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The Case for A Global Excess Profits Tax: A Response to Dr. Tarcísio Diniz Magalhães & Professor Allison Christians

PAIGE MCHUGH

I. INTRODUCTION

In striving to slow the spread of the COVID-19 pandemic, governments across the globe acted quickly to implement various "stay-at-home" orders and bans on all "non-essential activities."[1] While these actions were likely effective in slowing the spread of the virus,[2] the economic impacts were felt almost immediately. The US deficit rose to $3.1 trillion following massive spending to aid individuals and small businesses.[3] Internationally, governments have been increasing their debt loads to combat both the health and financial impacts of the pandemic. Indeed, by the end of 2020, the international debt load increased to a record-breaking $281 trillion.[4] Almost as quickly, various proposals have been offered regarding how to mitigate this pandemic-fueled deficit. One solution offered is the return of a historical tax scheme—an excess profits tax.[5] Excess profits taxes have historically

1. *See Policy Reponses to COVID-19*, INT'L MONETARY FUND, https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19 (July 2, 2021).

2. *See* Mary Van Beusekom, *Stay-at-Home Orders Likely Slowed COVID-19 Spread, Study Finds*, CTR. FOR INFECTIOUS DISEASE RSCH. & POL'Y (May 26, 2020), https://www.cidrap.umn.edu/news-perspective/2020/05/stay-home-orders-likely-slowed-covid-19-spread-study-finds.

3. Jim Zarroli, *$3.1 Trillion: Pandemic Spending Drives the Federal Budget Deficit to a Record*, NAT'L PUB. RADIO (Oct. 16, 2020), https://www.npr.org/sections/coronavirus-live-updates/2020/10/16/924582156/-3-1-trillion-pandemic-spending-drives-the-federal-budget-deficit-to-a-record.

4. *See* Sydney Maki, *World's $281 Trillion Debt Pile is Set to Rise Again in 2021*, BLOOMBERG (February 17, 2020), https://www.bloomberg.com/news/articles/2021-02-17/global-debt-hits-all-time-high-as-pandemic-boosts-spending-need.

5. *See, e.g.*, Reuven S. Avi-Yonah, *Taxes in the Time of Coronovirus: Is It Time to Revive the Excess Profits Tax?* 4 (U. of Mich. L. Sch., L. & Econ. Working Papers, Paper No. 170, 2020), https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1282&context=law_econ_curr

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been applied both domestically and internationally during times of war. Although there are variations in how an excess profits tax is calculated, traditionally, an excess profits tax is applied to those companies who earn returns in excess of a set "normal" rate of return.[6]

Despite variations in how excess has been calculated under the historical versions of excess profits taxes, all have been implemented on a purely temporary basis to raise revenue for a particular crisis. One recent COVID-19 excess profits tax proposal, however, suggests taking a different approach. Professor Allison Christians and Dr. Tarcísio Diniz Magalhães propose the implementation of a global excess profits (GEP) tax which aims to immediately address the fiscal crisis resulting from the COVID-19 pandemic by taxing those companies whose profits are especially fueled by "high tech and unique intangibles"[7] and redistribute such wealth to developing countries.[8] Professor Christians and Dr. Magalhães assert that, unlike with historical excess profits taxes, new tools made available by leveraging technology and increased globalization will make a modern-day excess profits tax more successful on a global scale. Indeed, Professor Christians and Dr. Magalhães propose implementing a GEP tax to effectively address the challenges brought on by an increasingly digital global economy.

This note argues that, while Professor Christians and Dr. Magalhães's GEP tax proposal improves upon some of the weaknesses of the historical excess profits taxes by leveraging new tools developed by the Organisation for Economic Co-operation and Development (OECD), their proposal, which utilizes a uniform, flat percentage for determining excess profits, remains largely inaccurate and thus will have inequitable

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ent (arguing that an excess profits tax should be implemented to address "some corporations . . . profit[ing] from the current crisis while everyone else suffers"); Emmanuel Saez & Gabriel Zucman, *Jobs Aren't Being Destroyed This Fast Elsewhere. Why Is That?*, N.Y. TIMES, Mar. 30, 2020, https://www.nytimes.com/2020/03/30/opinion/coronavirus-economy-saez-zucman.html (arguing that an excess profits tax should be revived like in times of war, "making sure that no one could benefit outrageously from a situation in which the masses suffered"); Alex Hemingway, *Excess Profits Tax Needed to Prevent Profiteering Amid COVID-19*, THE TORONTO STAR, Apr. 23, 2020, https://www.thestar.com/opinion/contributors/2020/04/23/excess-profits-tax-needed-to-prevent-profiteering-amid-covid-19.html (arguing that a "wartime-style excess profits tax would help prevent profiteering amid COVID-19").

6. Hemingway, *supra* note 5; *see* Avi-Yonah, *supra* note 5, at 1.

7. Allison Christians & Tarcísio Diniz Magalhães, *It's Time for Pillar 3: A Global Excess Profits Tax for COVID-19 and Beyond*, 98 TAX NOTE INT'L 507, 507 (2020).

8. *Cf. Pillar 3 for the OECD: A Global Excess Profits Tax*, FORBES (May 18, 2020, 1:18 PM), https://www.forbes.com/sites/taxnotes/2020/05/18/pillar-3-for-the-oecd-a-global-excess-profits-tax/?sh=13867cb536ac (discussing the redistribution of residual funds through the "OECD digitalization project").

results. Indeed, this note argues that Professor Christians and Dr. Magalhães's GEP tax proposal does not go far enough in leveraging the new tools made available by the OECD's digitalization project in order to create both an equitable and effective GEP tax.

Part II of this note will provide a historical overview of the experiences with various versions of excess profits taxes both domestically and internationally. Part III describes the modern context, which calls for the return of the excess profits tax. More specifically, it describes the rising profits of digital multinational corporations and the challenges of effectively taxing those profits, especially in light of the global economic strain resulting from the pandemic. Considering these issues, Part IV summarizes and highlights the key aspects of Professor Christians and Dr. Magalhães's proposal for implementing a GEP tax. Part V evaluates their proposal considering the lessons learned from the historical experiences with excess profits taxation. It evaluates their proposal, as well as historical excess profits taxes, on several accepted principles of sound tax policy, including accuracy, administrability, transparency, and the extent to which their proposal minimizes tax avoidance.[9] Finally, Part VI proposes that the GEP tax proposal be revised to leverage even further the new tools and data that were unavailable during historical applications of excess profits taxes. This note argues that international taxing authorities now have access to the data necessary to calculate nuanced rates of return at the firm level, making the tax significantly more equitable across firms and industries and limiting opportunities for avoiding the tax.

II. THE HISTORY OF DEFINING AND TAXING EXCESS PROFITS

The most basic concept of "profits" is "the financial benefit realized when revenue generated from a business activity exceeds the expenses, costs, and taxes involved in sustaining the activity in question."[10] Accountants also traditionally calculate the profitability of a firm by assessing "economic profits relative to the amount of investment."[11] Investors must choose whether they want to invest in a particular

9. *See* ASS'N OF INT'L CERTIFIED PRO. ACCTS., GUIDING PRINCIPLES OF GOOD TAX POLICY: A FRAMEWORK FOR EVALUATING TAX PROPOSALS 2–3 (2017). *See generally The Principles of Sound Tax Policy,* TAX FOUND. (Mar. 15, 2012), https://files.taxfoundation.org/20200723152458/PrinciplesOfSoundTP.pdf (describing the principles of the Tax Foundation's sound tax policy).

10. Will Kenton, "Profit Definition," INVESTOPEDIA (July 21, 2020), https://www.investopedia.com/terms/p/profit.asp.

11. JAMES M. WAHLEN ET AL., FINANCIAL REPORTING, FINANCIAL STATEMENT ANALYSIS, AND VALUATION 201 (9th ed. 2018).

company or invest elsewhere in the market. The rate of return they receive on their invested capital must adequately compensate them for the opportunity cost and risk.[12] Common measures for computing the required rate of return is the Weighted Average Cost of Capital[13] and the Capital Asset Pricing Model.[14] These measures determine "the minimum return that a company must earn on an existing asset base to satisfy its creditors, owners, and other providers of capital, or else they will choose to invest elsewhere."[15]

Economists divide a firm's profits into those that are "normal" and those that are "excess."[16] Normal profit is "the opportunity cost of the business" or the "amount of profit just sufficient to keep the firm in business."[17] According to international transfer pricing guidelines, normal or "routine" profit is evaluated through comparable data between similar firms or competitors.[18] Residual profit, on the other hand, is the product of market power or a unique innovation that allows the company to be more profitable than its competitors.[19] While seemingly simple in definition, these divisions are complex in application; accurate measurement requires understanding the firm's strategy, as well as the industry where it operates, as many factors can cause vast differences in the rate of return and profitability of firms. Some of these factors may include a firm's product life cycle, choices regarding operating leverage, business strategy, and the cyclicality of its sales.[20] Properly defining what range of profitability is normal or routine for a firm or industry and then assessing the position of a particular firm as above or below that threshold requires careful, and at times subjective, analysis; this has long been the goal of economists, investors, and tax professionals alike.

Whether profits are derived intentionally or are simply the result of

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12. *See id.* at 209.

13. *Id.* at 739 (describing WACC as the discount rate that reflects "the weighted-average required rate of return that encompasses the debt, preferred, and common equity capital used to finance the net operating assets of the firm").

14. *Id.* at 730 (hypothesizing that "in equilibrium, investors should expect to earn a rate of return on a firm's common equity capital that equals the rate of return the market requires to hold that firm's stock in a diversified portfolio of assets").

15. Alex Cobham et al., Global Inequalities in Taxing Rights: An Early Evaluation of the OECD Tax Reform Proposals 9 (Oct. 2019) (unpublished manuscript), https://osf.io/preprints/socarxiv/j3p48/.

16. Letter from PricewaterhouseCoopers to Working Party 6, OECD 1, 12 (2010) (discussing the transfer pricing aspects of intangibles).

17. *Id.*

18. *Id.* at 13.

19. *See* Cobham et al., *supra* note 15.

20. *See* JAMES M. WHALEN ET AL., FINANCIAL REPORTING, FINANCIAL STATEMENT ANALYSIS AND VALUATION 220 (9th ed. 2018).

favorable market conditions, governments have engineered complex schemes to tax profits deemed excessive.[21] Although exact structures vary, a classic excess profits tax is one "imposed on corporate earnings in excess of earnings during a base period, plus an allowance for new investment."[22] Put simply, the implementation of an excess profits tax requires determination of some base amount by which profits in excess can be determined. Indeed, "[p]rofits may be said to be [in] 'excess' only in relation to a concept of 'normal' profits."[23]

The US has had a tumultuous affair with excess profits taxation. An excess profits tax was first implemented in response to World War I with the Revenue Act of 1918,[24] which focused on principles of "shared sacrifice" by attempting to tax those corporations that had made "war profits."[25] The 1918 Act gave corporate taxpayers two alternative tests for determining excessiveness of profits.[26] The average profits approach compared profits in the 1918 taxable year with those in a pre-war period from 1911–1913 (in other words, the "normal" profit base) and imposed a tax of 80 percent on the excess.[27] Alternatively, the invested capital approach imposed a tax "on income in excess of a flat 8% return on invested capital for the taxable year."[28] For the purposes of the Act, invested capital was defined as "the capital actually paid into the

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21. *See, e.g.*, Douglas M. Robinson, *The Misnamed Tax: The Crude Oil Windfall Profits Tax of 1980*, 84 DICK. L. REV. 589, 591–92 (1979) (stating that President Carter imposed an excise tax on domestic crude oil production in the 1980s). *See generally* Lucy Chennells, *The Windfall Tax*, 18 FISCAL STUD. 279, 282–83 (1997) (analyzing the windfall tax on privatized utilities that was implemented in the UK in the late 1990s).

22. Robinson, *supra* note 21, at 590 n.7 (quoting STAFF OF THE JOINT COMM. ON TAX'N, 93D CONG, ENERGY TAXATION: ALTS.' FOR THE TAXATION OF INCREASED DOMESTIC OIL AND GAS PROFITS, 3 (1974)).

23. Clifford J. Hynning, *The Excess-Profits Tax of 1940—A Critique*, 8 U. CHI. L. REV. 441, 447 (1941).

24. There were two iterations of the excess profits tax that were implemented before the Revenue Act of 1918 and then quickly repealed. Introduced in March of 1917, Congress passed a law levying an 8% tax "upon the profits of corporations and partnerships in excess of $5,000, plus 8% of the capital actually invested." This Act was quickly replaced by the revised Act of October 3, 1917. This version applied an invested capital standard to determine excess profits, but applied progressive tax rates, with the highest being a 60% rate "applied to profits in excess of a 33% return on invested capital." Like its predecessor, this Act was also widely criticized for being "so unfair in its scope and so uneven in its application," as well as so difficult to administer, that it was repealed only a year later. COMM. ON POSTWAR TAX POL'Y, FINANCING DEFENSE: IS AN EXCESS PROFITS TAX THE SOLUTION? 8 (Comm. Print 1950).

25. *See* Carl C. Plehn, *War Profits and Excess Profits Taxes*, 10 AM. ECON. REV. 283, 285 (1920).

26. *See* Anita Wells, *Legislative History of Excess Profits Taxation in the United States in World Wars I and II*, 4 NAT'L TAX J. 237, 239–40 (1951).

27. *See* Plehn, *supra* note 25, at 289–90.

28. Wells, *supra* note 26, at 240.

business, including paid-in or earned surplus and undivided profits."[29] Borrowed capital, however, was specifically excluded. The Act limited the "value of tangible property . . . to the par value of the stock issued for it" and included intangible property, such as patents and copyrights, in the calculation "up to a limit of 25% of the par value of stock outstanding at the beginning of the taxable year."[30]

The 1918 Act, met widely with criticism, was repealed only a year later.[31] The business community loathed the tax for its "intricacy and capricious inequalities."[32] Administrators resented it for "clogging the administrative machinery,"[33] observing that "[t]he inadequacy of books and records made administrative findings of fact with respect to invested capital and prewar earnings extremely difficult."[34] One of the factors driving this administrative burden was the statute's use of a corporation's *originally* invested capital to determine the normal return.[35] Indeed, an accurate determination required a corporate taxpayer to do a complete revaluation of plant assets and inventories used many years ago, "even though they . . . are not part of the capital with which the taxpayer corporation is now operating."[36] Difficulties also arose in applying the average profits method, as an accurate calculation of average profits in the base period required adjustments of the income reported on tax returns for items classified as "abnormal."[37] Corporate taxpayers, however, were not maintaining their books in anticipation of complying with a future excess profits tax, and extracting "the amounts representing the abnormal expenses or losses . . . [was difficult or] impossible to [determine] . . . with exactness."[38]

Despite its wide disfavor, the US revived the excess profits tax roughly twenty years later at the onset of World War II to raise revenue for the war effort and again to ensure that "few [did] not gain from the sacrifices of many."[39] Like its predecessor, the Revenue Act of 1940

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29. *Id.* at 239.

30. *Id.* at 239–40.

31. COMM. ON POSTWAR TAX POL'Y, FINANCING DEFENSE: IS AN EXCESS PROFITS TAX THE SOLUTION? 8 (Comm. Print 1950).

32. Thomas S. Adams, *Should the Excess Profits Tax be Repealed*, 35 Q. J. ECON. 363, 369 (1921).

33. *Id.* at 371.

34. Wells, *supra* note 26, at 240.

35. Walter A. Cooper, *Accounting Problems Under the Excess Profits Tax,* 10 L. & CONTEMP. PROBS. 103, 104 (1943).

36. *Id.* at 104–05.

37. *Id.* at 106.

38. *Id.*

39. Alex Hemingway, *Excess Profits Tax Needed to Prevent Profiteering amid COVID-19*, POL'Y NOTE (Apr. 9, 2020),

provided taxpayers with two alternatives for calculating excess profits subject to the tax: (1) "95 [percent] of the average earnings in the base period years 1936–1939 or [(2)] a percentage of invested capital ranging from 8 [percent] on the first $5 million of capital down to 5 [percent] on invested capital above $10 million."[40] Congress implemented several changes, however, in response to the negative reaction to the first excess profits tax. In addition to expanding the definition of invested capital to include 50 percent of borrowed capital, the changes largely focused on providing specific relief for taxpayers, through a series of exemptions and qualifications, to meet particular, hard cases and to allow adjustments for certain abnormalities in income and capital.[41]

The choice of whether to use the average earnings method or invested capital method depended largely on where the corporate taxpayer fell in its business life cycle. The average earnings method tended to favor the "well-established corporation with a steady income" in comparison to a "smaller competitor whose income has been rapidly increasing in the base years and in 1940."[42] In calculating excess profits via the invested capital method, the Revenue Act of 1940, like its predecessor, avoided a "current valuation of the assets actually in use in the business and measure[d] instead the money and other property paid into the corporation [originally], plus earnings and profits accumulated subsequently."[43] Again, while simple in theory, this approach proved quite difficult in application because "the invested capital of a corporation depends upon the time and circumstances of its legal birth, upon the tone of its financial policy, [and] on the character of its bookkeeping."[44]

Like its predecessor, the 1940 tax became difficult both to administer and to comply with.[45] In response to frequently raised demands for relief provisions during the First World War, the Revenue Act of 1940 gave the IRS the authority to make exceptions for certain

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https://www.policynote.ca/profitstax/#:~:text=Roosevelt%20put%20it%20in%201940,%E2%80%9Cnormal%E2%80%9D%20rate% (Can.).

40. COMM. ON POSTWAR TAX POL'Y, FINANCING DEFENSE: IS AN EXCESS PROFITS TAX THE SOLUTION? 9 (Comm. Print 1950) (stating that the taxpayer has the option which method to employ, consequently, "a corporation making a high rate of return on its invested capital, as defined in the act, will be drawn toward the average income method, [whereas] a corporation with a record of low earnings in the past 4 years may be impelled toward the invested capital method").

41. Roswell Magill, *Relief from Excess Profits Tax*, 89 U. PENN. L. REV. 843, 845–46 (1941).

42. *Id.* at 845.

43. Carl Shoup, *The Concept of Excess Profits Under the Revenue Acts of 1940-42*, 10 L. & CONTEMP. PROBS. 28, 36 (1943).

44. Adams, *supra* note 32, at 377.

45. *See* Hynning, *supra* note 23, at 442.

classes of "abnormalities" in the taxpayer's income in the current or base period.[46] Yet whether a particular taxpayer qualified for relief was determined case-by-case, requiring administrative discretion "of a very considerable magnitude with very little or no statutory guidance." Additionally, only the most vocal complaints were heard and thus subsequently implemented in the Revenue Act of 1940, leaving many unrecognized "injustices" that could not be appropriately granted relief under the Act.[47] Indeed, opposition to the tax grew as the end of the war neared because "the appetite for fiscal sacrifice was waning" and "[t]he excess profits tax . . . [was] considered [a] serious threat to the economy's postwar recovery."[48] Thus, like its predecessor, the World War II excess profits tax was also repealed with the Revenue Act of 1945.[49]

It is of note that, although they were notoriously unpopular with the business community, the excess profits taxes of World War I and World War II were productive in term of revenues. In 1918 alone, the World War I excess profits tax provided over $2.5 billion to fund the war effort, but receipts from the tax declined significantly over the next three years until it was repealed in 1921.[50] The World War II excess profits tax likewise provided significant revenues—a total of $16.19 billion from 1941 to 1944—before it was repealed in 1945.[51] While the excess profits taxes, for the most part, were "cheerfully paid during the war" and "evasion and avoidance tended to be limited by the desire to help the government win the war with patriotic spirit,"[52] compliance with the tax significantly waned at war's end and taxpayers seemed increasingly unwilling to tolerate "their high rates, inequalities in burdens, and

46. *See id.* at 448–49.

47. *Id.* at 449.

48. Steven A. Bank, *The Rise and Fall of Post-World War II Corporate Tax Reform*, 73 L. & CONTEMP. PROBS. 207, 209 (2010).

49. COMM. ON POSTWAR TAX POL'Y, FINANCING DEFENSE: IS AN EXCESS PROFITS TAX THE SOLUTION? 8, 9 (Comm. Print 1950) (quoting Secretary Vinson, "the excess profits tax . . . has been an erratic and in many instances an inequitable tax. The difficulty is that calling profits excessive does not make them excessive. Calling profits normal does not make them normal. Normal profits and excessive profits look alike. There is no chemical regent to distinguish them. The excess-profits tax, to be sure, has a formula—a very complicated formula in its entirety—for distinguishing normal and excessive profits. But that formula is seriously defective.").

50. *See* Alfred G. Buehler, *The Taxation of Corporate Excess Profits in Peace and War Times*, 7 L. & CONTEMP. PROBS. 291, 293 (1940).

51. B. U. Ratchford, *The Federal Excess Profits Tax. Part One: Development and Present Status*, 12 S. ECON. J. 1, 2 (1945); *see also* COMM. ON POSTWAR POL'Y, *supra* note 49, at 9.

52. Buehler, *supra* note 50, at 294.

administrative complications."[53]

In 1950, the US again implemented an excess profits tax in order to "curb[] profits attributable to the war defense program resulting from the emergency following the Korean hostilities."[54] The US implemented the excess profits tax despite testimonies from businessmen, tax attorneys, and tradesmen who claimed the proposed tax to be "conceptually untenable and administratively unworkable because of the inherent difficulty of establishing a rational standard by which excess . . . profits could be disentangled from [war] profits."[55] A surtax of thirty percent was applied to "adjusted excess profits net income," [56] representing a combined "rate of 77 percent [together with the regular corporate normal rate] when fully effective."[57] As was the case in the previous world wars, the Excess Profits Tax of 1950 gave the taxpayer the choice of whether to use an average earnings method or an invested capital method in determining the portion of income subjected to the tax.[58]

Learning from experience, the Excess Profits Tax of 1950 strived to provide even more relief to taxpayers who found themselves in particularly inequitable or harsh cases. Indeed, Congress passed multiple revisions of the 1950 Act, resulting in "23 technical and structural changes" that established additional special relief provisions "for companies that had been able to convince the tax-writing Congressional committees of [their] particular injustices."[59] The end result, however, was not a broad excess profits tax applicable to all corporate taxpayers, but rather a bill that provided "a series of individual excess profits tax provisions for specific industries."[60] In November 1962, the Tax Foundation observed: "[s]ince every month brings to light more and more inequities, the law seems destined to become a hodge-podge of special provisions."[61] Indeed, the difficulty of its administration and the extensive research necessary to settle tax

53. *Id.*

54. Alan L. Gornick, *An Excess Profits Tax? If so, What Kind?* 7 ANALYSTS J. 55, 55 (1951). The Excess Profits Tax of 1950 levied a 30% tax on adjusted excess profits, net income.

55. James E. Dugan & Reuben A. Zubrow, *The Influence of the Excess Profits Tax on Business Decisions to Invest*, 7 NAT'L TAX J. 242, 242 (1954).

56. Schroeder Boulton, *The Excess Profits Tax of 1950*, 7 ANALYSTS J. 153, 153 (1951).

57. S. REP. NO. 81-2679, at 3 (1950).

58. *Id.* at 5.

59. THE TAX FOUND., IMPACT OF THE EXCESS PROFITS TAX OF 1950 II (1952).

60. *Id.*

61. *Id.*

liabilities in certain cases led to the repeal of the tax in 1953.[62]

An excess profits tax has not since been implemented in the US. Although it has been included in the proposals of some more recent political campaigns,[63] certainly the administrative difficulties, as well as the increasingly tepid US attitude toward shared wartime sacrifice and dwindling trust of political leaders, may also contribute to the relative disinterest in implementing an excess profits tax again.[64]

The US is not unique both in its experimentation with excess profits taxation and in receiving mixed results. Similar to the US, seeing a need to raise revenue to fund World War I, Great Britain levied an "excess profits duty" of "80 [percent] of the amount by which the profits of the taxable year exceeded the 'pre-war standard of profits,'" determined through an average profits approach or invested capital approach.[65] The British excess profits tax implemented in both world wars was accepted with overwhelming patriotism,[66] for it generated high revenue and appeared to impose much less of an administrative burden than its US counterpart.[67] Observers noted that the successful British experience with excess profits taxation may have been due largely to the "broadness and flexibility in their statutes as well as in their administration."[68] They developed a system of administration where local assessments at the individual-taxpayer level were made by highly skilled and business-minded civil servants who were allowed considerable discretion, injecting the broader system of taxation with a

62. THE TAX FOUND., *supra* note 59, at II; *see also* George E. Lent, *The Excess-Profits Tax and Business Expenditures*, 11 NAT'L TAX J. 254, 256 (1958) (stating that at its highest point, the Excess Profits Tax of 1950 resulted in $2.5 billion paid by 40,746 corporations in 1951. In 1952 and 1953, only "31,000 companies paid excess-profits taxes of $1.6 billion").

63. *See, e.g.*, Josh Barro, *What Does Obama Mean When He Says "Windfall Profits Tax"?*, TAX FOUND. (Aug. 11, 2008), https://taxfoundation.org/what-does-obama-mean-when-he-says-windfall-profits-tax/ (describing President Barack Obama's campaign trail proposal to tax excess profits of oil companies).

64. *See* Ajay K. Mehrotra, *The Price of Conflict: War, Taxes, and the Politics of Fiscal Citizenship*, 108 MICH. L. REV. 1053, 1077 (2010) ("Although . . . there has undeniably been a strong tradition of exacting shared sacrifices during wartime[,] [r]ecent and current tax policy seems to deny the significance of this tradition.").

65. Plehn, *supra* note 25, at 287.

66. *See* Alex Dunnagan, *Wars, Taxes, and Excess Profits*, TAX WATCH (May 1, 2020), https://www.taxwatchuk.org/excess_profits/#:~:text=In%20the%20First%20World%20War,80%20per%20cent%20in%201917.

67. *See* RICHARD WHITING, THE LABOUR PARTY AND TAXATION: PARTY IDENTITY AND POLITICAL PURPOSE IN TWENTIETH-CENTURY BRITAIN 17 (2001).

68. Robert Murray Haig, *British Experience with Excess Profits Taxation*, 10 AM. ECON. REV. 1, 11 (1920).

high degree of certainty and confidence.[69] Indeed, academics analyzing the British experience with excess profits taxation in relation to excess profits taxation in the US have "emphasized the extent to which administrative discretion is responsible for the superiority of the British law and [its] administration."[70]

Dominions of Great Britain, however, experienced lesser degrees of success with excess profits taxation. In response to both economic and patriotic demands, New Zealand implemented an excess profits tax in 1915, which was modeled after the British tax. Unlike the British model, however, the tax made no provision to adjust the capital percentage to reflect the economic reality of a particular business and also allowed very few exemptions.[71] Consequently, while the British excess profits tax remained for several years after the First World War, New Zealand repealed its tax only a year later, largely due to the lack of flexibility and discretion in its application.[72] Canada implemented the Excess Profits Tax Act in 1940 to raise revenue for the Second World War. The Canadian tax, however, abandoned any attempt to measure returns on capital and instead imposed a tax of 30 percent on those profits in excess of "standard" pre-war profits.[73] The Canadians even implemented a "Board of Referees" to evaluate "various business risks" of the taxpayers and appropriately set the standard for profits used in evaluating the part in excess.[74] While perhaps theoretically sound, one Canadian observer noted in 1941 that, "[i]n actual application the Act must inevitably become complicated . . . [because] [t]he fundamental principles must be adapted to meet the tremendous variations in the forms of business."[75]

Despite their variations both historically and internationally, excess profits taxes generally have had two aims: "(1) [t]he [m]oral [a]im of [t]axing [e]xcess [b]usiness [p]rofits" and (2) the fiscal aim of "[s]ecur[ing] [r]evenue from [b]usiness [p]rofits to [f]inance" a particular purpose—most typically, a war.[76] The varying degrees of effectiveness

69. *Id.* at 10 (The civil servants ensured that "every taxpayer need not be an expert in income and profits tax procedure in order to be assured of having his interests properly cared for.").

70. Adams, *supra* note 32, at 386.

71. Rob Vosslamber, *Tax Failure: New Zealand's Short-Lived First World War Excess Profits Tax*, 29 ACCT. HIST. REV. 79, 88 (2019).

72. *Id.* at 89.

73. James R. Withrow, Jr., *The Control of War Profits in the United States and Canada*, 91 U. PA. L. REV. 194, 230 (1942).

74. J. Ross Tolmie & Campbell W. Leach, *Excess Profits Taxation*, 7 CAN. J. ECON. & POL. SCI. 350, 353 (1941).

75. *Id.* at 362.

76. *Id.* at 350.

and efficiency with which the excess profits tax achieves these goals, however, have been highly criticized. The main difficulty has been that "[c]alling profits normal does not make them normal . . . [n]ormal profits and excessive profits look alike."[77] Indeed, there exists a formula for distinguishing normal and excessive profits—"a very complicated formula in its entirety"—and it has, thus far, been implemented in a manner that is "seriously defective," proving to be an "erratic and in many instances[,] an inequitable tax."[78]

Even a brief analysis of the historical attempts at taxing excess profits reveals that "[a]n exceedingly [complex] law is essential to cover the many conditions to which it must apply[, but] much has to be left, even then, to administrative procedure."[79] Of the various methods for calculating excess profits, however, the invested capital method has likely been the best devised.[80] Only the British have had any success in varying the "percentage of invested capital . . . to meet the peculiar conditions in each line of business," largely by leveraging a decentralized approach to administrative discretion.[81] Yet in terms of the US's ability to implement the tax with similar success, some have opined that perhaps "[w]ide administrative discretion is [simply] not suited to the American habit and tradition in matters of taxation."[82]

A French economist once defined the art of successful taxation as choosing the technique that plucks the most geese while causing the least squawk. With this view, "the excess profits tax is most inartistic, for certainly no tax measure has ever produced as much squawking. Possibly the reason is that no tax measure has tried to pluck so many feathers from each goose."[83] Despite the squawking, in the context of the ongoing COVID-19 pandemic, calls are again being heard in the US and around the world for the implementation of an excess profits tax.[84]

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77. Scott A. Hodge, *The History of Excess Profits Taxes Not as Effective or Harmless as Today's Advocates Portray*, TAX FOUND. (July 22, 2020), https://taxfoundation.org/excess-profits-tax-pandemic-profits-tax/.

78. *Id.* (quoting Secretary Vinson arguing against the excess profits tax in the 1947 hearings).

79. Harold M. Groves, *An Appraisal of the Excess Profits Tax from a Fiscal Standpoint,* 10 L. & CONTEMP. PROBS. 133, 137 (1943).

80. *Id.*

81. *See* Adams, *supra* note 32, at 389.

82. *Id.* at 387.

83. Tolmie & Leach, *supra* note 74, at 362.

84. *See, e.g.*, Avi-Yonah, *supra* note 5, at 4; Saez & Zucman, *supra* note 5; Hemingway, *supra* note 5.

III. THE COVID-19 PANDEMIC AND RISING PROFITS OF DIGITAL FIRMS

As the COVID-19 pandemic swept the world, governments responded with various emergency mandates and recommendations, including "stay-at-home" orders and bans on all "non-essential activities," in order to contain the virus.[85] In an effort to quell the economic impact of these containment measures, governments passed fiscal relief measures and stimulus packages to aid citizens and, particularly, owners of small businesses who were most negatively impacted by the virus.[86] These measures, however, came at a high price. In the US alone, the federal deficit has been pushed to $3.1 trillion—nearly 15 percent of the US economy.[87]

While many worldwide have suffered because of the pandemic, including 20.5 million Americans unemployed as of May 2020, some industries and firms have profited immensely.[88] With products viewed as essential to surviving life in lockdown, companies like Amazon, Facebook, Google, Apple, and Microsoft are able to "play offense in the middle of a pandemic," effectively creating two Americas that are experiencing the pandemic in drastically different ways.[89] Indeed, "[t]here is Big Tech and there is everyone else."[90] According to company filing data compiled by Statista, nearly all of "the world's most prominent tech companies . . . [earned] double-digit revenue growth" in the second quarter of 2020, "raking in a combined $33.9 billion in profit" in the three-month period alone.[91]

Even before the COVID-19 pandemic, large, technology based multinationals have been criticized for making extraordinary profits

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85. *See Policy Reponses to COVID-19*, *supra* note 1 (details the responses to COVID-19 internationally).

86. *See id.*

87. Andrew Taylor, *COVID-19 Relief Pushes U.S. Budget Deficit to a Record $3.1T*, ASSOCIATED PRESS NEWS (Oct. 8, 2020), https://apnews.com/article/virus-outbreak-business-economy-2bcc6fc65429d957b7f8275b2203f76d.

88. Rakesh Kochhar, *Unemployment Rose Higher in Three Months of COVID-19 than It Did in Two Years of the Great Recession*, PEW RSCH. CTR. (June 11, 2020), https://www.pewresearch.org/fact-tank/2020/06/11/unemployment-rose-higher-in-three-months-of-covid-19-than-it-did-in-two-years-of-the-great-recession/.

89. Elizabeth Dwoskin, *Tech Giants are Profiting – and Getting More Powerful – Even as The Global Economy Tanks*, WASH. POST (Apr. 27, 2020), https://www.washingtonpost.com/technology/2020/04/27/big-tech-coronavirus-winners/.

90. *Id.*

91. Felix Richter, *Tech Giants Shrug off COVID-19 Crisis,* NEWS ABODE (Aug. 1, 2020), https://newsabode.com/tech-giants-shrug-off-covid-19-crisis/; *see also* Steve Kovach, *Big Tech's Earnings Prove It's Immune to the Coronavirus*, CNBC (May 4, 2020, 12:42 PM), https://www.cnbc.com/2020/05/04/big-techs-earnings-prove-its-immune-to-the-coronavirus.html.

while simultaneously avoiding paying taxes on those profits.[92] Their business models depend largely on their unique "ability to reproduce digital offerings instantly and at low or zero marginal cost," allowing them to achieve large returns to scale.[93] Simultaneously, taxing these technology companies has continuously confounded policy makers, largely because "technological advances have enabled business enterprises to be heavily involved in the economic life of a jurisdiction without a significant physical presence."[94] Indeed, "[e]stimates of the global revenue losses due to the tax abuses of multinational companies" rise to the level of hundreds of billions annually.[95] This is particularly unfortunate given that "[l]ow income countries . . . are especially [vulnerable] to profit shifting and tax competition, and have limited alternatives for raising revenue."[96] While many global policymaking bodies have simultaneously observed the rising phenomena of global digitalization and "the need to mobilize revenue in developing countries in order to meet targets for sustainable and inclusive growth and development,"[97] finding a way to effectively reconcile these problems and opportunities with an international taxing scheme has posed a challenge.

IV. A GLOBAL EXCESS PROFITS TAX IN THE WAKE OF THE COVID-19 PANDEMIC

Two recent articles by Professor Allison Christians and Dr. Tarcio Diniz Magalhães[98] propose the implementation of a global excess profits

92. *See The Tech Giants Won't Like It, but a Digital Tax Must Become a Reality*, THE GUARDIAN (Feb. 3, 2019, 2:00 EST) https://www.theguardian.com/business/2019/feb/03/tech-giants-facebook-oecd-digital-tax-must-become-reality.

93. Karim Foda & Nirav Patel, *Competition Challenges in the Digital Economy*, BROOKINGS (Jun. 28, 2018), https://www.brookings.edu/blog/up-front/2018/06/28/competition-challenges-in-the-digital-economy/.

94. Iva Gyurova & Ralf Heussner, *Transfer Pricing in Financial Services: The Outlook for 2020 and Beyond*, INT'L TAX REV. (Apr. 29, 2020), https://www.internationaltaxreview.com/article/b1l0fxkmywy0kj/transfer-pricing-in-financial-services-the-outlook-for-2020-and-beyond.

95. Cobham et al., *supra* note 15, at 2.

96. *Id.*

97. Allison Christians & Tarcisio Diniz Magalhaes, *A New Global Tax Deal for the Digital Age*, 67 CAN. TAX J. 1153, 1176 (2019).

98. *See generally* Tarcísio Diniz Magalhães & Allison Christians, *Rethinking Tax for the Digital Economy After COVID-19*, 11 HARV. BUS. L. REV. ONLINE 1 (2021) (arguing for the implementation of a global excess profits tax instead of a windfall tax); Christians & Magalhães, *supra* note 7 (arguing for the use of a global excess profits tax and

(GEP) tax which aims to immediately address the fiscal crisis resulting from the COVID-19 pandemic by clawing back some of the enormous gains accrued by companies whose profits are especially fueled by "high tech and unique intangibles."[99] In the long term, their proposal aims to capitalize on the excessive profits of large, digital multinationals and redistribute such wealth to developing countries, fostering sustainable and inclusive growth and development.[100] In the short term, like the excess profits taxes of old, their GEP tax proposal has two goals: (1) to fairly address the challenges of the digital economy and the structural abnormalities of market conditions leading to excess profits and (2) to raise revenue needed to combat the global crisis resulting from the COVID-19 pandemic.[101]

In order to meet its fundamentally redistributive goal of effectively taxing the global profits being earned by large multinational companies, Professor Christians and Dr. Magalhães' GEP tax proposal leverages several tools recently developed by the Organisation for Economic Co-operation and Development (OECD). In its digitalization project, the OECD aims to create "a single set of consensus-based international tax rules" to combat base erosion and profit shifting (BEPS) by multinational corporations.[102] In an effort to provide greater transparency in the global operations of multinational companies in each jurisdiction, the OECD has developed country-by-country reporting requirements (CbCR) that mandate that these enterprises report certain financial information on a country-by-country basis.[103] Professor Christians and Dr. Magalhães assert that unlike with historical excess profits taxes, the new CbCR data collected provides the ideal

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"consider[ing] proposals to rebuild revenue coffers using excess profits taxes during the COVID-19 pandemic").

99. Christians & Magalhães, *It's Time for Pillar 3: A Global Excess Profits Tax for COVID-19 and Beyond*, *supra* note 7.

100. *See generally Pillar 3 For The OECD: A Global Excess Profits Tax*, *supra* note 8 (transcribing an interview with Allison Christians about the global excess profits tax).

101. *See* Magalhães & Christians, *Rethinking Tax for the Digital Economy After COVID-19*, *supra* note 97, at 12–13; *see also* Christians & Magalhães, *It's Time for Pillar 3: A Global Excess Profits Tax for COVID-19 and Beyond*, *supra* note 7. Note that the first goal of fairness is due to the tax's roots in concepts of restoring justice.

102. OECD, TAX CHALLENGES ARISING FROM DIGITALISATION – REPORT ON PILLAR ONE BLUEPRINT (2020) (quoting the summary on the back of the report).

103. *Country-By-Country-Reporting*, IRS, https://www.irs.gov/businesses/international-businesses/country-by-country-reporting (last visited Oct. 16, 2021); *U.S. Multinational Enterprises*, IRS, https://www.irs.gov/businesses/international-businesses/us-multinational-enterprises (last visited Dec. 15, 2021) (clarifying that these reporting requirements, facilitated through Internal Revenue Service Form 8975, apply only to multinational companies earning combined revenues of $850 million or more); *see also* Cobham et al., *supra* note 15.

mechanism to tax the profits of large multinationals because it "provides a base of information to identify [the] average earnings . . . in previous years or to establish a uniform threshold for normal profits, thus making it possible to calculate how much is to be considered excess today."[104]

Unlike in previous versions of excess profits taxation, however, Professor Christians and Dr. Magalhães propose a simplified approach to reaching the excess profits of large multinationals with their tax. In Pillar One of its digitalization project, the OECD states that one way of distinguishing between "routine" and "residual" profits is to agree to a fixed percentage.[105] The OECD proposes that this fixed percentage should be 10 percent or 20 percent for routine profits, categorizing 80 percent or 90 percent of a multinational's profits as nonroutine or "residual."[106] Professor Christians and Dr. Magalhães assert that the OECD's proposal to divide the profits of digital multinationals into routine and residual profits "already contemplates the value derived from the unique and valuable assets possessed by the multinationals."[107] Consequently, they argue that some part of the residual profits "are simply not attributable to the unique contributions of firms . . . but are the product of widespread market conditions that are created, facilitated, or maintained through regulatory actions of the states."[108] Indeed, they conclude that even before the onset of the COVID-19 pandemic, "some amount of residual profit . . . was already excessive because it was attributable to . . . quasi-monopolistic conditions."[109]

Professor Christians and Dr. Magalhães also propose utilizing a politically agreed-to fixed percentage to isolate the part of residual profits that is excessive—in this case, 22 percent.[110] Reports have revealed that from 2016 to 2019, "U.S. multinationals earn[ed] on average a 22% return on fixed assets, 8% of which can be attributed to routine profits and 14% to nonroutine profits."[111] Given that due to the

104. *See* Magalhães & Christians, *Rethinking Tax for the Digital Economy After COVID-19*, *supra* note 98, at 8.

105. *See* OECD, SECRETARIAT PROPOSAL FOR A "UNIFIED APPROACH" UNDER PILLAR ONE 15 (2019).

106. *See* Webcast Presentation, OECD, Tax Challenges Arising from the Digitalisation of the Economy: Update on the Economic Analysis & Impact Assessment 12 (Feb. 13, 2020) (on file with the OECD).

107. Magalhães & Christians, *supra* note 98, at 18.

108. *Id.*

109. Christians & Magalhães, *It's Time for Pillar 3: A Global Excess Profits Tax for COVID-19 and Beyond*, *supra* note 7.

110. Christians & Magalhães, *supra* note 7.

111. Magalhães & Christians, *supra* note 98, at 18.

impact of the COVID-19 pandemic most firms will not be expected to see anything like a 22 percent return in 2020, Professor Christians and Dr. Magalhães propose that "a firm earning worldwide profits in 2020 that exceed this 2016-2019 average could reasonably be considered to have earned an excess profit, and therefore could be subject to additional taxes in the form of a GEP tax."[112] The authors reason that this is a conservative, "objective and reasonable starting point for a GEP tax" because "[o]ne could certainly argue that some amount of residual profit, even within the pre-crisis global average of 14 percent, is already excessive because it is attributable to undue market advantages enjoyed as a result of quasi-monopolistic conditions, some of which have only been enhanced by the pandemic."[113]

The last part of their proposal discusses how the revenues from the excess profits tax will be collected and allocated globally. Put simply, the part of a multinational's residual profits associated with "marketing intangibles," as determined by the OECD, would be split between all possible market jurisdictions, likely through a single-factor formula based on sales or "users."[114] This piece would include any eventual excess profits to which a GEP tax could be applied at the country level.[115] The OECD's Pillar Two Global Anti-Base Erosion framework would work to ensure that even if one jurisdiction chooses not to tax the excess profits of a multinational at the GEP tax rate agreed to, the profits could be taxed by other jurisdictions where the company operates.[116] At its core, Professor Christians and Dr. Magalhães's GEP tax proposal aims to achieve a fair redistribution of the excess profits of large multinational enterprises as part of a larger effort to disrupt the structural inequalities in international taxation that had existed long before, and were only aggravated by, the COVID-19 pandemic.[117]

V. EVALUATION OF THE GEP TAX PROPOSAL

Both the recent proposal for a GEP tax as well as historical instances of excess profits taxes aim to redistribute the excess profits accumulated by a subset of corporations based on basic principles of fairness and restorative justice.[118] Simultaneously, the taxes aim to be

112. Christians & Magalhães, *supra* note 7.
113. *Id.*
114. Christians & Magalhães, *supra* note 97, at 1156.
115. *See* Magalhães & Christians, *supra* note 98, at 20.
116. *Id.* at 21.
117. *See id.* at 20; *see also* Magalhães & Christians, *supra* note 8.
118. *See* Magalhães & Christians, *supra* note 98, at 3, 12–13; *see also* Plehn, *supra* note 25, at 285.

an effective and efficient revenue source, whether the source be to fund a war effort or to quell the economic impact of a global pandemic.[119] More implicitly, however, excess profits taxes—like all taxation schemes—should aim to be accurate, administratively feasible, transparent, and structured to minimize gaming or tax avoidance. This section of the note will evaluate both the historical excess profits taxes and Professor Christians and Dr. Magalhães's GEP tax proposal on these basic merits.

Accuracy and Fairness

The historical versions of excess profits taxes have generally aimed to be as accurate as possible in measuring whether a corporate taxpayer had earned excess profits in the taxable year. It is largely agreed that the invested capital approach, as discussed in Section II, has come the closest in terms of accurately measuring normal versus excess profits when compared to its average-earnings counterpart. The invested capital approach imposes a tax on profits in excess of a predetermined, "normal" rate of return on invested capital for the taxable year.[120] With a few variations, invested capital under this method has generally been defined in terms of the dollars invested in the business originally, "adjusting the original investment for withdrawals of and additions to the capital."[121] Over time, the excess profits taxes evolved to allow for an increasing number of adjustments to the invested capital calculation, in an effort to more accurately determine whether a corporate taxpayer had actually accumulated excess profits in a taxable year and provide more relief for particularly difficult cases.[122]

The historical excess profits taxes nonetheless remained inaccurate in many ways, resulting in various inequities. Three inequities are of note. First, as discussed in Section II, the business community lamented the invested capital method's dependance on *originally* invested capital to determine normal returns. The calculation, which required a cumbersome revaluation of historical assets, clashed with normal bookkeeping practices. The widely accepted definition of invested capital used in business management was "the current value of the capital of the business."[123] Using originally invested capital to determine normal returns meant that corporations—that were identical in every regard

119. *See* Shoup, *supra* note 43, at 32–33; Scott A. Hodge et al., *Tax Policy After Coronavirus: Clearing the Path for Economic Recovery*, TAX FOUND. (Apr. 22, 2020), https://taxfoundation.org/coronavirus-economic-recovery/ (discussing COVID-19 fundraising from a tax policy perspective).

120. *See supra* Part II.

121. Roy Blough, *Measurement Problems of the Excess Profits Tax*, 1 NAT'L TAX J. 353, 358 (1948).

122. *See supra* Part II.

123. Blough, *supra* note 121, at 358.

except at the time funds were originally invested—may have had widely differing capital bases for purposes of calculating excess profits tax liability. In a dynamic economic environment, it may be difficult to design a tax system that is fair and equitable in its entirety; however, it is widely accepted that similarly situated taxpayers should be taxed similarly to foster a perception of fairness.[124] Using originally invested capital to calculate normal returns violates this basic principle of sound tax policy.

Second, the special relief provisions included in the historical excess profits taxes to address particularly hard or inequitable cases were only implemented for those companies or industries that were able to convince Congress in a timely manner of their particular injustice. Thus, there were likely a great many companies and industries who should have been afforded relief, but unfortunately, were not under any instances of the excess profits tax.[125] For example, in answering industry demands, the World War II excess profits tax provided particular relief for companies in the mining industry, exempting from the excess profits tax those companies mining or producing tungsten, quicksilver, manganese, platinum, antimony, chromite, and tin.[126] Yet, despite providing particular industries with relief, the historical instances of excess profits tax, which depended on determining returns in excess of a set "normal" rate, disproportionately penalized smaller and growing companies while simultaneously exempting larger, more established companies that may have had declining profits.[127]

Third, in calculating normal profits, none of the versions of excess profits tax effectively allowed for differences in risk across industries. Companies are subject to numerous industry and "firm-specific risks that are driven by the nature of the business, competition, supplier relationships, customers, and overall firm strategy."[128] The astute financial analyst knows that comparing rates of return of firms across industries is fraught with pitfalls if proper attention is not given to a firm's chosen capital structure, product life cycle, and cyclicality of sales.[129] Indeed, a measure of excess profit that depends on a uniform threshold for excess returns may in some cases allow a greater return

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124. *See generally* AM. INST. OF CERTIFIED PUB. ACCTS., GUIDING PRINCIPLES FOR TAX EQUITY AND FAIRNESS (2007) (outlining seven dimensions to consider regarding the fairness and equity of a tax).

125. *See* THE TAX FOUND., supra note 59, at II.

126. C. Rudolf Peterson, *The Statutory Evolution of the Excess Profits Tax*, 10 L. & CONTEMP. PROBS. 3, 24 (1943).

127. *See* THE TAX FOUND., *supra* note 59, at II; *see also* Hynning, *supra* note 23, at 463, 466.

128. *See* WAHLEN ET AL., *supra* note 11, at 279.

129. *See id.* at 216.

than the risk may warrant and in other cases set too low a ceiling on profits. New ventures and rapidly growing businesses are particularly discriminated against with such an approach.[130] The British attempted to mitigate this issue by augmenting the standard excess profits calculation with a decentralized and discretionary administrative process at the firm level, and the excess profits tax was received much more positively by taxpayers.[131] Indeed, one scholar observed that "what business fears is not heavy taxation, but unjust and discriminatory taxation, careless taxation, bungling attempts to do the impossible, inconsistent taxation, [and] the unlike treatment of like business situations."[132]

In a sense, Professor Christians and Dr. Magalhães's GEP tax proposal sidesteps these issues by relinquishing any attempt at accuracy. Indeed, rather than aim to precisely determine whether a particular taxpayer has accrued excess profits in a taxable year, their GEP tax proposes using a politically-agreed-to level of excess return—22 percent for 2020.[133] The authors base this threshold on reports that "determined that US multinationals earn on average a 22% return on fixed assets, 8% of which can be attributed to routine profits and 14% to nonroutine profits."[134] Using an average percentage as the threshold for normal profits versus excess, however, "fail[s] to appreciate the very great possibilities for injustice and unfair competition that are involved in its application."[135] For pharmaceutical and technology-based firms, for example, return on assets can be particularly misleading.[136] Both types of firms have significant resources that do not appear on their respective balance sheets, including highly specialized intellectual property and highly compensated employees, resulting in a low amount of recognized assets.[137] Additionally, both types of firms invest heavily in research and development. "U.S. GAAP requires [companies] to expense [these] costs [entirely] in the year incurred," leading to an understatement of income initially and an overstatement of income when revenues are accrued from successful products.[138] Consequently, a company in either industry may experience an overly inflated or

130. *See* HARLEY L. LUTZ, NAT'L ASS'N OF MFRS., AN EXCESS PROFITS TAX IS AGAINST THE PUBLIC INTEREST 1, 3 (revised ed. 1953).

131. *See* Haig, *supra* note 68, at 10–11.

132. T.S. Adams, *Principles of Excess Profits Taxation*, 75 ANNALS AM. ACAD. POL. & SOC. SCI. 147, 155 (1918).

133. *See* Magalhães & Christians, *supra* note 98, at 18.

134. *Id.*

135. Groves, *supra* note 79, at 137.

136. *See* WAHLEN ET AL., *supra* note 11, at 239.

137. *See id.*

138. *Id.*

understated return on assets in a given year depending on the timing of such accounting recognition. Consequently, a company may be subject to an excess profits tax in a given year not because it accrued excess profits in that year, but simply due to the simultaneous occurrence of a variety of the arbitrary factors aforementioned, undermining the effectiveness and perceived fairness of the GEP tax.

Administrability

As a basic principle, a tax should be easy for taxpayers to comply with and for governments to administer and enforce.[139] Indeed, one of the US Government Accountability Office's criteria for a good tax system is administrability, "including processing returns, enforcement, and taxpayer assistance."[140] These costs are also influenced by the number of revenue officers necessary to administer the tax. If the costs associated with administering a tax are too high, the revenue goals of the tax will be undermined. In pursuit of accuracy, the historical excess profits taxes sacrificed administrability. Indeed, the administrative burden was one of the reasons the tax was repealed each time in the US, as well as internationally.[141] Administration of the historical excess profits taxes was so complex that it required, in some cases, the implementation of entirely new governmental agencies such as the Canadian "Board of Referees" to address the various business risks of the taxpayers and appropriately set the standard for normal profits.[142] Upon repeal of the 1950 excess profits tax in the US, there were 8,973 unsettled cases involving $3.931 billion of contested excess profits tax liability. Most of these cases assumably dragged on for many years and required a great force of analytical accounting and legal work.[143]

Again, in many ways, Professor Christians and Dr. Magalhães's GEP tax proposal is a relief from the administrative burden experienced

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139. *See Principles of Sound Tax Policy*, *supra* note 9, at 2.

140. *See* ASS'N OF INT'L CERTIFIED PRO. ACCTS., GUIDING PRINCIPLES OF GOOD TAX POLICY: A FRAMEWORK FOR EVALUATING TAX PROPOSALS 2–3 (2017). *See generally The Principles of Sound Tax Policy,* TAX FOUND. (Mar. 15, 2012), https://files.taxfoundation.org/20200723152458/PrinciplesOfSoundTP.pdf (describing the principles of the Tax Foundation's sound tax policy).

141. *See, e.g.*, Adams, *supra* note 32, at 374 (commenting that "[i]nvested capital is chiefly responsible for the administrative burden created by the excess profits tax"); Richard W. Lindholm, *The Need for an Excess-Profits Tax Today*, 44 NAT'L TAX ASS'N 391, 391 (1951); Buehler, *supra* note 50, at 294 (stating that in 1936, Treasury officials admitted that "'great administrative difficulties' are encountered in the endeavor to enforce an excess profits tax effectively").

142. *See supra* Part II.

143. LUTZ, *supra* note 130, at 12–13.

by previous excess profits taxes. It suggests applying a politically-agreed-to fixed rate to determine the rate of return that is excessive. It does not attempt to factor in the various risks or subtleties of each firm or industry in calculating whether a company has made excess profits.[144] With this approach, administrative discretion is unnecessary. If, based on the CbCR reporting data, a corporation earned greater than twenty-two percent return on invested capital in a taxable year, the GEP tax would be applied to that portion of profits. While there may be reason to critique the administrability of the OECD's larger international tax proposal of which Professor Christians and Dr. Magalhães's GEP tax is one part, from an excess profits tax perspective, the proposed GEP tax is more easily administered than its predecessors.

Transparency and Simplicity

Taxpayers deserve consistency and predictability in the tax code. They should "know that a tax exists, and how and when it is imposed on them and others."[145] Additionally, the tax should be as simple as possible, such that the cost for taxpayers to determine their liability and file their taxes is minimized.[146] Corporate taxpayers are particularly harmed by unpredictability and uncertainty in the tax system because forecasting and planning is essential to both the short- and long-term viability of a business.[147] Historical excess profits taxes were exceedingly complex, and thus, it was nearly impossible for businesses to predict what their tax liability would ultimately be. A scholar providing advice to those considering investing in a company subjected to the Excess Profits Tax of 1950 observed that, as an external third party, determining potential excess profits tax liability would be quite difficult because even "managements of some companies have not been able to determine with assurance the [excess profits tax] position of their own companies," leaving them unable to accurately plan future expenses.[148]

While Professor Christians and Dr. Magalhães's GEP tax proposal is structured as a permanent addition to the international tax regime, the proposed threshold of a 22 percent return on assets for normal profits is based on average returns over just a four-year period from 2016 to

144. *See Pillar 3 For The OECD: A Global Excess Profits Tax*, *supra* note 8 (quoting Allison Christians, "But we understand it's a political compromise. It's a political statement, not an economic one.").

145. *See* Fiore, *supra* note 9, at 2–3.

146. *Id.*

147. *See* PIPER, *supra* note 140, at 4.

148. *See* Boulton, *supra* note 56, at 157.

2019.[149] This approach will leave businesses that are potentially subjected to the tax uncertain whether, in future tax years, the GEP tax will maintain the 22 percent return on assets threshold, or whether the excess profits determination will move as the four-year average base period also changes. Such instability and unpredictability will certainly have undesirable effects on the business community, as well as on governments that seek to have both a stable and predictable revenue stream.

Minimize Tax Avoidance and Gaming

Tax laws "should be structured to minimize noncompliance."[150] When drafting sound tax policy, the US Joint Committee on Taxation recommends asking whether "some individuals [can] successfully avoid their legal liabilities" under a given tax.[151] The OECD itself states that prevention of tax avoidance and evasion opportunities is one of the overarching goals of its digitalization project.[152] Since most of the historical versions of excess profits taxes were temporary, tax avoidance wasn't a paramount issue. One scholar noted, however, that while "[t]he American and British excess profits taxes were cheerfully paid during the war . . . and evasion and avoidance tended to be limited by the desire to help the government win the war with patriotic support," once the end of the war drew near, "the game of beating the government by tax evasion and avoidance began in earnest on a rather large scale."[153] Corporate taxpayers in both England and the US engaged in excessive capitalization in an effort "to spend . . . profits rather than be taxed upon them."[154] Indeed, it has been observed that if the tax were to be implemented permanently in times of peace, "abuses and evasion would increase greatly,"[155] and it would encourage imprudent investments that taxpayers would not make otherwise, including investment in questionable new products, unnecessary advertising, and plant expansion, to name a few.[156]

Even if the proposed GEP tax can garner enough public acceptance to be implemented as a permanent measure, the politically-agreed-to

149. *See supra* Part I, 22–9

150. Fiore, *supra* note 145.

151. *See* ASS'N OF INT'L CERTIFIED PRO. ACCTS., *supra* note 9, at 4.

152. *See* OECD, OECD WORK ON TAXATION 14–15 (2021), https://www.oecd.org/tax/centre-for-tax-policy-and-administration-brochure.pdf.

153. Buehler, *supra* note 50, at 294.

154. *Id.*

155. B.U. Ratchford, *The Excess Profits Tax: Part Two: Some Economic and Political Aspects*, 12 S. ECON. J. 97, 105 (1945).

156. *See* THE TAX FOUND., *supra* note 59, at 18.

fixed measure of excess profits will likely be ineffective in minimizing such tax avoidance and gaming. Indeed, there is evidence that when presented with a threshold—such as a GEP tax applied only if return on assets exceeds 22 percent—corporate executives will engage in earnings management practices (by boosting revenues or deferring expenses, for example) to ensure the firm reports earnings that minimize the negative consequences associated with such a threshold.[157] It should be noted that "earnings management, whether pushing earnings forward or back, are costly activities" that should be considered when implementing the GEP tax.[158]

VI. SUGGESTIONS FOR IMPROVEMENT TO THE GEP TAX PROPOSAL

In many respects, by leveraging the new tools recently developed by the OECD, Professor Christians and Dr. Magalhães's GEP tax proposal has improved upon many weaknesses of the historical excess profits taxes. Where the historical excess profits taxes were all eventually repealed largely due to the significant administrative burden both from an IRS and taxpayer compliance perspective, their GEP tax proposal is much simpler. Professor Christians and Dr. Magalhães's GEP tax proposal leverages new CbCR data collected from large multinational corporations that will give unprecedented insight into the financials of a subset of mostly digital companies who indeed are accruing astronomical profits while simultaneously avoiding paying taxes on those profits. Despite improvements in administrability, however, this note has pointed out that their GEP tax proposal remains inaccurate and thus will have inequitable results. Additionally, by utilizing a uniform, flat percentage for determining excess profits—indiscriminate across firm or industry—their GEP tax proposal provides clear opportunities for corporate taxpayers to avoid liability under the tax by engagement in effective earnings management practices.

Newly developed CbCR data provides the opportunity for calculating a more accurate, firm-specific rate of return. Facilitated through IRS Form 8975, the new reporting requirements apply only to multinational companies earning combined revenues of $850 million or more.[159] The data, released in August 2020, "provides aggregated information on . . . nearly 4,000 multinational enterprise[s] . . . headquartered in [over] 26 jurisdictions and operating in over 100

157. *See* François Degeorge et al., *Earnings Management to Exceed Thresholds*, 72 J. BUS. 1, 2–3 (1999).

158. *Id.* at 5.

159. *See U.S. Multinational Enterprises*, *supra* note 103.

jurisdictions worldwide."[160] Unlike with historical versions of excess profits taxes, the number of corporations potentially subjected to the tax is limited—in the case of 2020, to 4,000 multinational corporations. Additionally, with IRS Form 8975, the taxing authority has access to the data necessary to calculate nuanced rates of return at the firm level, making the tax significantly more equitable across firms and industries, as well as limiting opportunities for avoiding the tax.

As a starting point, the international taxing authorities could begin by developing an expected return model, such as the Capital Asset Pricing Model, that would produce a risk-based expected rate of return for each company after incorporating inputs from the collected CbCR data, as well as other factors like the size of the corporation.[161] This rate of return could then be multiplied by the book value of common equity, or the "balance sheet measure of the common equity shareholders' claim on the net assets of the firm."[162] Again, this financial data should be ascertainable based on the newly disclosed CbCR data.[163] The result of this calculation will be any positive excess profits earned by the firm to which a GEP tax can then be applied.[164]

Leveraging other data sources in order to augment the excess profits calculation has been considered before. Indeed, upon reflection on the US experience with excess profits taxation during World War II, one scholar considered the possibility of leveraging the newly required Securities and Exchange Commission filings from major corporations to reconcile any discrepancies in calculating excess profits based on corporate tax returns.[165] He explained in 1941,

> There is . . . in Washington a wealth of information which cannot but greatly offset the conventional difficulties of administering a tax based on invested

160. *New Corporate Tax Statistics Provide Fresh Insights into the Activities of Multinational Enterprises,* OECD (Aug. 7, 2020), https://www.oecd.org/tax/new-corporate-tax-statistics-provide-fresh-insights-into-the-activities-of-multinational-enterprises.htm.

161. *See* WHALEN ET AL., *supra* note 11, at 317.

162. *Id.* at 832.

163. *See New Corporate Tax Statistics Provide Fresh Insights*, *supra* note 160 ("Under Country-by-Country Reporting, large MNEs are required to disclose important information about their profits, tangible assets, employees as well as where they pay their taxes, in every country in which they operate. Country-by-Country reports (CbCRs) provide tax authorities with the information needed to analyse MNE behaviour for risk assessment purposes").

164. *See* WHALEN ET AL., *supra* note 11, at 837 ("[R]esidual income [(excess profits)] indicates an increase in shareholder wealth because the firm generates comprehensive income greater than the income required to cover the cost of capital.").

165. *See* Hynning s*upra* note 23, at 466, 470 (SEC filings were only required for corporations beginning in 1934).

> capital. To use these new sources efficiently, of course, requires imagination and ingenuity that may not always be found in bureaucracy, but that does not imply at all that the job cannot be done, and done ably.[166]

The administrability of the current GEP tax proposal will not be significantly undermined by making the calculation more nuanced in this manner. Considering that the IRS processed more than 253 million federal tax returns in fiscal year 2019,[167] determining excess profits for 4,000 multinationals at a more nuanced level is within the realm of administrative ability. Most stakeholders, including international taxing authorities, corporate executives, and investors, would be more likely to consider such a GEP tax to be both an acceptable and equitable redistribution of wealth from the world's most profitable corporations, particularly in this current, pandemic-fueled economic crisis. Altering the GEP tax proposal to leverage even further the data and tools now available through the OECD's efforts could enable such a GEP tax to become a permanent part of an effective international tax policy.

166. *Id.* at 470.

167. *Returns Filed, Taxes Collected & Refunds Issued*, IRS tbl. 2, https://www.irs.gov/statistics/returns-filed-taxes-collected-and-refunds-issued#:~:text=The%20IRS%20processed%20more%20than,)%20XLSX)%20in%20FY%202019.R (June 24, 2021).