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Taxing Excessive Profits

Designing a Pro-Competition Corporate Tax System

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Introduction

Political polarization defines much of how Americans see their government and their economy. Yet the American public shares a widespread concern—across political, generational, and class lines—over the outsized power of incumbent corporations and their failure to pay their fair share of taxes. About 7 in 10 Americans—both Republicans and Democrats—say large corporations have negative effects on the country (Pew Research Center 2024). Almost half of registered voters who support Trump say major corporations in the US make "too much profit," and 65 percent of Trump supporters feel that corporations have "too much power" (Van Green 2024). Americans' pervasive frustration with unchecked corporate influence over the economy extends to their views on how best to tax large businesses. About two-thirds of Americans polled contend that tax rates should be raised, with almost 40 percent arguing that corporate tax rates should be increased "a lot." Again, this is not a partisan phenomenon: To be sure, 85 percent of Democrats support corporate tax increases, with almost 60 percent arguing to raise those rates "a lot." But, in stark contrast to previous decades, 45 percent of Republicans now support corporate tax *hikes*. Even self-identified "conservative" Republicans are almost equally divided between wanting to raise, lower, or maintain corporate tax rates (Oliphant 2023).

This convergence of views about the excess power of large corporations over the economy—especially in light of how much else in US politics is polarized—may seem surprising on the surface. But these views are consistent with the lived realities of average Americans and find strong support in the data. Rising market concentration in the United States—fueled by both the creeping power of corporations and their ability to underpay taxes—has weakened the US economy, exacerbated economic inequality, and fueled a general feeling of disempowerment and economic backsliding. Incumbent firms' growing ability to capture markets has been shown to change consumer decisions and distort incentives for innovation over time (Döpper et al. 2023). Recent research indicates that greater market power hampers wage growth (Azar, Marinescu, and Steinbaum 2019; Bivens, Mishel, and Schmitt 2018), increases inequality (Furman and Orszag 2018), and lowers investment (Eggertsson, Robbins, and Wold 2021; Farhi and Gourio 2019; Brun and González 2017; Gutiérrez and Philippon 2017), which in turn stunts productivity, market dynamism, and economic growth (Stiglitz 2012; Clausing 2024a). Market power is estimated to cost the typical American household $5,000 a year in higher prices, lower wages, and lost growth (Philippon 2019). Companies' ability to control markets, while simultaneously paying low effective tax rates, directly facilitates the explosion of corporate profits and markups, especially in the pandemic and post-pandemic period (Konczal and Lusiani 2022; Davis 2024).

"Competition" has been the leitmotif leveraged by corporate tax cut proponents for decades, from the 1986 tax bill under Ronald Reagan through to the 2017 Tax Cuts and Jobs Act (TCJA) under Donald Trump. The idea was that lowering the tax dues of US

corporations would strengthen their competitive advantages internationally. The less-discussed effect was that these reductions in the base and rate of the corporate income tax (CIT) disproportionately benefited large, multinational incumbent corporations, who were able to use these unearned tax advantages to extend their market dominance over smaller, domestic competitors—sometimes using their tax cuts functionally as cash reserves or "dry powder" to build market share by simply acquiring rivals. In this way, the tax cuts that proponents claimed would boost competitive advantages internationally instead reduced competition domestically, fueling the extensive and economically harmful corporate consolidation we see today (Brennan and Hudgins 2023).

This brief—originally presented as a discussion guide to the October 2024 convening "Promoting Equity and Efficiency: Rethinking Corporate Taxation to Address Market Power," hosted by the Institute for Macroeconomic & Policy Analysis and the Roosevelt Institute—establishes a groundwork for developing a truly pro-competition corporate income tax system, focusing in particular on the economic case for taxing the excess profits of large US businesses.[1] Section I of this brief summarizes how the current corporate tax code exacerbates harmful market concentration and how effective taxation of excess corporate profits, or business rents, could yield positive economic effects. Section II reviews lessons from the historical and contemporary examples of excess profit taxation. Section III explores different design options and draws out careful considerations to guide the development of a corporate income tax system capable of raising revenue, reducing harmful market concentration, and boosting healthy economic competition.

I. Market Power, Corporate Taxation, and the Role of the TCJA

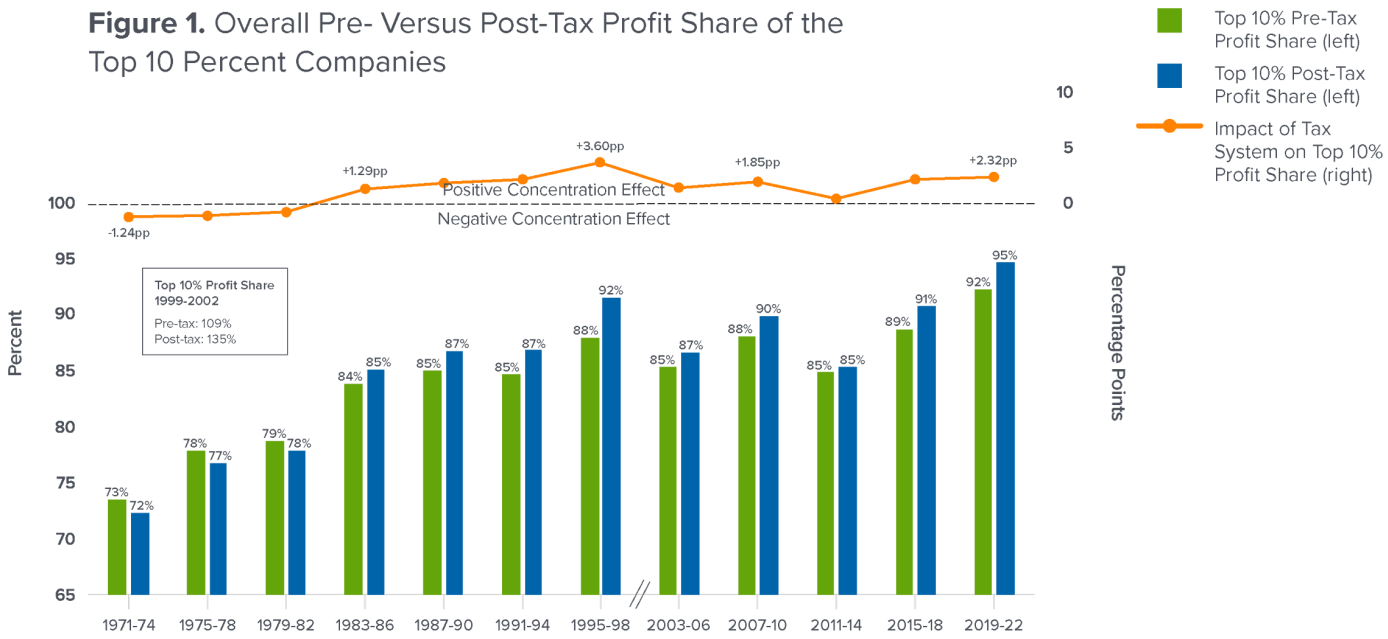
Underexplored until recently, the topic of how an increasingly anticompetitive US tax code exacerbates harmful market power has emerged in the literature over the past few years.[2] Federal tax provisions around tax-free reorganizations fuel certain types of all-stock merger and acquisition (M&A) deals by allowing sellers to defer (often indefinitely) the gain of their sale to avoid tax liabilities (Bearer-Friend 2018; Lusiani 2023a; Ramamurti 2024). The tax code also subsidizes harmful M&A by allowing some write-offs for the transaction costs of carrying these deals to fruition. The federal tax code also fails to prevent corporate tax avoidance, which benefits US multinationals

[1] The authors define *excess profits*, or economic/business rents, in this brief generally as individual company earnings that moderately exceed a safe rate of return on capital. See more on definitional debates under Defining Normal Returns and Excess Profits (i.e., Business Rents) on page 14.
[2] See, for example, Bearer-Friend 2018; Avi-Yonah 2020a; Clausing 2024b, 2024b; Christians and Magalhães 2024; Brun, González, and Montecino 2023; Fox and Liscow 2020; Lusiani and DiVito 2024; and Ramamurti 2024. For more on the US tax code's impact on market concentration, see the Taxing Monopolies series curated by the Roosevelt Institute.

with the resources to engage in large-scale tax avoidance practices, to the detriment of their domestic competitors (Clausing 2024a). Relatedly, large incumbent firms uniquely benefit from Internal Revenue Service (IRS) budget cuts and the resulting weakening in large corporate enforcement activities. Audit rates of these large firms dropped from 10.5 percent in 2011 to 1.7 percent in 2019 (IRS 2023) as a result of steady reductions in the IRS budget during the 2010s. While partially addressed by the investments in tax administration in the Inflation Reduction Act (IRA), the lax tax treatment enjoyed by large, complex corporate filers with well-paid tax teams has likely been leveraged into tangible business advantages over smaller competitors (Lusiani 2023b). State and local tax policies, including economic development subsidies, also tend to privilege large incumbents over their competitors (Mitchell and Holmberg 2023).

Taking all of these anticompetitive effects together, a recent study comparing the overall effects of the US tax code on the profit share of large and smaller corporations found that the largest 350 US public corporations by revenue have increased their after-tax share of total corporate profits for decades. Between 2019 and 2022, the profit share of the top 10 percent of firms went up a full three percentage points after factoring in federal, state, and foreign tax payments (Hager and Baines 2023), suggesting the tax structure as currently designed tilts the business playing field toward the most profitable corporations.

Figure 1. Overall Pre- Versus Post-Tax Profit Share of the Top 10 Percent Companies

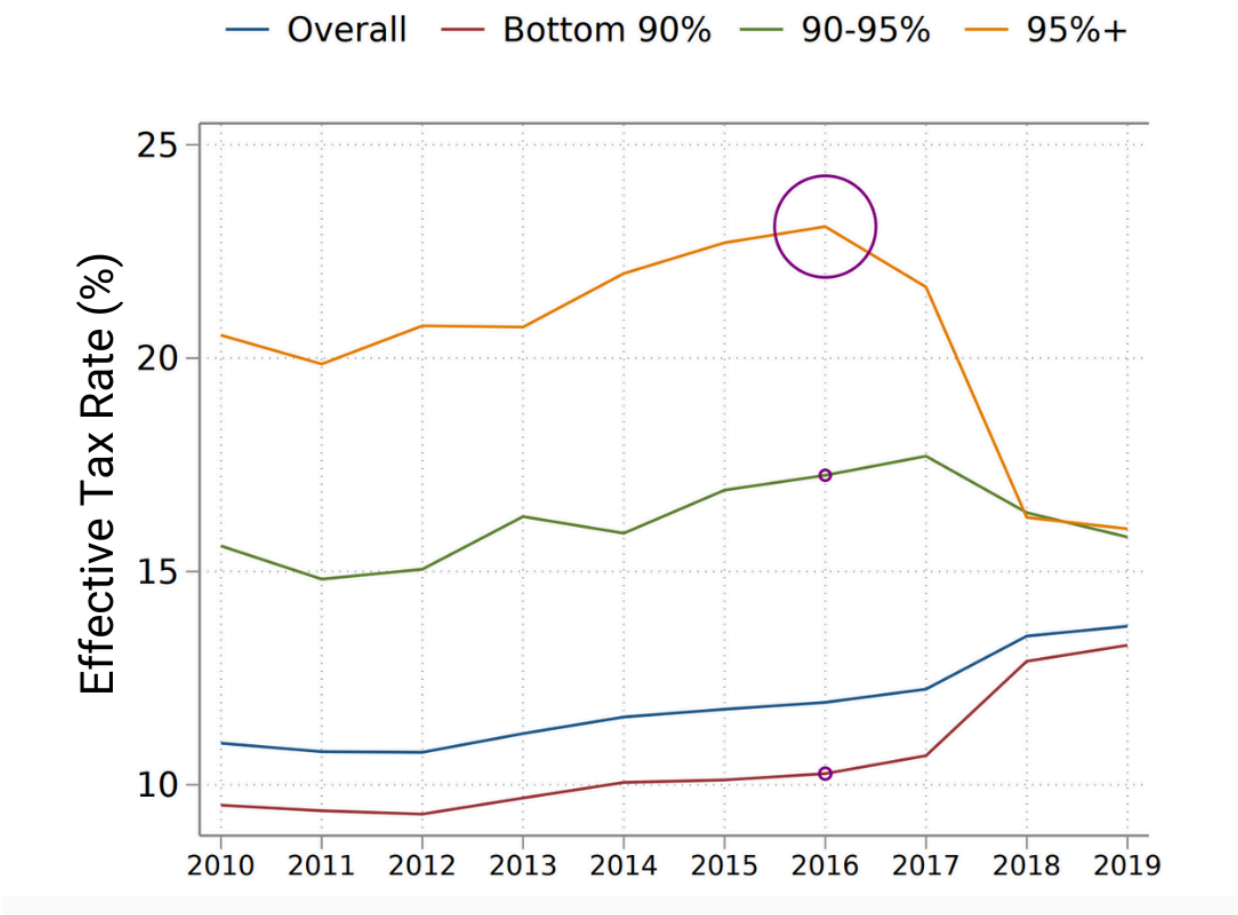


Source: Hager and Baines 2023

TCJA Corporate Tax Cuts Exacerbated Pro-monopoly Bias in the Tax Code

Among other things, the 2017 Tax Cuts and Jobs Act (TCJA) replaced a mildly progressive graduated corporate income tax rate structure with a flat 21 percent rate. A recent study by economists from the Federal Reserve Board and the Joint Committee on Taxation found that the flat 21 percent rate exacerbated the tax advantages large corporations enjoy over their smaller competitors. As shown in Figure 2, the top 5 percent of corporations saw their effective tax rate (ETR) drop 32 percent on average (from roughly 22 to 15 percent) between 2016 and 2019, while the TCJA *increased* the ETR paid by smaller corporations by around 40 percent (from approximately 10 percent to roughly 14 percent) (Dobridge et al. 2023). While more research is needed, this change likely exacerbated the tax code's bias toward market concentration.

Figure 2. Effective Tax Rates for C-Corporations by Firm Size (Sales): Before and After TCJA



Source: Dobridge et al. 2023

The Economic Case for Higher Taxes on Excess Earnings

To counteract the advantages that highly profitable market incumbents enjoy from the tax code, a growing number of economists and tax scholars are substantiating the economic case for taxing excess corporate earnings (also called rents) at higher rates than more routine profits. Establishing a threshold for what is considered excess and normal returns and thus drawing a distinction between them is challenging, especially if corporate income has immediate cost write-offs and no interest deductibility (see p. 14 for more on defining this threshold). That said, in some views, normal returns can simply be considered as safe and risk-adjusted returns on investment.

The changing legal structure of the corporate tax (e.g., more immediate deductibility of capital investment) has meant that the corporate tax increasingly taxes rents, or excess profits, over normal returns. Today's corporate tax base (i.e., the total amount of taxable income actually subject to the corporate income tax) is made up mostly of taxes on pure profits, and economic rents constitute a growing proportion of overall corporate profits. A recent study from International Monetary Fund (IMF) researchers found that from 2011 to 2017, 70 *percent* of the total profits of 10,000 large multinationals were excess profits, or economically inefficient rents. Notably, US multinationals are responsible for one-third of these excess profits (Beer et al. 2023). This IMF study corroborates other empirical evidence that finds that excess profits comprise the lion's share of the US corporate tax base (Hebous, Prihardini, and Vernon 2022; Fox 2020; Power and Frerick 2016).

As a result of these two trends, as Edward Fox and Zachary Liscow describe, "hitting these supernormal returns—usually known as 'economic rents'—is a sweet spot because taxing them is likely to be both economically efficient and distributionally progressive" (Fox and Liscow 2020; González, Montecino, and Stiglitz 2024). Contrary to what conventional economic theory says about taxing normal profits—that it raises revenue at the expense of overall economic growth—taxing rents raises revenue without compromising economic growth because rents are economically harmful. As long as the excess profits tax doesn't affect the normal returns, the tax rate on rents won't adversely affect investment decisions and thus can be considerably higher (Hebous, Prihardini, and Vernon 2022; Clausing 2024b; Fox and Liscow 2020). Intuitively, the profits that constitute the "normal" return on investment can be critical to retain as savings for future investments to propel business opportunities and to build "new capital." But taxing profits beyond the normal return does not deter investment, since firms' investment choices do not affect the amount of tax (González, Montecino, and Ramaswamy 2024).

Taxing corporate rents—for example through a graduated corporate income tax rate with high rates on high profits—would do more than raise a considerable amount of revenue (Clausing 2024a) that can be invested in pro-growth public programs. If designed right, taxing business rents can also support the country's broader efforts to

expand useful economic activities, such as clean-energy jobs, through tax-based industrial policy.

Taxing supernormal profits should enhance the responsiveness and thus effectiveness of clean energy and other investment tax credits because these credits are quite sensitive to the tax rate structure. The tax credits provided by the IRA, for example, are more valuable for very profitable firms facing higher marginal rates. That is, with a higher marginal rate, each dollar of credit realizes higher tax savings, so the effectiveness of the investment incentive is larger as one moves up the rate schedule. Taxing excess profits at higher rates—paired with tax credits and deductions aimed at stimulating climate investments and ensuring high-quality clean energy jobs—could provide a triple whammy of reducing rents in the economy, supporting job creation in strategic industries, and mitigating the negative economic effects of climate change.

Finally, and perhaps most importantly, more effectively taxing supernormal profits would reduce the power of incumbents and level the economic playing field currently tilted against small businesses, innovative startups, and new entrants. This would enhance a key regulatory or corrective function in the economy that the corporate tax structure executes (Richards 2019; Bearer-Friend et al. 2022; Pigou 1920; Kaplow and Shavell 2002). Taxing incumbent companies experiencing excess profits ("old" capital) boosts the competitiveness of newer, more innovative entrants and in turn reduces the significant concentrations of market power described above. Proponents of taxing excess profits at higher levels argue that the increasingly higher marginal rates would continually disincentivize rent-seeking, M&A, and market concentration more generally, while opening more avenues for fair competition by market entrants (Clausing 2024a; Ramamurti 2024; Avi-Yonah 2020a; Bearer-Friend 2018).

II. Lessons from Historical and Contemporary Examples of Taxing Excess Corporate Rents

Taxing excess profits at higher rates than ordinary, routine profits is hardly a novel idea. Industrialized countries across the world have been doing so for over a century, with administrative and revenue-raising success.

The United States has a long history of taxing excess profits at higher rates than routine or normal profits. From 1917 to 1921, the US joined many other countries involved in World War I to impose a "war-profits tax" and an "excess profits tax." With top-end rates of 65 and 80 percent respectively, these taxes were intended to raise revenue for the war effort, properly distribute the economic burden of the war, and prevent opportunistic firms from taking advantage of the war to boost short-term profits (Musgrave and Seligman 1944; Hebous, Prihardini, and Vernon 2022). When international war struck again in 1939, the US returned to taxing excess profits (Avi-Yonah 2020b). The World War II excess profit tax (EPT) regime lasted for five years

after the war, raising significant revenue to rebuild. Starting with the 1935 Revenue Act, the United States was also one of the early adopters of a graduated corporate tax rate structure with the express aim of leveling the playing field between market dominants and smaller competitors (Avi-Yonah, DiVito, and Lusiani 2024; Bank 2013). Even today, the basic concept of taxing inefficient corporate rents at higher rates than normal returns is found in other parts of the US tax code, including a 10.5 percent minimum tax on global intangible low-taxed income (GILTI), which defines the "non-routine" taxable profit as the total foreign income earned exceeding 10 percent of the firm's depreciable tangible property (Tax Policy Center n.d.).

Looking abroad, almost every European country has implemented some form of windfall tax in the face of recent pandemic and war-related shocks, especially in the banking and energy sectors (Hebous, Prihardini, and Vernon 2022; Avi-Yonah and Shanan 2024). Targeting skyrocketing oil and gas profits, the United Kingdom implemented a temporary energy profits levy of 25 percent on excess profits in the oil and gas sector in June 2022 (Baunsgaard and Vernon 2022). Ravaged by volatile energy costs following Russia's invasion of Ukraine, the European Union (EU) Council formally approved an emergency EU-wide windfall tax in October 2022 to address high energy prices (EU Council 2022). Several countries—including Romania, Greece, Italy, Spain, and Hungary—enacted further efforts to tax abnormal profits by electricity utility companies (Baunsgaard and Vernon 2022). Beyond the energy sector, a number of European countries also imposed new measures to tax abnormal profits in the finance sector in 2022 and 2023 (Reuters 2023). Spain introduced a windfall profits tax on banks for 2022 and 2023, Lithuania imposed a "bank windfall tax" of 60 percent on net interest income, Italy levied a one-off 40 percent tax on profits banks reap from higher interest rates, and Hungary settled on a windfall tax on banks and airlines. All in all, IMF researchers analyzing contemporary excess profit taxes across countries found that the average top-end marginal EPT rate is 58 percent, with the average top profitability threshold at 28 percent (Hebous, Prihardini, and Vernon 2022). The concentration of these windfall taxes in the hydrocarbon and financial sectors may be explained in part by the relative ease of determining real-time windfalls in sectors with more observable input costs.

Many countries—including Australia, Belgium, Canada, France, Japan, the Netherlands, Portugal, and the United Kingdom—also use a moderately progressive graduated corporate income tax rate system, which taxes higher profits at marginally higher rates. In most iterations of these graduated rate systems, as shown in Table 1, the difference between low-end and high-end rates is not huge. These countries' graduated rates may provide a tax leg up to smaller firms but likely do little to curb market power and the attendant economic distortions.

Table 1. Current Graduated CIT Rate Systems in Select Industrialized Countries

Country	Standard Graduated Statutory Rates (%)[3]
Australia	25 - 30
Belgium	20 - 25
Canada	9 - 28
France	15 - 25
Japan	15 - 19 - 23.2
Netherlands	19 - 25.8
Portugal	12.5 - 17 - 21
United Kingdom	19 - 25

Source: PwC - Australia; Belgium; Canada; France; Japan; Netherlands; Portugal; United Kingdom

Several lessons can be drawn from these historical and contemporary examples to inform the design of a newly restored corporate excess profit tax system in the US. First, ***sector-specific rent taxation*** (e.g., oil or banking windfall taxation) can increase the tax contributions of particular actors at particular points in time, capturing windfall gains that certain sectors accrue at the expense of others and possibly plugging some fiscal holes. Targeting a specific sector has also the benefit of simplicity, and the limited number of firms subject to the tax makes its effects more observable. But sector-specific taxation is less effective at reducing market concentration (Avi-Yonah and Shanan 2024) and thereby fostering the macroeconomic benefits that come with healthy competition.

Second, ***temporary taxation of excess profits*** can be more easily avoided and doesn't provide the signals that a permanently graduated rate would in shaping markets going forward. Similarly, although ad hoc taxation of *windfalls alone* (e.g., "war profits" or "pandemic profits") could be justified to respond to particular emergencies, this approach reduces the number of firms subject to paying excess profits and becomes difficult to sustain over time as the unexpected events leading to the windfalls disappear (Avi-Yonah and Shanan 2024). Designing the tax rate around a particular moment in time—such that excess profits are measured against a past period (e.g., pre-pandemic or prewar)—may capture the windfall portion of the rents but fails to tax incumbent firms' baseline monopolistic rents prior to any given shock. In the US, market power rents (as measured by markups) have grown steadily for decades across business cycles and across economic shocks, including during the pandemic and the subsequent upturn in inflation (Konczal and Lusiani 2022; Davis 2024). A temporary tax approach would not curb these longer-brewing economic distortions. While an excess

[3] These are standard rates that do not take into account any specific deductions and do not include any additional subnational rates nor supplementary industry-specific excess profits taxes.

profits tax creates the space to effectively distinguish between industries, the benefits of distinguishing profits based on industry are unlikely to outweigh the advantages of a simple, and less gameable, system that works across time and across sectors.

Third, and crucial to the US context, any excess profit tax system should be neutral to all business forms so as to ***prevent avoidance through restructuring***. All highly profitable businesses, including privately held corporations and large pass-through firms over a certain threshold, should be subject to the corporate regime at the business entity level, not passed through to the personal level (Clausing 2024a; Fox and Liscow 2020; Furman 2020; Congressional Budget Office 2012). Because current tax provisions contain many different definitions of what constitutes "large" versus "small" businesses, setting the threshold of what constitutes a large pass-through firm subject to excess profits will be challenging but surmountable. The tax system would also need to implement aggregations rule provisions to prevent companies from choosing their own regime by simply spinning off entities for tax purposes (Johnson et al. 2024).

Fourth, the excess profit tax system would have to include robust anti-avoidance provisions to prevent highly profitable corporations from avoiding the higher-end rates by, for example, ***acquiring loss-making companies*** with the purpose of reducing their overall taxable income under the higher rate brackets. Allowing mergers and acquisitions whose sole aim is to reduce an entity's tax base would have the perverse incentive of fueling increased corporate concentration. Increased cooperation between the IRS and antitrust agencies would be useful to identify those merger filings driven primarily by tax planning. Antitrust agencies may also need to revisit merger filing thresholds. And more research is needed to determine specific methods to distinguish purely tax-motivated mergers from others.

Fifth, and inversely, companies subject to higher rates on excess profits may choose to split up into a number of less profitable companies to remain under higher rate thresholds. As Reuven Avi-Yonah (2020) has pointed out, this is a feature, not a bug, of the proposal. Higher top-end rates would incentivize firms to divest some of their holdings, with an overall effect of reducing the consolidation of American enterprises. That being said, legislative provisions must ensure that divested or spun-off companies are not separated merely for tax purposes but are ***truly separate economic entities with distinct ownership, control, and governance*** (Clausing 2024a). Antitrust agencies would also need to monitor and prevent these forms of tax avoidance.

Lastly, taxing the excess profits of US multinational corporations is complicated by the fact that many of these same firms excel at artificially shifting their profits to low-tax countries to avoid paying US corporate income tax. In the absence of base protection measures, a higher top-end rate would incentivize domestic and global corporate tax avoidance. Therefore, a modern graduated rate system requires ***complementary domestic and international measures to reduce global profit-shifting opportunities***. Large economies such as the US can act unilaterally to tax the business rents of its

multinational corporations. Mandating that corporate taxpayers report and pay using a *worldwide consolidated returns approach* (which taxes at the conglomerate level rather than at the level of individual subsidiaries) would significantly reduce corporate gaming of the new higher rates (Avi-Yonah and Shanan 2024; Clausing 2024a). In tandem with strengthening anti-inversion rules and fixing GILTI by equalizing foreign and domestic rates (see, for example, the No Tax Breaks for Outsourcing Act [2023]), the US might also consider imposing some form of exit tax to disincentivize large multinationals from moving residency outside the US (Avi-Yonah 2020a). Alongside these domestic measures, the US would be well-served by aligning with international standards to counter multinational tax avoidance. This would include strengthening Organisation for Economic Co-operation and Development (OECD) Inclusive Framework initiatives, especially implementing a robust global minimum effective tax rate (ICRICT 2024) and over time moving toward a unitary taxation model with formulary apportionment (Avi-Yonah and Shanan 2024; Hebous, Prihardini, and Vernon 2022; Clausing 2020).

III. Designing a Pro-competition Excess Corporate Profits Tax

We can learn a lot from past and current efforts to tax excess corporate rents. Inevitably, however, key questions remain about the optimal design of a tax on supernormal rents at higher rates than normal profits through a graduated rate structure. The preferred design ultimately depends on which objectives lawmakers prioritize: revenue, redistribution, reducing market power, or a combination of the three. This section provides a number of considerations for designing a corporate income tax system to raise revenue, reduce harmful market concentration, and promote healthy competition.

Recognizing the Various Roles the Corporate Income Tax Plays in the Economy

The corporate income tax—depending on its design and effect—serves a variety of functions in the economy, oftentimes simultaneously. Constraining ourselves to prioritizing one function (say, promoting productive investment) versus another (say, raising revenue) not only reduces our policy imagination but also creates blind spots to evaluating the economic benefits of taxing excess corporate profits. Broadly speaking, the corporate tax has four essential functions: (1) revenue, (2) redistribution, (3) representation,[4] and (4) regulatory aims that promote efficiency (DiVito and Lusiani 2024), with the taxation of excess profits being particularly important for its potential

[4] Fundamentally, the tax code symbolizes the state's contract with its citizens and residents. When that breaks down—or is seen as corrupt, discriminatory, or otherwise unfair—so does the public's trust in government. When the tax code delivers for people, however, the bonds of trust and meaningful representation are strengthened.

to raise public revenue and to regulate or structure markets competitively. Drilling down further into this regulatory role of the corporate tax in incentivizing productive investments, the corporate tax can act as a tax on corporate capital, on entrepreneurship in the corporate sector, on pure corporate profits, and on risk-taking (Stiglitz 1976).

Given that the US after the TCJA allowed corporations to fully expense (Tax Policy Center n.d.)[5] not only inputs such as labor and intermediate goods but also many types of capital expenditures, attempts to portray the current US corporate tax as a capital tax that necessarily disincentivizes investment are difficult to sustain. In reality, corporations are able to write off most of their expenses (including capital expenditures) and deduct (as well as carry forward) most losses. In essence, the federal government incentivizes the risk that companies take by allowing deductions for that expenditure. In other words, the corporate income tax encourages risk-taking, with the government as a silent partner (Stiglitz 1976). While the US tax code today does not have perfect loss offset provisions and interest is still deductible (such that corporate investments may even be subsidized through the tax system), the US corporate income tax is much closer to a tax purely on profits than a tax on capital. Flowing from this view of the corporate tax, corporate taxation (including taxing excess profits) is less likely to discourage investment; in fact on net, the corporate tax (especially if designed to target excess profits and provide sensible expensing provisions) may well encourage productive investment (González, Montecino, and Stiglitz 2024). Recognizing the various roles of the corporate tax in this way can help address concerns over the supposed trade-offs between raising public revenue on the one hand and incentivizing economically useful business investments on the other. Promoting both equity and efficiency is possible when taxing excess profits; it all depends on getting the design details right.

Defining Normal Returns and Excess Profits (i.e., Business Rents)

Establishing a threshold above which to impose excess profits taxation requires drawing a line between "normal" and "excess" returns. This can be challenging. One view doesn't see much of a distinction between excess and "normal" profits: If corporate income already enjoys an immediate write-off of costs and no interest deductibility, the corporate income tax is essentially a tax on pure profits (Stiglitz 1976). Another view defines "normal" profits as the minimum expected earnings of a firm in a fairly competitive market: Individual company earnings that moderately exceed a safe rate of return on capital are a baseline expectation for companies operating on a level

[5] The TCJA's full expensing or bonus depreciation provision—allowing businesses to immediately deduct 100 percent of the cost of eligible short-lived capital investments in the year they are made—went into effect in late 2017, began to gradually phase out in 2023, and, with no legislative changes, will expire after 2026.

playing field. For a business to take on the effort and risk of operating, some argue, normal profits need to include a safe return on the investment plus a risk adjustment to account for unexpected occurrences (Hebous, Prihardini, and Vernon 2022). As shown in Figure 3, excess profits could be defined as essentially any returns above and beyond a safe, risk-adjusted return.

Figure 3. Defining Excess Profits

Total Profits = Normal Profits + Excess Profits				
Normal Profit		**Excess Profits / Economic Rents**		
Safe Return	Risk Adjustment	Market power rents	Place-based rents	Windfalls

Source: Authors' elaboration based on Hebous, Prihardini, and Vernon 2022.

Excess profits are generated by different factors, as laid out in Figure 3. ***Market power rents*** arise from a firm's ability to charge prices above competitive levels due to factors such as limited competition, barriers to entry, or monopolistic practices. Gains from intellectual property can also be seen as a state-sanctioned form of market power rents, which may or may not have broader benefits depending on the case. Business profits derived from market power may at the outset stem from higher skills or entrepreneurial talent, but over time, the persistence of an excess profit suggests a degree of entrenched and economically harmful market power based more on the ability to reduce market entrants and competition.

Excess profits could also be ***place-based***, such as when a business receives income from holding land or natural resources, beyond whatever investments the firm in question made. Lastly, ***windfall profits*** are business rents generated by companies leveraging extraordinary and unexpected events, such as wars, pandemics, and natural disasters (Hebous, Prihardini, and Vernon 2022) or even transitory excess profits due to new market opportunities. In certain cases, corporations can generate these rents via price collusion opportunities presented by such extraordinary events or shocks (Weber et al. 2024).

In principle, any of these excess returns can be taxed without significant economic trade-offs. Taxing these rents is unlikely to create significant distortions, as it targets the firms' ability to extract surplus value from consumers or suppliers rather than productive investment. Windfall taxes are also generally considered non-distortionary since they arise from circumstances beyond the control of business owners and leaders. Taxing place-based rents, such as natural resource royalties, could marginally influence investment decisions by altering the expected returns from resource extraction projects. However, the large swings in the returns in these assets are less a product of entrepreneurialism and risk-taking than the result of broader macroeconomic changes, such as global demand shifts.

With that context, how should a threshold between normal and excess profits be defined for the purposes of more effectively taxing excess profits? Two leading methods are available to define excess profits. One approach would be to use a *specific profit margin*, *notional rate of return*, or *corporate markup* as a proxy for a routine profit and then begin a graduated marginal rate from there (Beer et al. 2023). The benefit of this approach is that it is easy to communicate and is used by existing US law (e.g., GILTI, as described above, uses a 10 percent return) as well as within the OECD Base Erosion and Profit Shifting (BEPS) process. The main downside is that this approach may privilege some sectors with structurally lower profits (e.g., manufacturing) over other high-profit sectors—including those relying on intellectual property rights such as pharmaceuticals and technology (Avi-Yonah and Shanan 2024). It may also be difficult to find consensus on the precise percentage, especially given different dynamics across industries. For example, the 10 percent threshold used in current law via GILTI is arguably far too high to approximate a normal return.

A second option would be to define excess profits based on the size of corporate income, as is commonly done in the US tax code already. Any earnings under a certain bracket could be considered normal profits and more lightly taxed, while taxable income above that threshold would be increasingly taxed up to a top corporate income bracket. Kimberly Clausing (2024a) and Avi-Yonah (2020a) propose this method in their graduated corporate income tax rate proposals. In Clausing's proposal, the first bracket begins at $100 million in taxable profits—notably much higher than the pre-TCJA lowest bracket of $50,000. The highest marginal rate would kick in after $10 billion in profits in both proposals. Using level of income is an imperfect way to approximate excess returns, as certain low-margin but very high-revenue companies would be included. This income-based method may also give companies more room to game how they report taxable income. However, this approach is particularly convenient because it can draw on decades of administrative use in the US context, is simpler and more self-explanatory, and can clearly build on the thresholds set out in the graduated corporate tax schedule established for decades prior to the TCJA.

Promoting Productive, Pro-public Investment Through Expensing and Tax Credits in Tandem with a Higher Rate on Excess Profits

Intricately tied to the definition of the excess profits subject to higher rates is the question of what types of business expenses should be deductible, and when. As mentioned above, allowing full expensing while disallowing interest deductibility would move the corporate tax much closer to a pure profits tax, which effectively exempts the normal return. The TCJA's experiment with "bonus depreciation" has taught us that full expensing without an associated rate hike on excess profits nor a full stop to interest deductibility leads to significant revenue losses, creates tax shelters, and provides yet

another unearned benefit to large corporations (Wamhoff, Gardner, and Marasini 2023). In practice, the TCJA's bonus depreciation amounts to an interest-free loan from the federal government (Wamhoff and Phillips 2018). Yet if paired with significantly higher effective rates on excess profits, such a system could level the playing field by reducing effective tax rates for low profitability companies close to zero and boosting taxes paid by high-profit companies without affecting investment decisions. That being said, two sets of issues arise beyond the specific challenges of identifying excess profits.

First, a higher rate on excess profits paired with full expensing and interest deductibility would provide a net tax subsidy to investment and accelerate the existing incentives to overstate expensing, especially among those companies facing the highest marginal tax rates. Limiting practices wherein firms inflate or misreport expenses to reduce their taxable income would require increased corporate financial transparency over the real nature of expensed investments (especially research and development [R&D] expenses, which can be easily manipulated). The IRS would need more financial and human resources to closely monitor and audit the accuracy and reasonableness of business expenses among the top-profit companies subject to the higher rates. That being said, the higher rates would only apply to approximately 350 large, already well-known corporations (Clausing 2024b) that the revenue authorities have been dealing with for decades.

Second, not all business expenses are economically beneficial, and thus allowing deductions for harmful business spending will not result in useful activity. Allowing write-offs for the transaction costs of certain mergers and acquisitions, for example, does not improve market competition but incentivizes concentration. This amounts to a powerful tool corporations can leverage to artificially expand their competitive advantages and erect market barriers to entry. These sorts of anticompetitive business activities should be disqualified as deductible business expenses.

While expensing, depreciation, and deductibility rules can quicken the pace of investment in an excess profits tax system, tax credits are essential signals to ensure the direction of investment and innovation is productive, sustainable, and pro-public. While perhaps not intuitive, taxing excess business rents at significantly higher rates would likely support the US's broader efforts to expand useful and strategic economic activities, such as clean energy employment, through tax-based industrial policy. Because clean energy and other investment tax credits are quite sensitive to the tax system, taxing supernormal profits at higher rates compared to today's flat 21 percent rate can enhance the responsiveness and thus effectiveness of these tax credits. Assuming the base stays the same, increasing marginal tax rates also increases a company's tax bill, which in turn increases the value of tax credits.

One unintended consequence of combining a high excess profits tax rate with effective investment tax credits is that the most profitable firms might be in a better position to uptake more credits than less-profitable companies. Those tax-subsidized investments

would create more value for the more profitable companies, creating the perverse effect of expanding the market share of big players over smaller ones in particular industries. In this sense, policymakers should be aware of trade-offs between the positive effect of higher marginal top-end rates on the effectiveness of tax credits on the one hand and the possibility of worsened market concentration on the other. Outreach efforts to smaller competitors about the availability of these tax credits, and increasing the ease of access to them, can reduce information and compliance asymmetries. Market share or manufacturing caps could also be put in place to distribute the benefits across firms, similar to what the pre-2022 electric vehicle tax credit did. The credits should also be designed as much as possible to reward the desired activity rather than the level of firm profits. And refundability of tax credits can extend their benefits to a larger cross-section of firms irrespective of their level of profits.

Protecting the Excess Profits Tax Base from International Tax Avoidance

As discussed above, imposing higher tax rates on the monopolistic rents received by largely US multinational corporations—without proper base protection measures—could indirectly incentivize tax avoidance. All else being equal, a higher statutory rate on higher taxable business income would put more pressure on the existing base erosion measures, such as anti-inversion rules, GILTI rules, the base erosion and anti-abuse tax (BEAT), the corporate alternative minimum tax (CAMT), and the enhanced IRS funding provided by the IRA. As discussed above, various domestic measures (e.g., mandating a worldwide consolidated returns approach, equalizing the rates on foreign and domestic income, levying exit taxes) and international coordination measures (e.g., implementing the global minimum effective corporate tax rate, unitary taxation) are essential to protect the base of a new excess profits or graduated corporate tax rate system. A related option could be to improve either the GILTI tax or the CAMT by applying the taxes across the world on a country-by-country basis. Additional resources for tax enforcement would also do wonders to protect the tax base and would more than pay for themselves with the additional revenue gained.

Setting Statutory Rates That Raise Revenue *and* Reduce Harmful Market Concentration

Lastly, in light of the above discussion over the design of the base of an excess corporate profits tax, what should the rates be to both raise revenue and effectively level the economic playing field? Taking the top rate first, it should be high enough to influence the behavior of a small number of highly profitable incumbent firms with significant market power while also raising revenue. Two current proposals provide a range for the top-end marginal rates between 35 percent (Clausing 2024a) and as much

as 80 percent (Avi-Yonah 2020a) for taxable income above $10 billion. A separate cash flow tax proposal suggests a top rate of around 50 percent, which is around the statutory rate that the United States had from the 1950s to 1970s (Fox and Liscow 2020). The Clausing (2024a) proposal of a graduated corporate income tax rate system with a rate schedule from 21 percent at the low end to 35 percent at the high end could raise over $90 billion per year.[6] Given the concentrated nature of corporate profits, the grand majority of corporate taxpayers would not face tax increases in this system, which would more accurately target the inefficient corporate rents than the current flat rate does. This design option appears to meet the revenue test, but further research could identify whether a 35 percent top-end statutory rate is high enough to have the desired behavioral effects of reducing market concentration and enhancing competition.

Turning to the bottom end, what rate should very low-profit companies pay? On the one hand, reducing the tax burden of very low-profit companies generally enhances fair competition by giving entrants a leg up. If full expensing and disallowance of interest deductibility sat alongside high top-end rates, a bottom threshold could be designed to equate to normal profits, so companies would continue to be incentivized to invest in productive capacity. On the other hand, an excessively low effective rate on small profit levels would also provide a strong incentive to game the system by artificially reducing paper profits and would pose its own economic challenges. Further, corporations contribute taxes not only for economic reasons but also to both pay for the benefits of incorporation and provide public goods that create substantial advantages to doing business in the United States. Effectively zeroing out the low rate would disregard these public costs involved with incorporation. A balance should be struck here involving a lower but reasonable rate on low returns to support competition while raising some revenue to offset the public costs of protecting the corporate form.

Conclusion

Across the political divide, Americans are hungry for policies that reduce the concentrated economic power of large corporations. As federal, state, and local policymakers across the US grapple with the interrelated challenges of market concentration, public revenue needs, and growing inequality, this brief provides a series of considerations for developing pro-competition corporate tax reform. Several critical insights can guide future policy design: The low and flat corporate income tax rate system imposed by the TCJA has exacerbated the preexisting anticompetitive bias in the corporate income tax code. Excess corporate profits (or business rents) constitute a significant portion of overall corporate profits today. More effectively taxing supernormal returns is a rare economic “sweet spot” likely to be both economically efficient and distributionally progressive. When properly structured to target business

[6] This is a static estimate that does not incorporate behavioral response.

rents (potentially by allowing full expensing of useful business costs while disallowing interest deductibility), higher taxes on excess profits won't be distortionary but—especially when paired with forward-looking tax credits like those in the Inflation Reduction Act—would encourage real investment, fuel shared growth, and support US economic policy objectives.

Looking ahead, successful implementation of a renewed tax on excess profits will require careful attention to several key design elements discussed in this brief. The tax system must be neutral across business forms to prevent avoidance through restructuring. It should establish clear and administrable definitions of excess profits, and domestic and international enforcement mechanisms must be robust enough to ensure compliance.

A thoughtfully structured corporate tax reform focused on excess corporate profits could yield significant benefits for economic efficiency, distributional equity, economic deconcentration, and overall market competition.

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Appendix

Select participants at the joint Institute for Macroeconomic & Policy Analysis (IMPA) and Roosevelt Institute convening “Promoting Equity and Efficiency: Rethinking Corporate Taxation to Address Market Power”

Name	Affiliation
Josh Bivens	Chief Economist, Economic Policy Institute
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Zorka Milin	Policy Director, FACT Coalition
David Mitchell	Washington Center for Equitable Growth
Juan Montecino	IMPA
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Nabil Ahmed	Director of Economic and Racial Justice, Oxfam America
Joseph Stiglitz	Columbia University

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