Tax Excessive CEO Pay Act FAQs

(S. 2849/H.R. 5066 in the 116th Congress)

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 their median worker pay. Here is the tax penalty structure under this plan:

If a company's ratio between CEO and median worker pay 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 of at least $100 million for the three preceding years.

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

If current corporate pay patterns continue, the tax would raise an estimated $150 billion over 10 years. According to the Institute for Policy Studies, this additional revenue could finance important social needs, such as 2.7 million infrastructure jobs or 1.9 million elementary teacher jobs for a year.

- **Walmart**, with a pay gap of 983-to-1, would have owed an extra $855 million in federal taxes in 2019 with this penalty in place. With those millions, the federal government could have extended food stamp benefits to 543,830 people for an entire year.
- **Marathon Petroleum**, with an 877-to-1 gap, would have owed an extra $216 million, more than enough to cover the cost of 2,922 clean energy jobs for a year.
- **CVS**, a drug store chain with a 790-to-1 ratio, would have owed an extra $450 million, enough to provide healthcare for 126,368 low-income adults for a year.

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 study 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 is one of the key drivers of our country's extreme inequality. According to the Economic Policy Institute, from 1978 to 2019, CEO compensation grew by 1,167 percent. The compensation of a typical worker, meanwhile, rose just 13.7 percent. The ratio of CEO-to-worker compensation was 320-to-1 in 2019, up from 21-to-1 in 1965. 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 will this bill help workers at the bottom of the corporate pay ladder?**

This bill will change executives' incentives. CEOs today have an enormous personal motive—namely, their pay—to keep the cost of labor low. The more unpaid value they extract from their workers, the higher their own compensation. Channeling resources into executives' pockets also reduces the funds available for investment in training and other long-term strategies that could help workers move up the ladder.

7. **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. Excessive CEO pay 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 2020, 78 were either current or former top executives or their spouses.

8. **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. There is no evidence that the rise in CEO pay levels has anything to do with improved managerial performance.

9. **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.

10. **How would this tax affect corporate outsourcing?**

This bill will not incentivize companies to outsource the lowest-paid workers so they can keep CEO pay high and avoid the tax penalty. It 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)." In other words, if a company is found to have engaged in outsourcing to manipulate its pay ratio, it will face a tax penalty. The bill also creates a disincentive for offshoring by requiring corporations to take their offshore workers into account when they calculate their median pay. Shifting still more work to low-wage countries would actually lower their median wage and increase their tax liability.

11. **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.

12. **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. In November 2020, voters in San Francisco overwhelmingly approved a similar tax, which the city expects will generate $140 million per year. Lawmakers in at least nine U.S. states have also introduced pay ratio taxes.

Technical questions

1. **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. Under the proposed legislation, if the CEO is not the highest-paid, the numerator would be based on the highest-paid employee's compensation.
- ***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.

2. **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.

3. **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.

4. **What about firms that have small pay ratios because their CEO/founders take only nominal annual pay because they are sitting on mountains of their company's stock?**

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 in 2018, the CFO, made $47.3 million.