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COST ESTIMATE OF AN EXCESS PROFITS TAX

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The Parliamentary Budget Officer (PBO) supports Parliament by providing economic and financial analysis for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.

This report estimates the federal corporate income tax revenues that would be generated if an additional 15 percent tax rate was applied to excessive profits earned by big firms in 2020.

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Executive Summary

This report is based on a request by Member of Parliament Peter Julian (New Westminster-Burnaby) to estimate the cost of introducing an "excess profit tax on big corporations that have been profiteering from the pandemic."[1]

Specifically, this report estimates the federal corporate income tax revenues that would be generated if an additional 15 percent tax rate was applied to profits that met the following criteria:

- Generated in the 2020 calendar year;
- Generated by Canadian firms that earned more than $10 million in revenues in at least one year during 2016-2020; and,
- That exceeded a firm's 2020 expected profits, which is calculated for each firm according to their 2014-2019 average profit margin multiplied by their 2020 total revenues.

The proposed tax is incremental to the current 15 per cent statutory corporate income tax rate.

We estimate that an excess profits tax would generate $7.9 billion in federal corporate tax revenues for the 2020 year.

This is a static cost estimate. We do not attempt to quantify the effects of taxpayer behavioural response and we implicitly assume that complementary measures are put in place to prevent eligible firms reducing their tax burden in 2020, for example by applying losses or shifting depreciation and amortization otherwise recorded in other tax years.

It is also worth noting that our estimate should not be interpreted as evidence of undue price increases in response to the pandemic. Several factors can lead to an increase in profits, such as productivity improvements, economies of scale, or reduction in the cost of inputs.

1. Introduction

This report is based on a request by Peter Julian (New Westminster-Burnaby) to estimate the cost of introducing an "excess profit tax on big corporations that have been profiteering from the pandemic".[2]

Currently, the statutory federal corporate income tax rate is 15 per cent, with some firms qualifying for the small business tax deduction, reducing their federal rate to 9 per cent.[3] These tax rates apply to all corporate taxable income, referred to hereafter as profits.

The proposal would impose an additional 15 per cent tax to "excess profits" earned by large corporations in 2020, such that "excess profits" are subject to a 30 per cent federal corporate income tax rate.[4]

The requestor indicated to PBO the intent to align the proposed federal tax concept with a similar wartime measure. During World War II, Canada imposed a 100 per cent tax on all profits deemed excessive.[5,6] Excess profits were defined as profits that had exceeded 'normal profits, which were calculated as the average yearly profits from 1936-1939.[7]

2. Parameters

The proposed excess profit tax has several parameters and definitions, as provided by the requestor:

- The first key parameter is in defining *excess profits*. For the purposes of the request, excess profits are calculated as the profits earned in 2020 that are greater than what would have been expected in 2020, had the profit margin on revenues in 2020 been equal to the average profit margin from 2014-2019.[8]
- The next key parameter is the definition of *big corporations*, which PBO assumes are firms that have earned at least $10 million in total (gross) revenues in at least one year during the 2016-2020 period.
- Another key parameter is timing, where the excess profits tax is applicable to all excess profits earned in the 2020 tax year. For this report, we used calendar year, due to data limitations on firms' unique tax year.[9]
- The last key parameter is the tax rate that will be applied to excess profits from big firms, which is 15 per cent. The proposed tax is

incremental to the current 15 per cent statutory corporate income tax rate.

3. Data and Methodology

To estimate the revenues from an excess profit tax in 2020, PBO estimated, on a company-level basis, profits earned in 2020 and in prior years.

Capital IQ was used to obtain financial and industry classification information on individual corporations. This data source compiles and standardizes information on publicly-traded corporations around the world, and is constantly updated.[10] PBO selected corporations if they met the following criteria:

- Had earned more than 10 million in total revenue in at least one year between 2016 and 2020;
- Had reported income specifically in 2020; and,
- Was based in Canada.[11]

A firm was considered to be earning excess profits if it had achieved a profit margin in 2020 that exceeded the profit margin it had historically earned, on average, from 2014-2019.[12] Based on 2020 revenues, any profits in excess of what would have been obtained using the historic profit margin are subject to the tax.

Data from Capital IQ omits private corporations and may not reflect the complete universe of taxable corporations, so PBO scaled these results to represent the Canadian corporate sector as a whole on an industry-basis consistent with their relevant North American Industry Classification System (NAICS) code for the purpose of aggregation.[13,14]

Information from Statistics Canada was used to determine industry level profits for the period of 2014-2019.[15] Information for 2020 was not available, so PBO forecasted the profits for 2020 using industry-level GDP growth projections from Pre-Budget Outlook 2021.[16,17]

Excess profits were then aggregated by sector. PBO calculated the share of excessive profits for each industry and multiplied it by the share of forecasted profits for Canadian firms by sector.[18] This was then scaled down by the share of economic activity that was conducted by large firms.[19]

In nine sectors, there were fewer than 10 observations from Capital IQ with profits in 2020. For these sectors, PBO assumed the national average percent of profits estimated to be excessive would apply to the forecasted profits among big Canadian firms, as calculated from data from Statistics Canada. Collectively, these sectors represented 30.9 per cent of forecasted 2020 profits.[20]

To estimate the federal revenues the excess profits tax would generate in 2020, PBO multiplied the total estimated excess profits by the proposed tax rate of 15 per cent.

Our estimate is a static cost estimate. We do not attempt to quantify the effects of taxpayer behavioural response and we implicitly assume that complementary measures are put in place to prevent eligible firms reducing their tax burden in 2020, for example by applying losses or shifting depreciation and amortization otherwise recorded in other tax years.[21]

4. Results

We estimate that a tax on excess profits earned by large firms would generate approximately $7.9 billion dollars in 2020. “Excess profits” in a given sector should not be interpreted as evidence of price increases by corporations in response to the pandemic. Several factors can lead to increases in profits, such as economies of scale, improved productivity, or lower costs.

Table 4-1 Federal excess profits tax revenues by sector

	Excess Profits	Excess Profits Tax Revenues	2020 forecasted profits (%)
Agriculture, forestry, fishing and hunting*	1,483	222	1.9
Mining, quarrying, and oil and gas extraction	9,148	1,372	3.4
Utilities	321	48	0.4
Construction*	5,101	765	6.4
Manufacturing	12,430	1,865	10.6
Wholesale Trade	2,051	308	7.5
Retail	1,608	241	4.7
Transportation	1,813	272	3.7
Information and cultural industries	1,056	158	3.1
Finance and insurance	4,554	683	21.6
Real estate and rental and leasing	238	36	6.6
Professional and technical services	117	18	7.0
Management of companies and enterprises*	263	39	0.3
Administrative and support, waste* management and remediation services	1,327	199	1.7
Educational services*	-	-	5.3
Health care and social assistance	5,269	790	6.6
Arts, entertainment and recreation*	6	1	0.4
Accommodation and food services*	-	-	1.0
Other services (except public administration)*	906	136	1.1
Public administration*	5,287	793	6.6
Total	**52,980**	**7,947**	**100**

Sources: PBO, Statistics Canada, Capital IQ

Notes: All figures are in million of dollars, except where stated. Figures may not sum due to rounding.

* The number of observations from Capital IQ were too small to calculate the excess profit share at an industry level. Instead, we applied the national average share to the 2020 profits projected for each industry. The exceptions to this were the Accommodation and food services sector and the Educational services sector, which we assumed did not earn excess profits in 2020.

Notes

1. Canada. Parliament. House of Commons. Votes. *Opposition Motion (Tax Measures to support Canadians)*. 2nd Session, 43rd Parliament, Vote No. 22, November 16, 2020. https://www.ourcommons.ca/DocumentViewer/en/43-2/house/sitting-29/journals#DOC--10954210

2. Canada. Parliament. House of Commons. Votes. *Opposition Motion (Tax Measures to support Canadians)*. 2nd Session, 43rd Parliament, Vote No. 22, November 16, 2020. https://www.ourcommons.ca/DocumentViewer/en/43-2/house/sitting-29/journals#DOC--10954210

3. There are several criteria that must be met to be eligible for this reduced federal corporate tax rate, including being a Canadian-controlled private corporation (CCPC), having taxable capital of less than $15 million (where a phase-out of the deduction begins for firms with taxable capital over $10 million up to $15 million, after which it is eliminated), and having passive income of less than $150,000 (with a phase-out for firms with passive income between $50,000 and $150,000).

4. The 15 per cent statutory rate + 15 per cent additional tax on excess profits = 30 per cent.

5. The parameters and tax rates went through some revisions, ultimately ending up with a tax rate of 100 per cent. *The Excess Profits Tax Act, 1940*, SC 1939-40, c. 32., and *An Act To Amend the Excess Profits Tax Act*, 1940, SC 1943-44, c. 13.

6. Other nations have also imposed similar measures. See the United States' War Profits and Excess Profits Tax introduced in Part II B in the *Income and Profits Tax Regualations,* Public, No. 254, 65th Congress. H.R. 12863. Accessed: https://babel.hathitrust.org/cgi/pt?id=mdp.35112104900313&view=1up&seq=157&q1=excess;

7. This parameter too, was amended to this final version since it was first introduced. For a more detailed history, see Campbell, Collin. "J.L. Ilsley and the Transformation of the Canadian Tax System: 1939-1943", *Canadian Tax Journal*. 61. (2013): 633. Available for download here: https://www.ctf.ca/ctfweb/EN/Publications/CTJ_Contents/2013CTJ3.aspx

8. Profit margin is defined as the ratio of profits divided by revenues. In this report, we define profits as estimated income before tax, which includes gross revenues less expenses and additional expenses such as depreciation and amortization, but excludes any net losses from other tax years. Revenues are total gross revenues and include revenues from sales, dividend, and other income.

9. Corporations in Canada can define their tax year. See Canada Revenue Agency, "Determining your corporation's tax year", Government of Canada, last revised March 2, 2021. url: https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/corporation-income-

tax-return/when-file-your-corporation-income-tax-return/determining-your-corporation-s-tax-year.html

10. There is a lag between the tax year and when data is typically submitted and published to government such as the Canada Revenue Agency or Statistics Canada.

11. Geographical status was determined based on the location of the headquarters of the corporation, as indicated in Capital IQ.

12. Earnings before taxes by total revenue.

13. Capital IQ provides a 1987 US Standard Industrial Classification (SIC) for each firm. PBO used several US concordance tables to convert from SIC to NAICS 2017. While there are differences between the US NAICS and Canada NAICS, these differences were negligible at the 2-digit level. The only exception was that in Canada, the Wholesale sector uses a 2-digit of 41, whereas in the US the 2-digit identifier is 42. All NAICS codes within these sectors do not correspond with each other when comparing Canada to US, however, it appeared as though all the same classifications were contained within them. For example, 4131 in Canada corresponds with Food merchant wholesalers, whereas 4231 in the US corresponds with Motor Vehicle and Motor Vehicle Parts and Supplies Merchant Wholesalers. However, Food merchant wholesalers is contained within sector 42 in the US NAICS under different 4+ digit codes within sector 42, and Motor Vehicle Parts and Supplies Merchant Wholesalers is contained within sector 42 in the Canada NAICS under different codes within sector 41. Therefore, to match with Canadian industry-level data later on in the analysis, PBO re-assigned Capital IQ firms with sector 42 to sector 41.

14. We implicitly assume that the propensity to earn excess profits by publicly traded corporations captured in our Capital IQ dataset is representative of the population of firms in Canada.

15. There was no financial information for the Management of companies and enterprises, Public administration and Health care and social assistance sectors. PBO estimated the 2020 profits for these sectors by scaling up the total profits for all sectors based on their collective share of GDP, then multiplying this adjusted total by each of these sector's 2020 share of GDP. Sources: Statistics Canada. Table 33-10-0006-01 Financial and taxation statistics for enterprises, by industry type, url: https://doi.org/10.25318/3310000601-eng and PBO, Pre-Budget Outlook, March 2021, url: https://www.pbo-dpb.gc.ca/en/blog/news/RP-2021-046-S--pre-budget-outlook--perspectives-prebudgetaires .

16. PBO, Pre-Budget Outlook, March 2021, url: https://www.pbo-dpb.gc.ca/en/blog/news/RP-2021-046-S--pre-budget-outlook--perspectives-prebudgetaires

17. While scaling both by the change in economic activity is a strong assumption, information is not readily available to model how the profits and taxable income moved individually in response to changes in COVID.

18. The definition of profits collected from Capital IQ is not identical to profits from Statistics Canada. We expect much of this difference would be explained by the treatment of capital depreciation, whereby Capital IQ would

reflect an accounting framework and data from Statistics Canada would reflect the tax treatment of depreciation.

19. PBO analysis based on data from Canada Revenue Agency (CRA) T2 administrative data obtained through Statistics Canada.

20. The exceptions to this were the Accommodations and food services sector, and the Educational services sector. PBO assumed these sectors did not earn excess profits. These two sectors represented 6.2% of projected 2020 profits.

21. These were designed to stabilize corporate net income, which could vary significantly year to year. This is done by allowing companies who faced losses in a year – and therefore did not pay income tax – to apply those losses to a year where their income was greater. Companies may carry those losses back three years and forward twenty years (for losses arising in a tax year ending after 2005). See Canada Revenue Agency, "Line 25200 - Non-capital losses of other years", Government of Canada, last revised January 18, 2021. url: https://www.canada.ca/en/revenue-agency/services/tax/individuals/topics/about-your-tax-return/tax-return/completing-a-tax-return/deductions-credits-expenses/line-25200-non-capital-losses-other-years.html