes that violate horizontal equity, the Australian judiciary's interpretation of those legislative provisions, not being compatible with the best interpretation of those legislative

provisions (pursuant to the current approach of the Australian judiciary), can result in outcomes that violate horizontal equity.

Reason C

- Though the best interpretation (pursuant to the current approach of the Australian judiciary) of relevant legislative provisions does not result in outcomes that violate horizontal equity, the Commissioner's interpretation of those legislative provisions (generally, as evinced in rulings) can result in outcomes that violate horizontal equity. That would occur where the Commissioner's interpretation of relevant legislative provisions is not compatible with their best interpretation (pursuant to the current approach of the Australian judiciary).

Reason D

- Though the Australian judiciary's interpretation of relevant legislative provisions (despite not being the best interpretation of those legislative provisions, based on the current approach of the Australian judiciary) does not result in outcomes that violate horizontal equity, the Commissioner's interpretation of those legislative provisions (generally, as evinced in rulings) can result in outcomes that violate horizontal equity. That would occur where the Commissioner's interpretation of relevant legislative provisions is not compatible with their interpretation by the Australian judiciary (albeit, based on the current approach of the Australian judiciary, such interpretation of the Australian judiciary not being compatible with the best interpretation of those legislative provisions).

In the arrangements pursuant to which legislative provisions imposing CGT are enacted and implemented, there is an absence of systematic sensitivity to those four reasons. In those arrangements, there is also an absence of institutionalised processes (mandated by legislation or otherwise) for the identification of outcomes that violate horizontal equity, and effecting legislative amendments to prevent such outcomes. Due to those absences, in this thesis, the conclusion is reached that there is reason to expect outcomes from the detailed working of the CGT regime that violate horizontal equity to be widespread.

Those four reasons can be effectively addressed through: a consequentialist approach to interpreting legislative provisions imposing CGT, buttressed by legislative directives to the Australian judiciary and other means necessary for making such an approach practicable; post-implementation reviews of CGT measures enacted to ensure that those measures do not cause violation of horizontal equity; and enacting explicit legislative directives essentially precluding the Commissioner from issuing rulings (or any like pronouncements) which are inconsistent with judicial authority.

A status quo where there is reason to expect widespread violation of horizontal equity caused by the CGT regime may be perpetuated if those four reasons are not addressed. Such an outcome will retard sound tax administration because the public's willingness to optimally comply with a tax will not be fostered unless the public views that tax as one which satisfies horizontal equity. An absence of optimal compliance will make a tax inefficacious. The CGT may become a tax relegated to such a status if those four reasons are not addressed.