Australian Government
The Treasury

US Company Tax Changes: What do they mean for Australia?

It depends on….

- What the US does
- US labour response
- Terms of trade impact
- US savings response
- How other countries respond
- How Australia responds

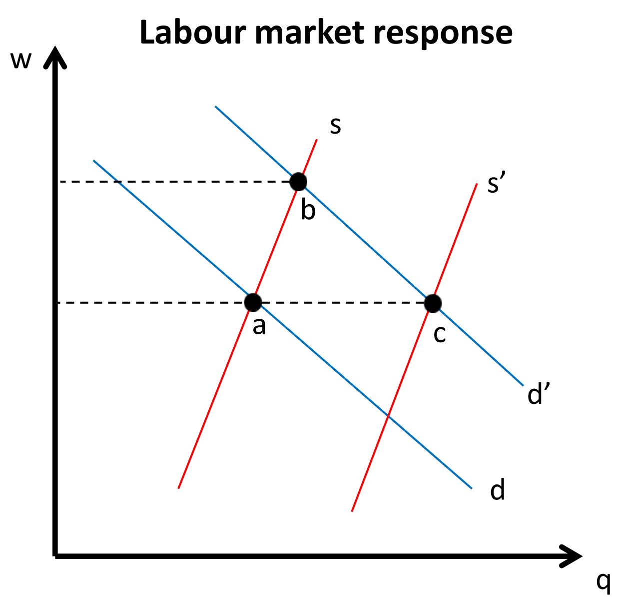
What the US does

Changes to US company tax have the potential to create a US investment boom – questions are: will it eventuate and, if so, how big would it be?

	Rate cut	**Destination based cash flow tax**
Funding	Budget rules mean the rate cut must be funded – to date unclear how	DBCFT – funded through the border adjustment. Imports are a bigger tax base than domestic production.
Impact on investment	Big (if permanent) - a lower corporate tax rate reduces the tax wedge on investment.	Bigger – cash flow taxation would mean some investments effectively face a 0% rate. All the action is in the “CF” part, not the “DB”.

US labour response

The investment boom requires goods, labour and capital. The question is – whether these inputs (particularly goods and capital) can be domestically sourced?



Investment boom drives up aggregate demand, increasing the demand for labour.

If labour supply responds (s→s’), (1) demand for goods can be met by the domestic market, (2) labour income rises as households work more.

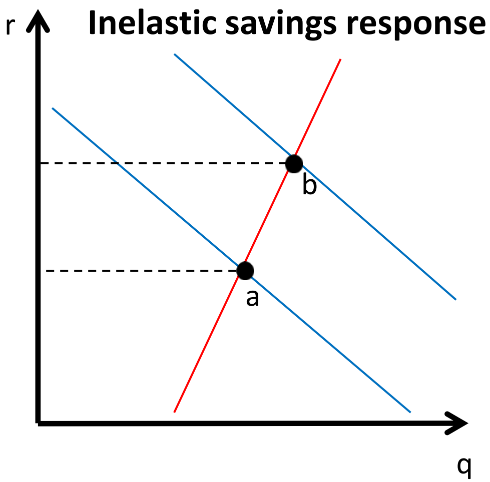
If labour supply cannot respond, (1) demand for goods met with imports, (2) labour income rises as wages rise.

Terms of trade impact

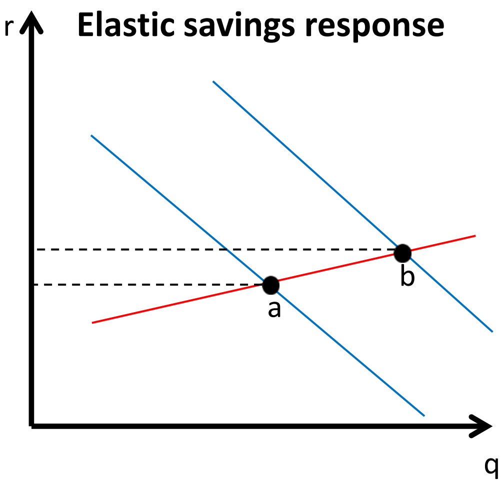
- Investment boom will increase US demand for goods.
- If the labour supply does not respond to increase production, goods must be imported.
- Question is – will US demand increase the price of the goods we export more than the goods we import? Or vice versa?

Labour and savings responses

The investment boom would increase the demand for capital – question is, do US savings respond to increase the global pool of capital?



If US savings are relatively inelastic, interest rates will increase. This will result in capital being pulled from the rest of the world.



If US savings are relatively elastic, interest rates will increase by less. This will result in some capital being pulled from the rest of the world (but less than in the first scenario).

Do US households save in order to buy into the boom? Or do they spend more because they think they'll have permanently higher household incomes?

How other countries respond

- History of global tax competition – suggests other countries likely to respond.
- Countries that respond by lowering their company tax rates likely to avoid the negative impact that the US cuts would otherwise have on investment, growth and wages.
- But this will compound the impacts on countries that do nothing.

How Australia responds

?

DBCFT – other issues

- Losses – refund or carry forward with uplift?
  - Tax driven merger activity
- Transitional arrangements – free entry or parallel systems?
- Integrity issues – direct foreign sales, missing trader schemes, CIT as a backstop for PIT