Preface

The theoretical case for comprehensive taxation of capital gains has always been contentious, even when there was wider support for the 'comprehensive tax base' as the goal of income tax reform in the 1950s and 1960s. Not only those who support capital gains taxes but also those who oppose them have inevitably been drawn into debating the serious design dilemmas such taxes present. Today, there is still very little agreement as to how these should best be resolved. Different countries have attempted to address them in different ways, but the literature on which of these responses might be best is sketchy and in some respects out of date. This book is aimed at making a contribution to filling that gap in the literature. We are extremely gratified to have been able to assemble a team of experts from around the world to take part in this venture.

The basic idea of capital gains taxes is, of course, to tax capital gains, and the basic scope of the tax is as indicated by its name. Most importantly, tax is generally charged on gains made on sales of investment property and shares in listed companies. But capital gains taxes typically extend also to gains made on the disposal of other sorts of property—for example, unlisted shares, securities other than shares, unincorporated businesses and collectable chattels. Such gains are typically chargeable to income tax in some circumstances—in particular, where the taxpayer is engaged in a business of dealing or otherwise acquires the property in question with the intention of selling it. The point of a capital gains tax is thus to tax gains made where the taxpayer is not engaged in business and acquired the property as an investment, rather than with a view to selling it. The line is not always easy to draw, but short-term profits are typically counted as income and longer-term gains as of a capital nature.

Beyond those basic parameters, however, the design of a capital gains tax presents a number of difficult questions. Perhaps the most notorious of these is, what should be done about the family home? One view is that all economically significant gains should be taxed; and that there is no reason for providing for any preferential treatment for family homes. In other words, according to this school of thought, gains made on the sale of a family home should be taxed in the same way as any other capital gain. But whatever arguments might be marshalled in support of this idea, any political party proposing it seems unlikely to be elected. The question, then, is, should family homes be categorically exempt? Or should the exemption be subject to some limitation? For instance, perhaps each family should be limited to only one tax-exempt family home—in which case the gain made on the sale of a holiday home would be taxable (unless it was the family's only home). Or perhaps the exemption should be limited to gains of less than a prescribed amount—in which case, how much? What should be done where the taxpayer buys a house, lives in it for a few years, moves out and lets it for a few more years—and then sells it at a profit?

Other design issues include the following. First, should the capital gains tax be a separate tax or part of the income tax? Should liability be based on residence? Or on the situs of the property on which the gain is made? In other words, should persons resident in a country be taxed there on their worldwide capital gains? Or only on gains made on property situated within the jurisdiction? Conversely, what should be done about gains made by non-residents? Should capital gains be taxed at the same rates as income? Or some other rate?

Some countries' capital gains taxes provide for rollover relief. That is, if you sell an asset and buy another of the same class, liability is deferred (for example, if you sell one investment property and buy another). In other words, you are not required to pay the tax until you sell the replacement asset (and at that point, liability might be again deferred, if you again buy another asset of the same class). The point of this is that it largely overcomes the 'lock-in' effect. If people are taxed on gains made on the sale of capital assets, they are likely to defer liability by simply retaining their assets—which is inefficient and tends to clog up the economy (in that the tax incentivizes people to retain assets that they would otherwise sell).

Rollover relief is thus one way of mitigating the lock-in effect. Another is to tax capital gains not when they are realized, but as they accrue. In other words, instead of paying tax on the whole of your capital gain when you sell your asset, you are required to pay the tax annually on the basis of the gain accrued over the previous 12 months. This approach has a number of theoretical advantages, but most people and most governments are unenthusiastic about it.

The first three chapters of this book deal with some general preliminary issues. Chapter 1, by Michael Littlewood, presents a general survey of the approaches to the taxation of capital gains that have been taken by the countries examined more closely in the second part of the book; and canvasses some general lessons that might be derived from them. Chapter 2, by David White, concerns theory. Specifically, White focuses on two major economic theoretical approaches (the comprehensive income tax concept and optimal tax theory) and examines the impact that these have had on tax reform proposals in a number of countries—namely, South Africa, Italy, the Netherlands, New Zealand, Australia and the UK. In Chapter 3, Craig Elliffe deals with cross-border aspects of the taxation of capital gains—in particular, how, if at all, should countries tax capital gains made within their territory by persons resident elsewhere?

The next nine chapters of the book examine the specific approaches that have been taken to the taxation of capital gains in, respectively, Australia (Ann O'Connell), Canada (David G Duff), China (Yan Xu), India (DP Sengupta), the Netherlands (Eric CCM Kemmeren), New Zealand (Shelley Griffiths), South Africa (Jennifer Roeleveld), the United Kingdom (Philip Baker and Mark Bowler-Smith) and the United States (Reuven S Avi-Yonah and Dmitry Zelik). The focus on English-language Commonwealth countries (the UK, Canada, South Africa, Australia and New Zealand) reflects our own backgrounds and also, we presume, the larger part of our readership; the Netherlands was identified as an appropriate representative of Continental Europe; and the US, China and India were considered of too great economic importance to leave out. We supplied each of these contributors with a template, with which we asked them to comply. Our aims were, first, to ensure that each chapter addressed the questions that we considered most important and, secondly, to ensure that the chapters added up to as coherent a volume as possible. Getting authors to adhere to a template is, of course, a notoriously difficult process and we are therefore very pleased at the degree of consistency that they have achieved.

The template envisaged that each chapter would comprise four main parts, in respect of each of which we posed a series of questions. In part I, we asked the authors to supply a historical overview of their country's capital gains tax. More specifically, we asked, what were the government's objectives in introducing the tax? Have they been achieved? How much revenue has the capital gains tax raised? And so on. In part II, we asked the authors to explain in general terms the basic design of the tax. More specifically, is it a separate tax or part of the income tax? What is its jurisdictional scope? What is the rate of tax? Are there different rules for different classes of assets? Is the capital gains tax based entirely on realization? Or partly on accruals? And so on. In part III, authors were asked to explain how their country has addressed those aspects of capital gains tax design that seem especially problematic in practice—such as how to deal with the principal family home, non-business assets, rollover relief, and avoidance. Finally, in part IV the authors were asked to set out their views as to the lessons—both positive and negative—that they thought might be learned from their country's experience.

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