A Global Excess Profits Tax for a Post-Pandemic World

By:

Tarcisio Diniz Magalhaes

July 22, 2020

As the COVID-19 global health crisis unfolds, scholars, international organizations and civil society members have proposed that governments reintroduce excess profits taxes to curb price gouging and profiteering, or simply to find a viable revenue source to meet the imminent fiscal crisis (Shaxson, 2020; Avi-Yonah, 2020; Saez & Zucman, 2020; Cammett & Lieberman, 2020; Hemingway, 2020; Laffitte et al., 2020; Bow, 2020; Dunnagan, 2020; OECD, 2020).[ii]Turning to wartime conditions as a corollary to the present global challenge, excess profits taxes can serve as the basis for a renewed social contract in an era where a few firms are seen to enjoy super profits,(see for example) which is compounded by the fact that most of such windfall gains will once again accrue to the wealthiest countries in the form of extra tax revenues (Christians & van Apeldoorn, 2019; Christians & van Apeldoorn, 2018). Indeed, it is well known that powerful states have historically captured more than their fair share of the global tax base (Magalhaes, 2018), and even under current circumstances, they continue to use their outsized

market and geopolitical powers to divert vital resources away from poorer states (see here).

Moreover, the contemporary context for viable excess profits taxes is fundamentally global in a way that wartime excess profit taxation was not. Then, most capital was much less mobile than it is today, and national tax systems were not challenged to the core by the globally problematic phenomenon of the digitalization of the economy as they are today. At the same time, cooperation and information flows among tax lawmakers and administrators was nearly non-existent then, while today such lawmakers and administrators have access to multiple modes of multilateral cooperation and assistance on the design, drafting, and implementation of tax policy.

To address the fiscal crisis brought on by COVID-19 effectively and fairly, what the world needs, and is substantively capable of producing, is a "global excess profits tax" (GEP tax). Using tools currently available for immediate action, a GEP tax could be developed alongside and complementary to the Organisation for Economic Co-operation and Development (OECD)'s two-pillar approach to reform the international tax system—a continuation of the Base Erosion and Profit Shifting (BEPS) project.[iii] Like the OECD's plan, the proposed pillar three would be aided by country-by-country reporting (CbCR), but differently, it is submitted that new cooperative governance structures such as the Inclusive Framework platform should be used to make sure that the revenues raised are appropriately deployed to meet the pressing needs of the world's most vulnerable, notably in the Global South (see for example).

Under pillar one, a "unified approach" was proposed by the OECD's Secretariat and approved by Inclusive Framework members, establishing that global profits of multinational enterprises can be allocated across countries without traditional tax nexus—understood as physical economic presence—as a barrier. This is intended by way of introducing a "new taxing right", constructed over a non-physical nexus and reformulated profit allocation rules as part of a so-called "amount A". Calculating "amount A" follows a series of steps. In the example given by the OECD, (OECD, 2019), the first step is to find the total worldwide profits of the multinational group (called "Z"). This amount is then to be divided between routine profits (called "X") and residual (or nonroutine)

profits (called “Y”). In a recent impact assessment, the OECD has suggested two possible percentages for X: 10% or 20% of Z (OECD, 2020: p. 12; Christians, 2020). The next step is to isolate Y’s market share, that is, the part of residual profits associated with marketing intangibles (called “W”). Here again, the OECD has suggested a fixed number: 20% (OECD, 2020). The 80% that is left (called “V”) will be allocated according to traditional transfer pricing rules, thus remaining with the production jurisdiction for trade intangibles, capital, risk, innovative algorithms, software, etc. Finally, W will be split between all possible market jurisdictions by a single-factor formula based on sales (assumedly, local sales over worldwide sales).

Note that Y (all residual profits) will necessarily include any excess income that digital businesses come to earn as a result of the COVID-19 crisis. This means that a portion of those excessive profits will be allocated to the head-office country (as part of V) and the other portion will be divided between market countries (as part of Y). If the unified approach is implemented, each market jurisdiction will get (in the form of W) a piece of residual profits that includes any eventual pandemic-related rents, which, under the OECD’s two-pillar approach, will be taxed at the regular corporate income tax rate (Burns, 2014: p. 403). Yet, in drawing a line between routine profits and the residual, the OECD could as easily do the same for normal and excess profits under a GEP tax.

In turn, pillar two, also called the Global Anti-Base Erosion Proposal (GloBE), sets a floor for international tax competition (OECD, 2019). The idea is that if one jurisdiction fails to tax the profits of a multinational at least at an effective fixed percentage previously agreed among countries, another jurisdiction, where a parent, a subsidiary or a permanent establishment (including a non-physical presence like a digital threshold) is located can jump in and fill this fiscal void (Mason, 2020). The framework was laid out in the form of four inter-related rules: 1) the income inclusion rule; 2) the undertaxed payments rule; 3) the switch-over rule; and 4) the subject-to-tax rule. Rules 1 and 2 would be enacted domestically, while 3 and 4 would be undertaken in tax treaties; rules 1 and 3 are expected to be enforced by residence countries, whereas rules 2 and 4 would be left for source country implementation. One of the reasons why residence-state rules need to be complemented with source-state ones is

attributed to the risk of inversions, that is, when a company changes its tax residence to avoid residence-based taxation (Englisch & Becker, 2019). In any case, the OECD justifies pillar two on the need to address remaining base erosion and profit shifting issues that go beyond digitalization and that were not entirely solved by the BEPS Action Plan.

What this whole exercise teaches us is that another political consensus, much like the one that created the international tax system almost one hundred years ago, is about to emerge. Like before, this global compromise will not be science-based, but rather will result from the need to find a quick and reasonable coordinated solution to current challenges. But even more urgent than the digital economy are the socioeconomic costs of the new coronavirus. A three-pillar approach could ensure that the normal portion of big multinationals' profits are brought up to the GloBE level, at the same time that the excessive portion is taxed at the GEP tax level, raising additional public money to help countries, especially developing ones, fight not only the viral outbreak and its disastrous consequences but also pursue the achievement of sustainable development goals.

In sum, owing to the combination of new data sources, evolving profit measurement and distribution norms, and multilateral cooperation, a GEP tax coordinated at the international level would have vastly larger prospects for building a new social contract for a post-pandemic world than any strictly domestic effort would.

---

[i] Tarcisio Diniz Magalhaes, Tax Lecturer and Postdoctoral Researcher, McGill University Faculty of Law.

[ii] This idea was first put forward in Allison Christians & Tarcisio Diniz Magalhaes, *It's Time for Pillar 3: A Global Excess Profits Tax for COVID-19 and Beyond*, Tax Notes Int'l (1 May 2020), at <https://www.taxnotes.com/featured-analysis/its-time-pillar-3-global-excess-profits-tax-covid-19-and-beyond/2020/05/01/2cg34>. The authors continue to work on the technical aspects of the proposal.

[iii] OECD/G20 Base Erosion and Profit Shifting, *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax*

Challenges Arising from the Digitalisation of the Economy, As Approved by the OECD/G20 Inclusive Framework (29-30 Jan. 2020).

View online: A Global Excess Profits Tax for a Post-Pandemic World

Provided by Afronomicslaw