Stock exchange paid for Australian tax report

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He who pays the piper calls the tune. The old adage finds its latest expression in the Australian government's plan, released last week, to halve the rate of the Capital Gains Tax—handing a windfall potentially worth billions of dollars a year to wealthy speculators.

It turns out that one of the plan's chief beneficiaries, the Australian Stock Exchange (ASX), paid for, commissioned and selected the author of the research that underpinned the recommendations of the government's Ralph Report, which were officially adopted with much fanfare last week.

Remarkably, the ASX chairman Maurice Newman claims that the arrangement arose because the Australian Treasury could not afford to commission the research, which dealt with the US experience with similar tax cuts for the rich.

Newman did not disclose how much the ASX paid Alan Reynolds, a senior fellow at the Hudson Institute, Washington DC—a long-time advocate of lower capital gains tax (CGT) rates. But his advice was worth a great deal of money to the share brokers. The *Sydney Morning Herald*'s economics correspondent, Tom Allard, describes the outcome as a "goldmine" for the ASX.

In Allard's words, the Howard government's scheme "makes share investments more attractive and encourages greater turnover in shares. That boosts the income of the ASX, a publicly-listed company, and the stockbrokers who own a substantial part of it."

According to Allard, Reynolds said the US experience showed that CGT revenues actually lifted when the rates were cut, because trading activity soared. Moreover, Reynolds claimed there was no danger that reducing the CGT rate to half the income tax rate would encourage tax avoidance by those people able to convert their income into capital gains.

Even more importantly, Reynolds opposed a tapering of the GST rate to reward longer-term investments. He argued that this would encourage people to hold onto their investments and cut into government revenue, because the tax is only paid when assets are sold.

Treasurer Peter Costello repeated these claims when he announced the scheme. In fact, Reynolds' "research" was so important that the Ralph Report was delayed a month because Reynolds' submission was late.

Another aspect of the scheme multiplies the benefit to high-volume, short-term speculators at the expense of long-term smaller investors. While slashing the CGT rate, the government abolished the indexation of the tax to allow for the impact of inflation. As a consequence, small investors who traditionally hold real estate or shares for a decade or more will pay a far higher effective rate of tax.

One commentator, the *Australian Financial Review*'s Ivor Ries, calculates that a typical "unsophisticated" small business couple would receive a shock if they sold real estate that they had held for a decade. If inflation averaged 2.5 percent and their property values rose by 3.5 percent, they would pay 76 percent tax—an increase of 27.5 percentage points from the current rate of 48.5 percent.

By contrast, a "sophisticated and active" investor who made gains of 15-25 percent on shares by selling them every two or three years would pay, even after adjusting for inflation, about 29 percent tax—a cut of nearly 20 percentage points.

Ries concluded: "Welcome to Peter Costello's new world of investing: where the information-rich and the fleet of foot are to be rewarded again, and again, and again—and the rest just pay, and pay, and pay."

Michael Raper, the president of Australia's peak welfare lobby group, the Australian Council of Social Service, said asking the ASX to fund the research was "like putting Dracula in charge of the blood bank. It seems extraordinary to get an organisation with a vested interest to provide fundamental research as to the costs of capital gains tax cuts."

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