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# Windfall Profit Taxation in Europe (and Beyond)

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**Abstract:** In 2022, the European Commission introduced, for the first time in its history, a windfall profit tax to be applied on "excessive" profits realized by qualified businesses operating in the "Oil and Gas" sector. Immediately after its implementation, questions arose as to its sustainability and its consistency with constitutional principles of the different member states regulating the domestic power to tax. To assess the consistency with the aforesaid rules, the article samples two countries, inside and outside the EU (Italy and Australia, respectively), and the historical precedents of the matter. Italy has been chosen due to the particularly stringent set of principles regulating the power of the legislature to tax, and Australia has been chosen because of the long-standing experience with superprofit taxes. In most of the scenarios analyzed, one common feature emerged: the complexity in defining the "Extra" nature of the profits and, consequently, the uncertainties in the calculation of the taxable base. In the case of Italy, for instance, the legislator had to intervene in several different moments to fine-tune the taxable base and restore certainty to the tax system. As a conclusion, while the taxation of extra profits should not per se be disregarded, its implementation demands a more robust and precise legal framework together with the understanding that the introduction of such a levy would be a one-way journey for the tax systems: windfall profits taxes would be here to stay.

**Keywords:** windfall profit tax; excessive profit tax; EU law; ability to pay; income taxation; tax policy; European recovery plan; EU tax policy

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## 1. Introduction

The explosion of the war in Ukraine prompted a fast reaction by the European Union and several countries in the world: states scrambled to help the attacked country by offering assistance and support, including significant financial aid (Umar et al. 2022). As the conflict endured, the Union found itself in the unpleasant situation of needing to address the consequences of a conflict that appears more and more to be a long-standing struggle rather than a *blitzkrieg*. Some of these consequences include the need to find economic means to continue with the assistance and the need to curb rampant inflation originating from the increased costs of raw materials once imported from Russia.

Taxation was immediately considered to be the most effective tool to address this goal.

The proposal on a possible windfall tax tabled by the EU Commission (a proposal for a Council Regulation on an emergency intervention to address high energy prices, 14 September 2022, COM (2022) 473 final) has drawn the interest of academics and stakeholders from the very beginning (Nicolay et al. 2023; Thomas 2022) due to its innovative nature and to the policy strategy pursued. When the proposal was eventually transformed into a binding European Regulation (2022/1854) the member states of the union witnessed the rise of the first pan-European tax on the "Extra profits" (Margalhães and De Lillo 2023).

The charge has been applied on companies which benefited from the price dynamics of fossil fuels in recent months essentially (although not exclusively) because of the situation in the east. Some European states had already moved in this direction before the intervention by the Commission (White et al. 2022) in an attempt to collect resources for the state budget in a moment of distress for the national budgets.

Irrespective of this, the subsequent implementation of the excess profits tax (dubbed as "contribution" in the wording of the regulation) via Council regulation n. 1854 (Articles 15, 16, 17, and 18) has ignited a debate on the possible impact of the charge in the domestic economies and the policy strategy underpinning it.

Some states, including Italy, tried to extend this tax to other business sectors later, such as the financial one (the first version of the excess profits tax was to be charged only to businesses active in the "Oil and Gas" sector. Italy, in August 2023, introduced another windfall tax on banks whose return on interests exceeded specific quotas (Article 26, decree passed on 7 August 2023), yet the law was subsequently amended and currently the charge can be avoided by the targeted business if they reserve profits for a multiple of the potentially chargeable tax (as a matter of fact under the current law, banks can decide whether to pay the tax or reserve profits: in the latter case, the tax is deferred to the moment of profit distribution).

In this case, just like in the previous one, justification for the new levy was found in the necessity to address inequalities as they emerged during (and after) the crisis Europe experienced.

Prominent economists argued that wars are outstanding redistributive events: because of the conflict, and the consequent disruption of the means of production, wealth is redistributed outside the ordinary accumulation patterns (Piketty 2013, at § 8).

The pattern emerging from studies in the history of economics is apparently that whenever a global conflict has taken place, or whenever a pandemic strikes at a global or regional level, some sort of redistribution of wealth has always also taken place, and inequalities were, somehow, reduced.

The ongoing war in the east, and the previous pandemic crisis, seem to escape from this pattern.

In both the situations, MNEs operating in specific business sectors benefited enormously (Armstrong 2022) from the distress, increasing their profits remarkably. That was the case of the pharmaceutical and internet service companies during COVID-19 and of the businesses operating in connection with the "*Oil and Gas*" extraction, manipulation, and dispatch in the second.

In ordinary times, corporation tax would automatically address the issue of redistribution by hitting harder these companies with higher tax bases. In the case of individuals, progressivity (where introduced) would ensure a more profound redistribution of income (Stiglitz 2012).

This is not the case in moments of serious imbalances, where decisions are time-sensitive and tax policy options must be adopted swiftly because of the immediate and ever-increasing need of resources to be spent. In these scenarios, ordinary income taxation would be unfit to achieve the goal or it would achieve it too late.

In March 2022, the Commission raised for the first time (EU Commission Press release IP/22/1511, "*REPowerEU: Joint European action for more affordable, secure and sustainable energy*", 8 March 2022) the necessity to introduce a special tax to address the impressive profits made by "*Oil and Gas*" MNEs and the prices of oil and electricity that are spiraling out of control, as they are left to the offer and demand mechanism.

Such a proposal was immediately endorsed by the European Parliament in a following resolution (European Parliament resolution of 19 May 2022 on the social and economic consequences for the EU of the Russian war in Ukraine—reinforcing the EU's capacity to act (2022/2653(RSP)), which subsequently urged the Commission to draft regulation introducing a Europe-wide windfall tax.

The Commission delivered the proposal on 14 September and the Council had it approved on 6 October in the framework of a vast array of measures aimed at giving answers to the distress in Europe and at the need for more resources to be tabled to face the crisis and address the Russian threat.

Alas, the European version of a windfall taxation was unable answer to the dilemmas that routinely come every time such a tax is introduced: Is it consistent with constitutional principles and redistributive justice? And, more than that, is it here to last, irrespective of what the EU promised?

**2. The European Vision** . . .

The European strategy on windfall profit taxation has been chosen under the rule of Article 122, § 1, TFEU, but a similar step had been taken also by the UK government (Nasralla 2022) earlier in the summer of 2022, and it is very likely that the British approach had influenced the EU's regulation in the matter. The Commission has proposed an extraordinary tax to be charged on the same assumption: the need to address the disproportionate profits some companies are making while most of the people are taking the toll of the complex political and economic moment the Union is experiencing. A temporary tax is seen as a tool envisaged to tackle market distortion in the pursuit of the general interest, empowering the principles of solidarity and social justice many constitutions defend.

In the view of the European Commission, such a solidarity levy would generate revenue to stimulate green transition and to mitigate the cost of the fuel, possibly allowing the state to adopt spending strategies suitable to this goal (Georgiou 2023).

Yet the European approach differs in many respects from the one chosen by several nations, including Italy and, earlier, the UK.

The decision to intervene on the fiscal aspect of the "*Oil and Gas*" business with a retroactive impact would grant this result without affecting the cost of the fossil fuel, which had already increased on the open market. The Union addressed this issue as well, adopting a price-capping policy (Johnson et al. forthcoming) on the raw materials imported from Russia that had a direct incidence on the prices to be paid and, to some extent, served to mitigate the steep increase in costs by households and families. Alas, this eventually ignited further tensions between the East and the West in the continent that fall outside the scope of this article.

**3.** . . . **and the Implementation of the Tax**

The European Union introduced, on 6 October 2022, a temporary "solidarity contribution" (that is, a tax) urging member states to charge it by the end of the year. The contribution is supposed to be temporary in nature (under Article 18, it is to be applied only to the tax year 2022) and henceforth retroactive.

Retroactive taxation is not per se inconsistent with the constitutional principles of fundamental charters in the Union (Lenaerts 2012), yet it contravenes taxpayers' fundamental rights and needs for legal certainty (Pauwels 2013).

The decision to use a regulation (instead of a directive) is significant as well and it gives hints about the extraordinary situation the Union is experiencing. It is probably because of the clear and present danger in the international scenario that the European Council boldly opted for such a measure, which demands no further implementation by the domestic legislators.

An EU regulation is self-executing by design (Craig and de Búrca 2020), although it might demand some technical regulations to allow the collection of the tax in the different jurisdictions. In the past, the EU has intervened in the field of direct taxation, although the leeway for legislative initiatives in the discipline is much narrower if compared to VAT, customs, and excise duties as the TFEU (Treaty on the Functioning of the European Union) does not provide a solid ground for that. When, in the past, such an intervention was necessary and possible according to the TFEU, directives were chosen instead, as they are more flexible legal instruments because they allow member states to adjust national rules consistently with the specific features each country wants to preserve.

On this occasion, the Commission proposed, and the Council accepted, the use of a regulation as the windfall profit tax was conceived as a tile of a much broader mosaic, encompassing several other initiatives aimed at addressing the price increase in energy and fossil fuels due to the war in the east. It was also necessary to immediately enforce the new tax, as otherwise the scope would have been increased and the financial resources would have been collected too late.

It is arguably the extraordinary situation and the time sensitiveness of it that allowed the swift implementation of such a measure, and with such binding legal instruments. A debate that would have taken decades to be managed in ordinary times has been processed in a few months, and the outcome unanimously accepted after the initial reservation of some countries.

Yet the point is now to assess up to what point the extraordinary circumstances may lead and to how many derogations to the ordinarily applicable rules might be accepted. It is also necessary to see whether the decision by the European Union constitutes an unicum in the international panorama or if other jurisdictions have chosen the same path: maybe earlier than in the old continent.

## 4. The Australian Perspective on Superprofit Taxation and the Difference with the EU Levy

In the previous paragraphs, we have provided some evidence of the fact that "Windfall taxation" has been a constant in the development of tax law through decades (if not centuries) in countries such as the United States and the United Kingdom. It is no surprise that some states are still currently making use of it when anomalies are registered in a qualified business sector: a case like this occurs when companies are making profits that are unexpectedly high according to the standard of the time. It is evident that appraisals like these depend highly on discretionary (political) evaluation and the policies pursued by the government, yet there are areas of business where such extraordinary profits are per se evident: this occurs in cases where monopoly (or quasi-monopoly) situations are detected or where the exploitation of natural resources allows such. Australia is a good example of this situation as it has a dynamic business sector and an extraordinary rich environment whose exploitation is operated by a handful of companies (all of them MNEs, multinational enterprises).

Being an important exporter of natural resources, and owning remarkable reserves of fossil fuels, Australia has more experience in addressing the oil and gas industries than Europe (Hattersley 1991; Murray 2017).

From a legal standpoint, Australia has a windfall profit tax, which is charged on the gas industry, as in Australia that resource is more abundant than oil. The Australian levy is charged on the extractive activity: it is the case of the petroleum resources rent tax (PRRT), which has been applicable since 1987 (Petroleum Resource Rent Tax Assessment Act 1987, C2019C00197).

The reason that is justifying the tax is that the companies exploiting a commonwealth asset such as gas (via offshore platform) should pay a fair share of their revenue to the government beyond the corporation tax that they are already liable to due to the monopoly situation that characterize the specific business sector and the limited nature of the resource. Such a share is currently equal to 40% (Kraal 2017).

Yet the way in which the tax is calculated, and the amount of revenue originated ever since its introduction, casts some shadows on the actual nature of the levy, including the fiscal nature of it, although under the Australian tax system there is no doubt in the matter that the PRRT is a full-fledged tax (Richardson 2022).

PRRT is not charged on the profits of a MNE but rather on the revenue once the investments the company incurred for the exploitation of the natural resources have been properly considered for tax purposes, either via depreciation or via other rules where applicable. Consequently, the rent tax has allegedly yielded a low revenue to the budget of the state and attempts to adjust it to take into account the actual revenue flow have not been successful so far.

Yet it is not possible to consider the PRTT a "Windfall Tax" in the sense that is commonly understood by the academic literature so far (Margalhães and De Lillo 2023). This is essentially because the Australian levy is not intended to address an unexpected increase in revenue (although of course this might trigger the PRTT) but rather to be indexed as a surcharge on a tax base that partially mirrors corporate tax.

Moreover, due to the very specific nature of the business considered, the Australian PRRT would be a levy applicable to a specific sector only (oil and gas) with no possibility to extend it as such to others such as the financial one where the investment amounts by the businesses are not comparable. This is essentially due to the way in which the tax base is calculated in the domestic legislation, which takes into account the level of investments made to initiate the extraction of the natural resources of the case (see in particular Part V, Division 3 of the Petroleum Resource Rent Tax Assessment Act 1987).

## 5. The Paradoxes of the Regulation: The Taxpayer Identification and the Legacy Effect of the Taxes Already in Force

The European windfall profit tax has been introduced in haste. This is evident in many aspects of the text where the rules drafted are not consistent with those normally expected in such a secondary source of EU law.

In a normal scenario, a European regulation is self-executing. It contains all the prescriptions and rules to be enacted with no need of further domestic provisions. It needs no adaptation to the domestic legislation, which is overridden where necessary, and must be interpreted consistently with it (Craig and de Búrca 2020) (see page 198 and sub.).

The primacy of the European regulations stems from the primacy of the EU law and has a robust background in the literature (Craig and de Búrca 2020, p. 110) and in the CJEU (Court of Justice of the European Union) case law (Judgment of the Court of 5 February 1963, Van Gend en Loos v Nederlandse Administratie der Belastingen (C-26/62), ECLI:EU:C:1963:1; Judgment of the Court of 15 July 1964, Flaminio Costa v E.N.E.L. (C-6/64), ECLI:EU:C:1964:66) ever since the inception of the European legal system.

The regulations have been used in the past as drivers to harmonize the law in the different member states or make it uniform in the continent: examples in this direction are customs law (whose discipline rests on regulations much more than in directives) and VAT, where these legal instruments are used to address technical aspects which cannot be relinquished to the legislation of the states.

Directives have been proposed in the past in cases where unanimity was not reached: this was for example the situation of the financial transaction tax (Commission proposal for a directive implementing enhanced cooperation in the area of financial transaction tax, COM (2013) 71 final, 14 February 2013), of the web tax (Commission proposal for a directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services, COM (2018) 148 final, 21 March 2018), and of the common corporate tax base (Commission proposal for a Directive on a Common Corporate Tax Base, COM (2016) 685 final, 25 October 2016): in none of these situations have the regulations have been used.

The European windfall profit tax is apparently a different matter, due to the need for a fast answer to the challenges coming from the east, which allowed the Commission to overcome the burdensome decision-making process the Union is known for and to reach an immediate result.

It was not possible however to draft the text of the tax consistently with the nature of the tool used: in other words, forms and substance do not coincide in this situation as the regulation adopted (self-executing by design) demands further (national) rules to be actually applicable.

The example of the taxpayer's identification and in the way in which states are supposed to deal with the taxes already in force are clear examples of that.

Taxpayers are, by definition, the individuals or the entities who are supposed to bear the burden of the tax (Barus 2022). In a normal scenario, the windfall profit tax should target the individuals or (more frequently) the legal entities which have registered extraordinary, disproportionate, or unexpected profits in any case (Baunsgaard and Vernon 2022). With a certain margin of appreciation, eventually, taxpayers should be those already targeted by income tax.

This is not the case, as the tax introduced by the Union is selective and it addresses only specific business sectors, allowing for a sort of qualitative discrimination amongst them. In other words, without the fine-tuning by the states of the Union it is not possible ex ante to unequivocally assess who is supposed to pay the tax.

## 6. Continued: The Oil Sector and a Legislator in Search of Boundaries

For policy reasons, excessive profits are taxed when they are received in "*crude petroleum, natural gas, coal and refinery sectors*" (Article 14(1)).

The logic underneath this choice is evident: as the war in the east is having dramatic consequences on the importation of natural goods, allowing speculation to expand, a tax on excessive profits should be introduced to this purpose to curb those profits and redistribute them consistently with a pattern inspired by social justice and fairness (although the EU emphasizes the need to address the green transition first).

Yet this kind of reasoning has an intrinsic fallacy. There is no need to specify the sector, as profit is excessive irrespective of that. If the purpose is to address exorbitant revenues in the pursuit of the goals specified above, then the fact that the excessive profits originate from "*Oil and Gas*" or pharmaceuticals (to name two sectors) would make no difference.

On the contrary, it seems evident that the EU is targeting excessive profits only when they are sourced from some selected sources in connection with the war in the east.

This is a sort of built-in (qualitative) discrimination whose consistency with the fundamental principles characterizing the Union can be defended only according to the extraordinary situation of distress that Europe is experiencing.

The decision to limit the taxation of "Windfall profits" to those arising in a specific business entails another consequence: namely, the necessity to define such a sector.

The regulation does not provide many details in this respect, as it refers to "*Crude oil and gas sectors*". Yet if we move from a generic reference to the business to a more precise and careful identification of the companies that are obliged under the law to pay the tax, problems arise.

The common understanding of the companies involved refers to extractive businesses: world-famous multinationals which operate in that context and are directly targeted by the charge. Yet there is much more than that: first, because the MNEs operate through groups of subsidiaries, each one of which is active in a very specific segment of a business. This would entail the necessity to give a clear definition of the areas of activity targeted by the tax.

On one side, it is evident that the companies (either part of a larger group or not) that are directly engaged in such activities are considered, but there are many others that are indirectly involved and yet have seen their revenues increase impressively in recent months. This would be the case of a business which provides services or goods necessary to perform extractive activities or of a business necessary to transfer the gas to other states either via ships or via pipelines. On the top of this, there are companies providing maintenance to the infrastructure and providing consultancy.

Eventually, if we move beyond the technical aspects of the oil sector, we should consider the companies which conduct trade activities of the commodities: that is, those which are involved for commercial purposes only (the stock markets, etc.).

It is evident that the letter of the law is of no help in defining any better the reason why it is drafted in that way: this vagueness would be coherent with a directive but not with a regulation, which is supposed to be applied in the same way in the continent.

The generic definition of the oil and gas sector, on the contrary, shall allow each member state to shape the windfall tax differently, eventually expanding or reducing the scope of it. Such leeway is not entirely consistent with the EU law, as it would create competitive advantages in some jurisdictions and eventually distortions in the common market.

The case of Italy is paradigmatic, as it decided (long before the regulation was enacted) that all businesses directly connected with the "*Oil and Gas*" sector would fall within the scope of the tax, except for those operating clearing houses and facilitating the payments (Article 1, § 115, Act n. 197 passed on 29 December 2022).

The second element of uncertainty is the relationship between the European tax and those already in force.

In the first chapter, we have seen that, long before the EU took the steps in this direction, some states of the Union and some states outside of it (most notably, the UK) had already introduced windfall taxes to raise more money on the spot. The case of Italy was once interesting in this example because of the haste the government decided to use the VAT base to calculate the profit tax, giving rise to criticism in the literature and a failure to raise the expected revenue (Greggi 2022).

The regulation in force retroactively validates the taxes already in force if they substantially address the same taxable base which is hit by the new provisions. Yet the law does not provide any guidance as to how precise this "similarity" test is, eventually leaving the judgment to the legislators and to the judiciaries of the different countries. Such flexibility is compatible with the directives, but it is not entirely within the scope of the regulation. Although the Court of Justice of the European Union has the power to interpret the regulation and therefore to extend (or shrink down) the similarity test. A more precise definition of the test would have been welcome.

## 7. Continued: Making Sense of the Already Existing Taxes

The European Union is in no way an early adopter of the windfall profit taxes strategy. When the necessary political consensus was reached in Brussels, both in the Commission and in the Council, some states had already decided to introduce the levy. The scenario was, in many respects, like the one experienced for the web tax a few years before; when the Commission was in the position to table a proposal (later rejected by the Council due to the lack of unanimity), some states had already introduced the fee.

The strategy pursued by the regulation was to consider the already existing taxes without any need for the member states of the case to adjust them dramatically to the new patterns as introduced by the Union.

Article 14(2) of the regulation says that national taxes pursuing "*similar objectives*" and inspired by "*similar rules*" capable of generating "*comparable or higher proceeds*" can be tolerated anyway.

It seems that the regulation allows for unprecedented flexibility in this respect, which is surprising on two grounds.

Firstly, because such flexibility and the possibility by the states to adjust is not consistent with the nature of a European regulation: a directive would appear more appropriate in the matter (Barnard and Peers 2020).

Secondly, because the regulation seems to pass a de minimis taxation on the windfall, which can be overcome by the state should they decide to go harder in the matter, allowing for a proportionality check ex post by the Court of Justice of the European union on the ground of reasonableness and proportionality.

The de minimis approach is confirmed in Article 16 of the regulation, where the rate is set at 33% or higher, depending on the decision by the state (Italy has set it to 50%).

The reason why the regulation on windfall profit taxation is blatantly derogating to the nature and purpose of a European regulation is to be found in its retroactive nature.

Non-retroactivity of the law in general is a principle modern and democratic legal systems are built on (Juratowitch 2008). It is normally considered absolute and non-negotiable in criminal law, *nulla poena sine praevia lege*, as most of the constitutions would consider a retroactive criminal law inconsistent with the fundamental pillars of any democratic society (Wernicke 2007). In this field, the academic literature is immense and decisions by international courts have established a robust set of precedents for decades now (Buyse 2006).

The situation is not the same when the principle is applied to other fields of the legal system, most notably civil, administrative, and eventually tax law (Wildhaber 2007).

In these areas of the law, the prohibition of the retroactive application of the rules blurs into an interpretive concept in the sense that the law is supposed to be applied in the future by design. However, should it expressly rule for the past, such a decision could not be automatically unconstitutional or an infringement of human rights. On the contrary, the decision would be taken on a case-by-case basis.

This is true in tax law as well, where the prohibition for a retroactive application of the law, although ruled on in some legal system, is not upheld in every state.

In this respect, a lot of uncertainties exist at the EU level. The case for a windfall profit tax would arguably be the first situation in the Union law where the retroactive application is set expressly, although is limited to the tax year in progress, as the regulation was introduced on 6 October 2022 and is applicable, in theory, to the fiscal year 2022.

The Commission has clearly accepted the retroactivity of it, as it would have been impossible to tax extra profits which are, by design, pertinent to the tax year in progress: yet common established principles are put under a serious stress test.

This is probably the reason why the regulation allows for the previous taxes to be upheld if they are proportional and reasonable with the European approach. In other words, the Commission was conscious of the (potential) infringement of a commonly accepted principle (non-retroactivity of the law). Although such a violation would not have resulted in a breach of a national constitutional principle (or EU principle), it was evident that that way of legislating would have been tolerable only under exceptional circumstances. To soften this contrast, Article 14 § 2 and § 3 introduced rules which are supposed to create a bridge between the previous legislation and the current European one, evidently to soften such a contrast.

## 8. The Tax Base

Article 15 of the regulation is aimed at identifying the base to be charged with the extraordinary tax.

Although some countries have decided to use data pertinent to VAT (see below regarding the case of Italy), the tax base considered are the profits routinely used for corporate tax purposes as the law does not provide for any derogation of it. Although different according to the nature, purpose, and legal definition, the "Windfall Profit Tax" is a surcharge on a qualified item of income.

The same provision rules that the tax "shall be calculated on the taxable profits, as determined under national tax rules insofar they overcome the 20% of the taxable profits as determined under the national rules on the average of the four preceding years" (Article 15 §1).

The definition is condensed, but it is possible to understand a series of conclusions, irrespective of how the member states shall decide to implement the measure of the case. The tax is intended to be applicable to businesses which have been operating in the last 4 years, but also be applicable to the recently incorporated ones. The excessive profits (as the European continentals call them) are the revenue overtaking 20% of the standard in the previous fiscal years. Reference is made to profits, not to income, and hence some sort of adjustment to the understanding of the tax is needed, as apparently it is not another kind of income charge. In this respect, a similarity exists with the Australian charge that does not address the same tax base that corporate tax does.

The conclusion is that the tax is not a pure income tax, yet it targets one item of income. It could be possible to argue that the windfall profit tax introduces, for the first time in recent history (at least in Europe), a kind of progressive taxation, as the actual overall rate on profits increases according to the amount of them.

Yet the tier is not static, as it would normally be under traditional progressivity. It is dynamic, as the top tier (the one that triggers the windfall) depends on the previous amount of profit.

This is arguably the first case of time-sensitive progressivity introduced in a corporate tax with such magnitude.

### 9. The Extraterritorial Reach of the Tax and Its Impact on Non-European Business (the Case of Australian Tax)

The windfall profit tax also has an international outreach that probably has not been considered properly by the European legislator due, once again, to the haste which has characterized its implementation.

In this respect, several questions are still lingering in the air. First, it is necessary to understand whether the tax can be considered to be a tax on income (or a tax equivalent to those). Only if this condition is met will the MNEs targeted with the tax (might) make the most of the double taxation convention in force with the European country of the case.

The second element to be considered is that the tax is not applicable only to companies which reside in Europe for tax purposes (Zummo et al. 2017) but also to permanent establishments in the EU of commercial entities residing abroad in other jurisdictions.

This feature significantly expands the outreach of the tax, potentially also targeting Australian MNEs which operate in Europe in the "*Oil and Gas*" industries or as service providers for businesses operating in the sector of the case (drilling companies, security companies, etc.), as they would be targeted by the European tax and liable to pay there (in the EU) any excess profits made. Possibly, transportation companies might be targeted as well as they provide services connected with the oil and gas sector.

The last question mark, which is still open, is the one related to the possible application of the transfer pricing discipline to the windfall profit tax.

The EU Regulation does not expressly mention transfer pricing (TP) as a legal instrument to be used to preserve the actual amount of the windfall profits to be taxed. Transfer pricing rules are commonly introduced for tax purposes to adjust the cost and revenue received during a transaction between associated enterprises which could be interested in manipulating the price to adjust their tax liability in the respective jurisdiction. In theory, if we exclude the windfall profit tax from the number of the levies on income, we could conclude that TP regulations are not applicable here. This would be because these rules are especially designed for taxes or income and can be used in other areas (such as VAT for example) only insofar as a provision allows for that: such a rule has not been introduced for the windfall profit tax.

The other interpretive option would be to allow TP regulations to be applied anyway to the tax of the case, as they de facto target profits which are considered to be a base for the WPT and one item of the base of income tax.

It is quite evident that this second option has not been chosen and that the scope of the tax would be frustrated if so as it would be very easy for each multinational to manipulate earnings and costs to erode the tax base of a company operating in the sector while favoring another company of the group. Yet the problem would emerge if such a TP strategy was pursued within a country.

In this case, normal TP regulation would not be effective under the law to income taxation and, therefore, also to windfall profit taxation.

These are essentially theoretical problems as the tax, extraordinary as it is, has been introduced to be applicable in the past only and just in a limited timeframe, and hence there would be no room anymore for transactions beyond arm's length. However, some MNEs might have already enacted these transactions in the last months of 2022 to mitigate the possible (future) introduction of the windfall profit tax by the EU Commission and the EU Council.

The conclusion would be that the tax office of the case should be entitled anyway in the future to check and assess the 2022 transaction within the group under the classic TP regulations, and the outcome of this audit should also be relevant for windfall profit tax.

## 10. The Italian Approach to Windfall Profits Taxation

Just like it happened in the digital/web tax *saga* (Greggi 2020), some states decided to go alone and introduce a windfall profit tax without waiting for a comprehensive framework by the Union: Italy is one of them. The decision was taken as the government was in need (and in a hurry) to raise money. This, in turn, was necessary to immediately subsidize the third wave of incentives introduced in order to give relief to the adverse effect of the crisis (to minimize the price increase of electricity).

Consequently, the attention of the government turned to the companies which were benefiting more from the situation, and whose balance sheets were overperforming, and thus to the only strategy capable of granting such financial resources on the spot.

A sheer increase of the corporate tax rate would not have been feasible, time-sensitive as it is (the increase in revenue flow in favor of the state would have come too late): the strategy pursued by the government was, therefore, to consider the monthly adjusted VAT tax bases, whose periodic payment and assessment would grant revenue in a timelier manner.

On 21 March 2022, Italy introduced an "Extraordinary contribution to address electricity prices increases" Decree n. 21, 21 March 2022 (this is, literally translated, the name of the Italian windfall profit tax) that was amended later on 21 May. Eventually, a third version of the WPT was enacted via the 2023 Finance Act (Act n. 197 passed on 29 December 2022) in Article 1 (§§ 115 and sub.)

Several companies were called to pay. This duty was not only for "*Oil and Gas*" producers (as few of them reside in Italy) but also for traders, resellers, and intermediaries with the only exceptions being those managing trade platforms, clearing houses, and ETS certificates. The tax rate was set at 10% at the beginning (soon increasing to 25% and eventually to 50%) of the so-called extra profits.

The Italian strategy demonstrates a remarkable originality in the definition of extra profits, as the new tax addresses the difference in the spread between active and passive operations (sales and purchases) and the net of value-added tax (VAT) charged, as it emerges for the periodic reporting and payment for VAT purposes.

The first differential is between the reporting in the period October 2020–March 2021 and the equivalent one year after, including April. In other words, if an oil company would earn more in the period between October 2021 and April 2022 than what it earned in the period from October 2020 to March 2021, then it would be liable to tax on such an increase with the tax base being assessed on a difference of differences.

In the last version of the tax (following the amendments introduced on December 2022), the charge is calculated according to the balance sheet as used for income tax purposes. In this respect, the previous payment made would be considered a sort of advance amount due for the tax that could be offset.

The tax enacted would be a one-shot payment, a sort of extraordinary levy to be paid once and for all, but at the very beginning it turned out to be a little more than a *fiasco* as the revenue collected was unexpectedly low.

This was due to an erroneous assumption by the legislator that the use of VAT (adjusted) as a reliable base would be a sufficient benchmark for the extra profit: moreover, in the first release of the decree introducing the tax (March 2022), the tax period was one month shorter and the rate lower (10%). The advance payment due (and actually paid) was of around 1 billion euros: the government expected the overall revenue to be close to 10 billion euros instead.

It is interesting to observe that the European Commission is no less optimistic in this respect, as it allegedly expects that the forthcoming EU windfall tax would generate no less than 140 billion euros of revenue, with little or no inflationary effect (Considerand n.12 to the Regulation (EU) 2022/1854).

## 11. The Constitutional Constraints

This is not the first case of an extraordinary windfall tax to be introduced in Italy, nor even the last one as we now know. It happened once in the recent past, in 2008, with the so called "*Robin Hood Tax*": it was a levy intended to "take from the rich and to give to the poor" in the words of the Ministry of Finance in charge at that time, where riches were ostensibly to be taken from financial companies (essentially, banks) and "*Oil and Gas*" industries, which were benefiting from an unprecedented moment of growth. In the first case (namely, in the case of banks), the tax was born out of sync, as the industry was about to be struck down from the consequences of the Global Financial Crisis that hit the USA in 2008 and reverberated in the old continent two years after, eventually peaking in 2011.

The tax was intended to be temporary when it was introduced (just like the windfall profit tax now) but then it was stabilized (made permanent) upon request by the government, only to be eventually struck down by the Constitutional Court (Sentence n. 10, 11 February 2015).

Several aspects of the windfall tax might collide with the constitutional principles, just like it happened with the "Robin Hood Tax" in the past, yet the conclusion might not be the same.

In 2015, the selectivity of the levy, its duration, and its excessiveness (proportionality and reasonableness) were considered by the Constitutional Court under Articles 3 and 53 of the Italian Charter (introducing the principles of economic solidarity, equality, and ability to pay).

The Court argued that selectivity is not per se an element incompatible with the constitution if the decision to target some business sectors and not others is "*objectively justified, reasonable and proportional*". As for the excessiveness (the tax was actually an increase of the one routinely charged on corporations' income), the Court observed that it was unfit to address the extra profits only as the base was incoherent with that assumption: eventually, no remedies were provided for a possible trickle-down of it on the consumers of the services and of the goods (actually, the tax might have been translated onto the latter via an increase in prices).

The duration of it was also considered in conflict with the constitution: a levy introduced in an extraordinary moment for extraordinary reasons could not be henceforth stabilized and made permanent in the legal system.

The current scenario is different in many respects, as the windfall profit tax has not been stabilized (yet) by the government, the extraordinary situation persists, the selectivity is coherent with the scope of the levy, and the reference for its calculation is the exact period in which prices have increased.

Yet the Italian legislator built the taxable base referring to VAT rather than to income in the first version of it. It could have avoided such spurious correlations with the consumption tax and act as it did in 2008 (and likely how the Commission will insist it act), waiting for the annual tax return to be filled in, unveiling the extra profits.

Yet it was in a haste, and the adjusted VAT base was the only reliable benchmark for them, although with a remarkable approximation. The transaction recorded by VAT purposes might not mirror the extra profits, influenced as they are by many other factors (including extraordinary operations falling nonetheless in the VAT scope, which is an amount in quantity of the transaction that would lead to an increase in profits but not because of the increase in prices, etc.). This is where the risk of unconstitutionality is nested: the Achilles' heel that the legislator deliberately has probably accepted as a price to pay to have money on the spot via taxation.

## 12. When the Profit Is Excessive (and How to Measure It)

If we were to paraphrase Karl Marx, we would say that all profit is intrinsically excessive (Marx 1867)[1]; as such, it should be expropriated, not taxed. This is not obviously this case, nor is the philosophy inspiring the Italian and European interventions in the matter.

[1] (The reference to Marx's position is not entirely accurate as the author sued to make reference to *superprofits* (in German *extra-Mehrwert*) whose understanding is partially different as they derive from an excessive exploitation of the workers. The Italian translation (by E. Sbardella) of *Das Kapital* has been used, where the concept is addressed at pages 151 and sub. (ed. Newton Compton, Rome, 2020).

Excessiveness can be measured in many ways, but it is always time-sensitive and path-dependent (Antón 2023). As the global financial crisis in 2008 has clearly demonstrated, excessive profits by banks in the first decade of the century were by far offset with the immense losses coming after, and the governments were urged to grant subsidies and incentives to the very same companies they overtaxed but some years before.

The conclusion in this respect is that any judgment of excessiveness depends on the timespan considered, and the consistency of any tax with the ability to pay principle should not underestimate this aspect: both the Italian and the European legislators seem to have forgotten this aspect. On the contrary, they seemed to have kept it when they decided not to tax pharmaceutical companies which overperformed during the pandemics: no windfall tax was ever conceived to target companies developing vaccines and making (arguably) outstanding profits out of it.

The Australian levy is fairer in this respect, although the revenue is not as high as expected, as it routinely addresses the higher revenue made by qualified companies: in technical terms, it could be argued, that the Australian levy is not a "Windfall Profit Tax" as it does not need an extraordinary event to be charged.

As to the path dependency, the legislator seems to confuse the VAT base with income: at least in the first version of the Italian windfall profit tax before it was repealed. If profits are to be charged with a tax, the appropriate tax base should be considered: it is a matter of coherency rather than proportionality. As a proportional (reasonable) tax charged on a base, which does not properly meet the benchmark of the ability to pay, should be considered unconstitutional anyway.

Alternatives to these misconceptions and misunderstandings are possible.

The tax literature has been developed ever since the 1990s, with techniques, rules, and regulations to identify and calculate the fair price (the arm's length price) relevant for tax purposes in every transaction (Rathke et al. 2021; Rogers and Oats 2022). The OECD has implemented these techniques in a way to preserve the tax base (for income tax purposes) in each county from the possible aggressive tax planning strategies by multinational enterprises (Riedel and Zinn 2014).

When a cross-border transaction occurs between associated enterprises, costs and revenues originating from it may be disregarded for tax purposes if they are not coherent with the market prices. If such a condition is met, a cost is not entirely tax deductible from a company that sustained it: therefore, the tax base (and the tax liability) of the latter would increase.

A possible alternative to the strategy enacted by the Italian legislator would have been to extend those principles and adjust the actual value of the transactions to the prices intended to be fair by the state (for tax purposes only).

Such a solution would have the advantage to strike a balance between the need for more tax revenue and possess an implicit capping to the costs of the natural resources, at least for tax purposes. This is would be complicated, but necessary, step toward a more unified approach to the challenges we must stand united against.

## 13. Conclusions

Windfall profit taxation, although known in the past, is another fruit of the current global crisis we are experiencing. The purpose is noble, as it is designed with a redistributive goal, and is (on paper) consistent with the principles of social justice and fairness.

The very idea of "Windfall" income might be misleading as an extraordinary, unexpected profit in one taxing year might be followed by an unprecedented loss in another. In such a scenario, a coherent tax system would introduce extraordinary reliefs, but this has never occurred for amounts that are equivalent to the tax imposed in good times.

Yet the road to hell is paved with good intentions, and the European Commission has lost several details on the path that had to be considered when the regulation was approved: consistency with international tax treaties, prevention of double taxation, and coherency with equality principle are just a few of them that were set aside in order to pursue a higher social justice.

The temporary nature of the tax (which is supposed to last one year only in all the countries of the EU as under Article 18 of the 2022/1852/EU Regulation) would apparently contribute to disregarding these aspects, yet the experience teaches us that once the cage opens and restraints are loosened up, we do not know what the imprisoned beast is going to do.

The only certain thing is that it will not return to its jail, and this tax is probably here to last.

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