PROPERTY TAX

A PRELIMINARY STUDY ON THE INITIAL IMPLICATIONS OF THE RALPH REPORT RECOMMENDATIONS FOR THE REAL PROPERTY INDUSTRY

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ABSTRACT

The real property industry is one that intersects the boundaries of many aspects of taxation. The changes recommended by the Ralph Report (the Review of Business Taxation, A Tax System Redesigned, 1999 chaired by John Ralph AO), have had flow-on consequences to the real property sector. The Ralph Report itself contained about 280 recommendations which were aimed at improving the competitiveness and efficiency of Australian Business, reduce compliance costs and enhance the stability of taxation arrangements. This paper will focus on those issues that relate primarily to the real property industry sector.

Therefore, this research paper examines a number of interrelated areas concerning the recommendations of the "Review of Business Taxation, A Tax System Re-designed" on the real property industry sector. The interrelated areas which have been selected includes the Capital Gains Tax regime, the Simplified Tax System, and Accelerated Depreciation.

The Ralph Report initially gave the appearance that everyone would benefit, however, this was not so. The findings in this paper show the Capital Gains Tax regime to have created a more complex tax system, with a different tax treatment of capital gains according to the structure of the ownership of the asset. The Simplified Tax System result for small business was to face higher costs to establish eligibility for the various concessions introduced, and the removal of Accelerated Depreciation as a direct trade-off for the company tax rate reduction did little to enhance new property development.

KEYWORDS

Taxation, real property, property tax, CGT, capital gains tax, Ralph Committee Report

INTRODUCTION

THE REVIEW OF BUSINESS TAXATION , A TAX SYSTEM REDESIGNED

The long-awaited Ralph Report[1] was eventually released publicly on the 21st September 1999 (Drum 1999). The report contained a detailed enumeration and analysis on the adequacy of the current business income tax policy together with a complementary investigation into accompanying legislation and administrative processes. The culmination of the Ralph Report was a delineation on how best to effect the Government's proposals outlined in "A New Tax System".[2]

The Ralph Report itself contained about 280 recommendations (Fiedler 2000) which aimed to be:

> "...consistent with the aims of improving the competitiveness and efficiency of Australian business, providing a secure source of revenue, enhancing the stability of taxation arrangements, improving simplicity and transparency and reducing the costs of compliance." (The Ralph Report 1999c)

This paper will not attempt to discuss all these recommendations, but instead will focus on those issues that relate primarily to Capital Gains Tax in the real property industry sector. The structure of this paper will include a brief introduction of the Ralph Report, and a brief history of taxation in Australia. The following sections consider Capital Gains Tax and the Simplified Tax System for small business and the removal of accelerated depreciation. In all these topics the substantive changes are discussed together with the Government's purpose. Also included is the effectiveness of the proposals and the impact on the Real Property Sector. In the final section of this paper is the summary of the conclusions from the various tax topics discussed.

Further research papers, will also be prepared to ascertain firstly, if in fact, these objectives have been met and secondly, to critically evaluate and analyse the impact of the Ralph Report on the real property industry.

IMPLICATIONS OF THE RALPH REPORT RECOMMENDATIONS FOR THE REAL PROPERTY INDUSTRY

The real property industry is one that intersects the boundaries of many aspects of taxation. Ownership of real property, for example, may be as simple and straight-forward as ownership of the family home or an investment property by individuals, or as complex as ownership of investment properties through companies, trusts and unit funds. Thus ownership of real property may involve taxation matters relevant to capital gains tax, small business taxation and company taxation. Real property may be income producing - a fact which means that taxation laws relating to the deductibility of items and negative gearing of real property are pertinent. Structures constructed on real property generally depreciate in value, raising issues with regard to changes in the laws dealing with accelerated depreciation.
An added importance of this cross-boundary characteristic of real property lies in the fact that as well as notable direct consequences, the changes recommended by the Ralph Report will have flow-on consequences on the real property sector.

This is an especially critical point when it is borne in mind that the government imposed a restriction on Ralph that any business tax cuts were to be paid for by crackdowns elsewhere in the

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[1]The Report of the Review of Business Taxation will be called the Ralph Report in this paper
[2]The Government's tax package, *A New Tax System,* set out plans for comprehensive business tax reform.

business tax system. ((The Ralph Report 1999c) Of necessity this resulted in some industries and interest groups gaining, whilst others had some very lucrative tax breaks taken away. The property industry lost more than any other sector because it lost accelerated depreciation and the indexation for capital gains tax was abandoned.

In addition the government proposed a phased implementation, with some proposals having immediate effect and others having variable commencement dates. For example, depreciation changes for the property industry were effective from 1st July 2000, whilst capital gain tax changes were effective from 21st September 1999.

HISTORY OF TAXATION

Income tax was introduced during the end of the 19th Century (Downing, Arndt, Boxer, Mathews, 1964). Tasmania introduced in 1880, tax on dividends paid by public companies, and South Australia introduced a general income tax four years later. By the turn of the century, the other states were taxing incomes, with the exception of Queensland, where although dividends were taxed, general income tax was introduced in 1902, and in Western Australian, company income was taxed only, until 1907 when general income tax was also introduced.

The main tax reviews since the Federation are (FitzGerald 1996):

- the Kerr Royal Commission into taxation, 1921-23
- the Fergusson Royal Commission into taxation 1934
- the Mills Committee on Uniform Taxation, 1942
- the Spooner Committee on Taxation, 1950-54
- the Ligertwood Committee on Taxation, 1961
- the Asprey Taxation Review Committee, 1975 (preliminary report in 1974);
- the in-house government review and Draft White Paper on Reform of the Australian Tax System, 1985 and
- the Review of Business Taxation , A Tax System Redesigned, 1999 chaired by John Ralph AO

The recommendations in this last tax review ("Ralph Report"), will have profound significances for the property industry. The Federal Treasurer, Peter Costello, on 21st September 1999, released the Governments outline of the new tax system in Australia (Anderson 2000).

REFORMING CAPITAL GAINS TAXATION

The Substantive Changes

The major implications in this field included the freezing of Capital Gains Tax indexation and the abolition of averaging and indexation - although taxpayers were able to retain the benefit of indexation up to the time the announcement was actually made. Moreover, individuals were required to include only half of the realised nominal gains in their taxable income. The processing of capital gains tax also differed according to the structure of ownership of the assets.

The new Capital Gains Tax rules were for individuals, superannuation funds and companies,(Department of Treasury) where indexation of the cost base for calculating Capital Gains Tax was to be frozen at 30th September 1999. For assets acquired at or before 11.45 am EAST, 21 September 1999 and held for at least one year, individual taxpayers had the choice of including in their assessable income either half the realised nominal gain or the whole of the difference between the disposal price and the frozen indexed cost base. Superannuation funds had the choice of including in their assessable income either two-thirds the realised nominal gain, or the whole of the difference between the disposal price and the frozen indexed cost base. Companies were to include in their assessable income the whole of the difference between the realised price of the asset and its frozen indexed cost base.

For assets acquired after 11.45 am AEST, 21 September 1999, and held for at least one year, individual taxpayers were to pay tax on half of the nominal gain, superannuation funds taxed on two-thirds of the nominal gain and companies taxed on the whole of the nominal gain at the company tax rate. Averaging of capital gains was no longer available for assets disposed of after 11.45 am AEST, 21 September 1999.

Capital losses were offset against capital gains so as to provide maximum benefits to the taxpayer. The Capital losses could also be offset against capital gains net of frozen indexation or the full nominal capital gain before it reduced to determine the amount included in assessable income.

The existing 50% capital gains tax goodwill exemption was replaced with a 50% general capital gains tax exemption for all active assets (with an increased threshold). When combined with the general 50% exclusion, this meant individuals owning small business were liable to tax on a maximum of 25% of their capital gains when they sold the business assets, (Department of Treasury). and the Capital Gains Tax small business concessions eligibility threshold was increased to $5,000,000

Further, there was a full exemption from capital gains tax on the disposal of a business asset which had been held continuously for 15 years and where the taxpayer was at least 55 years of age and intended to retire, or was incapacitated (Department of Treasury). Any profits made on the sale of plant and equipment was taxed as ordinary income instead of at capital gains rates.

The Government's Purpose

The Government desired to eliminate unintended outcomes from the way in which averaging provisions had been used.

Under the Capital Gains Tax rules which were introduced in 1985, taxpayers with no other income could receive capital gains of up to $27,000 without paying any tax. If the money had been received as income the effective tax rate would be 19.3%. Alternatively, a taxpayer could earn up to $103,500 in capital gains and pay only 20% tax, as opposed to an average tax rate of 37.9% if this had been received as income. The Ralph Report noted that the benefits of averaging would increase with the proposed lowering of personal tax rates. [3]

Under the new system, the maximum Capital Gains Tax would apply at half the individual investors marginal tax rate i.e. the maximum rate on capital gains by individuals from property transactions to be 24.25% (one half of 47% plus 1.5% Medical Levy). Taxpayers on low incomes would pay a Capital Gains Tax rate of only 10 to 10.75% as their marginal tax rate was 20%, and whether or not they were liable for the Medicare Levy. From 1 July 2000 income between $6,000 and $20,000 would attract a marginal rate of 17%, which would effectively lower the Capital Gains Tax liability for taxpayers in this group. The government sought to improve small business concessions by reforming the 50% capital gains tax goodwill exemption application.

[3] From 1.7.2000 Personal Tax Rates will be 0 - $6000: 0%; $6000-$20000: Nil + 17% over $6000; $20000-$50000: $2380 + 30% over $20000; $50000-$60000:$11380 + 42% over $50000; $60001 plus: $15580 +47% over $60,000

The Effectiveness of the Proposals meeting the objectives of the Ralph Report

The Capital Gains Tax recommendations appeared to have created a more complex tax system. The different tax treatment of capital gains depended on the structure of the ownership of the asset. For example companies paid a higher rate of capital gains tax than individuals but complying superannuation funds pay differential rates of tax on capital gains compared to their income. Small businesses received a more generous treatment than medium and large-size business.

The government predicted that the new Capital Gains Tax regime, had given the taxpayers a more straightforward obligation to pay tax on half of the capital gain earned on assets bought as investments.

Critics of the new Capital Gains Tax argued this was an overly generous concession. However, they overlooked that the Government would most likely collect more tax as a result of the new system. The prospect of paying less tax might encourage more people to sell assets.

In September 1985, when Capital Gains Tax was introduced, the then Treasurer, Paul Keating, told Parliament that Capital Gains Tax would not be a significant revenue collector and expected to raise just $25 million in the fifth year of collection. The actual amount which was collected in the fifth year was $534 million! Today the Government's annual Capital Gains Tax is counted in the billions (The Australian Financial Review, Pg 25).

According to leading property research group, Property Investment Research Pty Ltd (PIR), in the past decade real estate agents attracted $200 billion into direct property, 10 times the amount the managed funds industry attracted into managed property investments. That $200 billion - involving about 1.8 million properties - made up the bulk of PIR's estimate of the total $247 billion private investors have put into real estate (The Ralph Report, 1999c).

The Ralph Review was asked to consider specific options for reform of capital gains tax. and the recommendations were to be "..revenue neutral in respect of reforms to investment and capital gains tax" (The Ralph Report 1999c).

The Ralph Report admited that data limitations had been a significant problem in estimating the impact of the proposed reforms to capital gains tax.(The Ralph Report 1999c). Presently, under the self-assessment system, taxpayers provide minimal information on tax returns, the benefit being compliance cost minimised. Prior to 1999, the taxpayer only indicated the net value of capital gains or losses. There was no information detailing the indexation applied, the underlying value of the assets, the mix of losses and gains, or the period for which the assets were held.

This lack of historical information required the Ralph Report to assume certain data in relation to the value, ownership and composition of the asset stock subject to capital gains tax. The Review Secretariat also developed a simple numerical model of the asset stock held by individuals and used this model as the explanatory tool.

The Ralph Report forecasted that individual taxpayers would pay $210 million more Capital Gains Tax than they would have done under the old indexation-based Capital Gains Tax regime. If the underestimated revenue from the 1985 year is any indication of the reliance that can be placed on such estimates, how credible is the estimated $210 million additional Capital Gains Tax predicted in the Ralph Report.

Under these circumstances, It is difficult to comprehend how the capital gains tax recommendations are meeting the criteria of “revenue neutral in respect of reforms to investment and capital gains tax.” (The Ralph Report 1999c).

The Impact on the Real Property Sector

Arguable, the biggest benefit for individual investors was the effective maximum rate of Capital Gains Tax capped at 24.25 %, for superannuation and related funds 10% and for companies from the 2001-2002 income year 30%. KPMG'S National Managing partner for tax, Mr Graeme Bailey, saw two sides to the issue. He argued that with low inflation individual investors would be better off.

Table 1 below shows the before and after calculations where on a simple investment in a superannuation fund you would be 4.5% worse off than under the old system.

TABLE 1

Superannuation Tax - When a cut in tax might not help superannuation funds

	OLD SYSTEM	NEW SYSTEM
ORIGINAL COST	$ 1,000	$ 1,000
SELLING	$ 1,500	$ 1,500
INDEXED COST	$ 1,300	N/A.
TAX ON GAIN	30%	50%
BENEFIT	$ 470	$ 450
NET BENEFIT *	$ 400	$ 383

*Benefit after payout from fund and 15% tax paid
Source: Deloitte Tax Service (2001)

Therefore, Table 1 above shows that for the new system to give a break-even result, the net profit on sale needs to be three times the indexation on the cost base. In other words, the profit needs to outpace inflation by 200%. The reduction in the tax rate on superannuation funds' capital gains taxes was reduced by 30%. The tax on gains made outside the system in individual hands was reduced by 50% (The Australian Financial Review).

Whether the Ralph proposals were better from the point of view of the taxpayers, would depend largely on future inflation rates. With the elimination of cost base indexation, property investors were better under the Ralph proposals if the rate of capital appreciation was more than twice the rate of inflation over the same period. However, If the rate of capital appreciation was between one and two times the rate of inflation, then the new system would produce higher Capital Gains Tax. Therefore, if the rate of capital gain was less than the rate of inflation, then the new regime imposed taxes which the pre Ralph regime did not. If there was no bout of renewed ongoing inflation property investors would benefit from the Capital Gains Tax changes.

These proposals removed inflation and dispensed with averaging. Adversely affected was the property investment assets held for a long time and those taxpayers earning income below the highest marginal tax rates. Groups like senior citizens, other retirees and non working spouses who had realised real property or other assets.

Graham Middleton of Synstrat Accounting Pty Ltd modelled several scenarios which he says “lead us to conclude that the Government's apparently generous halving of capital gains tax is actually a dramatic tax increase for property owners who purchase with a long-term ownership intention”, further he continued by stating “there are an awful lot of passive investors” who could eventually be slugged by the new Capital Gains Tax proposals (Dunstan 1999). However, it can be argued that because of the nature of property investment as a capital asset, they are realised at times when the owners other income is low and the money is needed. Some assets might be sold when the owners are in retirement, perhaps they have even lost their job, or an event such as pregnancy.

The Real Estate Institute of Australia, stated that real estate tends to grow at 1% above inflation (Sydney Morning Herald). Consider the following two examples shown in Table 2, which rewards some investors and punishes others (Real Estate Institute of Australia).

TABLE 2

LONG-TERM PROPERTY INVESTOR

JUNE 1990	JUNE 1999	NOMINAL CAPITAL GAIN	CPI INFLATION (1990-1999)	CPI ADJUSTED COST BASE	ADJUSTED CAPITAL GAIN	C.G.T. PAYABLE CURRENT	NEW
$200,000	$280,000	$80,000	22.5%	$245,000	$35,000	**$16975**	$19,400

SHORT-TERM PROPERTY INVES TOR

JUNE 1998	JUNE 1999	NOMINAL CAPITAL GAIN	CPI INFLATION (1998-1999)	CPI ADJUSTED COST BASE	ADJUSTED CAPITAL GAIN	C G.T. PAYABLE CURRENT	NEW
$260,000	$280,000	$20,000	1.7%	$264,420	$15,580	$7,556	**$4,850**

The Long -term property investor shown above in Table 2 assumed the purchase of a Sydney house in June 1990 at $200,000 and its sale in June 1999 for $280,000.

The Short-term property investor shown above in Table 2, assumed the purchase of a Sydney house in June 1998 at $260,000 and its sale in June 1999 for $280,000.

The new Capital Gains Tax regime disadvantaged long term investors and rewarded short term investors. Given the fact that the majority of residential property investors were long-term investors these investors were disadvantaged by the taxation reforms.

As most property investments were held over the long term, the new “low” Capital Gains Tax regime would collect more tax revenue than the old “high” tax regime. Therefore, asset churning would become very popular, and the countries pool of patient, long-term capital could shrink and the pool of hot, speculative capital increase. Clearly the new Capital Gains Tax regime favoured high-growth investments.

When the Ralph committee worked through a number of examples assessing the capital gains under the current system and the one proposed they determined that in eight out of 10 cases taxpayers would be better off under the new regime. However, as stated by the president of the Real Estate Institute of NSW, Mr John Hill, his figures indicated that the residential investor in Sydney, Adelaide, Canberra and Hobart would have been better off during the 1990s under an indexation system. Only investors in Melbourne, Brisbane and Perth would benefit from the new system (Real Estate Institute of NSW Journal).

An obvious problem with the 50% capital gains exemption for individuals, is the incentive to shift holding assets in companies and discretionary or family trusts towards holding assets held by individuals and partnerships. Consequently, with higher income investors taxed at 24.25% on their capital gains and ordinary income taxed at marginal rates of up to 48.5%, this has culminated testing in the courts the difference between capital and income.

In table 3 below statistics are provided from the financial years 1990 to 1999, showing the capital gains subject to tax. The table identifies individuals, companies and funds. The tax office has yet to release similar statistical information from the financial years 2000 to 2005.

TABLE 3

Taxation Statistics 1998-99
Table 1: Capital gains subject to tax[1]
Income years 1990-91 to 1998-99

		1990-91	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Taxable individuals										
Number		136 506	169 994	208 565	346 417	270 531	369 189	579 183	709 880	766 390
Amount of capital gains	$m	669	822	1 033	2 285	1 541	2 111	2 899	4 656	5 369
Tax on gains	$m	174	244	312	711	476	709	823	1 570	1 862
Taxable companies										
Number		2 972	3 343	4 291	7 155	6 790	7 945	10 733	12 473	13 609
Amount of capital gains	$m	330	240	544	1 878	1 450	1 994	2 717	4 010	5 523
Tax on gains	$m	129	94	212	620	396	581	770	1 056	1 508
Taxable funds										
Number		2 530	4 357	6 687	14 695	13 059	20 292	31 412	40 326	45 563
Amount of capital gains	$m	243	234	446	3 192	811	2 197	3 870	8 504	6 598
Tax on gains	$m	36	35	67	479	122	330	582	1 276	986
Total										
Number		**142 008**	**177 694**	**219 543**	**368 267**	**290 380**	**397 426**	**621 328**	**762 679**	**825 562**
Amount of capital gains	**$m**	**1 242**	**1 296**	**2 023**	**7 355**	**3 802**	**6 302**	**9 486**	**17 170**	**17 490**
Tax on gains	**$m**	**339**	**373**	**591**	**1 810**	**994**	**1 620**	**2 175**	**3 902**	**4 356**

Note:
1. Due to privacy concerns, any indicator cell containing a value of 5 is indicative only and may represent any number between 1 and 5.

Source: Australian Taxation Office

For individuals, the tax on capital gains jumped from $174 million dollars to $1.862 million dollars a decade later. With companies the tax jumped from $129 million dollars to $1,508 million dollars, and funds started at $36 million dollars to $986 million dollars. These figures are relevant to the capital gains tax method of indexation and the benefit of averaging, hence, the lower the personal tax rates of an individual the greater the benefit and less tax paid on the capital gain calculation.

This is further identified below in **Table 4**, where the statistical information shows the taxable income brackets for individuals, companies and funds for the financial year 30th June 1999.

TABLE 4

Taxation Statistics 1998-99
Table 3: Capital gains subject to tax[1]
By business line and grade of taxable income

INB	Individuals[2]		
Grade of taxable income	Net capital gains		Tax on gains
	no.	$m	$m
Under $20 700	96 495	233	44
$20 700 to $37 999	157 114	521	133
$38 000 to $49 999	90 593	348	117
$50 000 to $99 999	103 530	727	277
$100 000 to $499 999	22 851	716	291
$500 000 to $999 999	754	168	78
$1 000 000 to $4 999 999	296	235	109
$5 000 000 & more	15	80	33
Total taxable	471 648	3 027	1 081
Non-taxable	87 558	192	0

SB	Individuals[2]			Companies			Funds		
Grade of taxable income	Net capital gains		Tax on gains	Net capital gains		Tax on gains	Net capital gains		Tax on gains
	no.	$m	$m	no.	$m	$m	no.	$m	$m
Under $20 700	77 127	232	45	3 798	53	5	14 662	54	8
$20 700 to $37 999	103 210	479	119	1 585	32	6	8 698	66	10
$38 000 to $49 999	45 258	271	86	904	23	4	4 256	43	6
$50 000 to $99 999	52 533	537	195	2 101	61	14	10 338	149	22
$100 000 to $499 999	15 632	546	214	3 313	217	57	6 796	283	42
$500 000 to $999 999	548	103	47	621	146	39	229	70	9
$1 000 000 to $4 999 999	172	107	48	443	424	112	215	134	20
$5 000 000 & more	9	34	13	50	401	112	29	22	3
Total taxable	294 489	2 308	765	12 815	1 356	350	45 223	822	120
Non-taxable	72 615	208	0	6 617	211	0	10 209	131	0

LB&I	Individuals[2]			Companies			Funds		
Grade of taxable income	Net capital gains		Tax on gains	Net capital gains		Tax on gains	Net capital gains		Tax on gains
	no.	$m	$m	no.	$m	$m	no.	$m	$m
Under $20 700	5	0	0	52	1	0	0	0	0
$20 700 to $37 999	7	0	0	22	1	0	5	0	0
$38 000 to $49 999	5	0	0	6	1	0	5	0	0
$50 000 to $99 999	5	0	0	34	4	1	5	0	0
$100 000 to $499 999	99	4	2	165	16	4	8	4	1
$500 000 to $999 999	76	4	2	101	26	7	7	7	1
$1 000 000 to $4 999 999	52	21	10	216	169	45	46	51	8
$5 000 000 & more	8	3	2	198	3 949	1 100	276	5 715	856
Total taxable	253	33	16	794	4 167	1 158	340	5 777	865
Non-taxable	5	0	0	414	390	0	18	26	0

Note:
1. Due to privacy concerns, any indicator cell containing a value of 5 is indicative only and may represent any number between 1 and 5.
2. Includes trustee assessments

Source: Australian Taxation Office

Interestingly, table 4 indicates that the highest grade of taxable income for individuals who paid tax on capital gain was those in the taxable income bracket of $20,700 to $37,999 pa for the financial year ended 30th June 1999, followed by the $50,000 to $99,9999 tax bracket, and third being under $20,700. Therefore, when the Ralph Report made the recommendations to abolish indexation and averaging for capital gains tax, and introduce the discount method, this would essentially disadvantage the individuals in the middle end of the tax bracket, and also disadvantage those seeking long term ownership investments.

Once the Australian Taxation Office releases the statistical information for the financial years 2000 to 2005, further studies would need to be carried out on the post Ralph Report taxable years to determine which tax brackets have been widely affected by these changes to the capital gain calculations.

Also, table 4 highlights the differences in the taxable incomes for Companies and Funds, with a comparison for the individuals, which again raises the issues on why individuals have been disadvantaged and also the changes mentioned previously for companies and funds, with respect to capital gains tax.

REMOVAL OF ACCELERATED DEPRECIATION

The Substantive Changes

Accelerated Depreciation was removed and replaced with a system which considered the effective life of the asset. The general principle was to treat depreciable assets consistently across a large range of various types of depreciable assets. For example, property investors lost the benefit of accelerated depreciation for plant and equipment used in rental properties.

Effective from **l July 2000**, depreciation arrangements for residential and non-residential buildings were to be replaced with an effective life regime. The new arrangements (which replaced building allowances) only applied to buildings constructed after 1 July 2000. If the building was eligible for depreciation, the difference between the sale price of the building and its written down value would be subject to ordinary income tax, not Capital Gains Tax. If land and buildings were sold together, an apportionment of the proceeds from the sale would be necessary. Buildings which were held (or where construction had commenced) prior to **1 July 2000** continued to be subject to Capital Gains Tax.

The simplified depreciation was the immediate write-off of assets acquired for less than $1000. A common pool of all depreciable assets acquired for $1000 or more with an effective life of less than 25 years (including existing assets) - would attract a write-off rate of **30% (37.5%)** per year (declining balance) - and effective life treatment for all depreciable assets with an effective life greater than 25 years.

The Government's Purpose

The removal of accelerated depreciation was a direct trade-off to facilitate tax reform for the company tax rate reduction and to improve the integrity and structure of the tax law.

The Effectiveness of the Proposals meeting the objectives of the Ralph Report

Accelerated depreciation allowed companies to write-off capital expenditure faster for tax purposes than the asset depreciated in practice. The benefits would relate to long-lived plant and equipment but would not apply to some forms of intangible capital such as **intellectual property.** By removing accelerated depreciation this increased the burden of taxation on those industries which employed a relatively large proportion of assets. Those industries included manufacturing - and especially those with heavy upfront capital investment such as mining. The property industry pays a lot of tax, has a lower intensity of long-lived assets and are not major users of accelerated depreciation.

Superficially, the implementation of an effective life regime would indicate a move towards a consistent treatment of different types of depreciable assets.

Impact on the Property Sector

Prior to the Ralph Recommendations, up to 20% of the cost of a high quality residential apartment could be depreciated at the accelerated rate: for commercial buildings 35% and for a five-star hotel up to 50%. In each scenario, the cost was able to be written off in five years with the balance to be depreciated at 2.5% or in the case of hotels and manufacturing building 4% (Napier and Blakely).

By removing accelerated depreciation the effective available tax deduction for new property investors had been halved. However, over the full property cycle the total tax paid would be much the same as under the system used prior to 1999. This threw a harsh light on the allowances that underpinned much of the new property development in the country this decade.

Contrarily, service industries such as the real estate and valuation sector which did not gain much from the special allowance, benefited from the trade-off of a lower corporate tax rate. Property investors lost the benefits of accelerated depreciation allowances for plant and equipment used in rental properties. Under the present system in 1999, investors were able to write off the cost of items such as stoves and carpets over a shorter period than the life of these items. However, with the removal of accelerated depreciation, new purchases from **21 September 1999** were to be written off over the effective life of the asset.

CONCLUSION

The Ralph Report initially gave the appearance that everyone would benefit, however this was not so. Many small business were not incorporated and therefore did not benefit from the reduced company tax rates, however, from an international perspective, Australia will be considered an attractive investment location.

The Capital Gains Tax regime created a more complex tax system with a different tax treatment of capital gains according to the structure of the ownership of the asset. As indicated in the tables in this paper, with the elimination of cost base indexation individuals pay a higher Capital Gains Tax if the capital appreciation is between one and two times the rate of inflation. Therefore property investment assets held for a long time are adversely affected, and the elimination of averaging affects individuals earning income below the highest marginal tax rates.

The Simplified Tax System attempted to reduce compliance costs faced by small business, however, the Government selectively decided on which areas to reform, with small business facing higher costs to establish eligibility for these concessions. The removal of Accelerated Depreciation as a direct trade-off for the company tax rate reduction did little to enhance new property development.

This paper also considered if the main aims of the government tax reform underpin the recommendations in the Ralph Report. These aims included optimising economic growth, ensuring equity in tax arrangements for investments and business activities, and making compliance as simple as possible.

The reduction of the company tax rate would appear to have satisfied the criteria for the first two aims. However, as indicated in the various tables in this paper, the recommendations on Capital Gains Tax reform does not appear to have satisfied the criteria supposedly set down by the government. The Simplified Tax system has resulted in small business requiring decisions which will affect both accounting treatment of profits and the tax treatment of those assets. The change to a cash-based rather than a law-based tax system will cause an upheaval and the removal of accelerated depreciation will have a devastating effect on the property development sector. It is perplexing that the government stimulates economic growth in this manner.

The governments grandiloquent aims and supposed objectives of the Ralph Report are inconsistent with the proposals adopted by the government.

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