FAQs on Proposed Legislation to Increase the Federal Tax Rate on Corporations with Extreme Gaps Between CEO and Worker Pay

Bill title: Tax Excessive CEO Pay Act

1. How would this tax work?

The wider a company's gap between CEO and median worker pay, the higher their federal corporate tax rate. The tax penalties would begin at 0.5 percentage points for companies that pay their top executives between 50 and 100 times more than their typical workers. The highest penalty would kick in for companies that pay top executives over 500 times worker pay. Here is the tax penalty structure under this plan:

If a company's compensation ratio is:	Their corporate taxes would increase:
More than 50 but not more than 100	+.5 percentage points
More than 100 but not more than 200	+1 percentage points
More than 200 but not more than 300	+2 percentage points
More than 300 but not more than 400	+3 percentage points
More than 400 but not more than 500	+4 percentage points
More than 500	+5 percentage points.

2. What corporations would be subject to this tax?

All private and publicly held U.S. corporations with average annual gross receipts for the 3 preceding years of at least $100 million.

3. How much revenue would be raised from this tax?

If current corporate pay patterns continue, the Sanders presidential campaign estimates the tax would raise an estimated $150 billion over 10 years. The Institute for Policy Studies analyzed the impact of the above tax rates on S&P 500 companies with ratios of 100 to 1 and higher (80 percent of the total). If the tax penalty had been in effect in 2018, these firms alone would've owed as much as $17.2 billion more in federal taxes. This additional revenue could have financed important social needs, such as 232,228 clean energy jobs or 1.9 million Head Start slots.

- **Walmart**, with a pay gap of 1,076 to 1, would have owed an extra $794 million in federal taxes in 2018 with this penalty in place. With those millions, the federal government could have extended food stamp benefits to 520,997 people for an entire year.
- **Marathon Petroleum**, with a 714-to-1 gap, would have owed an extra $228 million, more than enough to provide annual heating assistance for 126,000 low-income Minnesotans.
- **PepsiCo**, with a pay ratio of 545 to 1, would have seen its tax liability large increase by enough to cover the cost of replacing lead pipes in Flint, Pittsburgh, and Newark.
- **CVS**, a drug store chain with a 618-to-1 ratio, would have added a revenue stream that could have provided annual Medicare prescription benefits for 33,977 seniors.

4. What does the public think about putting a tax penalty on corporations with extreme gaps between CEO and worker pay?

We have no polling yet on the specific question of how the public feels about hiking corporate taxes on firms with CEOs making over 50 times worker pay, but a new Gallup analysis says such an approach "fits well with existing public opinion" and likely enjoys "majority support." A 2016 Stanford survey found that 52 percent of Republicans want to see a fixed cap on CEO pay relative to worker pay — a more radical approach than a tax penalty on large disparities.

5. How does this tax address income inequality?

The tax will discourage the runaway CEO pay that has been one of the key drivers of our country's extreme inequality. The earnings of the top 0.1 percent of U.S. income earners grew nearly 340 percent from 1978 to

2017. According to the Economic Policy Institute, CEO pay grew three times as fast, and in 2017, the average big company CEO raked in 5.4 times as much as the top 0.1 percent income group as a whole. The more corporations plough into executives' pockets, the less they have for workers' wages and other investments. A landmark 2005 Harvard study showed that pay for U.S. publicly held firms' top five executives amounted to 10 percent of aggregate earnings.

6. **How does this tax affect our democracy and the broader economy?**

The tax will discourage the outrageous levels of compensation that give executives an incentive to take excessive risks. Wall Street's reckless "bonus culture" proved a key factor in the 2008 financial crisis. Current executive compensation practices also contribute to short-term decision making that leaves payrolls, employee training, and R&D budgets slashed. CEO pay excess undermines our democracy as well. The best evidence of the CEO pay contribution to our democracy's increasing trend towards oligarchy: Of the top 100 political donors in the 2018 election, more than 80 percent turned out to be either current or former top executives.

7. **Why do some leading business experts support this tax?**

This tax will give corporations an incentive to narrow their pay differentials — by bringing down the top and/or lifting up the bottom — which academic research indicates is good for the bottom line. Extreme compensation gaps hurt worker morale. Lower morale, in turn, reduces productivity and increases turnover. A Glassdoor analysis of data from 1.2 million employed individuals suggests a statistical link between high CEO pay and low CEO approval ratings among employees. Peter Drucker, widely known as the father of modern management science, believed that the ratio of pay between worker and executive can run no higher than 20- or 25-to-1 without inflicting damage on a corporation's internal dynamics. In recent decades the CEO-worker pay gap has been many multiples wider than in the post-WWII period up through the early 1990s. There is no evidence that the rise has anything to do with improved managerial performance.

8. **How would this tax affect small businesses and worker-owned cooperatives?**

The tax targets the large corporate enterprises that are doing the most to exacerbate our country's income inequality. Because of their relatively very small pay gaps, small businesses and employee-owned firms and cooperatives — the building blocks of a democratic New Economy — would get a leg-up on large competitors as a result of this tax.

9. **How would the CEO-worker pay ratio be calculated?**

Large publicly held corporations are already reporting their pay ratios to the SEC, under a regulation that originated in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. Large privately held corporations will calculate their pay ratios based on the same methodology and report them to the Treasury Department. Under the SEC rule, companies key their ratios to two numbers:

- ***CEO compensation.*** The SEC regulations require companies to include in their executive pay calculations all salary, bonuses, the estimated value of stock and stock option awards, changes in pension value, and perks. The SEC has long required publicly held firms to disclose this information for their top five executives.

- ***Median employee compensation***. Companies can use various methods, including statistical sampling, to identify the employee with their firm's median — most typical — compensation. Part-time, temporary, and full-time U.S. and non-U.S. employees must be included, but not subcontracted employees. Companies can exempt non-U.S. employees from their ratio calculations only if these employees make up 5 percent or less of the total workforce. Companies cannot convert part-time and temporary employees into full-time equivalents.

10. **Why are foreign workers included in the median calculation?**

Industry groups pushed the SEC to exclude non-U.S. employees from pay ratio calculations. These same industry groups have been the driving force behind free trade agreements that increase the profit incentive for multinationals to shift production to low-wage countries. But the SEC did not back down to corporate pressure. By allowing only limited exceptions for including foreign workers in ratio calculations, the data increases understanding of how U.S. executives are globalizing away jobs for U.S. workers.

11. **Why are part-time workers included in the median calculation?**

The National Retail Federation and other corporate lobby groups fought relentlessly for regulation language that would let the corporations they represent convert part-time and seasonal workers into full-time equivalents, a statistical sleight of hand that would make their pay gaps look smaller. The SEC correctly refused to allow this conversion, arguing that basing pay ratio calculations on real paychecks would better reflect “the actual composition” of a company’s workforce.

12. **What about firms like Google and Twitter, which have small pay ratios because their CEO/founders take only nominal annual pay?**

If the CEO did not pocket the largest paycheck in the firm, the numerator in the ratio calculation will be based on the highest-paid employee. At Google, the highest-paid employee last year made $47.5 million.

13. **Won’t this tax incentivize companies to outsource the lowest-paid workers so they can narrow their internal pay gaps without having to reduce CEO pay?**

The bill directs Treasury to issue regulations to prevent avoidance, “including regulations to prevent the manipulation of the compensation ratio by changes to the composition of the workforce (including by using the services of contractors rather than employees).” Even without this anti-avoidance provision, it would be extremely difficult to avoid this tax without reducing CEO pay. At Walmart, for example, median worker pay would need to be raised from the current $21,952 to $472,365 to avoid the tax while keeping CEO pay at the current level of $23.6 million. At Home Depot, median worker pay would need to be raised from the current $23,389 to $227,333 to avoid the tax while keeping CEO pay at the current level of $11.4 million. In an era when outsourcing is already widespread, it’s hard to imagine that many firms would be able to shed enough of their low-level workers in a cost-effective way for this strategy to work.

14. **Isn’t CEO pay a shareholder issue? Why should government get involved?**

Lawmakers mandate limits on corporate behavior all the time. They limit how much pollution corporations can spew out. They limit the chemicals companies can put into their products. They limit the hours they can force employees to labor. They set these limits because they recognize that irresponsible corporate behavior harms our communities. As demonstrated by the 2008 Wall Street meltdown to today’s opioid crisis, excessive executive pay is clearly endangering the well-being of the public. This is a problem that is much broader than narrow shareholder concerns.

15. **Can people also work at the city and state levels to build momentum for a federal income inequality tax?**

Yes. In 2018, Portland, Oregon became the first jurisdiction to apply a tax penalty on publicly traded companies with wide gaps. More than 500 corporations that do business in the city are subject to the Portland pay ratio surtax. Many of these companies regularly appear on lists of America’s highest-paid CEOs, among them Goldman Sachs, Oracle, Honeywell, Wells Fargo, and General Electric. San Francisco will have a ballot measure for a CEO pay gap tax on the March 2020 ballot. The city controller’s office expects that a ratio tax would generate $140 million per year for mental health services. Legislators in seven other states — California, Minnesota, Rhode Island, Connecticut, Illinois, Massachusetts, and Washington — have introduced similar pay-ratio tax legislation.