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RETHINKING TAX FOR THE DIGITAL ECONOMY AFTER COVID-19

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Abstract

Before COVID-19 arrived, policymakers from around the world were busy working on the makings of a new global tax consensus to reflect structural changes in the world economy as a result of the rise of digitalization. The pandemic disrupted this process by delivering a shock that resulted in major contractions for most firms even as it created enormous windfalls for others, prompting some to call for excess profits taxes, usually associated with wartime economies, as a corrective. But an excess profit or windfall tax designed during the world war period is not effective in today's globalized and digitalized economy. To address effectively the fiscal crisis and tackle the challenges of the digital economy in a sustainable way, the world needs a "global excess profits tax"—a GEP tax. This article demonstrates that the vocabulary, the technical tools, and the political determination that were being built for the digital economy can and should be adapted to formulate a GEP tax. We establish the core elements of such a tax and demonstrate its compatibility with currently evolving thinking about how to tax highly digitalized firms.

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Introduction

As the COVID-19 pandemic unfolds, scholars, international organizations, and civil society members have proposed that countries introduce excess profits taxes to punish price gouging and profiteering, or simply to find a viable revenue source to meet the unfolding fiscal crisis.[1] Looking to history, and turning in particular to wartime conditions as a corollary to present circumstances, excess profits taxes arise as a politically viable strategy if a few firms are expected to enjoy significant economic windfalls while the majority of the population suffers.[2]

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[1] *See, e.g.*, Nick Shaxson, *Tax Justice and the Coronavirus*, TAX JUST. NETWORK (Mar. 24, 2020), https://www.taxjustice.net/2020/03/24/tax-justice-and-the-coronavirus (advocating at least a 50% tax on excess profits); Reuven Avi-Yonah, *It's Time to Revive the Excess Profits Tax*, THE AM. PROJECT (Mar. 27, 2020), https://prospect.org/coronavirus/its-time-to-revive-the-excess-profits-tax (arguing that the U.S. government should revive the U.S. excess profits tax to address the "unconscionable" prospect that "some companies would profit while everyone else suffers"); Emmanuel Saez & Gabriel Zucman, Opinion, *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 ("[W]indfall profits have a fair, comprehensive and transparent solution: The government should impose excess profits taxes, as it has done several times in the past during periods of crisis."); MELANI CAMMETT & EVAN LIEBERMAN, BUILDING SOLIDARITY: CHALLENGES, OPTIONS, AND IMPLICATIONS FOR COVID-19 REPONSES 28 (2020) (arguing for a national excess profits tax to "ensure that businesses do not gain disproportionately from increased government and consumer spending during the pandemic"); Alex Hemingway, Opinion, *Excess Profits Tax Needed to Prevent Profiteering Amid COVID-19*, THE STAR (Apr. 23, 2020), https://www.thestar.com/opinion/contributors/2020/04/23/excess-profits-tax-needed-to-prevent-profiteering-amid-covid-19.html (explaining that an excess profits tax would "prevent profiteering amid COVID-19, discourage abuse of government support programs for business, tamp down on price gouging, and raise public revenues from large, profitable corporations that are booming during the crisis"); Sébastien Laffitte et al., *International Corporate Taxation After COVID-19: Minimum Taxation as the New Normal*, VOX, CEPR POL'Y PORTAL (Apr. 14, 2020), https://voxeu.org/article/minimum-effective-tax-rate-global-multinational-profits (citing Avi-Yonah's and Zucman's proposals as a complement to the OECD's global minimum tax); Michael Bow, *Hedge Funds Profiting from COVID-19 'Must Give More Back'*, EVENING STANDARD (Apr. 15, 2020), https://www.standard.co.uk/business/hedge-funds-profiting-from-covid19-must-give-more-back-a4415121.html (calling for a windfall tax on hedge funds such as Citadel, AQR Capital, Odey Asset Management, Marshall Wace, Capeview Capital and Gladstone Capital); Alex Dunnagan, *Wars, Taxes, and Excess Profits*, TAX WATCH (May 1, 2020), https://www.taxwatchuk.org/excess_profits/ (claiming that an excess profits tax "would face little opposition from the public"); *Tax Talk #15*, OECD (May 4, 2020), https://www.oecd.org/tax/oecd-tax-talks-webcast-may-2020.htm (predicting rise in profits for some companies and tax policy reform responses including solidarity levies, super profits taxes, and stronger progressivity to close the post-crisis gap and restore public finances); Afton Titus, *Tax Policy for the Future of Developing Countries: The Synergies between COVID-19 and Automation* 12 (2021), https://law.indiana.edu/instruction/indiana-leeds/assets/tax-il_titus_tax-policy-for-the-future-of-developing-countries.pdf (arguing that "a proposal for either a global excess profits tax or a unilateral imposition of such a tax may be feasible for many countries.").

[2] *See* Sean Silcoff, *As Employers Send Workers Home, Some Tech Companies Stand to Benefit from COVID-19 Crisis*, THE GLOBE AND MAIL (Mar. 13, 2020), https://www.theglobeandmail.com/business/article-while-most-businesses-struggle-some-are-cashing-in-on-covid-1; Benjamin Chin-Yee & Dillon Wamsley, *Tech Firms Are Swooping in To Profit from COVID-19*, JACOBIN (Mar. 31, 2020), https://www.jacobinmag.com/2020/03/coronavirus-covid-tech-firms-telehealth; Kari Paul, *YouTube Profits from Videos Promoting Unproven COVID-19 Treatments*, THE GUARDIAN (Apr. 3, 2020), https://www.theguardian.com/technology/2020/apr/03/youtube-coronavirus-treatments-profit-misinformation; *Winners from the Pandemic: Big Tech's COVID-19 Opportunity*, THE ECONOMIST (Apr. 4, 2020), https://www.economist.com/leaders/2020/04/04/big-techs-covid-19-opportunity; Shira Ovide, *The Pandemic Feeds Tech Companies' Power*, N.Y. TIMES (Apr. 8, 2020), https://www.nytimes.com/2020/04/08/technology/coronavirus-big-tech.html; *Amazon to Add 75,000 Jobs as Online Orders Surge During Lockdowns*, REUTERS (Apr. 13, 2020), https://www.reuters.com/article/idUSKCN21V1DK; Scott Galloway, *Four Tech Giants Are Solidifying Their Dominance of the Post-Coronavirus World*, INTELLIGENCER (Apr. 20, 2020),

Yet, the contemporary context for excess profits taxes is fundamentally global today, in a way that excess profit taxation during the world war period was not. Then, most capital was much less mobile than it is now, and national tax systems were not challenged by the digitalization of the economy as they are today. At the same time, cooperation and information flows among tax lawmakers and administrators was nearly nonexistent 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.

As such, the world would need instead a "global excess profits tax"—a GEP tax. We introduced the idea in a recent essay,[3] and this paper lays out in more detail the framework for such a tax, arguing that it is a viable measure to address not only the immediate fiscal crisis brought on by COVID-19, but for the digital economy and beyond. In addition, we show that, due to structures available for global action today, a GEP tax is also feasible, if developed alongside and complementary to ongoing global consensus building on international tax, currently coordinated by the Organisation for Economic Co-operation and Development (OECD).

Part I examines the newly unfolding fiscal crisis brought on by the pandemic against the backdrop of global efforts underway at the OECD to address the negative effects of digital technology on national income tax regimes. Part II examines the concept of excess in relation to rents, windfalls, and super profits, establishing further links with the language of residual or nonroutine profits used in the contemporary digital tax debate. Part III applies these insights to demonstrate how a GEP tax could be formulated as a stabilizing third pillar within the ongoing digital tax program. The paper concludes that owing to the combination of new data sources, evolving profit measurement and distribution norms, and cooperative governance structures, a GEP tax coordinated at the international level would have vastly larger prospects for revenue raising than a strictly domestic effort would.

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https://nymag.com/intelligencer/2020/04/four-tech-firms-already-dominate-the-post-coronavirus-world.html; Angelika Albaladejo, *A Tale of Two Pandemics: The Rich are Getting Richer*, CAP. & MAIN (Apr. 23, 2020), https://capitalandmain.com/a-tale-of-two-pandemics-the-rich-are-getting-richer-0423; Matt Phillips, *Investors Bet Giant Companies Will Dominate After Crisis*, N.Y. TIMES (Apr. 28, 2020), https://www.nytimes.com/2020/04/28/business/coronavirus-stocks.html; Kristin Myers, *Wealthiest Americans Raking in Billions from Coronavirus Pandemic: Report*, YAHOO FIN. (May 2, 2020), https://finance.yahoo.com/news/wealthiest-americans-raking-in-billions-from-coronavirus-pandemic-report-182111832.html; Steve Kovach, *Big Tech's Earnings Prove It's Immune to the Coronavirus*, CNBC (May 4, 2020), https://www.cnbc.com/2020/05/04/big-techs-earnings-prove-its-immune-to-the-coronavirus.html; David Milstead, *Shopify's Soaring Share Price Vaults Founder Tobias Lutke Into the Ranks of Canada's Richest*, THE GLOBE AND MAIL (May 4, 2020), https://www.theglobeandmail.com/business/article-shopifys-soaring-share-price-vaults-founder-tobias-lutke-into-the; Kara Swisher, Opinion, *The Immunity of the Tech Giants*, N.Y. TIMES (May 1, 2020), https://www.nytimes.com/2020/05/01/opinion/tech-companies-coronavirus.html.

[3] Allison Christians & Tarcísio Diniz Magalhães, *It's Time for Pillar 3: A Global Excess Profits Tax for COVID-19 and Beyond*, 98 TAX NOTES INT'L 507, 507 (2020). *See also* ICRICT, *The Global Pandemic, Sustainable Economic Recovery, and International Taxation* 5 (May 2020) (agreeing with the Authors' proposal that a global excess profits tax would be the most appropriate route today).

I. Tax Policy Backdrop to the Pandemic

COVID-19 arose and spread around the world just as states were engaged in an ostensibly comprehensive reform of the international tax system to address common fiscal issues created by digitalization. This work is arguably a continuation of the Base Erosion and Profits Shifting (BEPS) project, which had emerged after the 2008 global financial crisis.[4] The new coronavirus pandemic delivered an even more devastating fiscal and public health challenge, with a shocking effect in a number of vulnerable states.[5] Political leaders were immediately forced to adopt a series of restrictive measures to slow down contagion, grinding economies around the world to a sudden halt. These measures included quarantines, lockdown on most economic activity except for essential services, closure of borders with bans on travelling, and the institutionalization of the practice of "social distancing."[6]

Significant economic impacts were immediately felt with vast distributional differences: for example, according to a study of job losses in the United States by the Washington Post, the pandemic delivered "a mild setback for those at or near the top and a depression-like blow for

[4] *See* Allison Christians, *Taxation in a Time of Crisis: Policy Leadership from the OECD to the G20*, 5 NW. J.L. & SOC. POL'Y 19, 21 (2010); Allison Christians, *BEPS and the New International Tax Order*, 2016 BYU L. REV. 1603 (2016); Dries Lesage & Mattias Vermeiren, *Neo-Liberalism at a Time of Crisis: The Case of Taxation*, 19 EUR. REV. 43, 49 (2011); Dries Lesage, Mattias Vermeiren & Sacha Dierckx, *New Constitutionalism, International Taxation and Crisis*, *in* NEW CONSTITUTIONALISM AND WORLD ORDER 197 (Stephen Gill & A. Claire Cutler eds., 2014); Rasmus Corlin Christensen & Martin Hearson, *The New Politics of Global Tax Governance: Taking Stock a Decade After the Financial Crisis*, 26 REV. INT'L POL. ECON. 1068, 1077 (2019); *see generally* RICHARD ECCLESTON, THE DYNAMICS OF GLOBAL ECONOMIC GOVERNANCE (2012).

[5] *See, e.g.*, Mohamed A. El-Erian, *The Coming Coronavirus Recession*, FOREIGN AFF. (Mar. 17, 2020), https://www.foreignaffairs.com/articles/2020-03-17/coming-coronavirus-recession; Robert Malley & Richard Malley, *When the Pandemic Hits the Most Vulnerable*, FOREIGN AFF. (Mar. 31, 2020), https://www.foreignaffairs.com/articles/africa/2020-03-31/when-pandemic-hits-most-vulnerable; Nouriel Roubini, *The Coming Greater Depression of the 2020s*, PROJECT SYNDICATE (Apr. 28, 2020), https://www.project-syndicate.org/commentary/greater-depression-covid19-headwinds-by-nouriel-roubini-2020-04?barrier=accesspaylog; Branko Milanovic, *The Real Pandemic Danger is Social Collapse*, FOREIGN AFF. (Mar. 19, 2020), https://www.foreignaffairs.com/articles/2020-03-19/real-pandemic-danger-social-collapse; Paul J. Angelo, *The Pandemic Could Bring Power to Latin America's Criminal Gangs*, FOREIGN AFF. (Apr. 21, 2020), https://www.foreignaffairs.com/articles/americas/2020-04-21/pandemic-could-bring-power-latin-americas-criminal-gangs; Steven Dudley, *Latin America's Prison Gangs Draw Strength from the Pandemic*, FOREIGN AFF. (May 5, 2020), https://www.foreignaffairs.com/articles/americas/2020-05-05/latin-americas-prison-gangs-draw-strength-pandemic; Ian Goldin, *Coronavirus is the Biggest Disaster for Developing Nations in Our Lifetime*, THE GUARDIAN (Apr. 21, 2020), https://www.theguardian.com/commentisfree/2020/apr/21/coronavirus-disaster-developing-nations-global-marshall-plan; Rozina Ali, *The Iraq War Paved the Way for Coronavirus Catastrophe*, FOREIGN AFF. (Apr. 23, 2020), https://www.foreignaffairs.com/articles/iran/2020-04-23/iraq-war-paved-way-coronavirus-catastrophe; Andrew Walker, *Developing World Economies Hit Hard by Coronavirus*, BBC (Apr. 23, 2020), https://www.bbc.com/news/business-52352395; Benn Steil & Benjamin Della Rocca, *Chinese Debt Could Cause Emerging Markets to Implode*, FOREIGN AFF. (Apr. 27, 2020), https://www.foreignaffairs.com/articles/east-asia/2020-04-27/chinese-debt-could-cause-emerging-markets-implode; Ariane M. Tabatabai, *Iran's Revolutionary Guards Play Politics with the Coronavirus*, FOREIGN AFF. (Apr. 29, 2020), https://www.foreignaffairs.com/articles/iran/2020-04-29/irans-revolutionary-guards-play-politics-coronavirus.

[6] Mark A. Rothstein, *From SARS to Ebola: Legal and Ethical Considerations for Modern Quarantine*, 12 IND. HEALTH L. REV. 227, 234–35 (2015) (defining social distancing as "the modern term applied to various mandatory and recommended strategies to limit close contact," including cordon sanitaire (area quarantine), isolation, quarantine, shelter in place, and work quarantine).

those at the bottom."[7] Recent estimates reveal a wealth increase to trillions of dollars among the world's billionaires during the pandemic.[8] At the same time that government spending has soared to unmanageable levels, some of the world's most profitable multinationals, notably in the technology sector, have seen their earnings spike.[9] Rather than the outcome of innovative and entrepreneurial strategies within a well-functioning competitive market, this sudden rise in profitability for firms that were already extremely lucrative was created by the severe restrictive measures governments had to impose on everyone else. In such a context, marked by economic distortions akin to wartime conditions, it is not surprising to see a surge in advocacy for excess profits taxes as a popular fiscal solution.[10]

One of the first to propose a revival of excess profits taxation was Reuven Avi-Yonah, who argued that such a tax would be wholly justified as a few become rich merely as a result of a crisis that impoverishes so many.[11] Avi-Yonah suggests that an observable base-period of comparability to measure this crisis-driven selective enrichment could be 2016 to 2019, from which a credit for average earnings would be derived to adjust the taxable base.[12]

Turning to excess profits tax levels imposed during World War II, Avi-Yonah recommends a rate as high as 95%.[13] Likewise, economists Emmanuel Saez and Gabriel Zucman have called on the U.S. Congress to re-enact a wartime-style excess profits tax to stop "the rise of business concentration and the upsurge of inequality,"[14] while political scientists Melani Cammett and

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[7] Heather Long, Andrew Van Dam, Alyssa Fowers and Leslie Shapiro, The Covid-19 recession is the most unequal in modern history, Washington Post, Sept 30, 2020, https://www.washingtonpost.com/graphics/2020/business/coronavirus-recession-equality/.

[8] *See* Rupert Neate, *Billionaires' Wealth Rises to $10.2 Trillion Amid Covid Crisis*, The Guardian (Oct. 7, 2020); BBC, *Wealth Increases of 10 Men During Pandemic Could Buy Vaccines for All*, BBC News (Jan. 25, 2021); Tim Smart, *The Pandemic Has Been a Windfall for Billionaires*, U.S. News (Feb. 14, 2021).

[9] *See* Richard Waters, *Software Stocks Emerge as Downturn Winners*, FIN. TIMES (Apr. 14, 2020), https://www.ft.com/content/b2be7db4-c445-4a50-9cee-db149eed29dd; Jordan Valinsky, *Business is Booming for These Companies During the COVID-19 Pandemic*, CTV NEWS (May 11, 2020), https://www.ctvnews.ca/health/coronavirus/business-is-booming-for-these-companies-during-the-covid-19-pandemic-1.4933907; Naomi Klein, *How Big Tech Plans to Profit from the Pandemic*, THE GUARDIAN (May 13, 2020), https://www.theguardian.com/news/2020/may/13/naomi-klein-how-big-tech-plans-to-profit-from-coronavirus-pandemic; *How the Coronavirus is Making Tech Companies Richer*, TRT WORLD (May 15, 2020), https://www.trtworld.com/business/how-the-coronavirus-is-making-tech-companies-richer-36350; Christopher Mims, *Not Even a Pandemic Can Slow Down the Biggest Tech Giants*, WALL ST. J. (May 23, 2020), https://www.wsj.com/articles/not-even-a-pandemic-can-slow-down-the-biggest-tech-giants-11590206412; Jeremy C. Owens & Jon Swartz, *Zoom Video Earnings and Sales Blow Away Expectations, Stock Rises Toward More Records*, MARKETWATCH (June 3, 2020), https://store.marketwatch.com/shop/us/us/mwevgsum20va/?trackingCode=aaqwkr3h&cid=MW_ON_ALL_ACQ_NA&n2IKsaD9=n2IKsaD9&Cp5dKJWb=Cp5dKJWb&cx_testId=113&cx_testVariant=cx_15&cx_artPos=0&cx_productId=8mhlunafs1xo#cxrecs_s; *Prospering in the Pandemic: The Top 100 Companies*, FIN. TIMES (June 19, 2020), https://www.ft.com/content/844ed28c-8074-4856-bde0-20f3bf4cd8f0.

[10] *See* Andrew Goodall, *Survey Shows British Support for COVID-19 Windfall Tax*, 97 TAX NOTES TODAY INT'L (May 18, 2020), https://www.taxnotes.com/featured-news/survey-shows-british-support-covid-19-windfall-tax/2020/05/18/2cjq8 (reporting more than 50% of voter support in the U.K.).

[11] Reuven S. Avi-Yonah, *COVID-19 and US Tax Policy: What Needs to Change?*, 48 INTERTAX 790, 790 (2020) (explaining that "[a]t a time when most American citizens and businesses suffer catastrophic economic damage from the Coronavirus Recession, some corporations such as Amazon, 3M, Gilead, and Zoom see their profits rise dramatically because of the pandemic").

[12] *Id.* at 791.

[13] *Id.*

[14] Saez & Zucman, *supra* note 1.

Evan Lieberman argue in a white paper that in times of war and crisis, excess profits taxes are a worthwhile strategy to build social solidarity.[15]

Similar calls are heard in Canada.[16] Speaking on behalf of the Canadian Centre for Policy Alternatives, Alex Hemingway prescribes excess profit taxes on businesses in the big tech, e-commerce, logistics, and cleaning products sectors, as well as anyone engaging in price gouging. [17] He theorizes that these companies are experiencing windfall gains during the pandemic and some of them are even benefiting from COVID-19-related government subsidies.[18]

As justifiable as these wartime measures might be, they are unlikely to be successful given that despite economic lockdown, we still live in a world in which capital is fully mobile and firms are still incentivized to shift their profits into low-tax regimes, notwithstanding multilateral efforts to the contrary. As seen over the past several years with the OECD's BEPS project and related European initiatives, maintaining a corporate income tax system under conditions of globalization and capital mobility now, more than ever, depends on enhanced coordination among countries. Both the digital economy and the COVID-19 crisis are global in scope, requiring solutions that are similarly global; isolated actions by one state or another may not only provide an insufficient response, they also stand to facilitate higher tax collection in relatively more affluent states when lower income states are in greater need of tax revenue.

In today's world, if excess profits taxation is to be adopted as a long-standing measure, as we further argue in Part II below, it has to be designed at the international level. Part III, in turn, shows how a GEP tax is technically feasible, by using mechanisms and tools the OECD has developed over the past decade to curb international tax avoidance in the name of preventing BEPS. Implementation would require a combination of buy-in to the theoretical idea that profits can be successfully separated between normal and excess, some rule adaptation around consolidation of profits and allocation formulas, and of course political will.

Among the tools available today that were not available during the last crisis—and that largely arose because of that crisis—is country-by-country reporting (CbCR), exchange of information, and other recent corporate transparency initiatives. These were largely designed to account for the kinds of international tax planning that can mask profits (normal or otherwise) at the national level. In particular, the OECD is developing a two-pillar approach for the taxation of the digitalized economy (so-called "BEPS 2.0"), which would isolate the above-normal returns of firms for redistribution and subject their consolidated profits to a global minimum rate.[19]

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[15] CAMMETT & LIEBERMAN, *supra* note 1, at 28.

[16] Don Pittis, *Taxpayers Will Be on the Hook Later for Today's COVID-19 Largesse*, CBC (May 19, 2020) (citing historian Elsbeth Heaman on how major events have the potential to change people's perceptions toward high taxation). *See also* CANADIANS FOR TAX FAIRNESS, *Canada is Launching the Most Expensive Programs in Our History: How Will We Pay for It and Rebuild for the Future?*, https://www.taxfairness.ca/en/news/canada-launching-most-expensive-programs-our-history-how-will-we-pay-it-and-rebuild-future; CANADIANS FOR TAX FAIRNESS, *Super Wealth Tax, Excess Profits Tax Among Progressive Policies to Tackle Inequality*, https://www.taxfairness.ca/en/newsletter/2020-05/super-wealth-tax-excess-profits-tax-among-progressive-policies-tackle-inequality.

[17] Alex Hemingway, *Excess Profits Tax Needed to Prevent Profiteering Amid COVID-19*, POLICYNOTE (Apr. 9, 2020), https://www.policynote.ca/profits-tax/. *See also* Alex Hemingway, *Tackling the Pandemic Profiteers*, TRIBUNE (Apr. 22, 2020), https://tribunemag.co.uk/2020/04/tackling-the-pandemic-profiteers/.

[18] Hemingway, *Excess Profits Tax Needed to Prevent Profiteering Amid COVID-19*, *supra* note 17.

[19] *See* Org. for Econ. Co-Operation & Dev. [OECD]/G-20 Inclusive Framework on Base Erosion & Profit Shifting Project, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, at 13–14 (May 28–29, 2019) [hereinafter *Programme of Work*].

The core idea is simple: CbCR provides a base of information to identify average earnings of large multinationals 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. Such calculations would be aided by Pillar One of the OECD's digitalization proposal, which provides a legal framework for separating profits into categories, one of which is considered "normal." Finally, Pillar Two provides a conceptual framework for cascading taxing rights, such that if one country fails to impose the GEP tax on what is defined as excessive, others can step in to fill the fiscal void. The next Part tackles the theoretical hurdle of defining excess and provides the historical and normative arguments for excess profit taxation.

II. What is Excess? From the War Economy to the Digital Economy and Beyond

Excess profits taxes have been widely used by multiple nations, usually as temporary responses to the economic and social impacts of waging war.[20] The first countries to adopt such a tax were Denmark and Sweden as early as 1915.[21] Later in the same year, the U.K. enacted its first excess profits tax with a 50% rate, raising the rate to 60% in 1916 and to 80% in 1917, reducing it to 40% in 1919, raising it again to 60% in 1920,[22] and finally reintroducing it during World War II.[23] During World War I, twenty-two countries had an excess profits tax.[24] The first U.S. excess profits tax was introduced in 1917 as a progressive five-bracket surtax (with graduated rates from 20% to 60%), later reduced to two brackets (30% and 65%) in 1918, reaching 95% during World War II.[25] Canada's experiment with excess profits taxation started during World War II, with the first law passing in 1939, which contemplated two alternative bases (one subject to progressive rates ranging from 10% to 60%, and the other subject to a single 50% rate), amended in 1940 to raise the rate to 75%, and then again in 1943 with a 100% rate.[26] Examples of developing countries include, among others, South Africa's excess profits duty introduced in 1917 and then again in 1940 (amended in 1941 with a rate of 66 $^{2}/_{3}$%),[27] as

[20] For a seminal work, examining wartime excess profits taxes in Great Britain, the United States, Germany, France, Italy, Scandinavia, Canada, Australia, New Zealand and South Africa, *see* J.R. HICKS & U.K. HICKS, THE TAXATION OF WAR WEALTH (1941). *See also* Carl Shoup, *The Taxation of Excess Profits I*, 55 POLITICAL SCI. Q. 535 (1940); Carl Shoup, *The Taxation of Excess Profits II*, 56 POLITICAL SCI. Q. 84 (1941); Carl Shoup, *The Taxation of Excess Profits III*, 56 POLITICAL SCI. Q. 226 (1941).

[21] Mark Billings & Lynne Oats, *Innovation and Pragmatism in Tax Design: Excess Profits Duty in the UK during the First World War*, 24 ACCT. HIST. REV. 83, 86 (2014).

[22] *Id.* at 96.

[23] J. Ross Tolmie & Campbell W. Leach, *Excess Profits Taxation*, 7 CANADIAN J. ECON. & POL. SCI. 350, 361 (1941).

[24] Anthony J. Arnold, *"A Paradise for Profiteers"? The Importance and Treatment of Profits During the First World War*, 24 ACCT. HIST. REV. 61, 69 (2014).

[25] Carl C. Plehn, *War Profits and Excess Profits Taxes*, 10 AM. ECON. REV. 283, 289 (1920); Clifford J. Hynning, *The Excess-Profits Tax of 1940 —A Critique*, 8 U. CHI. L. REV. 441, 446–447 (1940).

[26] Colin Campbell, *J.L. Ilsley and the Transformation of the Canadian Tax System: 1939-1943*, 61 CANADIAN TAX J. 633, 667–68 (2013).

[27] Afton Titus, *May an Investment in Interest-Bearing Securities Constitute a Trade for the Purposes of the Income Tax Act?*, 133 S. AFRICAM L.J. 504 (2016); Basil S. Yamey, *The Excess Profits Duty in South Africa*, 10 S. AFRICAN J. ECON. 263 (1942).

well as Brazil's excess profits tax in force during World War II and later integrated into the income tax as a surtax.[28]

Yet, the idea of imposing higher rates of tax on a portion of profits categorized as super-normal has not been confined to periods of war. Taxing exceptionally high returns has been long advocated as a way to curb monopoly power[29] or simply to capture rents and windfalls,[30] as exemplified by the numerous resource rent taxes around the world today.[31] In the Democratic Republic of Congo, for example, a 50%-rated tax applies to super profits from mining activities.[32] Even the Global Intangible Low-Taxed Income (GILTI) recently enacted in the U.S., which inspired the OECD's Pillar Two,[33] can be characterized as a form of global excess profits tax, because it applies a specified rate of tax (10.5%) on a specified excess amount of profit

[28] Ludmila Mara Monteiro de Oliveira & Tarcísio Diniz Magalhães, *Tributação de Lucros Extraordinários no Brasil: Da Guerra à Pandemia e Além*, in A PANDEMIA DA COVID-19 NO BRASIL EM SUA DIMENSÃO FINANCEIRA E TRIBUTÁRIA 547 (Hugo de Brito Machado Segundo et al. eds., 2020).

[29] C. Lowell Harriss, *Monopoly and the Excess Profits Tax*, 16 TAX MAGAZINE 717, 717 (1938) (arguing that an excess profits tax "is essentially an impersonal tax based on the proposition that no one—widow, orphan, university, or ruthless plutocrat, individually or in groups—should benefit from extorting monopoly gains from the community"); Alfred G. Buehler, *The Taxation of Corporate Excess Profits in Peace and War Times*, 7 LAW & CONTEMP. PROBS. 291, 299 (1940) ("The application of an excess profits tax to high monopoly profits is one of the most appealing arguments for the use of this tax in times of peace as well as in times of war. Where governmental price control is ineffective or impracticable, an excess profits tax might be employed successfully to draw considerable revenues from the surplus profits of monopolies."); Benjamin Higgins, *Post-War Tax Policy*, 9 CANADIAN J. ECON. & POL. SCI. 408, 423 (1943) ("[A]s a measure of monopoly regulation in peace-time . . . taxes should be imposed on profits in excess of some competitive norm instead of on profits in excess of the pre-war level."). *See also* Timothy Nuccio, *Substance Over Form: Creditability of the 1997 U.K. Windfall Tax as an Excess Profits Tax Under I.R.C. § 901*, 22 TRANSNAT'L L. & CONTEMP. PROBS. 267, 269 (2013) (discussing the U.K. use of windfall taxation in 1997 "against previously privatized monopolies").

[30] U.N. DEP'T OF ECON. & SOC. AFFAIRS, U.N. HANDBOOK ON SELECTED ISSUES FOR THE TAXATION OF THE EXTRACTIVE INDUSTRIES BY DEVELOPING COUNTRIES, at 367, U.N. Doc. ST/DESA(035)/T23, U.N. Sales No. 19.XVI.1 (2018) ("Resource rent taxation, which can be applied to mining as well as oil and gas, is generally a profit-related tax, but is not calculated on the basis of normal corporate profits. It is usually based on gross revenue from the resource development, and allows for certain allowances or deductions. Often, interest costs are not considered deductible and restrictions are in place for cost deductions regarding overhead services. It shares similar features with hydrocarbon taxation; Windfall profits tax, also referred to as excess profits tax or a cash flow tax, can be profit related. A windfall profits tax imposes a higher tax rate on profits or gains realized from a sudden windfall of a particular company or industry. Often the windfall or the increase in rate to deal with the windfall is not directly profit related but is linked to commodity price hikes, which are generally viewed as triggering disproportionate increases in profits . . . .").

[31] *Id.* at 4 ("[C]ompanies active in the extractive industries have the potential of substantial earnings in excess of the return on investment required to induce their acceptance of the risks they assume (i.e. windfall gains)."). Some leading forms of rent-based taxes include the "Brown tax" (or "r-based cash flow tax"), the "Garnaut and Clunies Ross resource rent tax," and the "allowance for corporate equity" or "allowance for corporate capital." Fiscal Aff. Dep't, *Fiscal Regimes for Extractive Industries: Design and Implementation*, at 1, 20 bx. 2 (Aug. 15, 2012); KEN HENRY, AUSTRALIA'S FUTURE TAX SYSTEM: REPORT TO THE TREASURER – PART 2: DETAILED ANALYSIS, VOL. 1 (2009), 1, 226.

[32] Titus, *supra* note 1, at 14-15.

[33] *See* Mindy Herzfeld, *Can GILTI + BEAT = GLOBE?*, 47 INTERTAX 504, 504 (2019); Daniel W. Blum, *The Proposal for a Global Minimum Tax: Comeback of Residence Taxation in the Digital Era?: Comment on Can GILTI + BEAT = GLOBE?*, 47 INTERTAX 514, 514 (2019).

attributable to foreign assets (10%).[34] This Part explains key concepts for the taxation of above-normal returns, to clarify the conceptual parameters of excess profits taxes.

A. Rents, Windfalls, and Super Profits

"Rent," "economic surplus," "windfalls," "super-profit," or "surplus profit," along with similar terms, have long captured the interest of economists, tax experts, and policymakers.[35] Oftentimes these terms are used interchangeably.[36] In one way or another, each term captures some notion of unwarranted or unearned gains, which are created unexpectedly by events over which the beneficiary had no control or to which the beneficiary made no particular contribution.[37]

The specialized literature, however, provides different meanings for these terms.[38] Rents, for instance, are said to have two classical definitions: one originated from Ricardo, according to which rent is "the excess amount earned by a factor over the sum necessary to induce it to do its work,"[39] the other, associated with Pareto, defines rent as "the excess earnings over the amount necessary to keep the factor in its present occupation."[40] Applying the Ricardian definition, Wei Cui and Nigar Hashimzade classify digital services profits as location-specific rents ("platform rents").[41] This is due to the non-rivalrous nature of the resources used by digital platforms (that is, users' data and activities), the exploitation of which lacks opportunity costs. As a consequence, Cui argues that present-day digital services taxes should be seen as analogous to resource royalties and rent-based resource taxes.[42]

[34] *See* G. Charles Beller, *GILTI: "Made in America" for European Tax Unilateral Measures & Cooperative Surplus in the International Tax Competition Game*, 38 VA. TAX REV. 271, 282 (2019).

[35] Robin Boadway, *Tax Policy for a Rent-Rich Economy*, 41 CANADIAN PUB. POL'Y 253, 253 (2015) ("Rents are of particular interest from a taxation perspective because, in principle, taxing rents can obtain revenue without any "deadweight loss" reduction of the social value of existing economic activity. Indeed taxing rents could potentially curtail unproductive "rent-seeking" activity").

[36] *Id.* ("Rents are returns from an economic activity over and above the opportunity cost of undertaking the activity, and are sometimes referred to as windfall gains or economic surplus. Examples include excess profits associated with a monopoly; the value of a natural resource above the costs of exploring, extracting, and processing the resource; and windfall gains from unexpected price increases, such as the extra income received by any kind of worker, from an employee to a corporate executive, when social or technological factors increase her/his wage.").

[37] *See, e.g.*, Barry R. Miller & Dan G. Easley, *The Windfall Profit Tax - An Overview*, 12 ST. MARY'S L.J. 414, 416 (1980) (explaining that the U.S. windfall tax of 1980 was a response to a widespread belief that "significant, 'unearned'" revenues would accrue to the oil industry solely because OPEC [Organization of Petroleum Exporting Countries] had been successful in artificially establishing the world price for crude oil.").

[38] *See, e.g.*, Eric Kades, *Windfalls*, 108 YALE L.J. 1489, 1491 (1999) (discussing the different meanings of windfall and proposing the following: "economic gains independent of work, planning, or other productive activities that society wishes to reward."); *see also* Douglas M. Robison, *The Misnamed Tax: The Crude Oil Windfall Profits Tax of 1980*, 84 DICK. L. REV. 589, 590 (1979) (claiming that the U.S. windfall tax of 1980 was not on profit, constituting instead an excise tax, because "[a] true windfall profits tax levies on the generation of those profits that exceed some statutorily determined reasonable level.").

[39] Robert H. Wessel, *A Note on Economic Rent*, 57 AM. ECON. REV. 1221, 1222 (1967).

[40] *Id.*

[41] Wei Cui & Nigar Hashimzade, *The Digital Services Tax as a Tax on Location-Specific Rent* 12 (Nov. 18, 2019) (unpublished manuscript) (on file with SSRN), https://ssrn.com/abstract=3488812 ("[R]ent is the amount earned by a factor of production or a resource in excess of the sum necessary for this resource to be supplied.").

[42] *See* Wei Cui, *The Digital Services Tax on the Verge of Implementation*, 67 CANADIAN TAX J. 1135, 1137 (2019) ("[M]any countries already levy royalties, rent taxes, and the corporate income tax on natural resource extraction;

In broad strokes, rents are profits that surpass all factors of production and any other economic costs, such as opportunity costs.[43] Hence, the concept covers the cost of capital, which includes the investor's expected normal return to engage and remain exploiting a given economic activity, instead of going somewhere else.

Where the resulting super profits are only temporary, meaning that they will probably be offset in the future by high marginal costs, economists talk instead of "quasi-rents,"[44] warning that taxation in this case can create a disincentive for continued business operations.[45] For true or pure rents though, it is well accepted in the economics literature that even at extremely high rates, taxation on such profits does not interfere with neutrality since it produces no distortions or inefficiencies with respect to the level of investment, consumption, or production.[46]

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one can think of the DST [digital services tax] as a tax on economic rents earned by digital platform companies from particular locations.").

[43] Joseph Bankman, Mitchell A. Kane & Alan O. Sykes, *Collecting the Rent: The Global Battle to Capture MNE Profits*, 72 TAX L. REV. 197, 200 (2019) ("In economics, a 'rent' is a payment to a factor of production (labor, capital, land) in excess of the amount required to induce that factor into the production process. Workers might be willing to work for $10 an hour, for example, yet their wages might be $12 an hour, the excess being a form of 'rent.'"); MICHAEL P. DEVEREUX et al., TAXING PROFIT IN A GLOBAL ECONOMY 23–24 (Oxford University Press 2021) ("Profit over and above the normal return is known as 'economic rent', or just 'rent' . . . . Under perfect competition businesses only earn a normal return. Generating an economic rent typically requires some market power, or a scare resource, such as intellectual property, that is not easily replicated. A common synonym for economic rent is 'economic profit' (or sometimes, and perhaps confusingly, simply 'profit'). . . . Other synonyms include 'supernormal' profit and 'inframarginal return.'"). *See also* Ross Garnaut, *Principles and Practice of Resource Rent Taxation*, 43 AUSTL. ECON. REV. 347, 347 (2010) ("Economic rent is the revenue derived from some activity minus the sum of the supply prices of all capital, labour and other 'sacrificial' inputs necessary to undertake the activity."); John A. Cordes, *An Introduction to the Taxation of Mineral Rents*, *in* TAXATION OF MINERAL ENTERPRISES 26 (James M. Otto ed., 1995) ("Economic rent can be defined as the difference between existing market price for a commodity or input factor and its opportunity cost."); Bryan C. Land, *Resource Rent Taxes: A Re-Appraisal*, *in* THE TAXATION OF PETROLEUM AND MINERALS: PRINCIPLES, PRACTICES AND PROBLEMS 241, 241 (Philip Daniel, Michael Keen & Charles McPherson eds., 2010) ("Resource rent is classically understood to be the surplus value generated by such exploitation over all necessary costs of production, including rewards to capital."); Jack M. Mintz, *Taxes, Royalties and Cross-Border Resource Investments*, *in* INTERNATIONAL TAXATION AND THE EXTRACTIVE INDUSTRIES 306, 307 (Philip Daniel et al. eds., 2017) ("[R]ent is the surplus value of revenues net of all economic costs, including opportunity costs, which are subtracted from revenues arising from the sale of goods and services.").

[44] Garnaut, *supra* note 43, at 348 ("Quasi-rents are payments that in the long term provide some incentive to maintain an economically valuable allocation of resources."); Bankman, Kane & Sykes, *supra* note 43, at 200 ("A 'quasi-rent' is a payment that fits the definition of rent, but that represents an ordinary return on investment, such as a competitive, risk-adjusted return to capital investment. Quasi-rents arise because of irreversible investments of various sorts, such as sunk capital investments in a factory, or in firm-specific human capital.").

[45] Bankman, Kane & Sykes, *supra* note 43, at 200 ("An expectation of quasi-rents is essential if such investments are to be attractive to the investor.").

[46] Alan J. Auerbach, *Taxation, Corporate Financial Policy and the Cost of Capital*, 21 J. ECON. LIT. 905, 930, 935–36 (1983) ("The taxation of these rents does not affect the incentive to invest . . . . In general, an income tax on excess returns above the safe rate will have no real effects. We may hypothetically separate an asset's return into two parts: a safe return at the riskless rate, plus an excess return that has zero value. Taking away part of the latter does not affect the consumer's welfare."); Mintz, *supra* note 43, at 308 ("Any tax or levy applied to pure economic rent will not distort the use of capital or other production factors. At the margin, firms employ capital, labour and other factors until the marginal return on the last unit employed is equal to its economic costs. In economic terms, rents are zero at the margin, negative if too much production takes place and positive if too little rent-earning production is undertaken by the producer. Hence, for marginal decisions—investment or otherwise—the rent earned is zero, as returns equal costs in using production factors. A pure rent-base tax will neither discourage nor encourage the investment or production decision since the levy is neutral in not affecting investment and technology

The concept of economic rent is also relevant for transfer pricing, as it closely relates to the idea of residual (or nonroutine) profits, in particular with the idea of "unique contributions."[47] Specialists in the field define *economic* rents as what results from the subtraction from revenues (that is, volume multiplied by market price) of the following amounts: general costs (for example, raw materials), wages (that is, the market return to labour), "rent" (that is, the market return to land, equipment, and so on), and interest (that is, the market return to risk capital, including debt and equity).[48]

If economic rents, windfalls, and super-normal earnings, which justify imposing higher tax rates and surtaxes,[49] constitute different forms of residual or nonroutine income, does it follow that all nonroutine profits of digital companies could be taxed with a GEP tax? The next sections answer this question by first looking at a concept that is central to excess profits taxes, especially in times of crisis, namely, the idea of abnormal profits, and then by proposing a common terminology for residual corporate taxation for a post-pandemic global digitalized economy.

B. From Abnormal to Nonroutine

Excess profits taxation essentially rests on a notion of structural abnormality in market conditions, which leads to unfair abnormal earnings for some taxpayers.[50] The basic idea is that market-spanning distortions caused by exogenous shocks upend normalcy, allowing some to

decisions."); Daniel Shaviro, *Mobile Intellectual Property and the Shift in International Tax Policy from Determining the Source of Income to Taxing Location-Specific Rents: Part Two*, 2021 SING. J. LEGAL STUD. 128, 129 (2021) ("[R]ents can generally be taxed without incurring the efficiency cost (such as from discouraging labor supply or investment) that often is otherwise associated with distribution-minded taxation."); Wei Cui, *The Digital Services Tax: A Conceptual Defense*, 73 TAX L. REV. 69, 100–01 (2019) ("A tax on true economic rent is nondistortionary with respect to both short-term production decisions and long-term investment decisions."); DEVEREUX et al., *supra* note 43, at 36, 49–50 ("A tax on pure economic rent is a special case. Such a tax should not induce a business to change any of its activities or prices . . . . It should also be recalled that the production efficiency theorem formally depends on either businesses not earning economic rent, or on economic rent being taxed at a rate of 100% . . . . [A] tax on economic rent should not affect competition between businesses in a market. That is because a tax on economic rent should leave prices un-changed; the profit-maximizing prices chosen by businesses are unaffected by a tax on economic rent. That implies that such a tax would not lead to one business reducing its price to under-cut another—hence competition should be undistorted.").

[47] Isabel Verlinden, Andrew Casley & Jutta Menninger, *Transfer Pricing Aspects of Intangibles*, PRICEWATERHOUSECOOPERS, 8 (2010), http://www.oecd.org/tax/transfer-pricing/46365081.pdf ("The concept of economic rent does seem to sit with much of what the OECD Guidelines already say and seek to achieve."); Isabel Verlinden & Bram Markey, *From Compliance to the C-Suite: Value Creation Analysed Through the Transfer Pricing Lens*, 44 INTERTAX 774, 782 (2016) ("The OECD Guidelines already embrace to a certain extent a philosophy that is inspired by economic rent and the competencies that lead to such above-average returns. This is illustrated by the notion of '*unique contributions*'").

[48] Verlinden, Casley & Menninger, *supra* note 47, at 2.

[49] U.N., *supra* note 30, at 423 ("Rents (sometimes called 'windfalls') are the financial returns above those a company requires to make the investment profitable. Mechanisms to measure and tax a share of windfalls can enhance state returns in times of high profits and adjust to allow for adequate company returns during times of low profits."); Wei Cui, *The Superiority of the Digital Services Tax Over Significant Digital Presence Proposals*, 72 NAT'L TAX J. 839, 853 (2019) ("[N]ew taxes imposed are not in conflict with existing international obligations, much as the imposition of resource royalties, resource rent taxes, taxes on extraordinary profits, and similar taxes by different governments — all of which, in some sense, stake out new claims of taxing rights over multinationals' profits — have been accepted by the international community.").

[50] Plehn, *supra* note 25, at 283 ("The tax is levied on something conceived as abnormal, and, in addition to the fiscal justification ever present in all taxes, there is a more or less distinct intent to give the public a share in the gains of 'profiteering' as something transitory and abnormal as well as undesirable.").

realize unearned returns. Among its justifications, there is a sense of restoring justice, deeply rooted (more so than regular corporate profits taxation) in the ability-to-pay principle, according to which those that stand to profit the most from social order and public goods must be made to pay a commensurate share to protect these things, especially in a time of great disruption.[51]

The main difference between modern corporate income taxes and excess profits taxes lies with the composition of the base. While the former starts with gross income figures, which are then reduced to a net value by way of subtracting deductions and other business expenses, the latter takes net income as a starting point.[52] As such, excess profits taxes can work in practice as a relatively straightforward corporate income surtax, levied at a higher rate on all additional or extraordinary profits generated during abnormal events, with an exemption for normal returns. This means that excess profits taxes only reach what could be called residual profits—they should theoretically exempt normal profits.

Nonroutine profit is a distinct concept with its own meaning and import, to be distinguished from the division between normal and abnormal profits under an excess profits tax. The distinction between routine and nonroutine income is more easily grasped in tying to benchmark activities and functions for transfer pricing purposes.[53] Sometimes qualified as "normal,"[54] routine profits are those that tend to be allocated among entities of a multinational group by reference to uncontrolled transactions found in an open and free market, that is, in accordance with the quintessential arm's length standard. In contrast, nonroutine or residual profits are those exceeding normal returns.[55]

As noted, nonroutine profits are typically viewed as distinct from profits that arise due to abnormal and unpredictable macroconditions that unduly benefit some businesses while others deteriorate, such as wars, recessions, and pandemics. Nonroutine earnings are habitually associated with special attributes of a particular business model that, even under normal macroeconomic circumstances, provide an advantage over other market agents (what economists call market power). These attributes can derive either from access to highly unique tangible

[51] Buehler, *supra* note 29, at 292 ("It is advocated as a measure which would recognize the so-called ability to pay of corporations more adequately than other profits taxes, as a device to strike at monopolies and regain for society their abnormal profits, as a supplement to price-fixing legislation, and as a stabilizer of business conditions which would tend to check runaway booms and prevent depressions.").

[52] Nuccio, *supra* note 29, at 276.

[53] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, at 29–30 (July 2017) ("Residual analysis[:] An analysis used in the profit split method which divides the combined profit from the controlled transactions under examination in two stages. In the first stage, each participant is allocated sufficient profit to provide it with a basic return appropriate for the type of transactions in which it is engaged. Ordinarily this basic return would be determined by reference to the market returns achieved for similar types of transactions by independent enterprises. Thus, the basic return would generally not account for the return that would be generated by any unique and valuable assets possessed by the participants. In the second stage, any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the facts and circumstances that might indicate how this residual would have been divided between independent enterprises."); U.N. DEP'T OF ECON. & SOC. AFFAIRS, U.N. PRACTICAL MANUAL ON TRANSFER PRICING FOR DEVELOPING COUNTRIES, at 642–43 (2d ed., 2017) ("Residual profit split[:] Under a residual profit split analysis the combined profits from the controlled transactions are allocated between the associated enterprises based on a twostep approach. In the first step sufficient profit is allocated to each enterprise to provide basic arm's length compensation for routine contributions. [I]n the second step, the residual profit is allocated between the enterprises based on the facts and circumstances.").

[54] Fiscal Aff. Dep't & Legal Dep't, *Corporate Taxation in the Global Economy*, at 6, 19/007 (Mar. 10, 2019) ("Routine return[:] Broadly equivalent to normal return, commonly as identified by transfer pricing methods").

[55] *Id.* at 6 ("Residual profit: Profits in excess of routine").

assets like rare raw materials and expensive machinery or, more predominately today, with exclusive and high-value intangible assets, such as some forms of intellectual property.[56]

Yet, when viewed against the backdrop of excess profits of old, the language being deployed in the current digital tax debate indicates a growing view that there is something abnormal about the way highly digitalized multinational enterprises earn their profits.[57] In the same essential way as in times of war, the rise of digital business models that heavily rely on hard-to-value intangibles creates a fundamentally disruptive situation for national tax systems. Under both circumstances, it is possible to talk about a structurally broken market where there is far from perfect competition.[58] We can see in the struggle to redefine value to take into account unconventional inputs like user data and network effects an implicit argument that some 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 by states.

C. A Unifying Vocabulary for Residual Taxation

The language of digital economy taxation bears a striking resemblance to that of excess profits taxation in that both try to isolate a residual portion of a company's total profits.[59] It is true that under a traditional income tax nonroutine profits cannot always be considered excessive in the sense of an excess profits tax,[60] in the same way that high profitability does not necessarily imply the existence of economic rent.[61] Yet, the focus of the current digital tax program on this

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[56] *See* Verlinden, Casley & Menninger, *supra* note 47, at 7.

[57] *See* Daniel Shaviro, *Mobile Intellectual Property and the Shift in International Tax Policy from Determining the Source of Income to Taxing Location-Specific Rents: Part One*, 2020 SING. J. LEGAL STUD. 681, 681-682 (2020) ("In recent decades, a number of fantastically successful, mainly American, multinational entities ('MNEs')—led and epitomized by the 'Four Horsemen,' Apple, Amazon, Facebook and Google (also known as 'FAANG' or 'GAFAM' if one changes the names a bit)—have risen to global economic hyper-prominence. While their market capitalizations and profits are high, reflecting that they earn substantial rents or quasi-rents, their aggregate global taxes are generally quite low, reflecting their ability to create stateless income."); Michael P. Devereux & John Vella, *Implications of Digitalization for International Corporate Tax Reform*, *in* DIGITAL REVOLUTIONS IN PUBLIC FINANCE, 91, 110 (Sanjeev Gupta, Michael Keen, Alpa Shah & Geneviève Verdier eds., 2017) (arguing that "in principle [a tax on digitalized multinationals] could be set at a rate that would not have any effect on the underlying activity, but would allow that state to capture a share of the economic rent earned by the multinational enterprise."); Svitlana Buriak, *A New Taxing Right for the Market Jurisdiction: Where Are the Limits?*, 48 INTERTAX 301, 315 (2020) (mentioning "stages of wealth production for data-intensive business models that generates an economic rent.").

[58] *See* Isabel Verlinden, Stefaan De Baets & Vasistha Parmessar, *Grappling with DEMPEs in the Trenches: Trying to Give It the Meaning It Deserves*, 47 INTERTAX 1042, 1049 (2019) ("An 'economic rent' is a profit in excess of the market return, or in excess of the opportunity cost, that companies are able to realize due to their position on the market given imperfect market conditions. Under perfect competition, the economic rent would be zero. However, conditions of the perfect competition are broken, for example, where there are barriers to market entry (e.g. intangibles), where distinct capabilities and business models are deployed, where resources are scarce (e.g. talented employees or production tools) or where the future is uncertain (e.g. volatile markets).").

[59] *See, e.g.*, Cui, *supra* note 46, at 87 ("residual profit—which, by definition, is free of opportunity cost and represents economic rent").

[60] *See* DEVEREUX et al., *supra* note 43, at 201 ("The concepts of routine and residual profit are broadly related to—but are not equivalent to—the economic concepts of 'normal' returns and 'excess' returns or 'economic rents' . . . .").

[61] For example, profit fluctuations are a natural aspect of the economic life of an enterprise. Verlinden, Casley & Menninger, *supra* note 47, at 6.

line-drawing exercise seems to suggest that at least some part of residual profit earned by tech giants is and always has been excessive.

What was latent in the discourse is now coming into clear focus in the face of the economic crisis brought on by the pandemic. Indeed, it is plausible that some amount of residual profit, even during pre-crisis periods, was already excessive because it was attributable to undue market advantages enjoyed as a result of quasi-monopolistic conditions.[62] This is especially true among highly digitalized firms, which can provide services at close-to-zero marginal costs and shift profits to holding companies in low-tax jurisdictions.[63] Furthermore, these firms are advantaged by the fact that estimating fair market returns on their intangibles is complicated due to the lack of comparable transactions among uncontrolled companies.[64]

[62] *See, e.g.*, Cui & Hashimzade, *supra* note 41, at 4 ("[T]he literature on the economics of platforms strongly suggests that large economic rent is possible, because of direct and indirect network effects. Moreover, the existence of monopoly rent is compatible with the observations that substantial investments may have to be made to capture it, and that, during periods when firms aim to build market share, they can show low accounting profits or even persistent losses."); Shaviro, *supra* note 46, at 149-150 ("[L]eading firms in these sectors [social media platforms, internet search engines, and online marketplaces], perhaps for broader structural reasons, have substantial market power, allowing them to earn monopolistic or oligopolistic rents, and creating incentives for over-investment in pursuit of market power."); Jeroen Lammers, *The OECD Concept of User Participation And a More Pragmatic Way to Tax Rent Seeking*, 96 TAX NOTES INT'L 611, 621 (2019) (claiming that current digital tax proposals seek to tax monopoly rents); Reuven S. Avi-Yonah, *A New Corporate Tax*, 168 TAX NOTES FED. 653, 657 (2020) (proposing to use the corporate tax to regulate monopolies and quasi-monopolies in the digital technology sector by focusing on taxing rents and supernormal returns); *see generally* Naomi R. Lamoreaux, *The Problem of Bigness: From Standard Oil to Google*, 33 J. ECON. PERSP. 94 (2019); Nikos Smyrnaios, *Google as an Information Monopoly*, 23 CONTEMP. FRENCH & FRANCOPHONE STUD. 442 (2019); Wil van der Aalst, Oliver Hinz & Christof Weinhardt, *Big Digital Platforms*, 61 BUS. INF. SYS. ENG'G. 645 (2019); Kenneth A. Bamberger & Orly Lobel, *Platform Market Power*, 32 BERKELEY TECH. L.J. 1051 (2017); Lina M. Khan, *Amazon's Antitrust Paradox*, 126 YALE L.J. 710 (2017); Ben Bloodstein, *Amazon and Platform Antitrust*, 88 FORDHAM L. REV. 187 (2019); Erik Hovenkamp, *Platform Antitrust*, 44 J. CORP. L. 713 (2019); Rory Van Loo, *The Missing Regulatory State: Monitoring Businesses in an Age of Surveillance*, 72 VAND. L. REV. 1563 (2019); Chris Jay Hoofnagle, Aniket Kesari & Aaron Perzanowski, *The Tethered Economy*, 87 GEO. WASH. L. REV. 783 (2019); Michal S. Gal, *Algorithms as Illegal Agreements*, 34 BERKELEY TECH. L.J. 67 (2019); Zane Muller, Note, *Algorithmic Harms to Workers in the Platform Economy: The Case of Uber*, 53 COLUM. J.L. & SOC. PROBS. 167 (2020); Ido Kilovaty, *Privatized Cybersecurity Law*, 10 U.C. IRVINE L. REV. 1181 (2020); Marlene Barken, Gwen Seaquist & Alka Bramhandkar, *AirBNB: A Digital Platform for Sharing or Excluding?*, 37 NORTH EAST J. LEGAL STUD. 1 (2018); FRANK PASQUALE, THE BLACK BOX SOCIETY: THE SECRET ALGORITHMS THAT CONTROL MONEY AND INFORMATION (2015); NICK SRNICEK, PLATFORM CAPITALISM (2016).

[63] *See* Rasmi Ranjan Das, *Is the Arm's-Length-Principle-Based Authorized OECD Approach to the Attribution of Profits to a Permanent Establishment Losing Its Authority?*, 73 BULL. FOR INT'L TAX'N 656, 659 (2019).

[64] *See* Michael Kobetsky, *The Transfer-Pricing Profit-Split Method After BEPS: Back to the Future*, 67 CANADIAN TAX J. 1077, 1079–80 (2019) (discussing different situations where comparables are unavailable, one of which is when transactions involve unique and valuable intangibles); Orly Mazur, *Transfer Pricing Challenges in the Cloud*, 57 B.C. L. REV. 643, 668 (2016) (identifying intangible-value drivers in new business models, specifically cloud computing, as a major challenge for transfer pricing because they are mobile by nature (statelessness) and lack comparables (uniqueness)); Ilan Benshalom, *Sourcing the "Unsourceable": The Cost Sharing Regulations and the Sourcing of Affiliated Intangible-Related Transactions*, 26 VA. TAX REV. 631, 649 (2007) ("[T]ransactions related to intangible assets often lack market comparables."); James R. Mogle, *The Future of International Transfer Pricing: Practical and Policy Opportunities Unique to Intellectual Property, Economic Substance, and Entrepreneurial Risk in the Allocation of Intangible Income*, 10 GEO. MASON L. REV. 925, 926 (2002) ("Determining an appropriate transfer price for intangibles has been particularly problematic because of the difficulty in identifying comparable uncontrolled transactions that provide a reasonable benchmark of an arm's length price. The problem of identifying comparables is increased when intangibles are transferred simultaneously with, or used in connection with, the transfer of tangible property or the provision of services."); Chi Tran, *International Transfer Pricing and the Elusive*

Once the connection between abnormality in corporate earnings and the concepts of residual (or nonroutine) profits within the OECD's digital tax work are brought together, it becomes easier to see that a GEP tax could be feasibly designed as a complementary third pillar to the ongoing reform of the international tax system. The following Part explains how in greater detail.

III. Design for a GEP Tax

Over the years, countries have structured their excess profits taxes in different ways, but the primary concern has always been the design of the tax base. Accordingly, any attempt to tax what is today considered excessive must start by defining what constitutes a normal return. One option is to use an average earning approach, reducing (via credit) current-year profits by the average profit of the firm over a few prior years, thus characterizing as a windfall all profit above the firm's own average over the period. Another option is to use an invested capital approach, whereby a specified return rate is established as "normal," and everything earned above that amount is treated as excess. For example, the 1918 U.S. wartime excess profits tax characterized returns on tangible assets above 8% as abnormal and thus subject to an up to 80% tax rate.[65]

If, as this paper contends, the GEP tax could be applied beyond COVID-19 as a post-pandemic measure for the digital economy, in the same way that excess profits taxes have been advocated for in peacetimes,[66] a combined adjusted version of those two approaches should be adopted, whereby an average rate of normal worldwide profits is established, whether on an industry, sector, or line-of-business basis. This Part shows how this is feasible. It starts by establishing that the implementation of a GEP tax should benefit from the same assessment tools and information flows currently being used to address base erosion, profit shifting, and the digitalization of the economy, notably CbCR. It then explains how the GEP tax proposal relates to Pillars One and Two of the OECD's current global tax reform program. Combining CbCR data with the norms of the OECD's two-pillar approach, it is possible to construct a comprehensive tax base and then determine which portion should be considered "excess" and subject to a GEP tax.

A. Consolidating Profits with Coordinated Tax Data

CbCR is a viable place to start because it is the most comprehensive source of aggregate data about the world's largest multinationals, a number of which appear poised to reap outsize profits as a result of the COVID-19 pandemic. Part of BEPS Action 13, CbCR constitutes one of the four minimum standards to which all members of the OECD Inclusive Framework have agreed.[67]

Arm's Length Standard: A Proposal for Disclosure of Advance Pricing Agreements as a Tool for Taxpayer Equity, 25 SW. J. INT'L L. 207, 207–12 (2019) (analyzing the problem of lack of comparables in light of cases involving transfer of intangible assets by big digital companies like Facebook and Amazon).

[65] EMMANUEL SAEZ & GABRIEL ZUCMAN, THE TRIUMPH OF INJUSTICE: HOW THE RICH DODGE TAXES AND HOW TO MAKE THEM PAY 33(2019).

[66] *See supra* notes 29–35 and accompanying text.

[67] *See* OECD/G20 Base Erosion & Profit Shifting Project, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13: 2015 Final Report*, at 9 (2015); OECD/G20 Base Erosion & Profit Shifting Project, *Action 13: Country-by-Country Reporting Implementation Package*, at 10 (2015); OECD/G20 Base Erosion & Profit Shifting Project, *Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting*, at 3 (2015) [hereinafter *Guidance*]; OECD, *Country-by-Country Reporting XML Schema: User Guide for Tax Administrations and Taxpayers*, at 3 (2016); OECD, *Country-by-Country Reporting XML Schema: User Guide for Tax Administrations*, at 3 (Sept. 2017); OECD, *BEPS Action 13 on Country-by-*

The OECD's adoption of CbCR was a momentous event, occasioned by the work of international tax justice advocacy groups.[68]

The core idea of CbCR is that multinational companies, at least those over a certain size threshold, should disclose how much tax they pay in each country in which they operate, and that every country in which a multinational company operates should have equal access to the information of the multinational group, regardless of which country gathers it.[69] Tax justice advocacy groups consistently called for CbCR disclosure to be public, as a necessary check on tax avoidance, but the OECD limited CbCR to governments, attaching strict use and confidentiality limitations.[70] As such, the OECD has become the depositary of what amounts to enough data to facilitate global consolidation of the firms within its scope.[71]

Two multilateral instruments assist the OECD in collecting these CbC reports: the Convention on Mutual Administrative Assistance in Tax Matters,[72] and the more specific Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (with 90 signatories).[73] That said, countries experience varying levels in capacity to use the data, and some countries are still reluctant to permit analysis, even on an aggregate or anonymized basis.[74]

Country Reporting: Guidance on the Appropriate Use of Information Contained in Country-by-Country Reports, at 4 (Sept. 2017); OECD, *BEPS Action 13 Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment*, at 3 (Sept. 2017); OECD, *BEPS Action 13 Country-by-Country Reporting: Handbook on Effective Implementation*, at 3 (Sept. 2017); OECD, *Guidance on the Implementation of Country-by-Country Reporting: BEPS Action 13*, at 27 (Dec. 2019).

[68] TAX JUSTICE NETWORK, COUNTRY-BY-COUNTRY REPORTING: HOW TO MAKE MULTINATIONAL COMPANIES MORE TRANSPARENT 4 (2008), https://www.taxjustice.net/cms/upload/pdf/Country-by-country_reporting_-_080322.pdf; Allison Christians, *Tax Activists and the Global Movement for Development Through Transparency*, *in* TAX, LAW AND DEVELOPMENT 288, 290–92 (Yariv Brauner & Miranda Stewart eds., 2013).

[69] RICHARD MURPHY, COUNTRY-BY-COUNTRY REPORTING: SHINING LIGHT ONTO FINANCIAL STATEMENTS 3–4 (2010), http://www.taxresearch.org.uk/Documents/CBCDec2010.pdf (listing reasons for public disclosure, including serving the interests of shareholders and the broader public).

[70] *Guidance*, *supra* note 67, at 5–6. *See also* Arthur J. Cockfield & Carl D. MacArthur, *Country-by-Country Reporting and Commercial Confidentiality*, 63 CANADIAN TAX J. 627, 632 (2015).

[71] *See generally* Serena Picariello & Vikram Chand, *The Use of Country-by-Country Reporting for Tax Risk Assessment: Challenges and Potential Solutions*, 3 INT'L TAX STUD. 1 (2020); Caroline Silberztein & Océane Le Naourès, *Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment*, 25 INT'L TRANSFER PRICING J. 3 (2018); Michelle Hanlon, *Country-by-Country Reporting and the International Allocation of Taxing Rights*, 72 BULL. FOR INT'L TAX'N 209 (2018); Christoph Spengel, *Country-by-Country Reporting and the International Allocation of Taxing Rights: Comments to Michelle Hanlon*, 72 BULL. INT'L TAX'N 218 (2018).

[72] *See* OECD & Council of Eur., *The Multilateral Convention on Mutual Administrative Assistance in Tax Matters: Amended by the 2010 Protocol*, at 3 (2011).

[73] *See* OECD, *Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports*, https://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/cbc-mcaa.pdf; OECD, *Signatories of the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA) and Singning Dates* (Mar. 12, 2021) https://www.oecd.org/tax/exchange-of-tax-information/CbC-MCAA-Signatories.pdf.

[74] *See generally* Annet Wanyana Oguttu, *Curtailing BEPS through Enforcing Corporate Transparency: The Challenges of Implementing Country-by-Country Reporting in Developing Countries and the Case for Making Public Country-by-Country Reporting Mandatory*, 12 WORLD TAX J. 167 (2020); Thomas Dubut et al., *Comprehensive Tax Treaties and Tax Information Exchange Agreements: Assessing Exchange of Information Mechanisms to Ensure Transparency in a Globalized World from the Perspective of Developing Countries*, 72 BULL. FOR INT'L TAX'N 57 (2018); Ani Tri Wahyuni, Angga Wahyu Anggoro & Danny Sirait, *Implementation of Country-by-Country Reporting to Tackle BEPS: Assessment of the Potential Benefits*, 25 ASIA-PAC. TAX BULL. 1

Despite these hurdles, the OECD has made some aggregated data available to the public, and some researchers have used this data in analyzing the likely impacts of the OECD digitalization project. In particular, researchers determined that U.S. multinationals earn on average a 22% return on fixed assets, 8% of which can be attributed to routine profits and 14% to nonroutine profits.[75] These findings are affirmed by a recent report by KPMG for Microsoft, which provides industry and country-level analysis of average routine and nonroutine profits.[76] A conservative position would be to say that returns above 22% are excess profits, but it is also possible to argue that some amount of nonroutine profits, even within the global average of 14%, is already excessive. If so, any return above that agreed amount could be subject to a higher tax rate like the GEP tax, in addition to the regular corporate income tax rate.[77] As explained below, either approach is compatible with the OECD's Pillar One proposal to establish normal rates of return for multinationals' global profits.

B. Allocating Digital Profits Across Countries

The OECD's Pillar One plan established that profits of multinational enterprises could 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 reformulated nexus and profit allocation rules. In formulating its proposed consensus on the matter, the OECD considered three proposals from different groups of countries, one of which was formed by non-OECD members, regarding what profits should be reallocated and in what manner.[78] Aspiring to reconcile these positions, the OECD's Secretariat put forward its own proposal, under the label of a "unified approach."[79] However, a closer look reveals that the unified approach does not display many similarities with the non-OECD countries' proposal.[80]

When it comes to the scope of application, the Secretariat's plan is closest to the European proposal, given that this was the only one of the three previous proposals that would not apply to all firms.[81] In a similar vein, the unified approach was restricted to some business models,

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(2019); Tim Meijer, Stef Kerkvliet & Bas van Stigt, *Country-by-Country Reporting - All Smoke and Mirrors or the BEPS Project's First Success?*, 24 INT'L TRANSFER PRICING J. 433 (2017).

[75] Alex Cobham, Tommaso Faccio & Valpy FitzGerald, *Global Inequalities in Taxing Rights: An Early Evaluation of the OECD Tax Reform Proposals* 10 (Oct. 3, 2019) (unpublished manuscript), https://osf.io/preprints/socarxiv/j3p48/.

[76] *See generally* KPMG, TRANSFER PRICING ANALYSIS OF ARM'S LENGTH RETURNS TO SALES, MARKETING & DISTRIBUTION ACTIVITIES (Feb. 2020) (on file with the authors)*;* Allison Christians, *Taxation of the Digital Economy: Preliminary Analysis of OECD Pillar 1 Impact Assessment + KPMG Transfer Pricing Study of Amounts B & C (Presentation Slides)* (Apr. 28, 2020) (unpublished manuscript), https://ssrn.com/abstract=3550803.

[77] Cui, *supra* note 42, at 1138 ("[T]axes on economic rent will be imposed independently of the income tax: the two are far from being interchangeable.").

[78] *See* Allison Christians & Tarcísio Diniz Magalhães, *A New Global Tax Deal for the Digital Age*, 67 CANADIAN TAX J. 1153, 1155, 1171 (2019) (analyzing the three proposals of "user participation," "marketing intangibles," and "substantive economic presence," as well as the OECD Secretariat's "unified approach").

[79] OECD, *Secretariat Proposal for a "Unified Approach" under Pillar One*, at 4–5 (Oct. 9, 2019), https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf.

[80] *See, e.g.*, Vidushi Gupta, *How Unified is the OECD's Unified Approach?*, 96 TAX NOTES INT'L 1143, 1145 (2019); Allison Christians, *A Unified Approach to International Tax Consensus*, 96 TAX NOTES INT'L 497, 500 (2019).

[81] The European proposal, entitled "user participation," was restricted to social media platforms, search engines, and online marketplaces. OECD/G20 Base Erosion & Profit Shifting Project, *Addressing the Tax Challenges of the*

namely digital-centric and consumer-facing business models,[82] and now reaching only firms that exceed $20 billion euros in worldwide gross revenue annually (to be reduced to $10 billion in 2029), with a pre-tax profit margin of at least 10%.[83] In terms of re-allocable profits, the unified approach resembles the U.S.'s proposal, since they both affect only a portion of nonroutine (residual) profits from digital companies related to the market.

Defining the new taxing right and calculating the profit attributable to it—obliquely entitled "amount A" in the proposal—entails a series of steps.[84] In the first example given by the OECD, the primary step was to find the total worldwide profits of the multinational group (referred to as *Z* in the initial proposal). This amount was to be divided between routine profits (*X*) and nonroutine profits (*Y*). In an early impact assessment of the proposal, the OECD had suggested two possible percentages for *X*: 10% or 20%.[85] The next step was to isolate the market share of *Y*, that is, the part of residual profits associated with marketing intangibles (*W*). Here again, the OECD had suggested the fixed number of 20%.[86]

As of July 2021, the OECD has reached an international political agreement on sourcing to the end market jurisdictions something between 20-30% of profits in excess of 10% of global revenues.[87] The remaining 70%-80% (previously referred to as *V*) should, therefore, be allocated according to traditional transfer pricing rules, namely where production intangibles (such as trade intangibles, capital, risk, innovative algorithms, and software) are located.[88] Finally, *W* will have to be split between all possible market jurisdictions, likely by means of a single-factor formula based on sales (presumably locally sourced in-scope revenue over worldwide revenues).[89]

Digitalisation of the Economy, at 9–10 (Feb. 13, 2019), https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf [hereinafter *Addressing*].

[82] More specifically, automated digital services—such as online search engines, social media platforms, online intermediation platforms (including the operation of online marketplaces, irrespective of whether used by business or consumers), digital content streaming, online gaming, cloud computing services, online advertising services—and consumer-facing businesses—such as personal computing products (for example, software, home appliances, and mobile phones), clothes, toiletries, cosmetics, luxury goods, branded foods and refreshments, franchise models (for example, licensing arrangements involving restaurants and the hotel sector), and automobiles. OECD/G20 Base Erosion and Profit Shifting Project*, 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*, at 10–11(Jan. 29–30, 2020).

[83] OECD/G20 Base Erosion and Profit Shifting Project, *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* 1 (July 1, 2021) [hereinafter *Statement*].

[84] *See* Hartmut Förster, Stefan Greil & Arnim Hilse, *Taxing the Digital Economy – The OECD Secretariat's New Transfer Pricing A-B-C and Alternative Courses of Action*, 27 INT'L TRANSFER PRICING J. 3, 4 (2020).

[85] OECD, *Tax Challenges Arising from the Digitalisation of the Economy: Update on the Economic Analysis & Impact Assessment*, at 12 (Feb. 13, 2020), http://www.oecd.org/tax/beps/webcast-economic-analysis-impact-assessment-february-2020.htm.

[86] *Id.*

[87] *Statement*, *supra* note 83, at 2.

[88] OECD/G20 Base Erosion and Profit Shifting Project, *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint*, Inclusive Framework on BEPS (2020), at 124 ("Under this approach, 80% of the residual profit of an MNE group (or segment where relevant) calculated for the purpose of Amount A would thus continue to be taxed in accordance with the existing ALP-based profit allocation system, and the other 20% would constitute the allocable tax base for Amount A purposes.").

[89] *Id*. at 125 ("Under a profit-based approach, the allocable tax base (a profit amount, i.e. PBT [profit before tax]) could be multiplied by the ratio of locally sourced in-scope revenue to total revenue of an MNE group (or segment where relevant) used in computing the tax base, including revenue from ineligible market jurisdictions (where no nexus would be established for Amount A purposes) and potentially out-of-scope revenue. Under a profit-margin

Note that *Y* (all nonroutine 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 where goods and services are used or consumed (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 excess (which will be taxed at the regular corporate income tax rate unless a GEP tax is introduced).[90]

In principle, a new political consensus, much like the one that created the international tax system about one hundred years ago, has recently emerged, but now involving 130 countries.[91] Just as before, this consensus is not science based, but rather results from the need to find a workable solution to the challenges of the digital economy in as little time as possible, lest countries begin to act unilaterally in mutually self-destructive ways.[92] The COVID-19 pandemic has served to amplify the immense challenges involved in building consensus on a solution that will be mutually beneficial to all participating parties. But by bringing wartime taxation measures to the discussion, the pandemic has also revealed that in drawing a line between routine profits and the residual, the OECD could as easily do the same for normal and excess profits.

C. Ensuring a Minimum Tax is Paid

Assuming that countries could use CbCR to undertake global consolidation (even if only in the aggregate) and Pillar One to distinguish normal and abnormal global profits, the final piece of a GEP tax would be to determine which country or countries would collect the tax. Pillar Two, also called the Global Anti-Base Erosion Proposal (GloBE), provides a framework even though it is still under construction.[93] Its structure has been initially laid out in the form of four inter-related rules: (1) the income inclusion rule, (2) the undertaxed payments rule, (3) the switchover rule, and (4) the subject-to-tax rule. The first and second rules would be enacted domestically, while the third and fourth would be undertaken in tax treaties. In turn, the first and third rules were expected to be enforced by residence countries; whereas, the second and fourth rules would

approach, the allocable tax base (a profit ratio, i.e. PBT / revenue) could be multiplied by locally sourced in-scope revenue.”).

[90] *See* Lee Burns, *Income Taxation Through the Life Cycle of an Extractive Industries Project*, 20 ASIA-PAC. TAX BULL. 401, 403 (2014) (“As the corporate income tax applies to all forms of economic activity, the rate of corporate tax is set on the assumption that taxpayers earn a normal rate of return. The normal rate of corporate tax, therefore, taxes both a normal return and economic rent. Thus, under the corporate income tax, companies earning economic rent face the same tax burden as companies earning only a normal rate of return.”).

[91] OECD, *130 Countries and Jurisdictions Join Bold New Framework for International Tax Reform* (July 1, 2021), https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm.

[92] One of the terms of the new consensus is precisely the removal of unilateral measures, such as digital services taxes. *Statement*, *supra* note 83, at 3. On the advent and proliferation of unilateral digital services taxes, *see* Ruth Mason & Leopoldo Parada, *Digital Battlefront in the Tax Wars*, 92 TAX NOTES INT’L 1183, 1184 (2018); Allison Christians, *Digital Services Taxes and Internation Equity: A Tribute to Peggy Musgrave*, 95 TAX NOTES INT’L 589, 591 (2019).

[93] *See* OECD, *Global Anti-Base-Erosion Proposal (“GloBE”): Pillar Two*, at 7 (Nov. 8, 2019) (requesting comments on three technical design aspects: tax base determination (the issue of “tax-book conformity”); blending; and carve-outs and thresholds), https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf.

be left for source country implementation.[94] The OECD characterizes Pillar Two as a tool to address remaining base erosion and profit shifting risks that go beyond digitalization and that were not entirely solved by the BEPS Action Plan.[95]

In the *Programme of Work*, the OECD signaled that the inclusion rule should operate as a top-up approach that supplements insufficient taxation by bringing the income to the minimum level. At the same time, the document allowed for the exceptional application of the full domestic rate or a higher than the minimum rate in the context of harmful preferential regimes.[96] For the undertaxed payments rule, the OECD left as an open question "whether the rule should deny deductibility in full or only on a graduated basis reflecting the level of taxation in the jurisdiction of the recipient."[97] Full denial of a deduction, however, would imply a final tax above the global minimum. To avoid this double taxation effect, making sure that this rule works as a complementary tax up to the minimum level, Joachim Englisch and Johannes Becker have proposed the following formula:[98]

$$x = 1 - \frac{t^{min} - t^{*}}{t}$$

where
x = deductible portion to be denied
t^{min} = minimum tax rate
t^{*} = receiver country's tax rate
t = payer country's tax rate

GloBE aims to set a floor for tax competition according to the principle that if one jurisdiction does not tax the profits of a multinational at least at an effective fixed percentage agreed among countries, the other jurisdiction, where a parent, a subsidiary, or a permanent establishment (or a non-physical presence in the form of a digital threshold) is located can do so.[99] The reason that residence-state rules need to be complemented with source-state ones is fundamentally attributed to the risk of inversions, that is, when a company changes its tax residence to avoid residence-based taxation.[100]

Coordination of these four rules can ensure that the normal portion of multinationals' profits are brought up to the GloBE level, as well as that the excessive portion is taxed at the GEP tax level. The next sections illustrate with hypothetical examples the workings of these rules.

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[94] *See Programme of Work*, *supra* note 19, at 26 (implying the second rule in the first rule, and grouping the third and fourth rules under the name "tax on base eroding payments").

[95] *Id.* at 6, 25 (claiming that a broader approach would ensure that the profits of "internationally operating businesses are subject to a minimum rate of tax," which is necessary to "stop a harmful race to the bottom [on corporate taxes,] which . . . risks shifting [the burden of] taxes . . . onto less mobile bases," and may pose a particular risk for developing countries with small economies).

[96] *Id.* at 27.

[97] *Addressing*, *supra* note 81, at 28.

[98] Joachim Englisch & Johannes Becker, *International Effective Minimum Taxation – The GLOBE Proposal*, 11 WORLD TAX J. 483, 508 (2019).

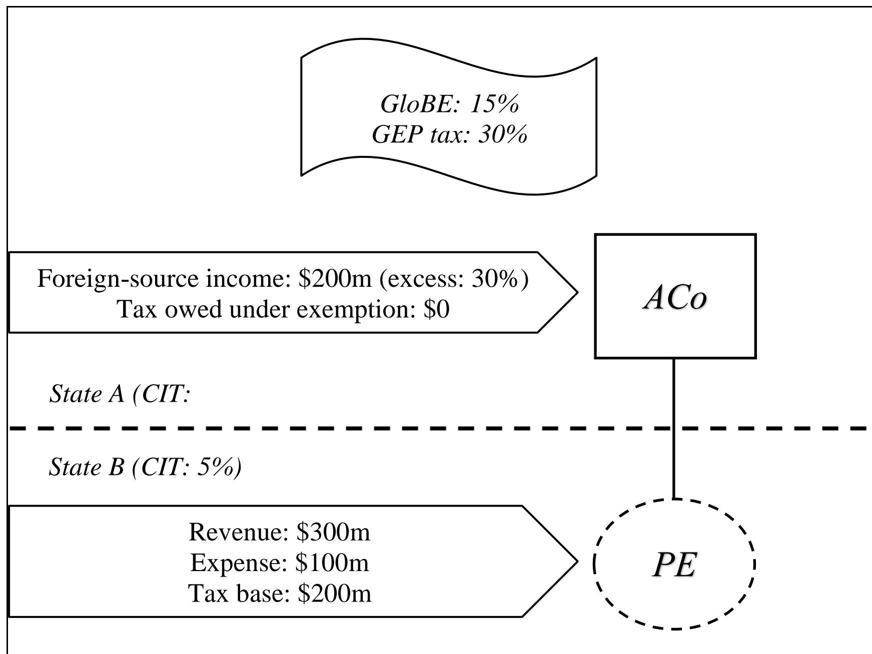
[99] Ruth Mason, *The Transformation of International Tax*, 114 AM. J. INT'L L. 353, 354 (2020) (calling this mechanism "fiscal fail-safes," the aim of which is to achieve "full taxation").

[100] Englisch & Becker, *supra* note 99, at 500 ("[I]n case of unilateral implementation in only some countries or regions, restricting the application of the minimum tax to the ultimate parent status may create significant gaps and increase the risk of inversions or other circumvention strategies.").

1. Residence Country Enforcement

Assuming that a headquarters jurisdiction would include—and tax accordingly—a shareholder's income generated through a branch or controlled entity in another jurisdiction when the associated income is effectively taxed at a rate below the globally agreed minimum, the OECD considered two rules: the income inclusion rule and the switchover rule.[101] The switchover rule, however, was omitted from the most recent statement agreed to by Inclusive Framework members.[102] Either way, the aim is to enable the residence state to eliminate under-taxation, thus resembling the secondary (or defensive) rule of the so-called "linking rules" for hybrids, according to BEPS Action 2.[103]

The main difference between an income inclusion and a switchover rule is that the former is domestic and the latter is treaty based. Because of this difference, the income inclusion rule applies to both foreign branches and foreign controlled entities, while a switchover clause, following the first discussions surrounding the global minimum tax, would be limited to permanent establishments and immovable property that is not part of a permanent establishment.[104] The following example illustrates the operation of these mechanisms:



[101] OECD/G20 Base Erosion and Profit Shifting Project, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint*, Inclusive Framework on BEPS (2020) [hereinafter *Pillar Two Blueprint*], at 112-122.

[102] *Statement*, *supra* note 83, at 3. *See also* OECD, *OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors* 10 (July 2021).

[103] Linking rules are thus called because they link the tax treatment of an instrument or entity in one jurisdiction to the taxation in the counterparty jurisdiction, in an effort to match tax outcomes. *See* Leopoldo Parada, *Hybrid Entity Mismatches and the International Trend of Matching Tax Outcomes: A Critical Approach*, 46 INTERTAX 971, 979 (2018)*; see also* OECD/G20 Base Erosion & Profit Shifting Project, *Neutralising the Effects of Hybrid Mismatch Arrangements - Action 2: 2015 Final Report*, at 23 (2015) [hereinafter *Action 2 Final Report*] ("If the payer jurisdiction does not neutralise the mismatch then the payee jurisdiction will require such payment to be included in ordinary income to the extent the payment gives rise to a D/NI [deduction/non-inclusion] outcome.").

[104] Presumably this would also include digital-virtual permanent establishments, or any remote presence applied to digitalized businesses, in line with the new nexus rules developed under Pillar One.

The OECD has recently reached agreement on a global minimum tax rate of at least 15%.[105] Assume that the GEP tax rate is conservatively set at 30%. *ACo*, a parent company located in State *A* (a high-tax jurisdiction with a 20% corporate income tax rate that exempts all foreign source active income), carries on businesses around the world, including in State *B* (a low-tax jurisdiction with a 5% corporate income tax rate) through a permanent establishment (physical or not). Assume further that there is no tax treaty between States *A* and *B*, and that the permanent establishment generates $300 million in revenue, while incurring in $100 million of deductible expenses. If per a similar approach to Pillar One 30% of the company's total profits are deemed to be excessive, the tax payable in reference to the transaction in the example should be $39 million (*$140 million x 15% + $60 million x 30%*). If State *B* applies its low tax rate of 5% to the whole income of $200 million, this would yield an insufficient tax amount of $10 million, activating the income inclusion rule. To work as a top-up, this domestic rule should allow State *B* to include the $200 million in *ACo*'s taxable base and tax the normal portion of those profits ($140 million) at 15% and the excess ($60 million) at 30%, providing a corresponding credit for what was previously paid to State *B* ($10 million). The result is an extra payable amount of $29 million owed to State *A*.

The same would happen if, instead of an internal statutory provision, State *A* had a tax treaty with State *B*, which provided for the exemption method (Art. 23-A of the OECD Model or the UN Model),[106] but containing a switchover clause tied to both global rates (the GloBE and the GEP tax). Linking the switchover clause to these rates would prevent the automatic application of State *A*'s regular domestic rate, thus ensuring the top-up approach. As such, the switchover clause would allow State *A* to deny the application of the exemption method, applying instead the credit method in the following manner: *15% x $140 million* (normal return) + *30% x $60 million* (excess profits) – *$10 million* (foreign tax credit).

2. Source Country Enforcement

According to the *Programme of Work*, the expression "taxes on base eroding payments" comprises the other two rules imposed by sources countries: the undertaxed payment rule and the subject-to-tax rule.[107] These rules can be implemented, for example, by denying a deduction (first rule); imposing source-based taxation, such as a withholding tax (first or second rules); or adjusting treaty benefits (second rule), such as reclaiming taxing rights exclusively allocated by the tax treaty to the low-tax jurisdiction. These rules resemble the primary rule of the *Action 2 Final Report*'s anti-hybrids measure.[108]

In denying a deduction or imposing a withholding tax, issues might arise about how to account for taxes paid or expenses incurred in the parent jurisdiction, as well as the applicable tax rate. In particular, denying a deduction raises two other issues. First, full denial would result in over-taxation, a problem that could be solved by applying the Englisch-Becker formula. Second, even a partial denial could imply taxation above the global minimum rate (but below the

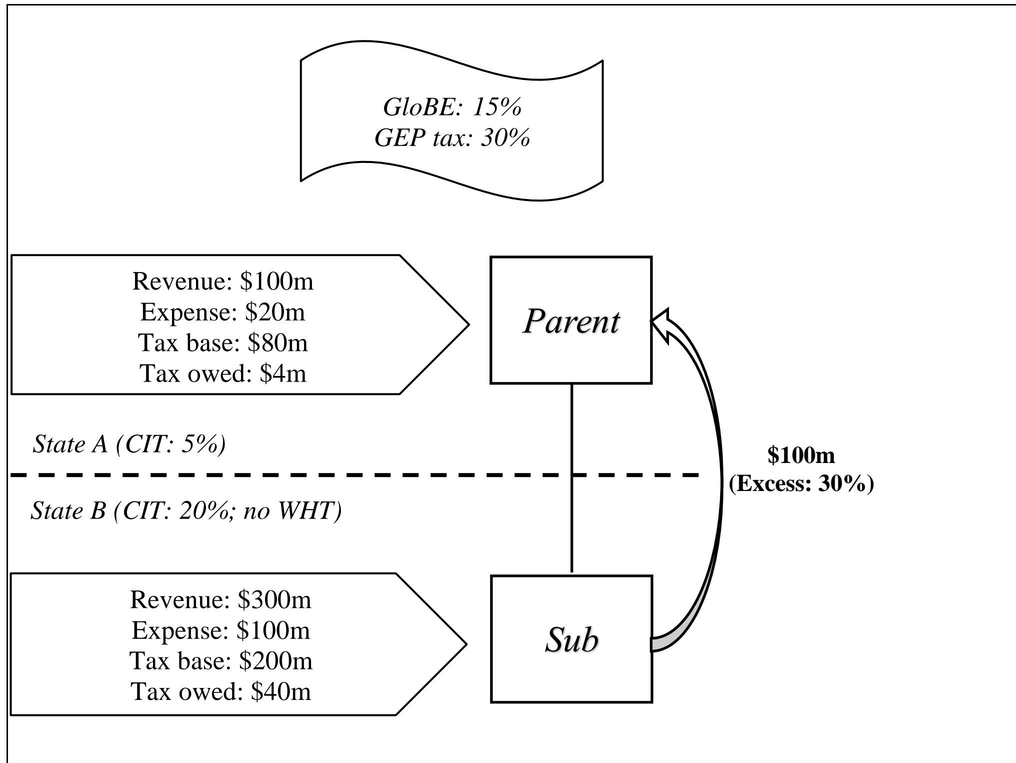
[105] *Statement*, *supra* note 83, at 4.

[106] OECD, *Model Tax Convention on Income and on Capital*, at I-8 (2017) [hereinafter *OECD Model Convention*]; U.N. DEP'T OF ECON. & SOC. AFFAIRS, *U.N. MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES*, at 33, U.N. Doc. ST/ESA/PAD/SER.E/213 (2017).

[107] *Pillar Two Blueprint*, *supra* note 102, at 123-143, 150-170.

[108] *See Action 2 Final Report*, *supra* note 104, at 23 ("The payer jurisdiction will deny a deduction for such payment to the extent it gives rise to a D/NI [deduction/non-inclusion] outcome.").

global excess profits rate) if the payment is included back as ordinary income at the level of the subsidiary and taxed at the full domestic tax rate. The following example illustrates:



With the GloBE fixed at 15%, assume again a GEP tax at 30% and 30% of the group's total income considered to be excess profits. A subsidiary in State *B* (a high-tax jurisdiction with a 20% corporate income tax rate and no withholding tax) earns $300 million in revenue and makes deductible payments of $100 million to a parent company in State *A* (a low-tax jurisdiction with a 5% corporate income tax rate).[109] Since these payments are fully deductible in State *B*, the taxable income is reduced at the level of the subsidiary by the total amount of $100 million. The parent incurs expenses of $20 million, reducing the tax base in State *A* to $80 million. If State *A* applies only its low tax rate, the tax payable will be $4 million (*$80 million x 5%*). This is insufficient according to both GloBE and the GEP tax, which would require an overall tax of $15.6 million *($56 million x 15% + $24 million x 30%)*. In this case, a domestic undertaxed payments rule calibrated as a top-up to achieve both GloBE and the GEP tax would allow State *B* to deny part of the deduction and tax 70% of that portion at 15% and 30% of that portion at 30%.

The alternative to denying a deduction is the undertaxed payments rule to determine the imposition of a withholding tax. This outcome is also possible under a tax treaty containing a subject-to-tax clause. Under either rule, the withholding tax would have to apply the GloBE rate to the normal portion of the payment and the GEP tax rate to the excessive residue. Alternatively, the subject-to-tax clause could determine that treaty benefits be adjusted. An example would be

[109] It is still an open question whether the mechanism would apply on a transaction-by-transaction or per entity basis.

when payments are a consideration for the use, or the right to use, intellectual property rights (that is, a royalty), and the tax treaty follows Article 12 of the OECD Model (which allocates an exclusive right to tax to the residence state).[110] In this case, the subject-to-tax rule would authorize this benefit to be revoked by the source state. As such, this state would reclaim the right to tax the royalty payments by imposing a withholding tax, which would have to apply both the GloBE rate and the GEP tax rate in the manner explained above.

Conclusion

COVID-19 poses an overwhelming public health challenge to populations across the globe, creating disastrous financial and fiscal consequences in multiple countries in its wake. Yet, unlike the state of international cooperation on tax and fiscal policy that existed during the 1918 pandemic, to which the present situation is often compared, we now have well-developed institutions coordinating policy at the international level. These institutions can and should be used to raise the needed revenues to meet the immediate needs associated with COVID-19 and ultimately to build more resilient and sustainable fiscal policies going forward.

The principles that were being developed before the pandemic demonstrate that an important shift in thinking was already underway with theoretically significant results, even if opinions differ on the extent to which practicable change had yet been implemented. In grasping for a vocabulary adequate to capturing the new sources of value and profit creation in a highly digitalized world economy, policymakers created the policy space to fundamentally revisit what creates profits for multinational firms, as well as what states ought reasonably to expect from one another in terms of fairly sharing those profits.

A GEP tax is a natural outgrowth of those principles, given the new circumstances in which the world finds itself. Because we now have sources of information on multinationals' profitability margins that did not exist before, and because we are already poised to accept new norms for the taxation of cross-border business profits, the world is currently capable of designing and implementing a GEP tax to effectively and fairly address the challenges of the digital economy, during and after COVID-19.

[110] *OECD Model Convention*, *supra* note 104, at 37 ("1. Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.").