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A DEFICIT OF DESERTS THE CASE FOR A PANDEMIC EXCESS PROFITS TAX

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The global COVID-19 pandemic caused, inter alia, the economic balance in the United States to tilt wildly. In earlier decades, such extreme social and economic upheaval led Congress to pass a special tax on those who benefitted from the crisis, known as an excess profits tax. This paper analyzes the relevant tax policy considerations of bringing back a similar excess profits tax, modeled off of the excess profits tax of World War II, as a response to this upheaval. While such a tax would be politically unfeasible at this time, it may be an effective way of redistributing unbalanced resources, counteracting the sudden lack of competition, and generating needed revenue. These benefits are counterbalanced by the risk of disincentivizing innovation and an uncertain tax incidence. Though the excessive profits of large companies were earned, they were undeserved. Given that these undeserved profits accrued against a backdrop of worsening income and wealth inequality, an excess profits tax to recapture this income would be appropriate.

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INTRODUCTION

Over the last couple of years, the United States has faced a novel crisis: the coronavirus pandemic. Along with its devastating public health effects, the pandemic upended economies across the globe. In the United States, unemployment quickly rose. By April of 2020, the unemployment rate peaked at 14.8%, the highest it had been in over seventy years.[1] Many individuals had to rely on savings, public benefits, and help from friends or family to get them through long periods of unemployment, and many households faced the threat of eviction.[2] Eviction moratoria at the local, state, and federal levels helped abate this threat, but the number of evictions filed increased dramatically in late 2020 once these protective measures expired.[3]

Early on, many small businesses were forced to close.[4] Many closures that were intended to be short-term became permanent.[5] Businesses that had to close even temporarily, whether due to safety considerations, government mandates, or a combination of both, were forced to lay off and terminate employees.[6] And businesses which closed for at least a portion of 2020 in response to the pandemic saw significant drops in revenue while their large overhead expenses (e.g., rent) still needed to be paid.[7] Government functioning suffered at all levels when local, state, and federal tax revenues decreased significantly.

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1. GENE FALK, CONG. RSCH. SERV., R46554, UNEMPLOYMENT RATES DURING THE COVID-19 PANDEMIC 4 (2021).

2. Nitasha Tiku & Jay Greene, *The Billionaire Boom*, WASH. POST (Mar. 12, 2021), https://www.washingtonpost.com/technology/2021/03/12/musk-bezos-zuckerberg-gates-pandemic-profits/ [https://perma.cc/7W5R-4Q9Z]; Kim Parker, Rachel Minkin & Jesse Bennett, *Economic Fallout from COVID-19 Continues to Hit Lower-Income Americans the Hardest*, PEW RSCH. CTR. (Sept. 24, 2020), https://www.pewresearch.org/social-trends/2020/09/24/economic-fallout-from-covid-19-continues-to-hit-lower-income-americans-the-hardest/ [https://perma.cc/2J7K-Z4E8]; Lindsay M. Monte, *Historic Look at Unemployment, Sectors Shows Magnitude of COVID-19 Impact on Economy*, U.S. CENSUS BUREAU (Mar. 15, 2021), https://www.census.gov/library/stories/2021/03/putting-economic-impact-of-pandemic-in-context.html [https://perma.cc/YV5C-A64D].

3. Peter Hepburn et al., *U.S. Eviction Filing Patterns in 2020*, SOCIUS: SOCIO. RSCH. FOR DYNAMIC WORLD, Jan. 2020–Dec. 2021, at 1, https://journals.sagepub.com/doi/pdf/10.1177/23780231211009983.

4. Robert Fairlie, *The Impact of COVID-19 on Small Business Owners: Evidence from the First 3 Months After Widespread Social-Distancing Restrictions*, 29 J. ECON. MGMT. STRATEGY 727, 727 (2020), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7461311/ [https://perma.cc/88TN-3DXB].

5. *See* Anne Sraders & Lance Lambert, *Nearly 100,000 Establishments that Temporarily Shut Down Due to the Pandemic Are Now Out of Business*, FORTUNE (Sept. 28, 2020, 9:25 AM), https://fortune.com/2020/09/28/covid-buisnesses-shut-down-closed/ [https://perma.cc/4BFB-76XB].

6. *See* Rohit Arora, *Study Finds Small Business Revenues Dropped 52% and Payrolls Declined 54% Due to COVID Pandemic*, FORBES (Aug. 7, 2020, 6:40 AM), https://www.forbes.com/sites/rohitarora/2020/08/07/study-finds-small-business-revenues-dropped-52-and-payrolls-declined-54-due-to-covid-pandemic/?sh=7f56bf4b56db [https://perma.cc/CJ8L-VN66].

7. *Id*.

But there were some entities that thrived. Big-box retailers and tech companies, to name a few, saw record high profits in 2020.[8] Top retailers saw a 40% increase in profit, and by the middle of 2020, the thirty-two largest companies worldwide were projected to bring in an extra $109 billion in profits, as compared to recent prior years.[9] By the end of 2020, these large companies had in fact earned billions above what they had previously.[10] For example, Amazon made almost $6 billion more and Walmart made almost $5 billion more.[11] The wealth of billionaire CEOs, particularly tech barons, also skyrocketed.[12] From March 2020 to March 2021, Amazon CEO Jeff Bezos saw his net worth increase by $58 billion, and Tesla CEO Elon Musk's net worth increased by $118 billion.[13]

These profits have not trickled down to employees. Companies were generally not generous in providing hazard pay, and what benefits were provided did not last through the entirety of the pandemic.[14] Instead, many companies spent the additional income on stock buybacks.[15] And of the fifty largest publicly traded firms, over half conducted large layoffs of staff.[16] These layoffs occurred despite public statements by CEOs in early 2020 assuring their employees and the public that the jobs were safe.[17] Instead of retaining workers, paying their workers more, or otherwise allocating excess profits in

8. Molly Kinder, Laura Stateler & Julia Du, *Windfall Profits and Deadly Risks: How the Biggest Retail Companies Are Compensating Essential Workers During the COVID-19 Pandemic*, BROOKINGS INST. (Nov. 2020), https://www.brookings.edu/essay/windfall-profits-and-deadly-risks/ [https://perma.cc/83DB-5Q89].

9. *Id.*; OXFAM, POWER, PROFITS, AND THE PANDEMIC (Sept. 2020), https://webassets.oxfamamerica.org/media/documents/bp-power-profits-pandemic-100920-en.pdf [https://perma.cc/ZX3B-STA8] [hereinafter POWER, PROFITS, AND THE PANDEMIC].

10. Molly Kinder & Laura Stateler, *Amazon and Walmart Have Raked in Billions in Additional Profits During the Pandemic, and Shared Almost None of it with Their Workers*, BROOKINGS INST. (Dec. 22, 2020), https://www.brookings.edu/blog/the-avenue/2020/12/22/amazon-and-walmart-have-raked-in-billions-in-additional-profits-during-the-pandemic-and-shared-almost-none-of-it-with-their-workers/ [https://perma.cc/ZA24-C6EA].

11. *Id.*

12. Tiku & Greene, *supra* note 2.

13. *Id.*

14. Kinder et al., *supra* note 8.

15. *Id.*

16. Douglas MacMillan, Peter Whoriskey & Jonathan O'Connell, *America's Biggest Companies Are Flourishing During the Pandemic and Putting Thousands of People Out of Work*, WASH. POST. (Dec 16, 2020, 5:28 PM), https://www.washingtonpost.com/graphics/2020/business/50-biggest-companies-coronavirus-layoffs/ [https://perma.cc/BT85-FFQY].

17. *Id.*

socially beneficial ways, companies chose to funnel their extra profit to their already wealthy shareholders through the stock buybacks.[18]

At several points in the last century, such historic, crisis-fueled profits were given unique federal tax treatment. During World Wars I and II, these profits were given the name "excess profits" because they were in excess of what a company would have made absent the war. Congress enacted a special excess profits tax on three occasions to capture a portion of these additional profits.[19] These wartime excess profits taxes are similar to a related tax, enacted in the 1980s, known as a "windfall profits" tax.[20] The two types of taxes are distinct in important ways, but both are aimed at recapturing above-average profits. The extremely high profits of just a few companies during the pandemic, acquired while the rest of the country suffered, have prompted a few calls to bring back a similar special tax on these earnings.[21]

When evaluating a tax intended to capture record pandemic-related profits, there are a number of factors to consider. This paper begins by looking at America's history of taxing businesses' unexpected high profits, including a brief review of legislative motivations and the mechanics of the taxes, and provides a comparison of the overall socioeconomic contexts. While the coronavirus pandemic and the world wars were all crises, there are a few important differences. The most notable and poignant difference is the current wealth and income disparity among Americans. This disparity had already attracted congressional and media concern, and reports of billionaires collecting even greater wealth while everyday Americans struggled have added further political pressure.[22]

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18. *Id.*
19. *See infra* Part II.
20. *See infra* Section II.B.
21. *See infra* Part III. *See also, e.g.*, POWER, PROFITS, AND THE PANDEMIC, *supra* note 9, at 38–39.
22. *See The Income and Wealth Inequality Crisis in America: Hearing Before the S. Budget Comm.*, 117th Cong. (2021); Moritz Kuhn, Moritz Schularick & Ulrike Steins, *How the Financial Crisis Drastically Increased Wealth Inequality in the U.S.*, HARV. BUS. REV. (Sept. 13, 2018), https://hbr.org/2018/09/research-how-the-financial-crisis-drastically-increased-wealth-inequality-in-the-u-s [https://perma.cc/2BPU-GRT9].

In December 2020, former Representative Tulsi Gabbard proposed a House resolution for an excess profits tax,[23] and Professor of Law Reuven Avi-Yonah also proposed a slightly different excess profits tax.[24] This paper critiques these proposals by looking at a number of arguments for and against an excess profits tax, as well as a few important concerns regarding implementation of such a tax. Notably, while the specific purpose of an excess profits tax is to recapture undeserved windfall, it must also fit with our overall economic and policy goals. One of these goals, economic neutrality, typically counsels avoiding such extreme government interference, but this unique event calls for concerns about equality and fairness to be given greater weight.

I. EXCESS PROFITS AND WINDFALL TAXES IN U.S. HISTORY

The imposition of tax on profits perceived as undeserved has historical precedents. Two types of taxes have been enacted in the United States, as well as around the world, in the last hundred years to address this issue: excess profits taxes and windfall profits taxes.[25] Each was calculated differently, and each responded to different events. But both targeted unexpected profits, i.e., those profits which occurred due to external events not anticipated by the taxpayer. Taxpayers subject to the excess profits tax experienced a lucky break, often when many others were experiencing the exact opposite. Thus, their profits, which can be categorized as windfalls, were seen as proper targets to help meet other political goals, such as funding war efforts and incentivizing oil production, respectively.[26]

A. Excess Profits Taxes

A tax on above-average corporate profits was enacted for the first time in the United States in 1917.[27] This tax was not limited to war-related industries, such as munitions manufacturing, but applied

23. *See infra* Part III.
24. *Id.*
25. Eric Kades, *Windfalls*, 108 YALE L.J. 1489, 1538 (1999).
26. *Id.*
27. Revenue Act of 1917, Pub. L. No. 64-377, 39 Stat. 1000. George K. Yin, *James Couzens, Andrew Mellon, the "Greatest Tax Suit in the History of the World," and the Creation of the Joint Committee on Taxation and Its Staff*, 66 TAX L. REV. 787, 795 (2013).

broadly to excess profits earned in all industries.[28] The goal of the tax was to recapture corporate profits earned, either directly or indirectly, due to the ongoing war.[29] Regarding a similar tax enacted in Europe at the time, an economist noted that it seemed fair to prevent some entities from "mak[ing] inordinate gains out of the misery of humanity . . . ."[30] In the U.S. the tax was in part a response to public outrage at certain companies' extreme profits.[31] To determine what profits were "excess" and thus subject to the tax, businesses had to determine their average profit rate.[32] Profits above what Congress deemed a "reasonable return on invested capital" were subject to a higher excess profits tax, though the exact rate varied.[33] The method was criticized for its complexity, and the tax was unpopular overall.[34] Congress repealed the tax in 1922 after World War I ended.[35]

An excess profits tax was enacted again in the 1940s when a bill designed to prevent war profiteering was passed in response to World War II.[36] This tax also applied a higher rate to profits deemed excess. First, "excess profits net income" was calculated by removing certain items that reflected past investments, such as long-term capital gains and losses, from net income.[37] A credit designed to approximate normal profits was then subtracted from this excess profits net income.[38] To ameliorate some of the flaws of the World War I tax,

28. Revenue Act of 1917, Pub. L. No. 64-377, 39 Stat. 1000. Originally passed in March, the Act was revised soon after in October of 1917. Yin, *supra* note 27, at 796; War Revenue Act of 1918, Pub. L. No. 65-50, 40 Stat. 300.

29. Alger B. Chapman, *Excess Profits Tax, in* FUNDAMENTALS OF FEDERAL TAXATION 389 (Am. Bar Ass'n 1944).

30. Yin, *supra* note 27, at 796 (quoting Edwin R.A. Seligman, *The War Revenue Act*, 33 POL. SCI. Q. 1, 25 (1918)).

31. Kades, *supra* note 25, at 1539–40. This is also true when the tax was enacted during World War II. *Id.*

32. Yin, *supra* note 27, at 799.

33. Ajay M. Mehrotra, *Lawyers, Guns, and Public Moneys: The U.S. Treasury, World War I, and the Administration of the Modern Fiscal State*, 28 L. & HIST. REV. 173, 185 (2010).

34. Revenue Act of 1921, Pub. L. No. 67-98, § 301(a), 42 Stat. 227, 272. Yin, *supra* note 27, at 801; L. Robert Driver, Jr., *The Excess Profits Tax—Proposals for 1941*, 50 YALE L.J. 1206, 1206–07 (1941).

35. *Id.*

36. Revenue Act of 1940, Pub L. No. 76-656, 54 Stat. 516.

37. Timothy Nuccio, *Substance Over Form: Creditability of the 1997 U.K. Windfall as an Excess Profits Tax Under I.R.C. § 901*, 22 TRANSNAT'L L. & CONTEMP. PROBS. 267, 277 (2013).

38. Reuven S. Avi-Yonah, *COVID-19 and U.S. Tax Policy: What Needs to Change?* (Univ. Mich. Pub. L. Rsch. Paper Series, Paper No. 679, 2020) (Univ. Mich. L. & Econ. Rsch. Paper Series, Paper No. 20-015, 2020), https://ssrn.com/abstract=3584330 [https://perma.cc/K5SQ-TNY5].

this iteration allowed taxpayers to choose between two methods of calculating their credit (and thus their normal profits).[39] One option was the *invested capital method*. This method entailed calculating a fair rate of return on invested capital, and then any profits above that amount were considered excess.[40] The other method was the *average earnings method*. Under this alternative method, the credit amount was equal to 95% of the company's average income from 1936 to 1939 plus or minus a few other small items which were also considered part of normal profit.[41] The amount of the credit, however it was determined, as well as a $10,000 exemption and any unused excess profits credit from two prior or two subsequent years were subtracted from excess profits net income. This final amount was what could be deemed excess profits, and it was subject to a 95% tax rate.[42] Unlike the World War I tax, the same rate was applied to all excess profits across companies.[43] The normal profits were still taxed at the prevailing corporate tax rate.[44] Lastly, there was an 80% ceiling, meaning the effective rate of tax would not be more than 80% once the total tax liability for normal profits and excess profits was added up.[45] This excess profits tax was maintained in some form in three subsequent annual revenue acts.[46]

A revitalized excess profits tax was enacted again in 1950 in response to the Korean War, but the rate of tax on excess profits was only 30%.[47] But legislators and business owners expressed concern that it was preventing economic growth and job creation for the new masses of unemployed individuals,[48] and the tax was allowed to expire at the end of 1953.[49] Though the tax originally helped fund the

39. Nuccio, *supra* note 37, at 277.
40. *Id.* at 277–78. The specific process was fairly complex. *Id.*
41. *Id.*
42. *Id.* at 278–79.
43. Driver, *supra* note 34, at 1214.
44. Chapman, *supra* note 29, at 390.
45. *Id.* at 393.
46. *Id.* at 389.
47. *Relief Provisions of the Excess Profits Tax Act of 1950*, 64 HARV. L. REV. 1143, 1143 (1951); Steven A. Bank, *The Rise and Fall of Post-World War II Corporate Tax Reform*, 73-WTR L. & CONTEMP. PROBS. 207, 221 (2010). This return of the excess profits tax continued to face fierce opposition from the business community. Bank, *supra*, at 221.
48. H.R. REP. NO. 83-743, at 4 (1953).
49. S. REP. NO. 83-1622, at 2 (1954).

war efforts, it came to been seen as a threat to the recovery of the economy once the wars were over.[50]

B. Windfall Profits Taxes

A windfall profits tax, like an excess profits tax, is designed to recapture above average profits. In the United States, a windfall tax was imposed on oil companies in 1980,[51] in an act which was introduced during the Ford administration but ultimately signed by President Carter.[52] The tax was enacted in conjunction with the removal of price controls on foreign oil.[53] At the time, the price of foreign oil was skyrocketing due to actions of OPEC.[54] There was concern in Congress that once price controls were removed, the price of domestic oil would increase dramatically to match the international market.[55] As the price of oil increased, the argument went, Americans would end up paying more for gasoline and companies would see above average profits.[56] The windfall profits tax was intended to recapture these above average profits, which were seen as unearned because they were due solely to the choices of foreign actors (i.e., OPEC).[57] This increased profit was also considered unearned because it would be significantly greater than companies anticipated when making their initial investments.[58]

The windfall profits tax had a very different structure than the excess profits taxes. Instead of being calculated based on amount of

50. Bank, *supra* note 47, at 209.

51. Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229.

52. BERNARD A. GELB, CONG. RSCH. SERV., 81-270E, THE CRUDE OIL WINDFALL PROFITS TAX ACT: CONTEXT AND CONTENT 9 (1981). *See also* All Things Considered, *Historian Details Roots of Windfall Profit Tax*, NPR (May 2, 2008, 4:00 PM), https://www.npr.org/templates/story/story.php?storyId=90142714 [https://perma.cc/AZ5H-8Y6U].

53. Kades, *supra* note 25, at 1547.

54. *See, e.g.*, *Crude Oil Tax: Hearings Before the S. Comm. On Finance*, 96th Cong. 48–49 (1979) (statement of Hon. W. Michael Blumenthal, Secretary of the Treasury). The Organization of the Petroleum Exporting Countries (OPEC) is a multinational government organization formed to "co-ordinate and unify petroleum policies among Member Countries." *Brief History*, ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES, https://www.opec.org/opec_web/en/about_us/24.htm [https://perma.cc/T6CG-UKT5]. The United States was not (and still is not) a member. *Id.*

55. J. Matthew Dow, *The Windfall Profit Tax Exposed*, 14 ST. MARY'S L.J. 739, 741–42 (1983).

56. *Id.* at 739–42; *see supra* note 54.

57. Dow, *supra* note 55, at 742.

58. Kades, *supra* note 25, at 1548.

income, the windfall profits tax looked more like an excise tax.[59] The amount of "windfall profit" was calculated per barrel of oil by subtracting a base price from the price at which each barrel was actually sold.[60] The tax rate applied to this windfall profit varied from 70% to 30%, depending on which tier the oil was in.[61] Classification into tiers depended on factors such as the age of the operation, the type of oil, and the geographic location.[62] A portion of the revenue from the tax was set aside to go towards energy and transportation programs.[63]

At the time of its enactment, the windfall profits tax was expected to generate over $200 billion,[64] but it ultimately fell short of anticipated revenues.[65] Also, because the base price did not perfectly match the real world costs of production, some domestic production was discouraged, which was contrary to the original goals of the legislation.[66] A large amount of tax revenue was captured before the tax was repealed early in 1988 nonetheless.[67] Despite critiques,[68] the concept of a windfall profits tax still appealed to some politicians and policymakers in later years. Both Barack Obama and Hillary Clinton included a windfall profits tax on the natural gas industry in their campaign platforms in the 2008 presidential election.[69]

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59. All Things Considered, *supra* note 52. An excise tax is one imposed on a specific good or service, as opposed to on income or a general sales tax. *See Excise Tax*, TAX FOUND., https://taxfoundation.org/tax-basics/excise-tax/. A familiar example is the flat per gallon tax on gasoline. *Id.*

60. Dow, *supra* note 55, at 742–43. The base price was equal to the 1979 controlled price. *Id.*

61. *Id.* at 743–44.

62. *Id.* The original motivation for price decontrol was to encourage investment in domestic oil production, and so these tiers were organized to incentivize certain investments. Kades, *supra* note 25, at 1547–48.

63. Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, § 102, 94 Stat. 229.

64. Dow, *supra* note 55, at 740.

65. SALVATORE LAZZARI, CONG. RSCH. SERV., RL33305, THE CRUDE OIL WINDFALL PROFIT TAX OF THE 1980S: IMPLICATIONS FOR CURRENT ENERGY POLICY 14–16 (2006), https://sgp.fas.org/crs/misc/RL33305.pdf [https://perma.cc/A7FA-AQ69].

66. Kades, *supra* note 25, at 1549.

67. *Id.* at 1550. Dow, *supra* note 55, at 745.

68. *See, e.g.*, THE COMM. ON POSTWAR TAX POL'Y, FINANCING DEFENSE: IS AN EXCESS PROFITS TAX THE SOLUTION 4 (1950), https://taxfoundation.org/financing-defense-excess-profits-tax-solution/ [https://perma.cc/AW35-JFEK] (stating that the tax is "unrealistic and fallacious"); Walter T. Mead & Robert T. Deacon, *Proposed Windfall Profits Tax on Crude Oil: Some Major Errors in Estimation*, 5 J. ENERGY & DEV., Autumn 1979, at 32; William F. Shughart II, *"Windfall" Profits Tax on Oil Would Slow Flow*, INDEP. INST. (Nov. 4, 2005), https://www.independent.org/news/article.asp?id=1605 [https://perma.cc/E7ZP-MFTH].

69. John M. Broder, *Democrats Divided Over Gas Tax Break*, N.Y. TIMES (Apr. 29, 2008), https://www.nytimes.com/2008/04/29/us/politics/29campaign.html [https://perma.cc/ZCN6-QQKK].

C. Comparing Excess Profits and Windfall Profits Taxes

This paper uses the term excess profits tax to describe the proposed pandemic profits tax, but many of the policy arguments apply equally to either type of tax. Both types target so-called windfall profits, defined as "gains independent of work, planning, or other productive activities that society wishes to reward."[70] The profits accrue due to external events that companies did not account for in their original investment or other business planning.

In each scenario the biggest functional question has always been how to differentiate between normal profits and windfall or excess profit.[71] The crude oil windfall profits tax used increases in price as a rough but direct proxy for windfall profits, which was feasible because the tax was only applied to one specific product. The excess profits taxes, on the other hand, applied across industries and products. To accomplish this broad application, the excess profits tax structure targeted excess profits in a roundabout way.[72] Instead of picking out what profits were directly attributable to the crisis, the tax picked out what profits are arguably *not* due to the crisis, i.e., normal profits as determined individually for each taxpayer.[73] The rest, it is assumed, are excess profits.

D. Classifying Pandemic Profits as Windfall or Excess Profit

The excess profits companies earned during the pandemic can be classified as windfall for the same reasons as either extreme profits during wars or high profits due to oil price increases. The money in isolation is arguably not a windfall because it was the result of increased operations, but the overall economic conditions that

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Additionally, these types of taxes have been used in other countries. In 1997, the United Kingdom enacted a windfall tax on private utilities. Ryan Bourne, *Why a COVID-19 Windfall Tax is a Terrible Idea*, CATO INST. (May 21, 2020), https://www.cato.org/commentary/why-covid-19-windfall-tax-terrible-idea [https://perma.cc/R8DY-FFPT]. In 2020 Romania passed a windfall profits tax on natural gas, which was structured similarly to the United States's 1980 tax. *Romania: "Windfall Profit Tax" on Natural Gas*, KPMG (Aug. 3, 2020), https://home.kpmg/us/en/home/insights/2020/08/tnf-romania-windfall-profit-tax-on-natural-gas.html [https://perma.cc/2E7M-HMBN].

70. Kades, *supra* note 25, at 1566.
71. Chapman, *supra* note 29, at 392.
72. *Id.*
73. *Id.*

allowed the profits to be made certainly was a type of windfall. In both situations the profits are undeserved in nature, and so historically enacted windfall taxes are illustrative from a policy perspective. Overall though, pandemic profits are more similar to wartime profits. The COVID-19 pandemic is a worldwide crisis similar to World Wars I and II. War profits could be directly earned by, e.g., munitions dealers or indirectly earned by companies benefitted by the mobilization efforts, but who were selling products or services less related to the war. Similarly, the pandemic profits can be direct or indirect; for example, a company selling coronavirus testing kits would profit directly, whereas a company selling household goods delivered to customers' front doors would profit indirectly.

A wartime-like excess profits tax is also more appropriate in response to the pandemic than a windfall profits tax because the latter focuses on price. Companies in wartime and in the pandemic experienced changes in operations and production, so it was not a mere increase in price that caused the profits in all cases.[74] Furthermore, focusing on the price alone would present an insurmountable problem in that assessing the tax correctly would be extraordinarily complicated, which was already a common criticism of the windfall profits tax.[75] This method was feasible for the windfall tax because it was always intended to be a tax on a single product.[76] Pandemic profits are not attributable to one type of product. Instead, the profits are spread across numerous products and industries. To target the range of products at issue in considering pandemic profits, the tax would have to be exponentially more complicated. The proposal for a broader, World War II-like excess profits tax gets at these profits in a simpler way and does not require taking the prices of individual items into account. It also leaves more room for companies to take their actual expenses into account, because the excess profit is classified based on their own earnings and not an industry-wide base price.

74. Amazon, for example, increased operations and hired 400,000 additional workers in the United States. Tiku & Greene, *supra* note 2.

75. CHARLES BOWSHER, GEN. ACCT. OFF., GAO/GGD-84-15, IRS' ADMINISTRATION OF THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980 1 (1984), https://www.gao.gov/assets/ggd-84-15.pdf [https://perma.cc/X68U-369K].

76. *See supra* Section II.B.

E. Key Differences Between 1940s World War II America and 2020 Pandemic America

One major concern facing legislators post-World War II was a growing labor force.[77] Taxing companies with additional profit meant that the companies could not reinvest those profits in expanding their businesses or hiring additional workers. Although today there are also massive numbers of unemployed workers, an excess profits tax will not affect unemployment in the same way. The companies affected by the tax have already expanded operations.[78] When spending patterns return to pre-pandemic norms, one of two things should happen. These profitable companies could carry on at their current level of operations. Alternatively, their operations could decrease. In either scenario, they are unlikely to be hiring more employees. An excess profits tax cannot disincentivize hiring that would not be happening regardless. On the other hand, many large companies have been laying off employees,[79] and so it is possible that they will hire them back. The number of workers companies previously employed was supported by their normal, pre-pandemic profits. Because these normal profits would not be subject to the excess profits tax, such a tax should not disincentivize this type of rehiring.

The overall economic situation is also very different than it was seventy years ago. The pandemic's vastly different consequences for high profit companies as compared to the average American were set against an existing backdrop of inequality. Over recent decades, both the wealth and income gap among Americans has been widening.[80] In 1976, the top 10% of income earners earned 35.2% of total pretax income, but in 2021 this share had risen to 46.1%.[81] In 2018 alone, about 52% of all income earned went to the top 20% of income

77. H.R. REP. NO. 83-743, at 4 (1953).

78. *See infra* Section IV.B.i.

79. MacMillan et al., *supra* note 16.

80. Bill Chappell, *U.S. Income Inequality Worsens, Widening to a New Gap*, NPR (Sept. 26, 2019, 2:12 PM), https://www.npr.org/2019/09/26/764654623/u-s-income-inequality-worsens-widening-to-a-new-gap [https://perma.cc/SN4J-9FPN].

81. Thomas Blanchet, Emmanuel Saez & Gabriel Zucman, *Who Benefits from Income and Wealth Growth in the United States?*, REALTIME INEQUALITY, https://realtimeinequality.org/.

earners, and almost half of that went to the very top 5% of income earners.[82] Additionally, 88.9% of all wealth belonged to the top 20% of the wealthiest Americans.[83] Wealth and income disparities also exist along racial lines, with white Americans possessing far more wealth than Black Americans.[84] This gap has only grown during the pandemic.[85] The number of Americans living in poverty has increased dramatically,[86] while during this same time American billionaires have added further billions to their already vast fortunes.[87] Further, one study reported that 90% of pandemic profits were expected to go to white Americans.[88] This worsening disparity cannot be addressed by the tax system alone, let alone just one excess profits tax. But it is an additional motivation to criticize the status quo. The potential consequences of an excess profits tax must be evaluated in the context of the problematic racial and socioeconomic dynamic that exists today, which naturally differs from the circumstances in the 1940s.[89] This disparity is the backdrop for any tax proposal in the twenty-first century, and therefore should be taken into account when considering proposals' fairness and implications.

82. JESSICA SEMEGA, MELISSA KOLLAR, JOHN CREAMER & ABINASH MOHANTY, U.S. CENSUS BUREAU, INCOME AND POVERTY IN THE UNITED STATES: 2018 P60-266, 8 (2019). Thank you to Professor Peter Weidenbeck at Washington University School of Law for highlighting this source in class materials.

83. Emmanuel Saenz & Gabriel Zucman, *Wealth Inequality in the United States Since 1913: Evidence from Capitalized Income Tax Data* (Nat'l Bureau of Econ. Rsch., Working Paper No. 20625, 2014), http://gabriel-zucman.eu/files/SaezZucman2014.pdf [https://perma.cc/328Q-P79N]. For more on this racial wealth gap and how it has been affected by the pandemic, see Christian E. Weller & Richard Figeuroa, *Wealth Matters: The Black-White Wealth Gap Before and During the Pandemic*, CTR. FOR AM. PROGRESS (July 28, 2021), https://www.americanprogress.org/article/wealth-matters-black-white-wealth-gap-pandemic/.

84. Palma Joy Strand & Nicholas A. Mirkay, *Racialized Tax Inequity: Wealth, Racism, and the U.S. System of Taxation*, 15 NW. J.L. & SOC. POL'Y 265 (2020).

85. Heather Long, Andrew Van Dam, Alyssa Fowers & Leslie Shapiro, *The Covid-19 Recession Is the Most Unequal in Modern History*, WASH. POST (Sept 30, 2020), https://www.washingtonpost.com/graphics/2020/business/coronavirus-recession-equality/ [https://perma.cc/HR3Q-BAT3].

86. Lauren Aratani, *Coronavirus Pandemic Plunges Millions of Americans into Poverty*, GUARDIAN (Oct. 15, 2020), https://www.theguardian.com/us-news/2020/oct/15/coronavirus-pandemic-plunges-millions-of-americans-into-poverty [https://perma.cc/AU9Z-FHQX].

87. Tommy Beer, *American Billionaires Have Added More Than $1 Trillion in Wealth During Pandemic*, FORBES (Jan. 26, 2021), https://www.forbes.com/sites/tommybeer/2021/01/26/report-american-billionaires-have-added-more-than-1-trillion-in-wealth-during-pandemic/?sh=26f72dc42564 [https://perma.cc/E5EK-XUFQ].

88. OXFAM, PANDEMIC PROFITS EXPOSED (2020), https://webassets.oxfamamerica.org/media/documents/Pandemic_Profiteers_Exposed.pdf [https://perma.cc/GY5A-WB3E].

89. *See, e.g.*, Chappell, *supra* note 82.

II. PROPOSALS FOR A PANDEMIC PROFITS TAX

At least two proposals for an excess profits tax have emerged since 2020. While the proposals differ in their level of detail, both advocate for a reimagining of the average earnings method used in the World War II excess profits tax. First, former Representative Tulsi Gabbard introduced a House Resolution calling for an excess profits tax on high pandemic profits of companies.[90] This resolution is a general recommendation to tax these "windfall profits," and it was referred to the House Ways and Means Committee and the House Committee on Small Business in December 2020.[91] The Resolution proposes a 95% tax rate on excess profits, defined as profits earned in 2020 above the company's average profits in 2016, 2017, 2018, and 2019.[92] This is necessary, the Resolution states, to prevent large corporations from gaining an unfair economic advantage.[93] The proposed tax has two goals. The first is to prevent companies from profiteering off of the pandemic, and the second is to bring in revenue when the federal government's deficit is increasing. Notably, the Resolution states that the tax revenue should be specifically earmarked to fund further economic relief for small businesses.[94]

The second proposal is by a law professor at the University of Michigan. Professor Reuven S. Avi-Yonah proposed an excess profits tax in an early paper on how the pandemic will affect tax policy in the United States.[95] This proposal also suggests a 95% tax on excess profits of corporations.[96] Excess profits would be differentiated from normal profits using the same average earnings method as was used in World War II,[97] which creates a benchmark based on the profits of the prior four years, adding an allowance for

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90. H.R. Res. 1267, 116th Cong. (2020).
91. *Id.* This resolution is fairly short, and does not get any further into the mechanics of the proposed tax, its budgetary implications, etc.
92. *See id.*
93. *Id.*
94. *Id.*
95. Avi-Yonah, *supra* note 38.
96. *Id.*
97. All corporations subject to the tax would use this method. *Id.* This is in contrast to the World War II law, which allowed companies to choose to use an invested capital method. *See supra* Section II.A. The invested capital method introduces significant complexity. Driver, *supra* note 34, at 1210.

return on invested capital.[98] Any net profit above this benchmark would be taxed at 95%, while profit below it would be taxed at currently prevailing rates. The total effective rate of tax would be limited to 80%. The proposal makes the novel addition of credits for wages paid to new employees hired in 2020.[99] The revenue would be earmarked for improvements to the social safety net.[100]

These two proposals are both modeled on the excess profits taxes of the earlier wartime acts.[101] The Avi-Yonah proposal is more developed and borrows the majority of its terms from the World War II tax.[102] The additional terms in the Avi-Yonah proposal take into account the practical effects of the tax. The allowance for a return on capital investment is necessary to target only unexpected profits. This allowance excludes profit attributable to decisions on certain investments made in prior years that happened to come to fruition in 2020. This avoids taxing expected increases in profit, as compared to undeserved profit. The credit for wages paid to employees hired in 2020 avoids at least one of the tax's potentially harmful disincentives: hiring fewer workers or paying them a lower amount. In contrast to Representative Gabbard's proposal, Professor Avi-Yonah's proposal does not advocate earmarking the revenue for a specific spending goal other than general improvements to the safety net.[103] Instead, the focus is more on carefully crafting a targeted tax that will reach only the intended excess profits. Because the proposals overall are so similar, this paper jointly evaluates their policy motivations.

III. THE CASE FOR AND AGAINST A PANDEMIC EXCESS PROFITS TAX

Congress might be inclined to adopt an excess profits tax to improve fairness and generate revenue. The market as we know it was distorted by the pandemic, leading to a windfall for companies whose

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98. Specifically, the amount of net profit not subject to the 95% rate would be the average of profits from 2016–2019 plus 8% of research and development, which is the main capital investment for modern companies. Avi-Yonah, *supra* note 38.

99. *Id.*

100. *Id.*

101. H.R. Res. 1267, 116th Cong. (2020); Avi-Yonah, *supra* note 38. The nonprofit Oxfam has also published a call for a special tax on profits earned due to the pandemic. POWER, PROFITS, AND THE PANDEMIC, *supra* note 9.

102. Avi-Yonah, *supra* note 38.

103. *Id.*

services were suddenly in higher demand. Against a backdrop of inequality, it is fair to recapture this windfall and redistribute it in the form of government aid. However, concerns about taxing the right profits and avoiding disincentivizing innovation must be addressed.

A. Arguments for a Pandemic Excess Profits Tax

1. Undeserved Profit

In a sense, profits earned due to the pandemic are undeserved. The exact classification of profits as deserved or undeserved is tricky and controversial. At a broad level, profits may be labeled undeserved when they are due to events unexpected by the earner. In the case of pandemic profits, the profits are undeserved where they were not earned due to thoughtful foresight by a business owner. The profits are not unexpected in form because the businesses are for the most part producing and selling the products and services around which their business model is centered. But they are unexpected in size and source. The profits are arguably undeserved in that these companies did not make any intentional decisions that put them in the position of profiting from a pandemic. They did not make good decisions while other companies made bad decisions. Instead, they happened to be well-placed during a crisis. In other words, the high profits were not caused by companies' prescience in anticipating and planning for increased demand. Moreover, small businesses which would typically provide some competition were closed.[104] An extreme crisis led to luck for a few and devastation for many due in no part to intentional positioning by either. Because the pandemic profits are undeserved, a high tax on them is more justifiable. Even if some companies can attribute their high pandemic profits to intentional decisions, for example, investing in robust supply chains, the profits could be taxable under an ability to pay theory.[105]

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104. Robert W. Fairlie, *The Impact of COVID-19 on Small Business Owners* 6 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27462, 2020), https://www.nber.org/system/files/working_papers/w27462/w27462.pdf [https://perma.cc/MF37-LQYW].

105. *See infra* Section VI.A for discussion on this point.

Even in the potential instance where pandemic profits are due to a calculated risk, they may not be fully deserved. The assumption that all intentional profits are deserved takes the existing status quo of resource distribution as an agreeable baseline. The appropriateness of the tax system as a vehicle for addressing the overall distribution of resources is outside the scope of this paper. That said, tax policy does not have to take the current status quo for granted. Tax proposals should incorporate challenges to the existing distribution where appropriate, and proposals which perpetuate an unfair distribution, whether intentionally or not, should reevaluate their assumptions. Resources are used to create profit, whether those profits are excess or normal. Therefore, who makes a profit is intimately related to the existing distribution of resources. If that existing distribution does not fall along lines of desert, there is no reason to presume that profits earned do either.

2. Prevention of Profiteering or Price Gouging

An excess profits tax removes incentives for companies to raise prices and exploit others' hardships. Certain products were in unusually high demand in 2020. For example, toilet paper shortages during the early days of stay-at-home orders are bitter memories for many Americans.[106] Demand also increased dramatically for hand sanitizer, cleaning products, and food delivery, among others.[107] In response, some companies raised the prices of essential items.[108] While increased demand almost always results in higher prices, the morality of overcharging for essential items during a crisis is troubling, to say the least. An excess profits tax would disincentivize price gouging because companies would not get to keep the profit earned through this behavior. The prevention of the unfairness of price gouging would be a proper target of an excess profits tax.

106. Bruce Y. Lee, *Is COVID-19 Coronavirus Leading to Toilet Paper Shortages?*, FORBES (Mar. 6, 2020), https://www.forbes.com/sites/brucelee/2020/03/06/how-covid-19-coronavirus-is-leading-to-toilet-paper-shortages/?sh=63a29b777a8d.

107. Naveen Donthu & Anders Gustafson, *Effects of COVID-19 on Business and Research*, 117 J. BUS. RSCH. 284, 285 (2020).

108. Grace Dean, *Hand Sanitizer Prices Have Jumped by a Massive 53% in the U.S. During the Pandemic, as Accusations of Price Gouging Continue to Roll In*, BUS. INSIDER (Nov. 17, 2020, 10:33 AM), https://www.businessinsider.com/hand-sanitizer-prices-price-gouging-bleach-toilet-paper-face-masks-2020-11[https://perma.cc/NX3P-PDTM].

3. Small Businesses' Competitive Disadvantage

The proposed tax should not focus solely on the prevention of price gouging because not all companies engaged in price gouging for all products. Many of the companies cited as making extreme profits simply had vastly more orders or were capable of adapting to the conditions of the pandemic market.[109] At least part of this competitive edge was gained through the temporary or permanent closure of small businesses. An excess profits tax could reduce this advantage to large companies and hamper monopolistic practices.[110]

In general, the tax policy principle of economic neutrality counsels that tax law should seek to minimize interference with market choices and thus avoid creating inefficiencies.[111] But in these circumstances, ensuring that an excess profits tax has a neutral effect on the pandemic economic should not be a priority. The goal of economic neutrality presumes that the market is functioning in a way that minimizes inefficiencies and, further, that leaving the market alone will result in the most desirable outcomes. But this goal assumes a level playing field. When extraordinary events occur, it is more appropriate for the government to step in and interfere because this level playing field no longer exists. Typically, businesses that plan carefully are rewarded more than those that do not, and this is considered a natural and desirable consequence. But the pandemic has altered the economic landscape so dramatically that this system of rewards was disrupted. This was a large external and unpredictable event, which has affected market conditions and changed the balance of fairness that is often thought to permeate the free market. Rewards accrued to companies because they happened to be in a position to profit from the hardship of others—not because they engaged in careful planning.

The market does not need to reward this kind of outcome, and it is not fair to do so. Despite capitalism's lauded tendency to reward companies that can adapt to any extreme circumstance, the pandemic was a unique, unexpected external event. Companies should not have

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109. *See supra* Section II.B.
110. H.R. Res. 1267, 116th Cong. (2020).
111. *See, e.g.*, Theodore J. Cranston, *Economic Neutrality and the Compensating Use Tax*, 16 STAN. L. REV. 1016, 1022 (1964).

to be pandemic-proof to stay afloat, and therefore it is not absolutely necessary to reward those which are. Consumers benefit when companies are flexible, but companies do not need to foresee every potential catastrophe and be able to survive it. It would be reasonable and desirable for the government to step in and attempt to adjust the market when small companies close due to the pandemic.

4. Revenue

The overarching justification for taxes overall, as well as specific tax increases or modifications, is the government's need for revenue. For example, the federal income tax was increased during World War I and World War II to provide the government with funds needed for the war effort.[112] Government spending during and following the pandemic has similarly been at an increased level. Worldwide, national debts have reached levels comparable to those following World War I,[113] and the United States's national debt is likewise at historically high levels due to pandemic aid bills.[114]

While government spending over the last year, and potentially into the future, is necessary to mitigate the negative economic impact of the pandemic, the deficit created will eventually have to be addressed.[115] Individuals are expected to return to a more normal routine soon, but there is a good chance that households' spending will stay lower than average for a period as many Americans work to rebuild their savings.[116] The government could address the deficit by

112. *See, e.g.*, Tracey M. Roberts, *Brackets: A Historical Perspective*, 108 NW. U.L. REV. 925, 933–35 (2014). In the early years of the federal income tax, 1913–1915, the highest marginal tax rates were less than 10%, but by 1918 the highest marginal rate was 77%. *Id.*

113. Yuka Hayashi, *Pandemic Spending Boosts Global Government Debt to 98% of Economic Output, IMF Says*, WALL STREET J. (Jan. 28, 2021), https://www.wsj.com/articles/pandemic-spending-boosts-global-government-debt-to-98-of-economic-output-imf-says-11611838809 [https://perma.cc/QJ93-TJ9J].

114. Jim Zarroli, *$3.1 Trillion: Pandemic Spending Drives the Federal Budget Deficit to a Record*, NPR (Oct. 16, 2020, 3:08 PM), https://www.npr.org/sections/coronavirus-live-updates/2020/10/16/924582156/-3-1-trillion-pandemic-spending-drives-the-federal-budget-deficit-to-a-record [https://perma.cc/LPT5-Q59S]. For updated numbers see Alan Rappeport, *The U.S. Budget Deficit Hit a Record $1.7 Trillion in the First Half of the Fiscal Year*, N.Y. TIMES (Oct. 22, 2021), https://www.nytimes.com/2021/04/12/business/united-states-budget-deficit.html.

115. Peter Thal Larsen, *Fringe Taxes Will Go Mainstream When Lockdowns End*, REUTERS (May 11, 2020, 4:50 AM), https://www.reuters.com/article/us-healthtax-breakingviews/breakingviews-fringe-taxes-will-go-mainstream-when-lockdowns-end-idUSKBN22N19I [https://perma.cc/9KR7-6NZD].

116. *Id.*

decreasing spending, but doing so risks undercutting the progress made as a result of previous aid packages. Raising taxes is another option. As discussed above, taxing the excess profits of corporations in particular may be an effective and fair way to produce needed revenue.

B. Arguments Against a Pandemic Excess Profits Tax

1. Earned Profits

One argument opponents of an excess profits tax may make is that profits earned should fairly be left with companies who received them, because the profits were not due solely to an increase in price. That is, while the profits may be unusual, they did not just fall from the sky. High profits were earned through additional business. Deliveries increased exponentially, and some biotech companies worked around the clock to offer solutions to new problems.[117] It could be argued that companies should keep the profits from the additional work that was put in.

One response is that the positioning of companies was inherently unfair because they did not face the typical level of competition, as discussed above. In addition, the change in output is not considered in justifications for other types of taxes. For example, the difference in rates in the individual federal income tax does not directly take into account how much more or less work the taxpayer is doing.[118] If a taxpayer makes more income year over year because they are working additional hours, they may end up paying a higher tax rate. The same is true if that taxpayer's employer just happens to value them and gives them a raise as an incentive to stay with the company, but the volume of work stays the same. That taxpayer will also pay a consequently higher rate, all other things being equal. While there must be some policy limits in this area, the volume of work being done is not dispositive.

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117. *Covid-19 Vaccines: A USD40bn Revenue Windfall for Pharmaceuticals*, EULER HERMES (Feb. 4, 2020), https://www.eulerhermes.com/en_global/news-insights/economic-insights/Covid-19-vaccines-a-USD40bn-revenue-windfall-for-pharmaceuticals.html [https://perma.cc/GV8C-WU8W].

118. *See* I.R.C. § 1.

2. Disincentivizing Investment

Another potential argument against a pandemic excess profits tax is that any tax triggered by an increase in profit risks disincentivizing innovation and adaptable business models. Legislators considering the excess profits tax of the 1940s were concerned about whether the tax would encourage companies to keep their profits low.[119] A significant downside of any excess profits tax proposal is that it could disincentivize future investment and innovation.[120] If companies expect that their future profits will be taken away by an excess profits tax, they may be less likely to make the investments needed to create them, which could have negative secondary effects. For example, one concern surrounding wartime excess profits taxes was that they "seriously undermined incentives for effort and enterprise that would increase the amount of war material produced."[121]

While the question of whether this would actually happen is difficult to know in advance, it does seem rational that corporate executives would not be inclined to put money, time, and effort into making profit the company will not get to keep. An excess profits tax that completely wiped out all incentives to improve and innovate moving forward would, on the whole, be a bad idea. The products and services offered by excessively profitable companies significantly improved life during the pandemic.[122] For some who are immune compromised, the companies' adaptability was potentially lifesaving.[123]

119. H.R. REP. NO. 83-743, at 6 (1953).

120. *See* Ufuk Akcigit & Stefanie Stantcheva, *Taxation and Innovation: What Do We Know?* 1–26 (Nat'l Bureau of Econ. Rsch., Working Paper No. w27109, 2020), https://www.nber.org/system/files/working_papers/w27109/w27109.pdf [https://perma.cc/QH2W-6LGU]. While the impact of tax policy on innovation should not be oversimplified, the corporate income tax has been found to negatively affect innovation. *Id.* The two are closely linked. *Id.*

121. Kades, *supra* note 25.

122. *See, e.g.*, Karen Weise, *Amazon's Profits Soars 220 Percent as Pandemic Drives Shopping Online*¸ N.Y. TIMES (May 12, 2021), https://www.nytimes.com/2021/04/29/technology/amazons-profits-triple.html [https://perma.cc/CTT7-VPCJ]; Leticia Miranda, *Amazon Has Been Indispensible During the Pandemic – But It's Clear Who Really Wins*, NBC NEWS (May 1, 2020, 6:07 AM), https://www.nbcnews.com/business/business-news/amazon-has-been-indispensable-during-pandemic-it-s-clear-who-n1197341 [https://perma.cc/7UD5-FDNH].

123. *People with Certain Medical Conditions*, CDC (Feb. 25, 2022), https://www.cdc.gov/coronavirus/2019-ncov/need-extra-precautions/people-with-medical-conditions.html [https://perma.cc/Q2YL-8QG4]. Shopping online and food delivery allowed these individuals to avoid potential exposures. *See Preventing the Spread of the Coronavirus*, HARV. HEALTH

While these are legitimate arguments, this is not a fatal blow to the pandemic profits tax specifically because the pandemic is such a rare event. The proposed excess profits tax would be limited to profits from 2020, or perhaps 2021. In order to work, an excess profits tax must be employed very sparingly.[124] As one scholar put it, "true surprises are uncommon and by definition are not recurring events."[125] The disincentive to innovation is not caused by excess profits taxes writ large, but rather by classifying profits as windfall too broadly or too frequently. Because disrupting positive innovation is an outcome to avoid, a broad excess profits tax such as that evaluated in this paper should not be employed in anything less than dire circumstances.[126]

Credits could be offered to address the potential disincentive to innovation. At present, the Avi-Yonah proposal includes a credit for the amount paid in wages to employees hired during 2020.[127] This credit would presumably encourage companies to hire more employees by rewarding companies for having done so. Introducing other credits could also be effective. Alternatively, existing credits such as the research and development credit or sustainability-related credits could be increased and expanded.[128] Credits are traditionally used to incentivize beneficial behavior, and in this case they could be designed to encourage innovation.

(Jan. 21, 2022), https://www.health.harvard.edu/diseases-and-conditions/preventing-the-spread-of-the-coronavirus [https://perma.cc/UK5G-GATV].

124. Kades, *supra* note 25, at 1551.

125. *Id.*

126. Interestingly, a more specific excess profits tax at an international level has been proposed to recapture business profits gained through unsustainable practices. This is an attempt to incentivize more sustainable economic behavior, rather than create revenue. Allison Christians & Tarcísio Diniz Magalhães, The Case for a Sustainable Excess Profits Tax 4 (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3811709. These authors refer to the pandemic as a "market failure." *Id.* at 9. *See also* Indiana University Mauer School of Law, *Tax Policy Colloquium: Christians (McGill)*, YOUTUBE (Apr. 15, 2021), https://www.youtube.com/watch?v=p6uggz8JcvA [https://perma.cc/7VD6-VJ8H].

127. Avi-Yonah, *supra* note 38. *See also supra* Part III.

128. *See, e.g.*, *Corporate - Tax Credits and Incentives*, PRICEWATERHOUSE COOPERS: WORLDWIDE TAX SUMMARIES (Aug. 2, 2021), https://taxsummaries.pwc.com/united-states/corporate/tax-credits-and-incentives [https://perma.cc/B9BY-HTE6].

3. Tax Incidence

A final concern for a tax aimed at improving equality is that the final incidence of the tax is somewhat unclear. All taxes are ultimately paid by individuals, not business entities, and which individuals are paying matters.[129] With any tax, it is necessary to consider whether the individual statutorily required to pay the tax is the same individual that will actually be burdened by it.[130] In the case of an excess profits tax, the concern is whether the burden of the tax will be passed on to consumers through higher prices. This effect would put an additional burden on the very individuals whose financial welfare the tax was intended to benefit.

Assuming the tax's revenue was redistributed to individual Americans in the form of government benefits, if consumers have to spend a significant portion of those benefits on more expensive products, then the overall improvement in equality is mitigated.[131] The demand for products that are not essential is likely to be more elastic, and companies are consequently less able to pass on the tax through increased prices.[132] If companies try to pass on the tax by increasing prices, consumers will respond by not purchasing the product. The relocation of the burden of the excess profits tax is primarily a concern for essential products, which taxpayers need to buy regardless of price.[133] Taxpayers who are harmed the most by the existing income and wealth disparity and who have the most to gain from improved equality—those at the lowest end of the income and wealth range—also spend the greatest percentage of their income on

129. Avi-Yonah, *supra* note 38.

130. Tyler A. LeFevre, *Justice in Taxation*, 41 VT. L. REV. 763, 790 (2017).

131. Alternatively, consumers could receive government benefits indirectly and thus save money they would have otherwise spent. But if they then spend the saved money on more expensive products, the effect is the same. The consumer is not benefitting from the government aid—the seller of the product is.

132. *See id.* at 791 (noting that taxes on products with a relatively inelastic demand tend to fall on buyers).

133. Sean Ross, *Types of Consumer Goods That Show the Price Elasticity of Demand*, INVESTOPEDIA (July 27, 2021), https://www.investopedia.com/ask/answers/012615/what-types-consumer-goods-demonstrate-price-elasticity-demand.asp [https://perma.cc/N67G-BXJZ]. Essential products include household stables such as food, which consumers are "unable . . . to eliminate from their budget." *Id.* Non-essential goods would include goods such as electronics, meals out, etc., that consumers can live without. *Id.*

essential products. Thus it is a major concern that these taxpayers could be burdened by an excess profits tax.

On the other hand, if companies are forced to decrease or eliminate dividends to pay their federal income tax bill, it is shareholders who would be effectively shouldering the burden of the excess profits tax. Given the fact that most stock is held by the wealthiest tenth of the population, this is a more desirable outcome than consumers being burdened with it.[134] Alternatively, if employee benefits are cut or workers are laid off, then it is employees or potential employees who bear the burden.

While the temporary nature of the excess profits tax alleviates some of these issues, the lack of control over how a corporation adjusts to pay the tax is a major concern. The economic considerations that would identify the likely incidence of an excess profits tax are outside of the scope of this paper. However, this concern must be flagged because the incidence will impact whether social welfare is improved or not.[135] If the burden of the tax falls on the taxpayers it was supposed to help, the desirability of the tax may need to be re-evaluated. This concern should be carefully evaluated by lawmakers in formulating an excess profits tax proposal.

IV. ISSUES IN IMPLEMENTATION

A. Targeting the Right Profit

There is a significant risk that an excess profits tax could be too broad, thereby unintentionally affecting companies that should not be subject to it and capturing their deserved profits. For example, a business's model could involve a heavy investment early on with very

134. Christopher Ingraham, *Businesses with 'Windfall' Pandemic Profits Are Showering Them on Investors, Study Finds*, WASH. POST (Sept. 16, 2020), https://www.washingtonpost.com/road-to-recovery/2020/09/16/corporate-profits-wealth-gap-oxfam/ [https://perma.cc/R4XD-6J5C]. *See also* CONG. BUDGET OFF., TRENDS IN FAMILY WEALTH, 1989 TO 2013 (2016) https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51846-familywealth.pdf. Though these shareholders would earn less that year, their total income and wealth is high enough that this decrease would not affect them nearly as much as it would a low income individual or family.

135. Stefanie Stantcheva, *Lecture 3: Tax Incidence and Efficiency Costs of Taxation*, HARV. U. 4 (2017), https://scholar.harvard.edu/files/stantcheva/files/lecture3.pdf [https://perma.cc/C5BN-YPGV].

little profit until six years down the line.[136] If that first profitable year happened to be 2020, then the company could be subject to the very high excess profits tax rate because its profits would be much higher than average. This is problematic because their business model anticipates and requires this relatively high profit in a single year to offset the previous profit-less years and recoup investment. The company, rather than earning undeserved profits by being in the right place at the right time, would be penalized for being in the right place at the wrong time. The same is true of companies in certain high-risk industries where a sudden highly profitable year is the typical goal.[137] Their normal profits could be inappropriately classified as a windfall.

Addressing this concern would add a significant level of complexity into the tax. One solution would be to have an optional second way to calculate the tax, other than the average earnings method, and allow each business to choose which it would use. In the 1940s, there was the invested capital method, which calculated excess profits by looking at profit above a reasonable return on invested capital based on prior years.[138] This may allow the calculation of excess profits to be more accurate by tailoring the calculation to the type of business. Also, the negative effect of incorrectly classified profits may be mitigated in cyclical industries because the excess profits tax will affect all companies in the industry.[139] Though the companies will not be able to keep their expected profits, at least neither will their competitors.

136. For example, development of pharmaceutical drugs takes many years. *See Nurturing Growth: Measuring the Return from Pharmaceutical Innovation 2021*, DELOITTE (Jan. 2022), at 13–14.

137. Driver, *supra* note 33, at 1210.

138. *See* Revenue Act of 1940, Pub L. No. 76-656, 54 Stat. 516. Avi-Yonah, *supra* note 38. This iteration of the tax, though complex, is much more accurate than the very first attempt in March 1917. *See* Revenue Act of March 3, 1917, Pub. L. No. 64-377, 39 Stat. 1000 (1917). In that statute, Congress assumed that normal profits constituted 8% of invested capital, and all profits above that were excess. *See* Yin, *supra* note 27, at 797. The 1940s iteration allowed individual companies to generate their own individual reasonable rate. *See* Avi-Yonah, *supra* note 38.

139. Driver, *supra* note 34, at 1211. This is assuming that their business models are on the same timeline, i.e., the one profitable year is the same year across companies, which may not be the case. But if each company has multiple projects with staggered timelines, it is more likely that the tax will affect all competitors similarly.

B. Targeting the Right Businesses

Another option to decrease the risk of taxing deserved profit is to target the tax on particular industries, rather than all companies. Some standout industries in particular have profited from the pandemic, such as delivery-based services and tech companies.[140] An excess profits tax applied only to particular industries may more correctly target excess profits than an across-the-board style tax. Yet, identifying the industries to be taxed would be complex. Characterizing individual companies as fitting within one particular industry would be a challenge, especially for large and diversified corporations with many types of services or products. More importantly, an industry-targeted approach assumes that the existence of pandemic profits follows industry divisions. It is not clear that pandemic profits occurred neatly within individual industries. Instead, a broad range of industry types were affected.[141] Essential products, such as toiletries and food, fall in a variety of industries. Companies that were able to pivot to delivery, either because their product enabled them to do so or because their market positioning allowed for it, also thrived. Clear winners in this regard were 3M, Zoom, and Amazon.[142] Products that could be delivered came from a wide variety of industries, from essentials like food to toiletries to anything else a quarantined individual might want, such as hobby supplies. A tax targeted to only a few industries would be complex and would likely miss capturing a range of pandemic profits.

C. Earmarking Tax Revenue

A subsequent concern is how the revenue is spent. Proposals for particular tax programs often include a plan for how their revenue should be spent. While advocating for a windfall tax on energy companies in 2008, President Obama stated that the revenues should

140. Sachin Nagarajan, *These Sectors Performed Best and Worst in the Pandemic*, MORNINGSTAR (Feb. 26, 2021), https://www.morningstar.com/articles/1026616/these-sectors-performed-best-and-worst-in-the-pandemic [https://perma.cc/GG5J-2G69].

141. Avi-Yonah, *supra* note 38.

142. *Id*. at 2.

be used to help families pay their high utility bills.[143] Similarly, former Representative Gabbard's proposal indicated the proposed tax's revenue should be earmarked for additional small business relief,[144] and a call for a pandemic profits tax by the charitable organization Oxfam argues that the tax's revenue should be funneled into pandemic relief.[145] Professor Avi-Yonah's proposal advocates using the funds to create an improved social safety net generally.[146]

While the best practical use of the tax money will depend on the status of the economy once it is collected, each of these potential usages is in line with the purpose of and justification for the tax. They either address the direct negative impact of the pandemic, which allowed the excess profits to bloom in the first place, or they generally address inequality and will dampen the effect of future disasters. Both goals are admirable. The more general goal of safety net improvement would allow the tax to be less complicated, in that there would be fewer constraints on the government's usage of the funds. This would make the entire project more feasible.

The amount of revenue for the government, while not negligible, is not likely to be significant over time.[147] During the short period of the tax, companies would be more inclined to keep earnings low.[148] This is why, when considering the repeal of the World War II excess profits tax in 1953, the Ways and Means Committee referred to it as "a tax of diminishing returns."[149] The revenue needed to fully solidify a safety net is therefore likely to exceed what an excess profits tax will bring in.[150] While this tax therefore cannot be justified by its ability to generate revenue long term, the sudden need for tax revenue

143. Daniel Nasaw, *Obama Wants Windfall Profits Tax on Oil Companies*, GUARDIAN (Apr. 25, 2008, 2:28 PM), https://www.theguardian.com/world/2008/apr/25/barackobama.uselections20081 [https://perma.cc/2SSP-PHC6].

144. H.R. Res. 1267, 116th Cong. (2020).

145. POWER, PROFITS, AND THE PANDEMIC, *supra* note 9.

146. Avi-Yonah, *supra* note 38.

147. *Id.*

148. This depiction of companies' actions assumes they are making choices after an excess profits tax has been enacted, or at least concurrently with political debate about such a tax. At the time of this paper's completion, any actual tax on pandemic profits would be retroactive. Because the tax is not currently politically feasible, the author has chosen to focus on the tax policy considerations from an academic perspective, and the retroactivity issue is not addressed.

149. H.R. REP. NO. 83-743, at 6 (1953).

150. Avi-Yonah, *supra* note 38.

does indicate we should be considering all possible sources. Given its other justifications, an excess profits tax is a good place to start.

V. EFFECT ON OVERALL EQUALITY

A. Vertical Equity

Fairness in the tax system is often understood in terms of horizontal and vertical equity.[151] Horizontal equity counsels that individuals in similar situations should pay similar taxes.[152] Vertical equity, the other side of the coin, counsels that individuals in different situations should pay different taxes.[153] That is, a taxpayer with a very high income should not pay the same exact dollar amount as a taxpayer with a very low income. This seems intuitively fair, and it is tied to the concept of ability to pay. In a very practical sense, the high earning taxpayers are more able to pay because they actually have the funds to pay a greater amount, where a low earner would run out of money. It is also important in terms of fairness because a higher tax is less of a burden on the high earner than it is on the low earner. If government needs revenue from somewhere, it seems fairer to tax high earners.

Relying solely on ability to pay can lead to some very difficult definitional problems which makes the theory hard to apply in practice.[154] The intuitions about fairness remain despite that. In the case of pandemic profits, the definitional problem of ability to pay is a non-issue because of the great disparity between excessively profitable companies and struggling Americans. Under any possible definition, those companies have a greater ability to pay. Regardless of whether profits are classified as deserved or undeserved, it is fairer to tax those companies for needed revenue.[155] But we can go one step

151. WILLIAM D. ANDREWS & PETER J. WEIDENBECK, BASIC FEDERAL INCOME TAXATION 12 (7th ed. 2015).

152. *Id.* In this instance "similar taxes" means a similar tax burden, that is, a similar proportion of their annual income or consumption potential.

153. *Id.*

154. HENRY SIMONS, PERSONAL INCOME TAXATION 17 (1938).

155. For a discussion of revenue, *see supra* Section IV.A.iv.

beyond typical vertical equity considerations to look at how the tax can improve overall equality.

B. Potential for Inequality Reduction

An excess profits tax has the potential to reduce inequality. Any tax, particularly one aimed at fairness and redistribution, should be designed to either lessen inequality or have a neutral effect. At present, there is a significant wealth and income gap among Americans.[156] The pandemic has exacerbated this existing problem. For example, high income jobs were more likely to transition to work from home, meaning high income individuals were more likely to remain employed and work safely.[157] Wealthy individuals are more likely to own homes, whereas less wealthy individuals are more likely to be imminently faced with housing insecurity when job loss hinders their ability to pay rent.[158] By redirecting funds in ways that will benefit taxpayers in general, the excess profits tax can slow down this aggravation of the disparity.

The interjection by the tax system to improve equality is further justified by companies' actions prior to and during the pandemic. These have worsened the wealth and income disparity and decreased overall fairness.[159] As workers and their families face the hardships of the pandemic, many companies have refused to provide hazard pay or laid off workers, which worsened those individuals' pandemic outcomes.[160] At the same time, companies donated only a very small amount of their profits to pandemic relief, an average of .32% of

156. *See supra* Part I.

157. Jim Tankersley, *Job or Health? Restarting the Economy Threatens to Worsen Economic Inequality*, N.Y. TIMES (Apr. 27, 2020), https://www.nytimes.com/2020/04/27/business/economy/coronavirus-economic-inequality.html [https://perma.cc/M7KY-A7N6].

158. *See* SOPHIA R. FOX-DICHTER, YUNG CHUN, STEPHEN ROLL, KATIE KRISTENSEN & MICHAL GRINSTEIN-WEISS, WASH. UNIV. IN ST. LOUIS: SOCIAL POL'Y INST., HOUSING HARDSHIPS DURING COVID-19 (Sept. 2021), https://cpb-us-w2.wpmucdn.com/sites.wustl.edu/dist/a/2003/files/2021/12/Survey-COVID-Housing_JPMC.pdf.

159. *See supra* Part I.

160. Many companies offered small pay increases for just a few months in mid-2020, but did not provide any other hazard pay despite the fact that employees faced ongoing risks. Kinder et al., *supra* note 8. In at least one case, this occurred concurrently with company efforts to prevent employees from organizing for improved benefits and treatment. *The Income and Wealth Inequality Crisis in America: Hearing Before the S. Budget Comm.*, 117th Cong. (2020) (statement from a warehouse employee in Bessemer, Ala. regarding Amazon's efforts to stop its employees from forming a union).

profit.[161] Lastly, companies did not distributing their extreme pandemic profits to their employees.[162] Instead, they have been giving out sizeable dividends and engaging in large stock buybacks.[163] While this was occurring prior to the pandemic, these activities are now being carried out with undeserved profit.[164] These factors exacerbate existing in equality at a time when many Americans are left with no options. An excess profits tax avoids worsening inequality by redistributing these profits, rather than allowing them to go to shareholders. Recapturing companies' top layer of profit with an excess profits tax allows for a more fair and equitable distribution of resources.

CONCLUSION

Along with life as we knew it, the ever forward-moving economy seemed to be suddenly derailed when the pandemic erupted across the globe. While many individual Americans experienced job loss and other losses of financial freedom, certain businesses were perfectly positioned to run full steam ahead. They accrued excessive amounts of profits due to good luck, which should be considered a windfall. An excess profits tax, similar to that used in earlier wartime crises, should be re-enacted to capture their undeserved profits. Given the pandemic's effect of worsening an existing inequality crisis, it would be appropriate to redistribute these profits through the tax system.

161. POWER, PROFITS, AND THE PANDEMIC, *supra* note 9. On top of that, the effective corporate tax rate for some companies is much lower than the flat statutory rate of 21%, which serves to reduce government revenue and exacerbate spending limitations. Patricia Cohen, *Profitable Giants Like Amazon Pay $0 in Corporate Taxes. Some Voters Are Sick of It*, N.Y. TIMES (Oct. 7, 2021), https://www.nytimes.com/2021/04/02/business/economy/zero-corporate-tax.html [https://perma.cc/LJ3A-ZVGB]. These lower effective rates are accomplished primarily by organizing operations so that profits are reported in low-tax countries. *Ending a Rigged Tax Code: The Need to Make the Wealthiest People and Largest Corporations Pay Their Fair Share of Taxes: Hearing Before the S. Comm. on Budget*, 117th Cong. 10–11 (2021) (testimony of Gabriel Zucman, Assoc. Professor of Econ., U.C. Berkeley), https://www.budget.senate.gov/imo/media/doc/Gabriel%20Zucman%20-%20Testimony%20-%20US%20Senate%20Budget%20Committee%20Hearing.pdf [https://perma.cc/7HNS-C3A4].

162. Ingraham, *supra* note 134.

163. *Id.* In an attempt to prevent these actions, the United States and France enacted a temporary ban on stock buybacks. *Id.*

164. POWER, PROFITS, AND THE PANDEMIC, *supra* note 9.

The proposal by Professor Reuven Avi-Yonah would achieve many of the goals of this tax, while avoiding some pitfalls. Additional credits to incentivize beneficial choices by businesses could be added to increase the net positive impact of the tax. While the revenue of this theoretical short-term tax may not be enough to solve all of our problems, it is an important step in reducing or slowing the growth of the national debt and creating a fairer system for taxpayers.