Capital Gains Tax – The New Zealand Case

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Introduction

New Zealand does not have a general capital gains tax, nor does it levy tax on inheritances. This makes New Zealand unusual in the OECD world. We inherited our lack of capital gains taxation, along with most of our other legal and constitutional framework, from the English. By contrast with other countries (the USA, UK, Canada and Australia) with a similar inheritance, we have retained an income tax that does not include capital gains as income. This paper, therefore, uses New Zealand as a sort of case study of what life is like without capital gains being taxed. I comment on this from my perspective, that of someone who was a tax practitioner and is now a tax enforcer or at least a tax policy adviser. I should point out at this juncture that the views in this paper are my own and not necessarily those of the New Zealand Inland Revenue Department or the views of the New Zealand Government.

To describe what life is like without a capital gains tax it is necessary to define more precisely what the term means. As a general rule, capital gains do not form part of income for the purposes of our income tax system. Indeed, our Courts have held that our income tax law does not even recognise the concept of capital gains. In our law it is not exempt or untaxed income; it has no legal recognition. This means, for example, that there is no requirement to apportion interest expenses between expenses that relate to the derivation of taxed income and expenses relating to capital gains.

Nor does New Zealand have a capital gains tax separate from the income tax, although matters do not stop there. Our income tax legislation (the Income Tax Act 1994) includes within "income" many forms of gain that in the absence of specific legislation would generally be considered capital gains. Each such provision has its own history, but very broadly, since income tax was first introduced in New Zealand, in 1891, our Parliament has considered it necessary to prevent people from characterising otherwise taxable income as untaxed capital gain. The result is detailed and often complex legislation. I shall describe that legislation in outline form.

The important point is that it seems a bit simplistic to describe a tax system as one that does or does not tax capital gains. Any income tax that left all capital gains tax-free would be unworkable. On the other hand, I am not aware of any income tax that taxes all capital gains in all circumstances. The issue is always to what extent capital gains are taxed. From a policy perspective, the issue is to what extent capital gains should be taxed. Different countries have positioned themselves at different points along a spectrum from fully untaxed to fully taxed. New Zealand is towards the untaxed end of the spectrum. Even so, for some asset types we would be located towards the extreme of the fully taxed end of the spectrum. Debt instruments and certain overseas equity holdings of residents are examples of these asset types. In these cases New Zealand legislation can tax all capital gains on a full accrual basis.

Bearing these points in mind, this paper focuses on the effect of this income tax that does not bring to tax capital gains. My first point here is that New Zealand is an example that totally refutes Professor Herbert Grubel's following claim:

> "If the capital gains tax were abandoned completely, many government employees, and private sector tax accountants and lawyers could be re-employed to produce goods and services valued by society more than the enforcement and manipulation of the tax code."[1]

I am an accountant and a lawyer, and I can assure you that I have for many years been very gainfully employed both in manipulating and enforcing tax legislation that has no specific capital gains tax. Indeed, in both my private sector and public sector work, manipulating and enforcing the border between taxed income and untaxed gains has been a central part of that work.

Simplicity has not been the outcome of a lack of capital gains tax in New Zealand. Nor is there much evidence to suggest that the absence of taxes on capital gains has had a marked effect on investment, capital markets and overall economic performance. A possible but unlikely exception here is the propensity for New Zealanders to hold their wealth in the form of real property. From my perspective, the most marked effect of not having a specific capital gains tax has been on the inconsistencies and complexity of our income tax rules that have resulted.

Our income tax system is especially open to manipulation as a direct result of not having a general body of rules taxing capital gains. Moreover, in some areas our tax rules defy policy logic, creating problems that defy an obvious policy solution for this same reason. It is this aspect on which the paper focuses.

Personally, I am neither a zealot for a capital gains tax, nor am I a vehement opponent of introducing one. The issue requires a detailed weighing up of arguments for and against taxing capital gains. For those who oppose this form of taxation, New Zealand is an example of how the grass is not always greener on the other side of the hill.

New Zealand Income Tax Law

New Zealand has two main forms of taxation: income tax and Goods and Services Tax (a VAT). The income tax is levied as one tax across personal, business and investment income. There is no separate set of tax rules for the corporate sector or any other sector.

New Zealand's income tax legislation leaves the term "income" undefined. Tax is levied on all income derived by every person but there is no comprehensive statutory definition of what income is. That has been filled out by our judiciary. The judiciary turned to trust law and other precedents for a definition of income. In general, this meant that most increases in the value of assets, other than trading stock, were excluded from the tax base. This was generally derived from trust law concepts that differentiated the interests of the life tenant (entitled to income) from the interests of the remainder man (entitled to capital and so to the realisation of capital assets of the trust).

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[1] Grubel, HG *The Case for Capital Gains Tax Reform*, The Fraser Institute, Vancouver BC, 2000, page 30.

This is what is meant by not taxing capital gains. It is divorced from any economic concept. As New Zealand's 1988 Royal Commission on Social Policy commented: "With hindsight it seems surprising that concepts of trust law were considered an appropriate substitute for a direct focus on economic efficiency and equity concerns in the raising of taxes".[2] In practice, the distinction between income and capital gains is difficult to apply. The Privy Council noted in *BP Australia Limited* v FCT[3] that the distinction is "sometimes difficult to draw and leads to distinctions of some subtlety between profit that is made "out of" assets and profit that is made "upon" assets or "with" assets."

An example of this difficulty can be found in the investment area. An entity holding a portfolio of shares, such as a mutual fund, is usually taxed on profits on realisation. The rationale is that shares held in a portfolio are on revenue account because selling shares is a normal part of the business of such an entity. A small investor holding shares directly, on the other hand, can realise a tax-free capital gain. New Zealand's Inland Revenue Department has held that a share portfolio that is determined by an index based on listed shares does not hold those shares on revenue account and can make tax-free capital gains. That is because its share purchases and sales are not part of a business but determined by the requirements of the index. This provides a tax incentive for investments in passive funds rather than actively managed funds.

This ill-defined capital/revenue boundary provides many opportunities for tax advisers and many problems for the revenue authority. In a trust situation, the courts can refer to the intention of the settlor to help determine what is income and what is capital. In a tax situation the intention of the taxpayer is invariably to make all gains capital and all expenses deductible on revenue account. Hence to protect the tax base it has been found necessary to bring into taxable income many items that would otherwise have been tax-free capital gains.

The following are some examples of how New Zealand has legislatively broadened what is included in taxable income.

Gains from the sale of personal property

Profits or gains from the sale of property where the taxpayer is a dealer in such property are taxable. It appears that the legislative intent was to tax those who were dealers in property of a particular type even if the property on which the profit was made was held by the person for other purposes. The courts, however, have restricted the provision to trading assets that would have been on revenue account in any case.

All profits or gains from the sale of property acquired for the purpose of sale are taxable. This means, broadly, that shares acquired for their dividend yield give rise to untaxed gains, while those acquired for their capital yield do not. The provision has given rise to lengthy case law distinctions between property acquired with the purpose of sale (taxable) and those acquired with the intention of sale (not taxable).

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[2] New Zealand Royal Commission on Social Policy, *April 1988 Report*, Volume III Part 2, Wellington, NZ, 1988, page 450.

[3] (1964) AC 244 at 262.

Gains from profit-making undertakings or schemes are also made taxable by legislation. Again, however, the courts interpreted the provision out of existence by requiring the gains to be taxable as ordinary income before the provision operates.

Land transactions

New Zealand income tax legislation has detailed and complex provisions bringing many gains on land transactions into the tax net. This was to counter the situation whereby land developers and builders became, in effect, untaxed occupations. In broad terms, we tax gains on the sale of land acquired with an intention of resale, gains made by land dealers, developers and builders and gains arising from the rezoning, subdivision or development of land. There are exceptions for private residences, business premises and farmland.

Income from debt instruments

The difficulty of sustaining the traditional capital/revenue distinction is particularly acute with respect to debt instruments. In the UK, profits on discounts of financial instruments were made taxable as early as 1805. If a lender can make a return that is taxable by way of coupon payments or tax-free by way of a redemption payment, it is likely that the lender will prefer the latter. Since 1986 New Zealand has effectively removed the capital/revenue distinction for debt instruments and taxed all gains as they accrue.

Foreign investment fund rules

New Zealand aims to tax the worldwide income of its residents. This includes income derived by offshore companies and similar entities. Since it is not possible to subject foreign entities to tax, as a proxy for this New Zealand levies an accrued capital gains tax on all foreign portfolio equity investment if the companies are not resident in one of the following countries: Australia, Canada, Germany, Japan, Norway, the UK and USA.

Other provisions

Other New Zealand legislative provisions tax the following: redundancy payments, lease premiums, site goodwill on sale of a business, royalties, income from patents and copyright, and income from the sale of forests and petroleum mining interests.

The Results

It is difficult to see evidence that New Zealand's lack of a capital gains tax has had a major impact on our capital markets. The New Zealand stock exchange has not been noted for its high performance. The stock exchange capital index still remains below the high it achieved in October 1987. In any case, New Zealand listed shares are strongly influenced by non-resident investors who hold up to 40% of the value of total market capitalisation. Such shareholders have been the marginal investors and are generally unaffected by domestic tax rules on mobile capital. Under international rules, which New Zealand follows, investors with no establishment in a foreign country are not taxed on capital gains in that country.

There is also little evidence that lack of a capital gains tax has encouraged entrepeneurial endeavour. New Zealand's post-war economic performance has been well below the OECD average. Moreover, New Zealand has one of the lowest levels of business expenditure on research and development in the OECD. In 1997/98, our business expenditure on R&D was 0.32% of GDP compared with an average of 1.48% of GDP. The Government is considering ways to encourage business investment in R&D.

The absence of a capital gains tax may have encouraged New Zealanders to invest heavily in real property, especially housing. New Zealand's home ownership ratio (percentage of homeowners as a proportion of the household population) is a bit higher than most OECD countries (73% compared with 66% in the UK, 60% in Canada and over 60% in the USA). The most significant difference, however, arises when comparing housing investment as a proportion of total investment. Housing represents approximately 70% of total net assets for New Zealand households, while it represents only about 30% of US total net assets. One explanation for this is that New Zealanders are simply poorer, so that the same level of home ownership constitutes a higher percentage of wealth. The result is that New Zealand holdings of financial assets are relatively low. In 1998 approximately 15% of assets were holdings in investment intermediaries (superannuation, life insurance and mutual funds), 14% in bank accounts and only 1.4% in private share holdings.

Although the pattern of New Zealand savings is clear, it is less clear that this can be attributed to tax causes. As explained later, the most tax-favoured form of investment – direct equity – constitutes a very small proportion of household assets. Debt instruments and equity held through intermediaries are not tax-favoured to the same extent but constitute a much higher proportion of wealth. The average real capital gain on housing since 1960 has been, in real terms, towards 1% per annum. A far higher return (estimated at 2% to 2.5% per annum real) has come in the form of untaxed imputed rental income. Not fully taxing imputed rental income is a feature of most tax systems (where housing is a less dominant feature of investment) and in New Zealand is significantly clawed back by not allowing mortgage interest deductions.

It is likely that many years of high inflation, government subsidies and controlled interest rates (often negative in real terms) that applied until the late 1980s have been more influential than the tax system in setting the pattern of private investment in New Zealand. Similarly, our economic performance has probably been influenced more by broader economic issues than by the absence of a capital gains tax.

A concern that has been raised by countries with a capital gains tax is that, in the absence of such a tax, there could be an incentive for the excessive reinvestment of business profits. As well as eroding the tax base by encouraging the transformation of otherwise taxable income into non-taxable gains, this could incur a high economic cost by locking capital into existing firms with a lower rate of return than new firms.

There is no evidence of this being a consequence of the lack of a capital gains tax in New Zealand. The average dividend yield of New Zealand's listed companies is about 5% to 7% per annum. That is high by world standards. Smaller companies tend to distribute most of their available income to the owners.

The reasons for this are likely to lie in the overall structure of the tax system. Obviously, where there is a choice between providing owners with a return that could be either taxable (salary or dividends) or non-taxable (capital gain), owners will prefer the non-taxable form of return. In New Zealand, however, salaries are deductible and dividends carry credits for tax paid at the corporate level[4]. Until 1 April 2000, the company rate was equal to the top personal marginal tax rate (33%). This meant that any tax on distribution of income taxed at the company level was offset by a deduction or tax credits. Indeed, because of the progressive tax scale there could be incentives to distribute income. That occurs when the recipient of the distribution is on a low tax rate (say, a spouse or child on 19.5%), whereas the salary deduction is taken at a 33% rate.

There has always been an incentive in New Zealand not to distribute non-taxable company income (such as capital gains) in a taxable form. This has led to some retention of income and then tax planning to return it in a non-taxable manner. It should be noted, however, that merely selling a company pregnant with non-taxable profits is not a solution. It merely passes the problem of extracting those profits tax-free to someone else.

From 1 April 2000, New Zealand's top personal marginal tax rate was increased from 33% to 39%. The company and trustee tax rates remained at 33%. It is likely that this will lead to an increase in profit retention. That will be balanced by the increased advantage from income splitting by making distributions to low-tax rate family members.

In general, however, it is the overall nature of the tax system, such as the rate structure and the manner in which dividends are taxed, that can lead the tax system to encourage excessive profit retention. The presence or absence of a capital gains tax seems peripheral.

Problems created by not taxing capital gains

The conclusion of the previous section was that the absence of a capital gains tax has not had an easily identifiable impact on the economy. Earlier, however, I described some of the complexities of New Zealand income tax legislation caused by not taxing capital gains. Why the legislative complexity in the absence of discernible impacts?

The answer is that while it may be difficult to attribute any underperformance of our economy to the absence of a capital gains tax, the absence of such a tax has caused us significant problems. This is the result of it leaving a structural weakness in the income tax base. The concept of a capital gain is not an economic concept; it is a concept from equity law. By not taxing capital gains a type of income return is removed from the income tax base in a rather ad hoc fashion.

[4] Small, family-owned companies can pay out dividends from income on which no company tax is payable (such as capital gains) tax-free under the qualifying company rules.

Two consequences flow from this. First, artificial boundaries are required between what is taxable and what is not taxable. Defining those boundaries leads to complex tax legislation. It also leads to policy inconsistencies and unintended incentives built into the tax structure that cannot be resolved without moving closer to a concept of economic income and thus removing the capital/revenue distinction. Second, artificial boundaries are the life-blood of the tax planner. The capital/revenue boundary is a prime hunting ground for tax planning schemes. The remainder of this paper considers these two issues by way of examples drawn from the New Zealand experience.

Structural problems created by the capital/revenue boundary

The structural problems created by the capital/revenue boundary in New Zealand are probably best illustrated by the inconsistent tax rules in the savings area when an individual wishes to invest in equity or bonds. This can be done directly through an intermediary such as a mutual fund. The lack of a general capital gains tax has resulted in a series of rules that generally encourages direct over indirect investment, and equity over debt instruments.

First, dividends are taxable as ordinary income. The problem of double taxation of corporate income is overcome by allowing the dividend recipient to get a credit for tax paid at the corporate level. However, when a company distributes to its shareholders a capital gain, no tax credit is available because no company tax has been paid. The end result is that the capital gains exemption provided at the company level is clawed back when the gain is distributed as a dividend. If, on the other hand, the shareholder held equities directly and not through an intermediary company, the shareholder would retain the benefit of tax-free capital gains.

Trusts are not subject to this dividend claw-back, so an investment made through a trust retains the benefit of capital gains. That clearly places trusts at an advantage over companies as an investment intermediary. In response, New Zealand legislation deems certain trusts to be companies subject to the dividend rules. The trusts treated in this way are those that subscribe for funds – what in North America, I understand, would be mutual funds. Although this shores up the tax base, it reinforces the incentives of the tax system towards disintermediation.

The general common law rule that profits from the sale of shares held in a managed portfolio are taxable as ordinary business income has the same disintermediation incentive. It makes it very difficult for intermediaries to make capital gains even if they can distribute the profits tax-free. The effect of the rule seems to be to give a tax break to portfolios that are not properly managed. Naturally, individuals have a better chance than professional intermediaries of making a convincing case that investments are mis-managed in this way.

An exception to the rule that investment intermediaries have difficulty establishing that their share gains are tax-free is an Inland Revenue ruling that passive funds (funds tied to a stock index) are not in business and therefore not taxed under the business income test. This removes one penalty on intermediation but creates an incentive for passive funds over those that are actively managed.

The previous discussion has been in terms of equity investments. New Zealand taxes debt investments on a full accrual basis, creating an incentive for equity over debt for resident investors. This contrasts with tax rules applying to non-residents that heavily favour debt investment over equity. Finally, as previously noted, New Zealand has rules that tax overseas share investments in most countries on a full accrual basis, in contrast to the capital gains available for domestic share investments.

As a government policy adviser I can say that there was never a deliberate intention to design a set of tax rules that discouraged intermediation, and favoured mismanagement of equity portfolios, domestic shares over foreign shares and equity over debt. These rules have been the consequence of the need to protect a tax base that suffers form the structural problem of not taxing one form of income.

A second example of a structural problem caused by the lack of a capital gains tax is share repurchases by the issuing company. Conceptually, a share repurchase is the same as a dividend. A dividend is the distribution of corporate reserves to shareholders. From the company's point of view, a share repurchase produces the same transfer of legal ownership of wealth from the company to shareholders as a dividend. From the shareholder's point of view, however, selling the share back to the issuing company can be equivalent to selling the share to any other party so as to realise a capital gain.

Other countries deal with this issue by taxing share repurchases either as a dividend or as a capital gain. New Zealand does not have that option. If the shares are held on capital account, the repurchase is either a taxable dividend or a tax-free capital gain. This leads to complex rules and somewhat arcane legislation necessary to determine what is taxable as a dividend and what is not. Under these rules, some taxpayers are taxed on gains they have not made, while others are not taxed on gains they do make.

The lack of a capital gains tax has also resulted in New Zealand tax legislation having unclear basis rules for determining and modifying the tax value of assets. This can lead to opportunities for taxpayers to hold assets deliberately on revenue account and to take multiple deductions - for example, a deduction for the share subscription and a deduction for expenditure incurred by the subsidiary company. This is not, of course, an inevitable consequence of not taxing capital gains. It is, however, the consequence of a tax system that does not focus on changes in the wealth or balance sheet of the taxpayer.

Depreciation creates a further structural problem. A system that provides for depreciation recognises that holders of depreciating assets suffer an annual unrealised decline in wealth, or loss in income terms. Since our income tax system was based on the non-recognition of changes in asset values, our original income tax system did not provide for depreciation. Within a few years the obvious over-taxation of actual business income that this caused led our Parliament to legislate for depreciation as a special allowance.

Few would argue against the proposition that an income tax system should recognise depreciation, although it creates an asymmetry in a tax system that does not tax capital gains. Declines in asset values give rise to deductions, while increases in those values are tax-free. Tax planners have recognised the opportunity. For example, a company can be paid a capital sum for running a pipeline underground rather than overground.

The funds are used to build the pipeline, which is then depreciable. The odd result is that the company appears to have obtained a deduction for expenditure that, in substance, it has not had to outlay. The result seems even odder if the person making the payment receives a deduction. Odd as these results may seem, they can arise, illustrating some structural problems when capital sums or gains are not taken into account for tax purposes.

Tax planning problems created by the capital/revenue boundary

The examples of multiple deductions and depreciation lead naturally to the problems created by the capital/revenue boundary in creating tax planning opportunities. Tax practitioners attempt to get all accretions to wealth on tax-free capital account and all expenditure on deductible revenue account. Methods to achieve this are myriad and sometimes ingenious. The following are a few examples drawn from the New Zealand experience.

The average salary earner has few opportunities to earn tax-free capital sums. One opportunity was a redundancy payment. This is, in effect, a payment for human capital. Since in many circumstances such payments could be traded off for taxable salary, the New Zealand Parliament made redundancy payments taxable. However, payments for humiliation on redundancy have retained their tax-free status. As this opportunity has become more widely known, New Zealand employers have shown a tendency to ensure that redundant staff have been subject to increasing levels of humiliation.

In a similar way, employers and contractees have shown an increasing tendency to provide workers with capital payments to induce them to leave their previous occupations or restrictive covenants to inhibit their ability to work elsewhere. The tax-free nature of such payments has been upheld by our courts. The apparent ability to substitute in this way tax-free for otherwise taxable remuneration has led the Government recently to propose that legislation be enacted that taxes inducement payments and payments under restrictive covenants.

A recent variant of this was a case where an international accounting firm received a lump sum payment to lease floors of a commercial building. It was clear that, in present value terms, the lump sum payment offset rentals set above prevailing market levels. The rentals were deductible but the Privy Council held that the lump sum payment was a tax-free capital sum.

More imaginative schemes also utilise the capital/revenue boundary. Two examples illustrate this.

First, as previously mentioned, New Zealand levies tax on the worldwide income of residents. This includes income generated through offshore subsidiaries. One attempt to get round this is for a New Zealand company to pay an unrelated non-resident bank a sum of money in return for the option to purchase, for a minimal amount, shares in a New Zealand cash-box subsidiary of the non-resident bank. The bank then invests the sum tax-free in a haven and returns the capital plus tax-free interest in the form of share capital in the New Zealand subsidiary. The New Zealand company gains the value of the return of capital plus interest when it exercises its option to purchase the subsidiary.

A second example of such a scheme is one used by high wealth individuals who feel that their tax bill is excessive. The taxpayer borrows funds from offshore. The funds are used to invest in a venture entity. The loan is back-ended so that no payments are required until the loan matures, although accrued interest on the borrowings is deductible. The venture entity expends the funds on a high-risk venture (in which the lender also has an interest), giving rise to further tax deductions. The loan plus interest can be repaid at maturity by way of the investor exercising an option to put his or her interest in the venture entity for the principal plus interest. The gain is a tax-free capital gain. The investor, for an up-front investment, receives a return by way of substantial tax deductions.

The examples here are merely illustrative of the many ways in which taxpayers do use the capital/revenue boundary in their attempts to organise their affairs so as minimise tax.

Proposals for Reform in New Zealand

The structural problems that the lack of tax on capital gains poses for our income tax system have not gone unnoticed. A number of reviews of the tax system have considered the extent to which New Zealand should tax such gains.

In 1966 the Government established a committee of independent experts (the Ross Committee) to undertake a comprehensive review of all aspects of central government taxation in New Zealand. The committee reported in October 1967[5]. It noted that there was a strong justification for taxing realised capital gains, although it considered the issue needed further study, and any reforms in this area should follow implementation of other reforms such as lower marginal income tax rates.

In 1982 a task force on tax reform[6] reported. It concluded that although there was no reason in principle not to tax capital gains, it did not recommend the introduction of a capital gains tax at that time. The task force's views seemed to be influenced by its view that introducing a capital gains tax during a period of high inflation, as then prevailed, would create more problems than it would cure.

In 1989 the then Labour Government did propose the taxation of capital gains, along with across-the-board indexation of the income tax base.[7] With the defeat of that Government in a General Election late in that year, the proposals did not proceed.

In 1998 the then Government established a "Committee of Experts" to review a number of aspects of the tax system, including compliance costs and how to make the tax system more robust against avoidance. The committee reported in December 1998[8]. Whether capital gains should be taxed was outside the Committee's terms of

[5] Government of New Zealand, *The report of the New Zealand Taxation Review Committee* Chaired by Sir Lewis Ross, Wellington, New Zealand, 1967.
[6] New Zealand Government, *The Report of the Task Force on Tax Reform* Chaired by PM McCaw, Wellington, New Zealand, 1982.
[7] New Zealand Government, *Consultative Document on the Taxation of Income from Capital*, Wellington, New Zealand, 1989.
[8] New Zealand Government, *The Report to the Treasurer and Minister of Revenue by a Committee of Experts on Tax Compliance*, Wellington, New Zealand, 1998.

reference. The committee did comment, however, that whether a capital gains tax would be a beneficial reform would probably be determined by the type of taxation reform proposed.

Finally, the Labour-Alliance Coalition Government formed at the end of 1999 has stated that it will not introduce a capital gains tax in its first term of office. The Government has announced an inquiry into the tax system. Questions that will be posed to the Inquiry include whether the tax system can be made fairer and whether the income tax base should be broadened. This may involve consideration of the issues surrounding the taxation of capital gains.

Conclusion

This paper has canvassed the problems posed for a tax system by the absence of a general capital gains tax. That reflects the New Zealand experience. Undoubtedly, if we had a capital gains tax, the paper would have canvassed the problems posed by having such a tax. Certainly, designing an efficient capital gains tax raises a number of issues for policy makers. They include the following:

- whether the tax base needs to be indexed for inflation;
- the timing of recognition of gains and the extent to which tax can be levied on an accrual basis (and if on a realised basis, as is likely, the definition of “disposal” or “realisation” is critical);
- the ambit of any such tax, including the treatment of personal assets such as including residences;
- the treatment of capital losses;
- the appropriate rate of tax.

The issue is always the extent to which capital gains should be taxed. The best option needs to be determined by a careful analysis of where any boundary should be drawn so as to produce a tax system that is as fair and as efficient as possible. This needs to be considered in the context of the overall structure of each country’s tax system. There is probably no perfect answer. What seems clear to me is that economic and tax Nirvana is not to be found by an income tax that simply excludes from measured income that which the English Court of Chancery has held is properly attributed to the remainder man of a trust with a life tenant.

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