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Senate Standing Committees on Rural Affairs and Transport
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Dear Sir or Madam

Reducing overpayments of foreign investors with boomerang ownership

This submission is made in regards to your “Examination of the Foreign Investment Review Board National Interest Test”. Its scope transcends the seven specific points of reference by providing a fundamental review of foreign investment and ways for improving its contribution to economic efficiency, equity, economic independence and national sovereignty.

The objective of this submission is to:

- (1) Show how foreign investors can be overpaid in conflict with the national interest;
- (2) Introduce the idea of “boomerang ownership” to attract more foreign investment while minimizing overpayments by returning long term alien ownership to Australian voters to increase their income;
- (3) Recommend that a working group be established to refine and develop how best to introduce boomerang ownership that is beyond the scope of this submission.
- (4) Recommend that a basic requirement for foreign investment is that if Australian tax deductions are used for recover the money invested, then the cost of the investment is written off so its ownership can be transferred to Australian voters without cost.
- (5) Recommend that time limits be imposed on all foreign ownership and control of national resources including agricultural and urban land.

All investors can get overpaid to exacerbate economic inefficiency and inequality in ways not reported by accountants and so not considered by economists.

The introduction of boomerang ownership to transfer assets producing overpayments to voters provides a way to reduce the need for taxes, big government and welfare costs. The arrangements are described in my 1975 book [*Democratising the Wealth of Nations*](#). My book proposed tax incentives for the voluntary introduction of boomerang ownership for either foreign or domestic investors.

Overpayment of foreign investors is especially contrary to the national interest because it:

- Depresses the potential living standards of Australian citizens and,
- Increases the “unlimited, unknown and uncontrolled foreign liabilities” of Australia as noted by Professor Penrose (1956). However, like accountants who do not identify

overpayments to investors, economists do identify unnecessarily incurred foreign liabilities with the associated losses of foreign exchange.

The neglect to identify and be concerned about foreign liabilities arises from economists using the word wealth to mean income rather than assets minus liabilities. This problem can be traced back to Adam Smith who founded modern economics when he wrote about “The Wealth of Nations” to mean income. The neglect of economists in identifying the liabilities of nations explains why the Third World debt problem in the last century was not anticipated. In a similar way the Australian government and its regulators did not anticipate the problem created by the reliance of Australian banks on foreign liabilities revealed by the 2008 global financial crisis. Six months before their liabilities had to be guaranteed by the government I had raised concerns over their foreign liabilities in *The Australian Financial Review* (Turnbull 2008).

A contributing problem of economist in not being aware of foreign liabilities in the last century was that most countries did not prepare national accounts that identified their assets and liabilities. Professor Colin Clark worked on developing national accounts with this omission in the 1930’s. He revealed the shortcomings of economic analysis by his statement to me after he read my 1975 book. He informed me that it was not about economics. The basis for his statement was that my book used the word “wealth” in its commercial sense of assets minus liabilities. So in his mind it was not about economics!

Likewise today many economists neglect the distribution of assets and liabilities in providing policy advice. An ownership impact analysis should become a standard consideration in any economic legislation brought before Parliament. This is especially so for tax legislation.

At present foreign investors can recover the cost of their investment by tax concessions described as “depreciation” or “depletion” allowances. These are imaginary expenditure created by accountants whereas financial analysts treat them as a cash return! (Turnbull 1975b) Other Australian taxpayers must pay for the loss of tax revenues from these imaginary accounting costs that provide tax shelter to foreign investors. This cannot be accepted to be in the national interest unless foreign investors are required to write down the cost of their investment to zero when they have fully recovered all their expenditure. In this way foreign ownership of assets can be transferred to voters without a cost. After all, it is other Australian taxpayers who facilitate foreign investors getting their money back.

This proposal would not reduce reported profits as the cost of paying back the foreign investment expenditure from the tax concessions are already recognized by accountants as an operating cost. This also explains why profits reported by accountants underestimate the returns calculated by investment analysts as illustrated in the Appendix. The Appendix also indicates how overpayments to investors not identified by accountants and economists can become over two and half times greater than the original cost of the investment.

To encourage the voluntary adoption of boomerang ownership it is recommended that a reduction in the tax rate and/or relief from any resource rent tax be made for either foreign or local firms who voluntary adopt boomerang ownership. It also shows the need for any changes in tax policy to take into account the issues raised in this submission.

Because commercial investors discount the value of future cash at a compounding equity rate of return, the value of a future dollar becomes inconsequential after ten years. This can allow

a small tax reduction in early years to become more valuable than all the profits that might be received after ten years in perpetuity (Turnbull 2000: 409).

Commercial investors will volunteer to give up long-term ownership with uncertain and so more risky profits if they possess the option to obtain bigger, quicker less uncertain profits from a tax concession.

All Australian workers are in the opposite situation of being required to give up their immediate earnings to fund their superannuation income in the future whose value they do not discount. Their retirement income is not discounted because it is expended to support their living expenses. This denies the possibility of there being an investment opportunity cost and so a discount rate.

Ownership transfer arrangement creates a complementary match between investors who discount the future and retiring voters who do not. In this way it creates a win-win situation.

Ownership transfer arrangements provide a way to reduce the need for workers to reduce their living standards today to fund their retirement in the future. In this way boomerang ownership reduces the need to increase superannuation contributions and/or the need for the government to collect taxes to fund pensions. Boomerang ownership provides a way of democratizing the wealth of nations with smaller taxes, smaller government and less welfare expenses in a way commonly neglected by policy advisors.

How overpayments arise

Overpayments arise because investors in corporations and realty obtain property rights that last longer than the time required by the investor to recover all their investment expenditure with a competitive return.

All intellectual property rights have limited life. Patents typically have a life of 20 years. To create a level investment playing field, ownership of corporations and realty should also be limited - except in cases like owner occupied homes.

When making an investment decision, investors will not rely on receiving any cash beyond their foreseeable future to recover either their investment expenditure or a competitive return. Any cash received by an investor beyond their foreseeable future becomes surplus to the incentive to invest.

The surplus incentive represents a "surplus profit" (Turnbull 1997: 142, 2006). It is a windfall profit not identified by accountants and so it does not become a concern of economists (Turnbull 1975b). Accountants do not report it because they do not identify the foreseeable future of the investor described as their "time horizon". Profits reported by accountants may be considered "excessive" and described by economists as "rent". But economic rent is not a surplus profit when it arises before the investor's time horizon. What is not reported is not seen or managed by policy analysts.

It is not proposed that any tax be applied to any excessive profits obtained before the investor's time horizon as investors can also make losses. The argument that investors need long-term ownership to recover the cost of failed investments is not accepted. This is because the risk of such losses is covered by the risk premium included in the target rate of return accepted for all new investments.

Unlike “cash flow accounting” (Turnbull 1979) the current system of accrual accounting requires the cash surpluses made in each accounting period to be reduced by an artificial cost described as a depreciation or depletion when calculating a profit. This reduces the reported rate of return of investors as illustrated in the Appendix.

Surplus profits are inconsistent with the rationale for a market economy where competition is assumed to limited profits. However, surplus profits are not exposed to competition because ownership rights are generally static, perpetual and exclusive. Efficiency and equity can be achieved by using a tax incentive to introduce ownership that is dynamic, time limited and inclusive (Turnbull 1975a, 2006, 2012). This type of ownership arises naturally in squatter settlements where if you do not use property you loose it to those that do.

Efficiency and other benefits of boomerang ownership

Overpayment of investors is inefficient and inequitable. The overpayment of alien investors is contrary to national interests as it reduces resident income and runs down foreign exchange reserves.

As Australians provide the taxes to allow foreign investors to recover all the cost of their investment from depreciation and depletions tax concessions, it makes sense that individual Australians who become beneficiaries of ownership transfers incur no cost. The ownership interests accruing to individuals could be vested in their superannuation account and be subject to similar rules.

However, it makes good business sense that a significant proportion of the ownership interests accruing to voting Australians be those who are in a position to monitor and/or improve the efficiency in how the assets are managed. In this way more citizens would have an interest in improving the productivity, efficiency, sustainability and social accountability of productive activities.

There are two ways for introducing boomerang ownership:

1. On specific foreign owned and/or controlled assets and/or
2. Introducing Ownership Transfer Corporations (OTCs).

A number of additional advantages arise when ownership transfer involves corporations to create OTCs. An OTC is created when its shareholders approve the creation of a stakeholder class of shares. The stakeholder shares would acquire all the property rights of the investor shares over an agree time period like 20 years. Stakeholder shares are then issued to citizens without cost according to their involvement with the company and other political criteria (Turnbull 2000). Localizing ownership of a firm in its host community is one such consideration to make firms environmentally and socially accountable as well as making the host community more economically independent.

To maximize the return to investors, OTCs would distribute all their profits each year like many cooperatives. Growth of the business would be financed through forming “offspring” corporations funded by dividend re-investment and/or new share issues by the offspring firms.

To sum up, OTCs would introduce many profound benefits such as:

- (1) Reducing inefficiency in the extent of (a) surplus profits and (b) re-investment of profits;
- (2) Reducing the inequity of overpaying investors with profits surplus to providing the incentive to invest.

- (3) Avoiding corporations becoming too big to fail as firms obtain an incentive to distribute all profits;
- (4) Allowing market forces to allocate corporate resources more efficiently through dividend reinvestment in offspring firms and/or cyclic recapitalizations instead of relying on a very imperfect market for corporate control through takeovers;
- (5) Establishing many smaller firms with less market power to improve competition in providing goods and services;
- (6) Reducing the economic and political power of corporations that can undermine democracy;
- (7) Reducing taxes, welfare and the size of government;
- (8) Reducing alien disconnected capitalism by increasing local ownership with strategic stakeholder engagement;
- (9) Facilitating protection of the host environment of firms through greater local control;
- (10) Introducing “boomerang” ownership to attract more foreign investment with more local ownership long term;
- (11) Furthering the financial independence of local communities and so
- (12) Providing environmentally sustainable prosperity even without growth (Turnbull 2012).

A working group is required to develop proposals

A working group is required to consider how boomerang ownership could be introduced in the most efficacious way in various situations and with consideration of the wider tax implications.

A cost benefit analysis of the tax incentive required to encourage corporations to voluntarily convert to OTCs was undertaken by the Australian Treasury over 35 years ago. This arose from my submission to the Australian Senate Select Committee on Foreign Ownership and Control (Turnbull 1972) when my Father was an independent Senator for Tasmania.

It is possible for the government to gain more taxes than are lost from providing an incentive for boomerang ownership. This is because as ownership of corporations transfer from investors to individuals, more taxes are collected as individuals pay tax at a higher rate than corporations. However, this analysis needs to be revisited because of the many changes in tax arrangements during the last 39 years.

Another issue that requires consideration is that tax deductions are not available for either urban or agricultural land purchases. This denies investors obtaining a tax-funded cash payback for the land proportion of their investment. On the other hand owning land can yield windfall gains that are not created by the investor but by local demand for land. It is not in the national interest for this to occur. This was demonstrated by my case study on General Motors Holden. It provided evidence that the windfall gains arising from demand for urban land in Melbourne in the 1950's were much greater than the profits generated by a tariff protected monopoly automobile manufacturer (Turnbull 1973).

There are at least two ways that a working group could consider to mitigate this problem. One is to extend tax reductions to investment in land in return for boomerang ownership. The other approach is to separate land ownership from the improvements on the land like office buildings and residential accommodation. The inefficiencies and inequities in land ownership and details of how these can be overcome in an urban context are set out in my other writings such as Turnbull (2007).

Another issue that requires further consideration is when foreign investment is made for non-commercial reasons. The fact that an investment is made wholly or in part for strategic reasons rather than increasing productivity and profits should be sufficient reason for a prima facie rejection of such foreign investment.

Such situations can arise in regards to residential properties to provide foreigners with a political safe haven. The acquisition of agriculture land may be motivated to assure foreign interests with a sustainable source of food. Acquisition of Australian resources from investments can provide a much more efficient way for foreign interests to secure resourced then by sending an invading army to obtain access. For Australia to protect its national interests there is a need to place time limits on all alien rights to ownership and/or control of Australian resources whether the foreign investment is made for commercial and/or strategic reasons. Otherwise Australian sovereignty becomes diluted, diminished until deleted.

Exceptions could arise when foreign interests have non-commercial interests like owning a global communication facility. Acceptance could then be negotiated in sharing its strategic benefits with Australians on a more open and transparent basis than currently exists.

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This submission with my address details may be made public and I would be please to accept an invitation to explain these ideas in greater detail in person.

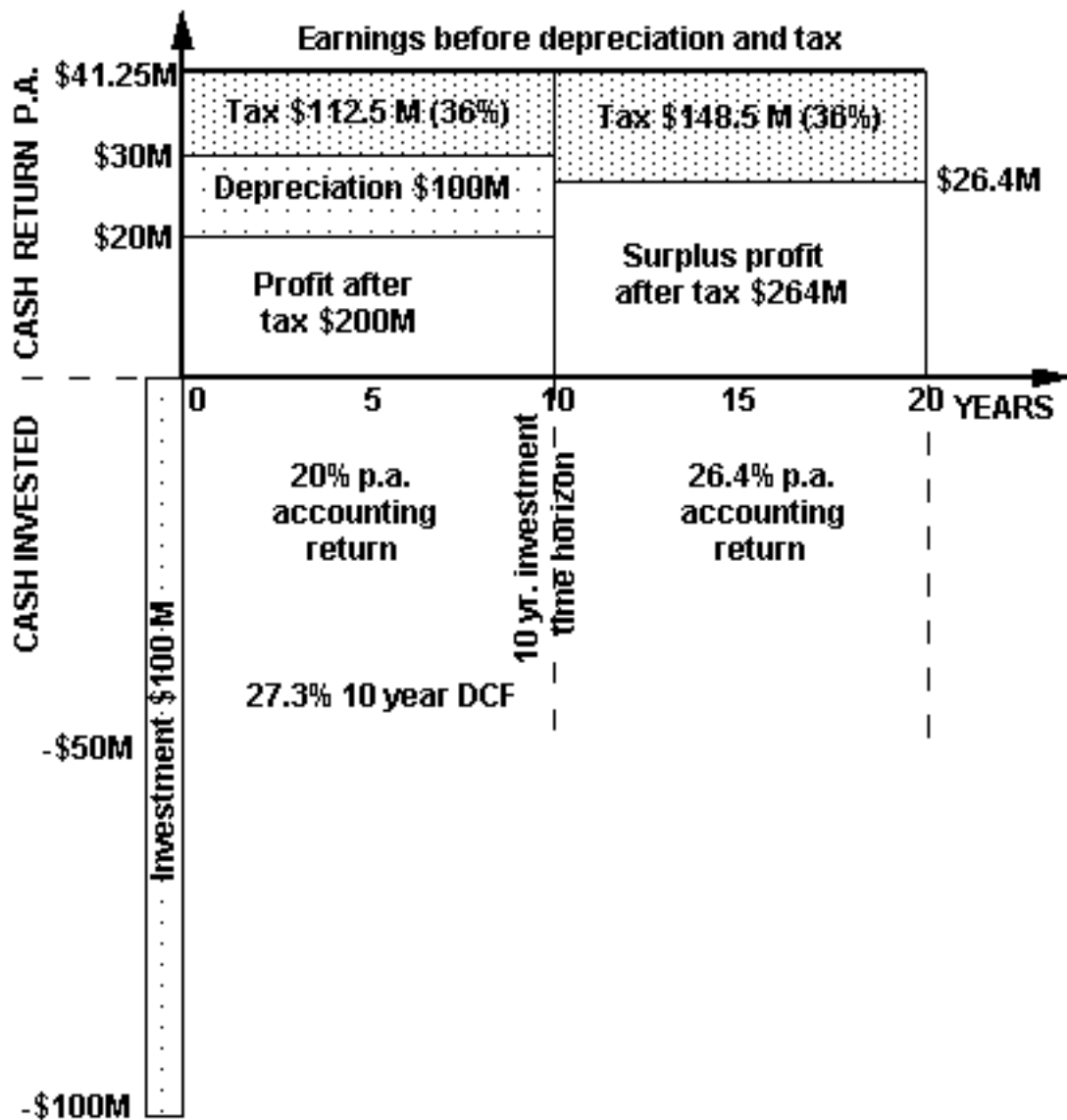
Yours faithfully

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APPENDIX

If an investment is producing a cash surplus equal to 30% of the investment and a depreciation cost of 20% is applied then the reported profit before tax is reduced to 10%. With a 30% tax rate the reported profits is reduced to an apparently uncompetitive equity return of 7%. However, the cash return to the investor is 27% each year. So after 3.7 years the investor has completely recovered all the money put at risk. During the next 1.3 years when the book cost of the investment has been reduced to zero the net cash profit for the investor is $1.3 \times 27\% = 35\%$. When the time value of money is taken into the account the rate of return becomes an acceptable 11% rather than uncompetitive return of 7% as reported by accountants.

An illustration of surplus profits from Turnbull (2006) is reproduced below. It considers a twenty-year operating life for a \$100M investment when the investor's foreseeable future/time horizon is ten years.



\$100 million investment with ten year investment time horizon and 20 year life	YEARS 0-10	YEARS 11-20
	Millions p.a.	Millions p.a.
Earnings before depreciation and tax	\$41.25	\$41.25
Depreciation	\$10.00	\$0.00
Earnings before tax	\$31.25	\$41.25
Tax at 36%	\$11.25	\$14.85
Profit after tax	\$20.00	\$26.40
Cash return	\$30.00	\$26.40
Accounting return	20%	26.4%
Surplus profit	\$0.00	\$264.00
Discounted Cash Flow return (DCF)	27.3%	