MONEY, MONEY, MONEY; IT'S A RICH MAN'S WORLD: MAKING THE CORPORATE TAX FAIR*

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INTRODUCTION

Corporate tax policy exacerbates income and wealth disparity by

* ABBA, "Money, Money, Money" from Arrival (Atlantic) (1976).

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increasing the gaps between the rich and everyone else. The corporate tax is a burden to taxpayers not in the highest tax brackets, while those taxpayers in the upper tax brackets can avoid it if they choose. One of the fundamental principles in tax policy is fairness: the idea that those with higher incomes have a higher tax burden than those with lower incomes. Because of the structure of business tax policy, this notion of fairness has not been met, and instead those with higher incomes bear a lower tax burden on their investments than taxpayers with lower incomes.

There are two pieces of business tax policy that create this injustice. First, the accredited investor rules of the Securities and Exchange Act provide that wealthy taxpayers can choose among a myriad of investments – publicly held corporations, hedge funds, partnerships and limited liability companies – whereas ordinary taxpayers can only choose from investments in publicly held corporations. Second, the tax on corporate income is a double layer tax, whereas the tax on other investment choices is a single layer and most often at a lower rate. When the Securities Act of 1933 was passed and the corporate income tax was enacted in 1916, the composition of stockholders was very different, and, therefore, the laws were enacted without the consequences that lower and ordinary income taxpayers now face as a result of the interaction of the two laws. The solution to this issue is to integrate the corporate and individual income taxes and then ensure that investment income from all investments are taxed at progressive tax rates, so that taxpayers with higher incomes do not ultimately have a lower tax burden than those with lower incomes.

This article examines the most prominent corporate integration proposals and evaluates these proposals as they relate to the principles of equity and fairness. The objective is to find an approach that achieves corporate integration and all of its goals while also mitigating any unfairness and inequity created by the proposal. This article suggests ways to modify these integration proposals so that they also further vertical equity. As currently designed, nearly all of the recent integration proposals do not address vertical equity at all or actually serve to exacerbate the unfairness of the corporate income tax.

The corporate tax was initially enacted to tax the wealthy on their investments.[1] As this article demonstrates, the corporate tax no longer

1. *See* Steven A. Bank, *Entity Theory as Myth in the Origins of the Corporate Income Tax*, 43 WM. & MARY L. REV. 447, 452 (2001) (arguing that a corporate income tax was enacted as a means to reach the growing amount of wealth held in intangible assets such as stock). The corporate tax in 1909 was actually an excise tax intended to reach wealthy taxpayers after the Supreme Court had ruled the income tax unconstitutional in 1894. *Id.* at 464; *cf.* U.S. CONST. amend. XVI (granting Congress the power to collect income tax without regard to state population); Tariff Act of 1913, ch. 16, 38 Stat. 114, 166–81 (re-imposing federal income tax).

serves to tax the wealthy and instead is a tax on ordinary taxpayers, permitting the wealthy a way to avoid the tax by choosing other investments if they prefer. However, the misguided perception that eliminating the corporate tax will only serve to benefit the wealthy continues to persist.[2] While the rich have continued to get richer, it is not the corporate tax that the rich have benefited from- it is the investment choices available to the rich that provide lower tax rates not available to ordinary taxpayers that has added to the growing wealth and income disparity. Recent data demonstrates that the top 1% of taxpayers receive only 16.6% of their capital gain income from qualified dividends, whereas taxpayers in the second to lowest income quintile receive 62.4% of their capital gains come from qualified dividends, bearing the double layer of tax.[3] The corporate tax disproportionately taxes the capital gains of taxpayers with lower incomes and spares those with the highest levels of income.

This article will introduce and analyze various approaches to business tax policy, how corporate capital investment is taxed, and how the way capital investments in other entities are taxed "has an essential role to play in terms of progressivity, given the fact that capital income is so highly concentrated."[4] Part II of this article looks at concepts of fairness, Part III examines business tax policy, Part IV examines the accredited investor standard, Part V evaluates the corporate tax and looks at integration proposals, modifying them to achieve the goals of vertical equity, and Part VI concludes.

I. FAIRNESS

Basic fundamental principles in taxation include the precept that taxes must be equitable and fair.[5] Fairness is determined by whether two chief

2. *See, e.g.,* David Kocieniewski, *Since 1980s, the Kindest of Tax Cuts for the Rich*, N.Y. TIMES, Jan. 18, 2012, at A12 (asserting that tax cuts have benefitted the wealthy because investing is how they get a large percentage of their income).

3. Calculations are from date of the Tax Policy Center. *See* URBAN-BROOKINGS TAX POL'Y CTR., TABLE T-09-0484, DISTRIBUTION OF LONG-TERM CAPITAL GAINS AND QUALIFIED DIVIDENDS BY CASH INCOME PERCENTILE, 2010, BASELINE: CURRENT LAW (2009), http://www.taxpolicycenter.org/numbers/Content/PDF/T09-0490.pdf (showing that the top 1% have $71,530 million in qualified dividends and $429,575 million in all capital gains versus the second quintile having $4,455 million in qualified dividends and $7,133 million in all capital gains).

4. Kimberly A. Clausing, *The Future of the Corporate Tax*, 66 TAX L. REV. 419, 428 (2013).

5. *See* ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 777 (Modern Library 1937) (1776) (explaining that taxes should be equitably distributed by how much a person earns); Scott A. Taylor, *Corporate Integration in the*

focus areas have been met: vertical equity and horizontal equity.[6] The concept of fairness is central to the thesis of this proposal: "[f]airness is the true focus of the corporate tax debate."[7] The horizontal equity theory holds that similarly situated taxpayers engaged in similar activities should pay analogous amounts of tax.[8]

Vertical equity is the theory that taxes should be progressive, based on the idea that those with higher incomes have a greater ability to pay and more disposable income and, therefore, should have a higher tax burden, while those with a lesser amount of income have less of an ability to pay and less disposable income and, therefore, should have a lesser tax burden.[9] Ability-to-pay is determined by how much money taxpayers have available to pay taxes after the payment of necessities. Lower-income taxpayers have a lower ability to pay and less disposable income, which places a greater tax burden on these taxpayers than the on higher-income taxpayers.

Integrating corporate and individual income taxes and increasing the progressive tax rates on investment income will eliminate the two-layer tax imposed on non-accredited taxpayers. Integration and higher progressive tax rates will ensure that taxpayers who earn more, and have a greater ability to pay, bear a higher burden of the tax.

II. ACCREDITED INVESTORS

Throughout this article, the term "ordinary taxpayer" is used to

Federal Income Tax, 10 VA. TAX REV. 237, 242 (1990) (referencing Adam Smith's assertion that equitable taxation yields a fair result based on each citizen's income level).

6. See H.R. REP. NO. 83-1337, at 39 (1954), *reprinted in* U.S.C.C.A.N. 4017, 4055 [hereinafter HOUSE REPORT] (complimenting the bill on treating like outcomes, even though affected by different methods, the same under tax law; AMERICAN ASSOCIATION OF CERTIFIED PUBLIC ACCOUNTANTS, GUIDING PRINCIPLES FOR TAX POLICY AND FAIRNESS 3 (2007), *available at* http://www.aicpa.org/InterestAreas/Tax/Resources/TaxLegislationPolicy/Advocacy/DownloadableDocuments/TPCS%204%20-%20principles%20for%20tax%20equity%20and%20fairness.doc.

7. Yariv Brauner, *The Non-Sense Tax: A Reply to New Corporate Income Tax Advocacy*, 2008 MICH. ST. L. REV. 591, 629 (2008). Professor Brauner focuses on redistribution as the main element debated in fairness. As illustrated here in great detail, redistribution is not the central element of why the corporate income tax is unfair. It is unfair because higher income taxpayers can choose among other investments, leaving the high corporate tax rates to be imposed on those without a choice.

8. *See* HOUSE REPORT, *supra* note 6, at 39 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4017, 4055 (discussing the virtues of the proposed bill, insofar as it provides ex ante clarity by analogously taxing similarly situated parties); Alan J. Auerbach & Kevin A. Hassett, *A New Measure of Horizontal Equity*, 92 AM. ECON. REV. 1116, 1116 (2002) (asserting that horizontal equity theoretically treats similarly situated people equally).

9. Taylor, *supra* note 5, at 242-243 (explaining both horizontal and vertical equity).

distinguish between wealthy taxpayers, who earn enough income or possess enough wealth to qualify as accredited investors under the Securities and Exchange Act of 1933 and 1934, and "ordinary taxpayers," who do not earn or own enough and are, therefore, classified as unsophisticated, non-accredited investors.

Non-accredited investors include taxpayers that earn less than $200,000 a year individually or $300,000 as a married couple filing jointly or have less than $1 million in assets, not including their primary residence.[10] As a result, ordinary taxpayers, who are non-accredited investors, include a broad base of income levels and encompass the vast majority of taxpayers.

The accredited investor rules were designed after the Great Depression to protect investors from relying on false or incomplete financial information from potential investments in business entities.[11] The Securities and Exchange Commission was charged with regulating businesses and their financial disclosures, so that individual investors could trust those financial statements and disclosures of the businesses when selecting an investment, thereby avoiding some of the causes of the Great Depression. The businesses that are regulated by the SEC, publicly held corporations, are the businesses in which non-accredited and accredited investors alike can invest.

However, it became clear that the SEC could not regulate or properly investigate every business. Businesses that were too new or were privately held and too small could not be evaluated and regulated by the SEC. For this reason, the SEC decided that only investors who were determined to be "sophisticated" would be permitted to invest in these businesses. Other investors would be limited to those businesses subject to SEC regulation: publicly held corporations.

Whether an investor is sophisticated, and therefore an accredited investor, is determined by meeting an income test or a wealth test.[12] An

10. SEC Regulation D: Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.501, 230.504 (2014). The definition of an accredited investor also includes someone who has over $1,000,000 in assets at the time of the purchase of the investment, not including their primary residence. Id.

11. Securities Act of 1933, ch. 38, Title I, § 4, 48 Stat. 77 (codified as amended 15 U.S.C. § 77d (2012); SEC Regulation D: Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.501–508 (2007); Rule 504, 17 C.F.R. § 230.504 (2007); Rule 505, 17 C.F.R. § 230.505 (2007); Rule 506, 17 C.F.R. § 230.506 (2007); *see generally* Wallis K. Finger, *Note: Unsophisticated Wealth: Reconsidering the SEC's "Accredited Investor" Definition Under the 1933 Act*, 86 WASH. U. L. REV. 733 (2009) (summarizing the SEC rules that were developed).

12. Securities Act of 1933, 15 U.S.C. § 77d (2000); Regulation D, 17 C.F.R. §§

accredited investor is an individual who earns over $200,000 individually, or $300,000 if married, yearly for the past two years, with a reasonable anticipation of earning a similar amount, or an individual or couple with at least $1,000,000 in net worth, not including the value of the primary residence.[13] Consequently, on the basis of the income test under the accredited investor rules, most Congressmen are unsophisticated investors, as are most of the other employees of the Federal Government.[14] However, reality television star Scott Disick, and others like him, who earn money through club appearances, are sophisticated investors (his advisors however, may not be).

As a result of these limitations on investment choices, non-accredited investors are limited to investing in the equity of publicly held corporations, while accredited investors may choose investments among corporation stock, as well as equity investments in hedge funds, real estate partnerships, venture capital partnerships, investment partnerships, and limited liability companies.[15] Furthermore, only accredited investors can invest in initial public offerings (IPOs).[16]

These regulations may have been enacted to protect unaccredited investors, but too often these rules serve instead to increase the amount of income and wealth disparity. This is particularly true in light of the higher tax burdens imposed on corporate equity compared to the lower tax burdens on the investments available only to accredited investors, but not available to non-accredited, "unsophisticated" investors. Investors who do not qualify as accredited investors are precluded from investing in private

230.501–508 (2007); Rule 504, 17 C.F.R. § 230.504 (2007); Rule 505, 17 C.F.R. § 230.505 (2007); Rule 506, 17 C.F.R. § 230.506 (2007).

13. Accredited investors also include several types of business entities, many of which must be owned by accredited investors themselves to avoid circumventing the rules. However, this article is evaluating the tax burdens placed on individuals and therefore the accredited investor rules outside of the application to individuals are not relevant here. Rule 501(a), 17 C.F.R. § 230.501(a) (2007); *see also* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 413, 124 Stat. 1376, 1577 (2010) (recent amendment excludes the primary residence from the calculation of net worth).

14. *See generally*, Ida A. Brunick, *Congressional Salaries and Allowances*, CONGRESSIONAL RESEARCH SERVICE (2014), *available at* http://www.senate.gov/CRSReports/crs-publish.cfm?pid='0E%2C*PL%5B%3D%23P%20%20%0A (describing the salary of congressmen and women).

15. There are exceptions to the accredited investor standards for friends, families, employees and those forming their own businesses, but this article is examining the tax rules and inequities placed on investors, therefore, these exceptions are not relevant to this discussion.

16. *See* Finger, *supra* note 11, at 733 (illustrating the bar against non-accredited investors in trying to invest in private offerings).

offerings.[17] Because the accredited investor standard forces investments by non-accredited investors into the high tax burden investments, the rule creates a regressive tax structure and violates vertical equity.

III. THE STATE OF BUSINESS TAX POLICY

The corporate tax needs to be reformed. It is inefficient, unfair, burdensome, does not raise the desired revenue, and makes the United States less competitive internationally.[18] "There is unanimous consensus regarding the need for reform."[19] Corporate integration serves as a means to increase vertical equity in corporate tax policy between low income or typical taxpayers and high-income taxpayers.[20]

The three fundamental principles that guide the assessment and analysis of tax provisions are efficiency, simplicity, and fairness.[21] Current corporate tax policy violates notions of vertical equity, a principle of fairness. Taxpayers are taxed differently depending on the type of business entity that they invest in. However, hedge funds, partnerships, limited liability companies, and a variety of other business choices are only available to accredited investors, who earn high incomes or have a certain amount of wealth.[22] Consequently, higher income investors are allowed to invest in certain entities with lower tax consequences, which are not available to lower income investors. The freedom of the wealthy to select among investment options while ordinary taxpayers have limited investment choices, combined with the two layers of tax on corporate investment, violates the theory of vertical equity. Corporate integration can alleviate or eliminate the vertical inequity. Many integration proposals have been made, some alleviate vertical equity more than others, and some can be modified to address the inequity.

17. *Id*.

18. Clausing, *supra* note 4, at 428.

19. *Id*. at 419.

20. This article only examines the potential fairness issues for taxpayers who are acting as investors. It does not discuss or examine any fairness issues present for taxpayers who are setting up or establishing a business.

21. Richard Winchester, *Parity Lost: The Price of a Corporate Tax in a Progressive World*, 9 NEV. L. J. 130, 130 (2008)(*citing* M. LIVINGSTON, TAXATION: LAW, PLANNING AND POLICY xxxiv (2003)); *see* DEPT. OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2009 REVENUE PROPOSALS 1 (2008), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2009.pdf (advocating that "Americans deserve a tax system that is simple, fair, and pro-growth."); *see generally* The President's Advisory Panel of Federal Tax Reform: Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System (2005) (discussing efficiency, simplicity, and fairness, among other factors, and their relation to the tax codes).

22. SEC Regulation D, *supra* note 10, at §§ 230.501, 230.504.

Ordinary taxpayers are limited in their investment choices by the Securities Act of 1933 and the accredited investor standard. The security laws are designed to protect investors and to minimize the concealed risk investors may take. One way the laws seek to do this is through the accredited investor rules. One possible way to eliminate the vertical inequity created by the accredited investor standards is to repeal the standard. However, the rules may serve a valuable purpose, and therefore the alternative is to attack the inequity through corporate tax policy. It may not be possible or feasible to tax all investment identically, but if higher income taxpayers are a select group of permitted investors, those investments cannot have a preferred rate compared to higher tax investments available to all taxpayers.

A. *Who are stockholders and who carries a heavier burden for the corporate tax?*

The nature of stock ownership has changed with time, but corporate and business tax policy has not kept up with the changes in ownership. Historically, it was wealthy individuals who held stock.[23] At present, stock is owned primarily by institutional investors, either through deferred retirement plans or directly by ordinary individuals.[24] However, corporate tax policy has not stayed contemporary with these changes, remaining stagnant, and, as a result, the burden of the corporate tax, which was initially designed to impact wealthy individuals, now instead impacts ordinary taxpayers, either through direct or indirect ownership via intermediaries. This obsolete tax policy, combined with the rules limiting certain investments to accredited investors creates a regressive tax structure on investments.

A study by the Brookings Institute in 2009 examined the total amount of qualified dividends and capital gains rates received by taxpayers in quintiles based on income.[25] While the wealthiest taxpayers received the

23. *See* Bank, *supra* note 1, at 478 (proving that exclusive privileges were historically granted to corporations where the rich held much of their wealth); cf. U.S. CONST. amend. XVI (granting Congress the power to collect income tax without regard to state population); Tariff Act, *supra* note 1, at 166–81 (re-imposing a federal income tax); Kristian Rydqvist, Joshua Spizman, Ilya Strebulaev, *Government Policy and Ownership of Equity Securities*, 111 J. OF FIN. ECON. 70, 71 (2012) (discussing the changes in stock ownership from households to financial institutions).

24. Rydqvist, *supra* note 23, at 71; *see* URBAN-BROOKINGS TAX POL'Y CTR., *supra* note 3 (showing tax ownership and income by quintile).

25. Calculations are derived from data collected by the Tax Policy Center. *See* Urban-Brookings Tax Pol'y Ctr., Table T09-0484, *Distribution of Taxes on Long-Term Capital Gains and Qualified Dividends by Cash Income Percentile, 2010, Baseline: Current Law*

highest *amount* of qualified dividends and capital gains, the *percentage* those qualified dividends made of their total capital gains created a very different picture, and demonstrated concretely that taxpayers with lower amounts of income carry a greater share of the corporate tax burden proportionately to their income. For example, the top 1% of the wealthiest taxpayers received only 16.6% of their capital gains from qualified dividends, the top 20% received 20.7% of their capital gains from qualified dividends, the fourth quintile received 47.3% of their capital gains from qualified dividends, the middle quintile received 53.6% of their capital gains from qualified dividends, and the second quintile received 62.4% of their capital gains from qualified dividends. Based on these numbers, it is clear that as income goes down, the proportion that dividends represent of capital gain income goes up, and, alternatively, as income goes up, the fewer dividends are part of capital gain. The corporate double tax is ensnaring those taxpayers in the lower brackets on their capital gains, while the wealthy are able to escape the corporate tax on most of their capital gains.

Dividend tax rates became progressive in 2013, including three rates for taxpayers reaching 20%, in the highest ordinary income tax bracket.[26] These rates were also increased by a surcharge on capital gains of 3.8% by the Affordable Care Act.[27] In spite of the progressivity built into the dividend tax rates, unfairness still exists - the progressivity is not sufficient to create vertical equity. The accredited investor standard still exists, and as a result, taxpayers with large amounts of wealth or income who will qualify as accredited investors have the ability to choose to invest in identical businesses held in different types of entities- a partnership that is subject to only a single layer of tax or a corporation that is subject to a double layer of tax. Higher income taxpayers can still choose between investing in a low tax entity versus a high tax entity, while ordinary taxpayers are only permitted to invest in publicly held corporations. As a result, investments by the wealthy are taxed at a lower rate and investments by ordinary taxpayers in corporations are subject to the double tax. Even though the capital gains rates are progressive, only higher income taxpayers have the option of choosing between identical investments in two types of business entities - entities with a single layer of tax or with a double layer of tax - ensuring that the higher income taxpayer will seek the most economically efficient return and will invest in an entity in which ordinary taxpayers

(2009), http://www.taxpolicycenter.org/numbers/Content/PDF/T09-0484.pdf.

26. American Taxpayer Relief Act of 2012, H.R. 8, 112th Cong. (2013).

27. Patient Protection and Affordable Care Act, H.R. 4872, 111th Cong. (2010), *amended by* Health Care and Education Reconciliation Act of 2010, Pub. Law No. 111-152, 124 Stat. 1029 (2010).

cannot invest.

B. *Calls to Revise the Corporate Tax*

Much has been made in the public and legislature about corporate inversions and corporations fleeing the United States taxing jurisdiction because of high corporate income tax rates.[28] The United States Treasury Department has stated that inversions cost the United States billions in lost taxes each year.[29] Corporations are encouraged to earn their income elsewhere to avoid the high tax rates in the United States.[30] Lowering tax rates alone, as a sole remedy, is not enough to address the issues with competitiveness of the United States internationally; it is not enough to fix the many issues with the corporate tax, and it is not enough to redress the lack of fairness created by the corporate tax.[31]

A growing consensus of experts have suggested that it is imperative we re-evaluate the corporate income tax.[32] There is a bipartisan call to revise the corporate tax because it is decidedly complex and inefficient, and because of the harm it does to the competitiveness of the United States.[33]

28. *See* Tyler M. Dumler, *Charging Less to Make More: The Causes and Effects of the Corporate Inversion Trend in the U.S. and the Implications of Lowering the Corporate Tax Rate*, 13 U.C. DAVIS BUS. L.J. 89 (2012)(examining the causes and effects of tax avoidance schemes, including the corporate inversion trend, pursued by U.S. multinational corporations (INCs)).

29. *See Corporate Inversion: Hearing on S. 2119 Before the S. Subcomm. on Treasury and Gen. Gov't of the Comm. on Appropriations*, 107th Cong. 39 (2002)(statement of William Gale, Senior Fellow and Deputy Director for Economic Studies, The Brookings Institution)(examining in depth the inversion cost due to lost taxes).

30. *See Principles for Comprehensive Income Tax Reform: Testimony Before the United States S. Comm. on Finance*, 110th Cong. (2008) (statement of Daniel N. Shaviro, Wayne Perry Professor of Taxation, New York University School of Law) [hereinafter Shaviro] (detailing Professor Shaviro's statements on the need to reform U.S. tax policy); THE WHITE HOUSE, FISCAL RESPONSIBILITY SUMMIT 29 (Feb. 23, 2009) [hereinafter FISCAL RESPONSIBILITY SUMMIT].

31. *See* David Cay Johnston, *Keynote Address at the Kansas Journal of Law & Public Policy's 2012 Symposium, Corporate Tax Reform: Making America Competitive*, 21 KAN. J.L. & PUB. POL'Y 371, 372 (2012)(calling for active reform of the American tax system).

32. *See* Shaviro, *supra* note 30 (providing Professor Shaviro's viewpoint on re-evaluating the corporate income tax); FISCAL RESPONSIBILITY SUMMIT, *supra* note 30; *see also* Michael Doran, *Managers, Shareholders, and the Corporate Double Tax*, 95 VA. L. REV. 517, 518 (2009) ("[A] recent turn of the wheel has again put forth one of the more intriguing reform proposals: relief from the double taxation of corporate income."); David Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1637 (1999) (citing opponents of double taxation); *see generally* George K. Yin, *Corporate Tax Reform, Finally, After 100 Years*, TAX ANALYSTS 114 (2009) (arguing for changing the tax system).

33. *See* Noel B. Cunningham & Mitchell L. Engler, *Prescription for Corporate Income Tax Reform: A Corporate Consumption Tax*, 66 TAX L. REV. 445, 445 (2013) ("[T]here is a

President Obama has declared a need to revise the corporate income tax.[34] Corporations spend significant resources trying to navigate or circumvent the corporate income tax.[35] The Treasury Department recently advised that relief from the double corporate tax would increase overall economic growth.[36] Furthermore, the United States has one of the highest statutory and effective corporate tax rates in the world.[37] Some experts have advanced that the corporate tax policy has diminished the United States' competitiveness, costing jobs and decreasing the tax base.[38] They have suggested that corporate integration would make the United States more competitive by lowering or eliminating the corporate income tax rates.[39]

Vertical equity and fairness are missing, however, from the discourse. Absent from the debate regarding the state of the corporate income tax and integration, is the prospect that corporate integration could further vertical equity by increasing progressivity, and eliminating the repressiveness of the corporate tax policy. As one commentator noted, if a study of the deals made by Bain Capital Management was done it would reveal that most of the deals would have been organized as a pass through entity because "virtually the only tax ever paid is the 15% by the owners of the firm."[40] Ensuring that accredited investors with high incomes carry a higher tax burden than lower income, non-accredited, investors will eliminate the regressivity of the corporate tax policy combined with the accredited investor standards.

widely-shared bipartisan view that the corporate income tax is a 'bad' tax that is desperately in need of reform or repeal").

34. THE WHITE HOUSE & DEPT. OF THE TREASURY, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM (2012), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf.

35. JOINT ECON. COMM., REFORMING THE U.S. CORPORATE TAX SYSTEM TO INCREASE TAX COMPETITIVENESS (2005), *available at* http://www.jec.senate.gov/republicans/public/?a=Files.Serve&File_id=f1647b9a-4418-4bb1-8b03-941a528ae6fc.

36. DEPT. OF THE TREASURY, TREASURY CONFERENCE ON BUSINESS TAXATION AND GLOBAL COMPETITIVENESS: BACKGROUND PAPER 1–2, 710 (2007), *available at* http://www.treasury.gov/press-center/press-releases/Documents/07230%20r.pdf [hereinafter TREASURY CONFERENCE].

37. *See* ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT TAX DATABASE, CORPORATE AND CAPITAL INCOME TAXES, *available at* http://www.oecd.org/tax/tax-policy/tax-database.htm#C_CorporateCaptial [hereinafter OECD Corporate Rates 2009](showing the United States with the second highest corporate tax rate and the highest central government corporate tax rate); *see also* TREASURY CONFERENCE, *supra* note 36, at 35 (stating within the OECD, the United States has the second highest statutory corporate rate and the fourth highest effective marginal rate).

38. *Id*. at 1–2.

39. *See* TREASURY CONFERENCE, *supra* note 36 (explaining the positive effects of corporate integration).

40. Johnston, *supra* note 31, at 374.

IV. THE CORPORATE TAX

The structure of the corporate income tax is not aligned with the vertical equity principle and imposes a higher burden on other taxpayers. The corporate income tax is often referred to as a double tax, but technically the term "double tax" is not accurate because there is not an equal tax applied twice. Instead, there is a corporate income tax, and then a second tax at the individual shareholder level on earnings generated by the corporation that are distributed to the shareholders, and the increase of value in the stock when the shareholder sells his investment.[41] The undistributed earnings of the corporation increase the value of the corporation's stock so that earnings of the corporation are taxed to shareholders either as distributions or when the stock is sold.[42]

A. *Rationales for the Corporate Tax*

The rationales behind the corporate tax must be evaluated to ensure that those principles are still relevant all these years later, and to make certain that alternative methods of corporate tax and integration can still achieve the relevant goals. One of the most prevalent justifications for the tax policy on corporations is that the corporate income tax serves as a means to tax wealth, particularly because when it was enacted, there was no individual income tax.[43] This was the reasoning given for enacting the corporate tax in 1909.[44] Back when it was enacted, the corporate tax was an effective method for reaching wealth since much of the wealth in the United States was held in corporations.[45] At that time, the corporate income tax was seen as a means of maintaining or increasing progressivity and

41. *See* Taylor, *supra* note 5, at 246 ("[A] ten dollar dividend from a share of stock is no different from a ten dollar increase in the value of the same stock. Yet the realization model taxes the dividend but not the increase in value.").

42. *See* DEPT. OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2004 REVENUE PROPOSALS 11 (2003), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2004.pdf (providing that earnings retained by a corporation increase the value of the stock and as a result, the value of the stock reflects the retained earnings).

43. Bank, *supra* note 1, at 452, 478 (arguing that a corporate income tax was enacted as a means to reach the growing amount of wealth held in intangible assets such as stock).

44. The corporate tax in 1909 was actually an excise tax intended to reach wealthy taxpayers after the Supreme Court had ruled the income tax unconstitutional in 1894. *Id*. at 478; U.S. CONST. amend. XVI; Tariff Act of 1913, ch. 16, 38 Stat. 114, 166–81.

45. *See* Steven A. Bank, *Is Double Taxation a Scapegoat for Declining Dividends? Evidence from History*, 56 TAX. L. REV. 463, 478 (2002) (explaining the reasons behind passing corporate taxation).

avoiding the significant evasion that was common.[46] When the Sixteenth Amendment to the Constitution was passed, the individual income tax was enacted and resulted in the two layers of tax on corporate income.[47]

However, the preferred investment vehicles for the wealthy are different from the investment choices available in 1909. In 1909, there were no hedge funds, limited liability companies, or complex financial products. Accordingly, wealth is held and invested differently today than how it was in 1909, and yet tax policy on corporate income taxes has not kept pace with these changes. For example, investments in partnerships and many limited liability companies are not subject to an entity level tax. Instead, only the investor bears the burden of the tax in his personal income tax rates. Consequently, the current corporate income tax encourages self-integration when choosing the entity to form a business and the type of investment options, such as choosing the partnership form rather than the corporate form, and subsequently the choice of investments in the different entities.[48] However, since these investment choices are limited to accredited investors, the corporate tax policy becomes regressive because non-accredited investors do not have the option of self-integration through investment choice, and therefore bear a higher tax burden than higher income taxpayers.

"Up to 40% of all stocks in the United States- and between 60% and 85% of stocks held by domestic agents such as mutual funds, pension funds, and insurance companies are now kept in tax-deferred plans."[49] Tax deferred plans imply that the individuals are not paying tax yet, but the implications of the regressive nature of the corporate tax still affect stock held in tax deferred plans because the corporation is paying the income tax and, therefore, the indirect equity investment held by the taxpayer carries the tax burden of the corporate income tax. When the taxpayer withdraws his investment, he will be subject to tax at ordinary income tax rates, not just on the deferred income from his labor, but also on the appreciation value of his equity investment.

Congress used the corporate tax as a way to regulate corporations

46. *See* JANE GRAVELLE, CRS REPORT FOR CONGRESS, CORPORATE TAX INTEGRATION: ISSUES AND OPTIONS 3 (1991) (arguing while progressivity is often given as a justification, it may be overstated); *see generally* STEPHEN FRANCIS WESTON, PRINCIPLES OF JUSTICE IN TAXATION 283 (1903)(examining the tax system's complications through an analysis of the political, economic and ethical principles of taxation).

47. U.S. CONST. amend. XVI; Tariff Act of 1913, ch. 16, 38 Stat. 114, 166–81.

48. *See generally* DEPT. OF THE TREASURY, INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS: TAXING BUSINESS INCOME ONCE vii (1992), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/integration.pdf (describing different methods of integration).

49. Rydqvist, *supra* note 23, at 3 (2012).

before the Securities Acts of 1933 and 1934.[50] After these acts were passed, however, Congress did not also review the corporate tax in light of no longer needing this second layer of oversight.

The varied tax structures and disparate tax burdens for different types of entities are normally rationalized by the assumption that distinct business entities have distinct privileges and design entitling them to different tax burdens. Absent, however, in this analysis, is the recognition that only wealthy or high income taxpayers deemed "sophisticated" accredited investors can invest directly in most of these entities, while the vast majority of taxpayers are limited to investments in publicly held corporations. Unfortunately, this consideration has been neglected when deciding corporate tax policy.

The income generated from businesses has changed with time as well. Business income received by unincorporated forms of business increased from twenty-one percent in 1980 to fifty percent in 2008.[51] Revenue is a significant consideration for any corporate integration recommendation. The potential for revenue loss if the corporate income tax is repealed is often identified as a potential barrier to corporate integration.[52] Some have argued that the corporate income tax is not in fact a significant source of revenue.[53] The challenge then becomes apportioning the tax burden from the missing revenue among the taxpayers that should properly bear the tax burden. However, in most contexts, placing the responsibility for the lost revenue on the corporation is misplaced. Rather, the revenue obligation is more fittingly assigned to the individual investors because it is individuals that carry the burden of the corporate income tax.[54] There is a debate over who ultimately bears the incidence of the corporate tax: shareholders

50. SEC Regulation D: Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933, 17 C.F.R. §§ 230.501, 230.504 (2010) (defining an accredited investor as also including someone who has over $1,000,000 in assets at the time of the purchase of the investment).

51. J. GREGORY BALLENTINE, EQUITY, EFFICIENCY AND THE U.S. CORPORATE INCOME TAX 5 (1980); *see* STEVEN A. BANK, FROM SWORD TO SHIELD, THE TRANSFORMATION OF THE CORPORATE INCOME TAX, 1861 TO PRESENT xviii (2010) [hereinafter FROM SWORD TO SHIELD] (noting that the corporate income tax still does serve as meaningful revenue source).

52. *See* David J. Shakow, *Wither, "C"!*, 45 TAX L. REV. 177, 213 (1990) ("A significant political problem with a proposal for corporate integration is that it would eliminate all or part of the corporate tax, a significant source of federal revenues.").

53. *See* Yariv Brauner, *The Non-Sense Tax: A Reply to New Corporate Income Tax Advocacy*, 2008 MICH. ST. L. REV. 591, 592-593 (2008) (citing Organization for Economic Co-Operation and Development, Revenue Statistics 1965–2006 (2007)).

54. David A. Weisbach, *The Irreducible Complexity of Firm-Level Income Taxes: Theory and Doctrine in the Corporate Tax*, 60 TAX L. REV. 215, 218 (2007); JOINT ECON. COMM., *supra* note 35, at 2.

through less profits, consumers through higher prices or labor through lower wages or unemployment.[55] Recent studies indicate that the burden of the corporate income tax falls on labor.[56] Ultimately, however, whether it is the investor or the consumer or labor, the corporate tax is not borne by the corporation, but by individuals.

Another outdated explanation for the corporate income tax is the benefit theory. A separate justification for the corporate tax, known as the benefit theory of limited liability, was that the various legal protections corporations receive due to their classification as a separate entity justified the tax.[57] The benefit theory asserts that because the shareholders of corporations are entitled to limited liability, this limited liability is a taxable government service.[58] Notwithstanding the limited liability that shareholders enjoy, because of the similar limited liability enjoyed by members in a limited liability company, limited partnerships and other types of entities not subject to an additional tax for this government service, this theory is no longer relevant.

The two layer corporate income tax is frequently justified as a way to raise revenue.[59] Some argue that the revenue from corporate income is overstated.[60] Many corporations pay taxes and do generate revenue. However, if the corporate tax is revised, any perceived lost revenue can be made up by taxing the appropriate individuals, the investors, which would increase the burden on the wealthier taxpayers with a greater ability to pay, resulting in more corporations remaining in the United States rather than

55. *See* Adam H. Rosenzweig, *A Corporate Tax for the Next One Hundred Years: A Proposal for a Dynamic, Self-Adjusting Corporate Tax Rate*, 108 NW. U.L. REV. 1029, 1032 (2014) (discussing different sides of the argument).

56. WILLIAM M. GENTRY, DEPT. OF THE TREASURY, A REVIEW OF THE EVIDENCE ON THE INCIDENCE OF CORPORATE TAX 32, 35 (2007); JULIE-ANNE CRONIN ET AL., DEPT. OF THE TREASURY OFFICE OF TAX ANALYSIS, DISTRIBUTING THE CORPORATE INCOME TAX: REVISED U.S. TREASURY METHODOLOGY 2 (2012), http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-T2012-05-Distributing-the-Corporate-Income-Tax-Methodology-May-2012.pdf; Bruce Bartlett, *Who Pays the Corporate Income Tax*, N.Y. TIMES ECONOMIX BLOG (Feb. 19, 2013, 6:00 AM), http://economix.blogs.nytimes.com/2013/02/19/who-pays-the-corporate-income-tax/ (summarizing 4 recent articles discussing the incidence of the corporate income tax).

57. *See* BALLENTINE, *supra* note 51, at 5 (stating "[w]hile limited liability may provide very large benefits, it is a virtually costless government service"). While this is true, limited liability is provided by the state corporate codes, not by the federal government or the federal taxing authority. Thus, the federal government was taxing corporations on a "benefit" that it did not bestow upon them.

58. *Id*.

59. *See, e.g.*, FROM SWORD TO SHIELD, *supra* note 51, at xviii (noting that the corporate income tax still does serve as meaningful revenue source).

60. *See* BALLENTINE, *supra* note 51, at 7 ("The need for revenue as the sole reason for a tax could give rise to odious taxes.").

leaving through corporate inversions and similar techniques.[61]

The corporate income tax is also used as a tool for taxing foreign investors and tax-exempt investors that invest in corporate equity and would escape taxes without applying the tax at the corporate entity level.[62] Some of these tax-exempt entities are deferred tax plans and other retirement plans where the investments will ultimately be subject to tax when the investments are distributed.

B. *The Impact of the Corporate Tax on Fairness*

The cumulative tax rate on corporate earnings is essentially a flat tax and not in any way progressive, despite the goals of vertical equity. The tax rate on corporate equity investments is the same regardless of a taxpayer's income level. The progressivity reflected in the tax rates on corporate income was eliminated in 2003 and only returned in a moderate form in 2013. However, when coupled with the choices that a high-income taxpayer can make as an accredited investor, whether the system reflects any vertical equity is tenuous. Prior to 2003, dividends were taxed as ordinary income, while the sale or exchange of an investment was characterized as capital.[63] The progressivity of ordinary income rates ensured that high-income taxpayers at least carried a higher tax burden with respect to dividends, if not other capital gains.[64] In 2003, dividend taxation

61. *See* Jon Greenberg, *Sanders: One out of four corporations pay no taxes*, Tampa Bay Times, *available at* http://www.politifact.com/truth-o-meter/statements/2013/sep/26/bernie-s/sanders-one-out-four-corporations-pay-no-taxes/; Robert S. McIntyre, Matthew Gardner & Richard Phillips, The Sorry State of Corporate Taxes: What Fortune 500 Firms Pay (or Don't Pay) in the USA and What They Pay Abroad — 2008 to 2012 (2014), *available at* http://www.ctj.org/corporatetaxdodgers/sorrystateofcorptaxes.pdf.

62. *See* Reuven S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1201-1202 (2004) (explaining the defenses of the current corporate tax structure).

63. Jobs and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA"), Pub. L. No. 108-27, 117 Stat. 752, Sec. 302. When dividends were taxed as ordinary income, some taxpayers were able to use the corporate form to shelter income when their individual ordinary rates would have exceeded the corporate rate. This assumes investors chose to invest in corporations rather than other options available to them as accredited investors. *See* Mark P. Gergen, *How Corporate Integration Could Kill the Market for Corporate Tax Shelters*, 61 TAX L. REV. 145, 156 (2008) (describing the decision-making process for choosing a corporate form when considering tax implications); *see also* Gravelle, *supra* note 46, at 5 (discussing the different tax statuses); William Plumb, *The Federal Income Tax Significance of Corporate Debt: A Critical Analysis and Proposal*, 26 TAX L. REV. 369, 374–75 (1970) (analyzing how corporations' accumulation of earnings can enable shareholders to avoid the double-tax).

64. I.R.C. § 1(a)-(c). While ordinary income tax rates are intended to be progressive in their increasing in percentage as income levels increase, whether they are in fact progressive

was revised and dividends and capital gains were taxed at a flat 15%, regardless of a taxpayer's income level. In 2013, capital gains rates were amended to be more progressive and, as a result, dividend tax rates jumped from 15% to 18.8% (15% plus 3.8% from the Medicare) for joint taxpayers making over $250,000 up to 23.8% (20% plus 3.8%) for joint taxpayers that make over $400,000.[65]

In addition to the capital gains rates on dividends, the corporate income tax rate is also not progressive. The corporate income tax rate is a flat 34%.[66] Combining that tax with the capital gain tax results in a total individual tax rate, applicable to income generated by corporations of between 43.9% and 49.75%.[67]

Further exacerbating the lack of vertical equity and the regressive nature of the corporate income tax is the fact that income tax rates are higher than non-accredited investors' ordinary tax rate. The individual income tax rate ranges from 35% to 39.6% for taxpayers earning between $405,100 and $457,600 respectively.[68] For taxpayers earning less than $300,000, the minimum income level needed to meet the accredited investor standard, the tax rate drops from 33% to 10% while the typical corporate tax rate ranges from 35% to 38%.[69] As this illustrates, the corporate income tax rate is higher for non-accredited investors than their personal tax rate, whereas the corporate income tax is lower than the tax rate for accredited investors. The higher tax rate on corporate income means non-accredited investors bear a higher tax burden on their investment income than from their earnings from labor or interest.[70] The ability to choose among investments in various types of entities, and in particular tax-efficient pass though entities, affects the tax burdens on investors.

Vertical equity supports progressive tax systems by imposing a larger portion of the income tax on those with both a greater ability to pay and more disposable income. Ironically, the corporate income tax may actually

is questionable. Ordinary income tax rates are essentially flat once a taxpayer earns over $375,000, whether that be $3,750,000 or $375,000,000. However slight, the ordinary income rates on dividend income formerly offered a semblance of progressivity for non-accredited taxpayers.

65. I.R.C. § 1(h)(11).

66. The rate changed to 35% for a brief period and then returned to 34%. I.R.C. § 11.

67. I.R.C. § 1 (a), (b), (c), (h). The current corporate tax rate according to I.R.C. § 1 is 35%. Therefore, if a corporation earns $100, its income tax will be $35, leaving $65 to be distributed to shareholders. The current capital gains rate in I.R.C. § 1(h) is 15%, so the tax on the $65 would be $9.75. This means out of $100 in earnings $44.75, or 44.75%, is taxed.

68. I.R.C. § 1 (a).

69. I.R.C. § 11 (a).

70. I.R.C. § 1(a), (b), (c), (h); I.R.C. § 11.

be regressive, as those with lower incomes potentially have a higher tax burden than those with larger incomes. The combination of preferential capital gain rates, high corporate income tax rates, and the limitation on the investment choices of non-accredited investors results in a regressive tax burden.

Some contend the burden created the corporate income tax is progressive because, although the income tax rates are flat, the taxpayers bearing its burden are the wealthy, who hold the vast majority of corporate stock.[71] However, while this viewpoint may have been accurate in the past, it is no longer an accurate characterization of corporate stock ownership. Although the corporate income tax was originally enacted as a proxy for tax wealth, since the wealthy are no longer the primary stockholders, the income tax actually primarily affects ordinary shareholders and institutional investors. Strebulaev and his coauthors, Kristian Rydqvist and Joshua Spizman of Binghamton University in New York, made the empirical discovery that up to 70% of all stocks in the United States - held by domestic agents such as mutual funds, pension funds, and insurance companies - are now kept in tax-deferred plans. They found "[i]n the United States, just after the war [World War II], households directly own[ed] 90% of the stock market; by 2010, this figure has come down to below 30%. The share ownership has largely migrated to financial institutions that have ascended to the largest holder of equity. In 2010, domestic financial institutions own almost 50% of U.S. stocks."[72] They estimated that "up to 40% of all stocks in the United States between 60% and 85% of stocks held by domestic agents such as mutual funds, pension funds, and insurance companies—are now kept in tax-deferred plans."[73]

Some academics dismiss the need for integration or the treatment of ordinary taxpayers by claiming that despite the tax rates, the wealthy ultimately bear the burden of the corporate tax. Resolving which taxpayers bear the burden of the corporate income tax is a fundamental question to appropriately designing the tax.[74] There are three parties who each may bear the majority of the tax burden: investors, consumers, or labor.[75] The

71. Bank, *supra* note 51, at xviii.

72. Rydqvist, Spizman, & Strebulaev, *supra* note 23, at 2.

73. *Id*. at 1-2.

74. *See* William M. Gentry, *A Review of the Evidence on the Incidence of the Corporate Income Tax*, DEPT. OF THE TREASURY (2007) *available at* http://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/ota101.pdf (noting the uncertainty of who bears the burden of the corporate tax); *see also* Emil Sunley, *Corporate Integration: An Economic Perspective*, 47 TAX L. REV. 621, 623-26 (1992)(analyzing how various forms of corporate integration would affect the tax burden).

75. Gentry, *supra* note 56; *see also* Gravelle, *supra* note 46, at 34-35 (discussing tax burdens).

latest studies conclude labor bears most of the corporate tax's burdens rather than investors.[76] Because of how the primary investors in corporations have changed, regardless of whether the burden is placed on investors or labor, the ordinary taxpayer bears the tax burden (as opposed to the wealthy or even corporations themselves).[77]

C. *Fairness in Light of the Issues Raised by Accredited Investor Standards*

Wealthy taxpayers, because they are accredited investors, have investment options. If they find investing in corporations to be too expensive, the wealthy have the freedom to make less expensive investments, enabling better returns and creating less of a tax burden. Corporations typically carry a higher tax burden than partnerships.[78] Ordinary taxpayers, however, do not have this choice and are limited to investing in highly taxed corporate stock.

The tax legislation that provided that dividends from corporations would be taxed at capital gains rates, rather than ordinary income, mitigated some of the regressive nature of the tax burden placed on non-accredited investors. However, it did not eliminate the regressive nature of the corporate income tax itself. It did not make the tax burdens placed on equity ownership progressive and did not result in vertical equity.

Vertical equity is not possible because of the accredited investor rules. Taxpayers with enough income or wealth to qualify as an accredited investor can choose from identical investments, some of which are taxed at the investor's tax rate because ownership is through a partnership or an limited liability company as compared with others that would bear the burden of the corporate income tax, as well as ownership takes the form of corporate stock. The accredited investor can choose which investment will be more economically efficient. Non-accredited investors, in contrast, are limited to only investing in corporate stock, even though that investment carries a high tax burden. This choice, or lack there of, coupled with the tax policies in place for taxing corporate income and stock versus partnership ownership create a regressive tax burden. "[T]he double tax puts the public businesses at a disadvantage" to private businesses not subject to two layers of taxation, demonstrating the lack of vertical equity.[79] The only investment option available to non-accredited investor taxpayers, save for specific

76. *Id*. at 32-35.

77. *See* David Weisbach, *supra* note 54, at 218 (explaining who bears the burden of corporate tax).

78. *See* Bank, *supra* note 51, at xii–xiii (comparing the tax burden of various entities).

79. Doran, *supra* note 32, at 528.

limited exceptions, is to invest in a public corporation. However, tax policy provides that corporations face a double tax, an initial tax on corporate income and a second tax on distributions to the shareholder. Partnership income, however including income from LLCs taxed as partnerships, is typically only taxed once.

Only accredited investors are permitted to invest in both public corporations and pass-through entities. Non-accredited investors are considered too unsophisticated to invest in the partnership or the LLC taxed as a partnership. As a result, ordinary taxpayers who are not accredited investors face a higher tax burden. Corporate investments bear an average tax of thirty percent, whereas investments in partnerships are taxed at a twenty percent rate.[80] "Effective tax rates on corporate equity capital are seventy percent higher than rates on non-corporate equity capital."[81]

In the debate over corporate integration, many critics of integration demonstrate a disregard of non-accredited investors. Some argue the double tax is elective because taxpayers can simply choose to invest in either a corporation or in an entity such as a partnership or LLC.[82] However, non-accredited investors cannot choose between these investments. The corporate income tax is elective for accredited investors, but not for non-accredited investors.[83]

Because non-accredited investors are not considered sophisticated enough to invest in entities with a single layer of tax, it could be argued that the higher tax burden these taxpayers face is instead the cost of better security in their investments as provided by oversight by the Securities and Exchange Commission. Essentially, the higher tax burden imposed on non-accredited investors could be seen as a fee the investor must pay for government supervision. "Whether it makes policy sense or not, the corporate double tax serves as a toll charge imposed by the government on

80. Bank, *supra* note 51, at xii–xiii.

81. *See* Gravelle, *supra* note 46, at 14 (providing that there is "no ideal solution . . . as long as tax-exempt entities maintain their preferential tax treatment").

82. *See Tax Reform for Fairness, Simplicity, and Economic Growth, Office of the Secretary Department of the Treasury*, at 135 (1984), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/tres84v1All.pdf (noting the neutrality in the selection of organizational form would eliminate such tax differences and the ability to circumvent the double tax).

83. The number of accredited individual investors was estimated to be between 5 and 7.2 million people prior to the enactment of Dodd–Frank Wall Street Reform and Consumer Protection Act, which in turn decreased the number of accredited investors by excluding primary residences from the calculation of net worth. *See* Scott Shane, *How Dodd's Reform Plan Hurts Startup Finance*, BUSINESSWEEK, March 19, 2010, *available at* http://www.businessweek.com/smallbiz/content/mar2010/sb20100318_367600.htm (examining the reduction of the number of accredited informal investors from 121,000 to 174,000 people in the United States).

accessing capital through the securities markets."[84] And because accredited investors can elect not to pay the "fee" by investing in lower tax burden investments, the fee is only mandatory for non-accredited investor taxpayers, who cannot make unregulated investments. The corporate tax penalizes businesses that choose to be corporations rather than other forms such as limited liability companies or partnerships.[85]

The violation of vertical equity caused by the accredited investor standard and the tax burden felt by investors in corporations versus taxpayers in partnerships is evidenced by the following example illustrating the after tax returns for a non-accredited taxpayer's investment in a public corporation as compared with the after tax returns of an accredited investors in a partnership. Alex is an accredited investor who invests $200,000 in a partnership, Pennsatucky, which is in the business of pharmaceutical distribution. In 2014, Pennsatucky earns and distributes $15,000 in pretax ordinary income earnings on Alex's $200,000 investment as a pass-through entity. Pennsatucky will not pay a tax on its earnings or on distribution to Alex. Alex in turn incurs a single level tax at a maximum ordinary rate of thirty-five percent on the $15,000 partnership earnings, resulting in a tax of $5,250 and an after-tax return of $9,750 to Alex, an effective tax rate of 35%. The effective rate would be even lower if the income from Pennsatucky is capital. If his income was considered capital, Alex would be taxed $3,570 and receive an after tax return of $11,430, reflecting a burden of 23.8% percent (assuming the highest capital gain tax rate).

Contrast Alex's tax burden with non-accredited investor Piper who invests $200,000 in the publicly traded corporation Dandelion, which is also engaged in pharmaceutical distribution. If Piper earns $15,000 of pretax earnings on her $200,000 investment, Dandelion will incur a corporate tax of $5,250. It can then distribute a dividend of $9,750 to Piper, who will incur a second level of tax of $1,462.50 ($65 dividend distribution multiplied by the 15% tax rate) resulting in an after tax return of $8,287.50 and an effective tax rate of 44.75%. The effective rate will not be lower for Piper, even if the income earned by Dandelion is capital. Therefore if the income is capital, Piper's after tax return will still be $8,287.50 and her effective tax rate would remain 44.75%.

The regressive nature of the corporate tax burden and the concomitant violation of vertical equity is apparent in the additional tax burden that Piper bears of 9.75 %, if the business generates ordinary income, or

84. Doran, *supra* note 32, at 528.

85. Noel B. Cunningham and Mitchell L. Engler, *supra* note 33, at 447; Joseph J. Thorndike, *The Durability of a Dysfunctional Tax: Public Opinion and the Failure of Corporate Tax Reform*, KAN. J.L. & PUB. POL'Y 347, 354 (2012).

20.95% if the business generates capital income because Piper is a non-accredited investor and can only select the Dandelion investment. In contrast, Alex can choose which entity to invest in, put forward an identical amount as Piper in the same type of business, and still generate an identical amount of pre-tax earnings on her $200,000 investment. Despite how equivalent their businesses are, Alex is bears a lower tax burden even though she is a high income tax payer. Alex has the choice to invest in either Pennsatucky or Dandelion whereas Piper is only permitted to invest in Dandelion.

Ironically, to achieve the same after-tax result as Alex (an after-tax return of $9,750), Piper, the taxpayer deemed "unsophisticated" as an non-accredited investor, will have to consistently make significantly superior investment decisions than Alex, the "sophisticated" accredited investor. Specifically, Piper will have to make an investment in a publicly traded corporation that would generate pre-tax earnings of $17,647 (compared to Alex's $15,000) on her $200,000 investment in order to realize an after tax return of $9,750. If the business generated capital income, Piper would have to select an investment in a publicly traded corporation that generates $20,688 of pre-tax earnings compared to Alex's investment earnings of $15,000 to match Alex's after-tax returns. This scenario reveals the regressive nature of the corporate income tax burden when examined in conjunction with the investment choice limitations placed on ordinary taxpayers by the accredited investor standard.

As a result of the lack of vertical equity in the tax policy for corporations and the fact that non-accredited investors face a higher tax burden on equivalent investments compared with accredited investors, non-accredited investors face greater pressure to make investments that generate significantly superior returns in order to earn a similar amount after taxes. Accredited investors are permitted to avoid paying the structural tax penalty inherent in investments in publicly traded corporations, while non-accredited investors do not have the ability to elect out of the corporate tax burden.

V. SOLUTIONS TO THE VERTICAL EQUITY ISSUE IN CORPORATE TAX POLICY

There are ultimately two possible solutions to addressing the unequal tax burden placed on non-accredited investors by corporate tax policy. The first is to revisit the accredited investor standard. The second is to revise the corporate income tax to address the inequity caused by rates and the double tax. This article is focused on the latter of these options.

There are several possible strategies to eliminating the inequity caused by the corporate tax. These include actions as simple as raising the tax rates on those who qualify as accredited investors beyond the tax rates applicable to ordinary investors. An alternative way of addressing the issue, and the focus of this article, is to integrate the corporate and individual income taxes to achieve vertical equity. This article argues that corporate integration is necessary to maintain and promote a progressive income tax. The theory of vertical equity depends upon progressive tax rates and burdens; the only way to achieve a truly progressive tax structure is to integrate corporate taxes so that those with more income carry the higher burden. To achieve vertical equity among taxpayers, all income profits and gains on equity investments, regardless of the entity invested in, should be taxed at progressive tax rates.

Correcting the lack of vertical equity on the taxation of corporate investments can also address the revenue losses that can occur as a result of corporate integration. This would not only promote vertical equity, but also would minimize revenue loss by integrating the corporate and personal income taxes. It would eliminate the double tax and reduce the tax burden for some taxpayers while increasing the tax burden for higher income taxpayers, regardless of their classification as accredited investors or the type of entity they invest in. Instead, their income tax would be based only on the amount of their income. There would no longer be a lower tax rate available to those who have accumulated wealth in the past. Under the improved regime, if a taxpayer receives income from an equity investment, the logic behind its taxation would be the greater the income, the greater the ability to pay.

In addition, if the real goal of tax policy is to tax wealth, then the partnership and hedge fund tax structures also should be overhauled to promote vertical equity.[86] It is estimated that hedge fund assets will grow to over $ 1 trillion over the next five to ten years.[87] The amount invested in partnerships and limited liability companies rather than corporations has also increased over the last 30 years,[88] with business income generated by unincorporated forms growing from twenty-one percent in 1980 to fifty percent in 2008.[89] Even if it is presumed that more high-income taxpayers hold stock, that does not change the lack of progressivity and as a result the lack of vertical equity faced by lower income taxpayers who make the

86. The number of hedge funds has increased tremendously over the last 20 years and it has been projected that the assets held in hedge funds will exceed $1 trillion in the next five to ten years. Wallis K. Finger, *Unsophisticated Wealth: Reconsidering the SEC's "Accredited Investor" Definition Under the 1933 Act*, 86 WASH U. L. REV. 733, 736 (2008-09).

87. *Id.*

88. Bank, *supra* note 51, at 258.

89. *Id.*

same investment.

A. *Taking a Look at Integration*

Corporate integration seeks to eliminate the corporate income tax and tax earnings at the shareholder level.[90] A number of experts and analysts believe the solution to corporate tax policy issues is to integrate the corporate and individual income rates so that a single rate applies to income generated by corporations. As argued by Michael Doran in *Managers, Shareholders, and the Corporate Double Tax*, "[b]oth policymakers and academics generally agree that the double tax results in significant distortions of economic and business decisions and argue for its repeal."[91] Many economists have proposed integration as a solution to the corporate tax's inefficiencies, the competitive disadvantages produced by the double layer of tax and the high expenses incurred by corporations avoiding, complying or navigating the tax.[92]

Many critics of corporate integration assume that integration "would be accomplished at a substantial cost in revenue and progressivity, since a high proportion of dividends flows to high-income, wealthy individuals."[93] However, as this article's analysis has already shown, the current corporate tax policy is regressive and contravenes vertical equity. The solution to this is corporate integration.

How integration should be implemented varies across proposals. Some proposals suggest a direct tax on shareholders on the corporation's earnings while exempting corporate income from tax. Other proposals advocate taxing the corporation on the income it generates and excluding or exempting profits distributed or recognized by the shareholders.

Full integration proposals suggest taxing corporate income at the tax rate of the corporation's shareholders and completely eliminating the two layers of tax.[94] Partnership taxation is a prevalent illustration of full integration and has been offered as a model for corporate integration.

90. Sunley, *supra* note 74, at 626.

91. Doran, *supra* note 32, at 528; *see also* American Law Institute, FEDERAL INCOME TAX PROJECT, SUBCHAPTER C: PROPOSALS OF THE AMERICAN LAW INSTITUTE ON CORPORATE ACQUISITIONS AND DISPOSITIONS AND REPORTER'S STUDY ON CORPORATE DISTRIBUTIONS 337 (1982) (highlighting "widespread discussion" on integrating corporate and shareholder taxes).

92. *See, e.g.*, Ballentine, *supra* note 51, at 7 (proposing integration as a solution to the double-level corporate income tax); Cunningham, supra note 33, at 445-448 (noting the context of worldwide policy, the competitive disadvantage created by the double tax rate on corporations in the United States).

93. American Law Institute, *supra* note 91, at 328-29.

94. *Id.*; Ballentine, *supra* note 51, at 7.

However, this mode of integration is routinely dismissed as highly complex and infeasible to administrate.[95]

Partial integration proposals are usually adaptations of two fundamental integration structures. These proposals reduce the burden imposed by the double tax, but generally retain both taxes in some form. One approach to partial integration suggests retaining the corporate income tax while allowing the corporation to take a deduction for any dividends it pays to its shareholders.[96] The second approach promotes retaining the corporate income tax, but providing a tax credit to shareholders for their share of corporate income taxes paid on dividends distributed to the shareholder.[97] Integration proposals rarely advance beyond discussion and analysis because the transition to an integrated corporate tax structure could involve significant administrative upheaval and uncertainty.[98]

1. Integration Issues with Tax-Exempt and International Investors

A significant challenge that integration proposals face is how to treat shareholders who avoid the shareholder tax under the current tax system, but are subject to the corporate income tax, in particular tax-exempt and foreign shareholders. Because of this challenge, many integration proposals focus on ways to achieve an integrated corporate tax while ensuring these unique shareholders are taxed on their share of corporate earnings.[99] Some of the proposals resulting from this type of focus are not ideal and fail to advance vertical equity or resolve the repressiveness of corporate tax policy. Instead, such proposals either maintain or exacerbate the repressiveness of the tax.

The complications involved in tailoring an integration proposal that captures these unique shareholders is especially problematic in the context of debt investments. Debt investments in a corporation are already a tax-free investment as a result of the corporate income tax deduction for interest.[100] The tax-exempt or foreign shareholder is not subject to tax on

95. *Id.* ("Many early proponents of integration have recognized a number of practical administrative problems that might be involved in shifting to a fully integrated—or even a partially integrated system."); Sunley, *supra* note 74, at 625.

96. American Law Institute, *supra* note 91, at 328.

97. *Id.*

98. *See* Ballentine, *supra* note 51, at 9 (providing that because of the difficulties of administering an integrated system, "there appears to be a temporary impasse with respect to any broadly based support for tax reform by way of integration").

99. *See, e.g.*, Gravelle, *supra* note 46 at 14 (explaining his plan for integration).

100. *See* Dept. of the Treasury, INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS: TAXING BUSINESS INCOME ONCE 1 (1992) *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/integration.pdf (explaining

their receipt of interest income (by the United States) and the amount of interest distributed to these holders is not subject to corporate income tax because of the deduction corporations are permitted for interest paid. Tax-exempt shareholders currently do not pay any tax on income they earn that is generated in partnerships and other pass though entities. Therefore, that income escapes taxation.

Over sixty percent of shareholders in publicly held corporations are tax "insensitive" investors including foreign shareholders and tax-exempt entities such as 501(c)(3) entities, tax-deferred accounts, pension plans, retirement funds, and state and local governments.[101] Hence, integration could lead to a significant revenue loss.[102]

There is, however, a point that is often overlooked when considering the tax consequences to tax-exempt entities in an integration proposal. That is that although the tax-exempt entity itself is exempt from taxation on its investments, in the case of deferred tax plans, 401(k) plans, pension plans and similar tax-exempt entities, when its corporate investments are distributed to the individual taxpayers, those taxpayers will pay tax on the amounts they receive at ordinary income rates.[103] Therefore, the earnings generated by the corporation and the appreciation in the value of its stock does not entirely escape taxation, but is merely deferred and then taxed at ordinary income rates.[104] Currently, tax-exempt entities bear their share of the corporate tax burden through the 34% corporate income tax and its investments being taxed a second time at ordinary income tax rates when distributions are made to their participants.[105]

By maintaining the corporate income tax to ensure tax-exempt entities bear a portion of the corporate income tax burden, integration proposals actually increase the tax burdens borne by individual taxpayers who hold indirect ownership in the entities' corporate investments. This again raises the specter of the regressive nature of the corporate tax as well as the limited choices of investment available to taxpayers. If the goal of these

that corporate earnings distributed as interest to debt suppliers are only taxed once since the interest is deductible and taxed to lenders as ordinary income; *see also* Gravelle, *supra* note 46 at 14 (noting the preferential tax treatment and admitting that there is no ideal solution.)

101. Rydqvist, *supra* note 23, at 2-3; *see* Doran, *supra* note 32, at 542-43 (analyzing the twenty-five percent of corporate equity held by shareholders that are exempt from income tax); Gergen, *supra* note 64, at 156 (noting that sixty percent of tax equity is held by tax-insensitive investors).

102. *See* Doran, *supra* note 32, at 542-43 (analyzing the ramifications of the percentage of corporate equity held by income tax-exempt shareholders); Gergen, *supra* note 63, at 156 (examining the makeup of investors that are not subject to income tax).

103. I.R.C. § 61(a); I.R.C § 401(a); I.R.C. § 401(k)(1); Treas. Reg. § 1.401-1(a).

104. *Id.*

105. *Id.*

proposals is to avoid lost revenue as a result of shares owned by tax-exempt entities, then other revenue sources such as the income from partnership and LLC investments should be considered to mitigate the regressive nature of taxes on corporate investment.

For similar reasons, integration proposals that support maintaining the corporate income tax and allowing dividends to be tax-exempt may actually undercut the benefits received by tax deferred and other retirement plans. If the corporate income tax is maintained and dividends are excluded from shareholder income, then the incentive to invest in tax-deferred plans is eliminated because it is just as profitable to hold stock directly rather than through a retirement plan.[106]

Although foreign taxpayers are often subject to withholding structures, many treaties deliberately exempt certain types of income, including dividend income from taxation. Therefore, integration proposals that seek to continue the corporate income tax as a means of circumventing true tax exemption for foreign shareholders do so at the expense of vertical equity and ordinary taxpayers.[107] Alternatives include modifying treaties to ensure these shareholders are subject to taxation, engaging the withholding systems that currently exist or allowing the income generated by corporations and distributed to foreign shareholders to escape taxation. Directly taxing foreign shareholders would also create more transparency in the corporate tax rules and simplify the current tax structure.

2. Integration Issues – Corporate Managers and Retained Earnings

Some experts have asserted that corporate integration has not successfully advanced into practice because corporate managers do not support integration.[108] Corporate managers prefer the two layers of tax on corporate income because it allows them to exert greater control over retained earnings. The argument is that even if shareholders prefer integration, corporate managers will continue to oppose and lobby against pro-integration policies.[109] Furthermore, many of the managers that do not openly oppose integration will at the very least demonstrate "managerial

106. *See* Doran, *supra* note 32, at 547 (acknowledging that if there were not shareholder-level taxes imposed on dividends paid by stock held outside a plan, there would be no incentive for holding it inside the plan).

107. *See* Reuven S. Avi-Yonah, *Corporations, Society and the State: A Defense of the Corporate Tax*, 90 VA. L. REV. 1193, 1205 (2004) (comparing maintaining the corporate tax to tax foreign shareholders in the United States to "letting the tail wag the dog").

108. *See* Jennifer Arlen & Debra Weiss, *A Political Theory of Corporate Taxation*, 105 YALE L. J. 325, 327 (1996) (attributing the otherwise "puzzling" persistence of the double-level tax to the lobbying of corporate managers).

109. *Id.*

diffidence" to its proposals.[110] Some have argued that the corporate tax may be justified because a unique attribute of corporations is their managers have the ability to retain earnings and use them as necessary for corporate affairs.[111]

Economic scholars used to assume that if the way dividends were taxed changed, then the dividend distribution policies of corporate managers would also change.[112] The basic assumption was that if the tax cost imposed on dividends decreased, then more dividends would be distributed.[113] Instead, more recently, scholars have opined that a change in the tax costs affecting dividends does not affect the dividend distribution policies in the long term.[114] Rather, the decisions by corporate managers regarding distributions of dividends are driven by other factors. As a result, the pressure on managers to distribute dividends from corporate income tax integration proposals should be irrelevant. Despite the reality that corporate tax policy is unlikely to affect the dividend distribution practices of corporate managers, these corporate managers continue to keep the issue at the forefront to discourage attempts at integration. The corporate managers suggest that integration proposals that provide for a deduction on dividends will be to the detriment of the corporation, as corporate managers are forced to distribute dividends because of the changes — a suggestion not supported at all by the facts. Over 70% of chief financial officers (CFOs) of dividend paying corporations asserted that dividend taxation did not, or

110. *Id*. at 327.

111. *See* Steve Bank, *A Capital Lock-In Theory of the Corporate Income Tax,* 94 GEO. L. J. 889, 893 (2006) (highlighting that managers in the corporate context may use corporate resources for "empire-building at the expense of shareholder interest"); Sunley, *supra* note 74, at 622-623 (attributing business opposite to integration to concerns regarding unfairly dispersing its benefits across and within industries).

112. *See* James M. Poterba & Lawrence H. Summers, *The Economic Effects of Dividend Taxation*, *in* RECENT ADVANCES IN CORPORATE FINANCE 267–69, 277 (1985)(discussing several competing hypotheses, based off of British data on security returns, dividend payout rates, and corporate investment, about the economic effects of dividend taxation); *see also* George R. Zodrow, *On the "Traditional" and "New" Views of Dividend Taxation,* 44 NAT'L TAX J. 497, 504-07 (1991)(providing six studies of direct empirical evidence regarding the effects of dividend taxation).

113. *See* Katherine Pratt, *Deficits and the Dividend Tax Cut: Tax Policy as the Handmaiden of Budget Policy,* 41 GA. L. REV. 503, 533 (2007)(explaining that the effects of a dividend tax cut would vary depending on the correct view of dividends—either traditional or new. For example, under the new view, a permanent dividend tax cut would result in elimination of the tax incentive to pay dividends).

114. *See* Bank, *supra* note 1, at 518-520 (demonstrating through historical analysis that previous enactments of undistributed profits tax, irrespective of their severity, generally failed to affect dividend tax policy); *see also* Poterba & Summers, *supra* note 112 (discussing the recent British tax policy changes and their applicability to the United States); Zodrow, *supra* note 112 (noting the lack of change in long term policies).

probably did not, affect dividend distributions, and 87% of CFOs at non-dividend distributing corporations stated that eliminating taxation of dividends would not, or probably would not, lead to an increase in the payment of dividends.[115] "Integration of the corporate and shareholder income taxes might not affect corporate dividend policy as significantly as its proponents predict."[116]

Recently, the amount of dividends distributed did increase after the reduction in dividend tax rates in 2003; however, many postulated that this increase was temporary.[117] Two explanations for the increase in dividend distributions include that managers were pressured to distribute more dividends at reduced rates, or alternatively, corporate managers were concerned that the reduction in dividend tax rates was temporary and therefore made distributions to take advantage of the change while they had a chance.[118] As a result, once the reduced tax rate became permanent, the pressure on managers was eliminated.[119] Second, reflecting the more recent proposition that tax policies do not affect dividend distribution rates, corporate managers pay dividends for other reasons, such as dividend payments sending a message about the health of the corporation.[120]

Corporate managers prefer to retain earnings, which gives them the discretion to spend or save these funds.[121] Therefore, corporate managers will evaluate integration proposals based on how they affect distribution, retention policies, and strategies.[122] Corporate managers argue that by incentivizing distribution of retained earnings, Congress would be substituting its own business judgment for the judgment of corporate officers regarding the best time to distribute earnings.[123] The double tax on corporate income creates an incentive to retain earnings because leaving

115. Bank, *supra* note 1, at 517.

116. *Id*. at 466.

117. *See* Pratt, *supra* note 113, at 517 (discussing the 2003 dividend tax cut, where Bush proposed a dividend exclusion that "would have permitted shareholders to exclude from income 100% of dividends on corporate earnings that had already been fully taxed on the entity level").

118. *Id*. at 533–34.

119. *Id*.

120. *Id*. at 535 (citing Alon Brav, et. al., *Payout Policy in the 21st Century*, 77 J. FIN. ECON. 483 (2005).

121. *See* Bank, *supra* note 112, at 933-34 (positing that managers would rather that corporations rely on outside financing resources than take from their retained earnings by changing their dividend policy).

122. *See also* Gergen, *supra* note 64, at 156 (stating that in evaluating proposals, managers aim to maximize shareholder value).

123. *See* Bank, *supra* note 112, at 933-34 ("A forced change in dividend policy would effectively substitute 'the blanket judgment of Congress and the Treasury department, based on a general theory,' for the individual judgment of business managers, based on their direct knowledge of the needs of their particular company'").

the earnings in the corporation allows them to grow subject to only one level of taxation, avoiding the second dividend level tax.[124] Some analysts have suggested that corporate managers are willing to subject corporate earnings to a second layer of tax if it preserves their ability to control the distribution of earnings.[125] Consequently, rather than seeking the repeal of the double tax on corporate earnings, corporate managers express support for reduced tax rates or other tax preferences.[126] Individual taxpayers also have an incentive for the corporation to retain the corporate earnings. When the tax rate for individuals is higher than the tax rate for corporations, higher income taxpayers may prefer leaving the earnings in the corporation, which permits those earnings to grow subject to the lower corporate tax rate.[127] In this manner, the corporate form can serve as a tax shelter for high-income taxpayers.[128] Larger distributions could help vertical equity in the sense that more distributions allow for a greater ability to pay taxes.

Although corporate managers are protective of their control of retained earnings, the practice is subject to criticism. High amounts of retained earnings were cited as one of the causes of the Great Depression.[129] Critics argued that the practice of retaining high amounts of earnings gave business managers too much confidence, causing them to act outside the best interests of the corporation.[130] Recent corporate scandals raised similar criticisms, as some observers attributed the misuse of funds to the practice of corporate managers' accumulation and hoarding of those corporate funds.[131]

124. *Id.*

125. *See* Bank, *supra* note 1, at 466 ("[e]ssentially, business agreed to trade double taxation and higher corporate income tax rates for the right to retain earnings without government interference.").

126. Bank, *supra* note 51, at 193; Sunley, *supra* note 74, at 622-623.

127. *Id.*

128. *See* Gergen, *supra* note 63, at 156 (explaining that a large portion of a company's income can be shielded from being reported as taxable income by maximizing shareholder value through serving an identified tax clientele. That clientele benefits by having its tax attributes inputted into the company's financial test for evaluating projects.).

129. Bank, *supra* note 1, at 466, 506.

130. *See* REXFORD G. TUGWELL, THE INDUSTRIAL DISCIPLINE AND THE GOVERNMENTAL ARTS 205 (1933)(explaining that the government has a social responsibility to regulate economic matters including business managers' practice of retaining high amounts of earnings); 75 CONG. REC. 6341 (1932) (statement of Rep. McFadden) (arguing that corporations' profits were too large, and that after dismissing workmen and cutting dividends sold to the public, with remaining surpluses, these corporations no longer benefitted the public or the corporations themselves); Speech Before the Democratic National Convention (July 2, 1932), 1 PUB. PAPERS AND ADDRESSES OF FRANKLIN D. ROOSEVELT 651 (1938) (providing that corporations retained unnecessary surpluses and expanded needlessly and speculatively, which led to the Great Depression).

131. *See* Steven A. Bank, *The Dividend Divide in Anglo-American Corporate Taxation*,

Because of the issues raised by retained earnings, full integration proposals such as the partnership model, or the total elimination of the corporate income tax, are likely not feasible. Some form of the corporate income tax must continue to ensure that retained earnings are subject to tax, and are not forever exempt by being held within the corporation.[132] Otherwise, the corporate form would serve as a tax shelter for high-income taxpayers until they sold their interests in the corporation.[133] It could also permit high-income taxpayers to completely escape taxation by holding onto the stock until death, and receiving a step-up, allowing the corporate earnings to completely escape taxation.

3. Integration Proposals

The Dividend Exclusion Method

The 2003 reduction in dividend tax rates was an attempt at partial integration through dividend exclusions, which meant that the corporate income tax stayed intact, but the shareholders reduced their tax rate on dividends received.[134] Originally the proposal had been to completely exclude dividends, but a modified version was ultimately enacted.[135] Corporate managers objected to the proposal because they were concerned about the possible pressure from investors to distribute tax-free earnings.[136] Although the 2003 dividend rate cut was a move toward corporate and income tax integration, it did nothing to alleviate the regressive nature of corporate tax policy. Because the progressive ordinary income rates were

30 J. CORP. L. 1, 6 (2004-2005) (describing the concern that Enron and associated scandals were associated with the reported decline in dividend paying companies and President Bush's proposal to eliminate double taxation was partially justified to address such a concern).

132. Ballentine, *supra* note 51, at 8.

133. *Id*. at 7 ("To omit any tax on retentions allows a large loophole for investors to channel their savings through corporations tax-free.").

134. Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, § 302, 117 Stat. 752 (2003).

135. H.R. 2, 108th Cong. § 201 (2003) (enacted); S. 2, 108th Cong. § 201 (2003) (enacted); *see* DEPT. OF THE TREASURY, GENERAL EXPLANATIONS OF THE ADMINISTRATION'S FISCAL YEAR 2004 REVENUE PROPOSALS 12 (2003), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2004.pdf (providing an overview of the proposal for eliminating double taxation of corporate earnings); *see also* Pratt, *supra* note 110, at 517(describing President Obama's 2003 dividend exclusion proposal that would have allowed shareholders to exclude all dividends on corporate earnings that were already fully taxed on the entity level).

136. Pratt, *supra* note 135 at 520–22,571 (stating others have argued that dividend tax cuts were not implemented correctly and should be repealed because they are ineffective at ensuring that corporate income is taxed once, and because of revenue loss); *but see id*. at 517 (pointing out that there were at least some benefits to the dividend tax cuts).

no longer applicable to dividends, higher income taxpayers had a lower tax rate available to them, making the corporate tax policy more regressive and, once again, failing to meet vertical equity.

A dividend exclusion model could work to integrate personal and corporate taxes, and contribute to greater vertical equity, if the individual income tax rates for high-income investors were greater than the corporate income tax rates; this would ensure that income generated from non-accredited investors would face a higher tax burden. Many countries in the European Union moved to a dividend exclusion model after the shareholder credit method was successfully attacked in the European Court of Justice.[137] The dividend exclusion method of integration also ensures that tax-exempt entities and foreign persons are subject to at least one level of tax on their corporate equity investments.[138]

The Shareholder Credit Method

Another integration model that could be modified to promote the principles of vertical equity is the shareholder credit method. Many foreign countries have also enacted this form of integration.[139] In the shareholder credit model of integration, the corporate income tax remains intact; the corporation pays the tax, and when dividends are distributed to shareholders, they also receive a tax credit equal to the relative portion of the corporate income taxes paid on those distributions. Therefore, while the corporation pays the tax, the corporation's income is ultimately imputed to the shareholder. This method could serve vertical equity and eliminate the current regressive quality of the corporate tax. If the tax rates on dividends were progressive, and, as a result, high-income taxpayers had a tax rate higher than the corporate income tax rate, then the credit would alleviate some of the tax burden but provide for an additional tax on the proceeds. On the other hand, low-income taxpayers' tax burden would be met by the credit. Certain shareholder credit models go further to improve vertical equity by allowing shareholders a refundable credit, so if the taxpayer's personal tax rate is lower than the corporate tax rate, he or she actually gets a refund.[140] This would make the corporate tax more progressive. Moreover, some shareholder credit proposals suggest that the corporate income tax rate should match the highest personal income tax rate to

137. *See* Michael J. Graetz & Alvin C. Warren, Jr., *Income Tax Discrimination and the Political and Economic Integration of Europe*, 115 YALE L. J. 1186, 1212 (2006) (detailing countries in the European Union's tax policies).

138. Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 DUKE L. J. 1021, 1025, 1033 (1996-97).

139. *See* Gravelle, *supra* note 46, at 14.

140. Bank, *supra* note 51, at 225.

prevent the corporation from serving as a tax shelter for high rate individuals.[141] A downside to this approach, however, is that it raises corporate tax rates even higher, which may further damage the competitiveness of the United States.[142]

The CBIT

The Treasury Department designed an integration model in 1992 called the Comprehensive Business Income Tax (CBIT). The goal of the CBIT was to integrate personal and corporate income taxes, and at the same time, come up with equivalent tax rules for partnerships and other types of business.[143] This type of proposal could have achieved vertical equity among investment types by establishing the same tax models for equity investments by both accredited and non-accredited investors, provided the tax rates are progressive. The CBIT taxes almost all businesses alike, regardless of form.[144] In the original CBIT proposal, most distributions received would be excluded from tax.[145] Because the CBIT would serve a flat tax on investment income, it would not create a more progressive tax burden, although it would alleviate the regressivity in current corporate tax policy.[146] Moreover, the CBIT could create an even more regressive system because of ability-to-pay concerns.

Accordingly, to achieve vertical equity within the CBIT system, the corporate tax rate would have to be lower than the tax rate available to other types of entities that non-accredited investors are precluded from investing in, or there would have to be an additional tax to high-income taxpayers on their investment to create the necessary progressivity. The CBIT did safeguard the revenue from tax-exempt and foreign investors who would not escape taxation under the CBIT.

Similar to the shareholder credit method, because it may require a higher tax rate to maintain progressivity, it might not enhance the competitiveness of the United States internationally.

The BEIT

The Business Enterprise Income Tax (BEIT) is an integration proposal designed by the former Chief of Staff of the Joint Committee on Taxation, Edward Kleinbard. The BEIT taxes all income from equity interests in

141. Gergen, *supra* note 63, at 146.

142. American Law Institute, *supra* note 91, at 393; GRAVELLE, *supra* note 46, at 14.

143. DEPT. OF THE TREASURY, INTEGRATION OF THE INDIVIDUAL AND CORPORATE TAX SYSTEMS: TAXING BUSINESS INCOME ONCE 39 (1992), *available at* http://www.treasury.gov/resource-center/tax-policy/Documents/integration.pdf.

144. *Id*.

145. *Id*.

146. *See* Sunley, *supra* note 74, at 632 (discussing the affect the CBIT would have).

partnerships and corporations at an identical rate.[147] The corporation receives a deduction for a fixed percentage of its capital, and the investors receive a tax bill for a corresponding fixed percentage on their investment (debt or equity). The individual taxpayers pay the tax.[148] The BEIT removes the regressivity of the corporate tax because investors are assessed a tax under the BEIT, and then also pay tax on the income they receive at their personal income tax rates. An investor in a corporation is taxed on his investment based upon an imputed rate of return, regardless of the amount distributed.[149] The BEIT imposes an entity tax rate between twenty-five to twenty-eight percent.[150] The investor tax rates would be graduated and progressive.[151] If investors receive distributions exceeding the imputed percentage, there is an additional tax.[152] The BEIT reverses the regressivity of current corporate tax policy because the personal tax rates on the investment income are progressive, and equity investments in partnerships no longer have a lower tax burden than equity investments in corporations, putting accredited and non-accredited investors on equal footing.

Nonetheless, the BEIT does not completely resolve lack of vertical equity. The BEIT creates an ability to pay issue and an affordability issue. The BEIT requires investors to pay tax on these percentages even if the investment loses value.[153] The BEIT imposes the tax even on investments that lose value, under the assumption that the decrease in value must be illusory otherwise investors would dispose of the investment.[154] As a result,

147. *See* Edward D. Kleinbard, *Rehabilitating the Business Income Tax*, BROOKINGS INSTITUTION THE HAMILTON PROJECT (2007) [hereinafter *Rehabilitating the Business Income Tax*](presenting Kleinbard's BEIT proposal for parallel taxation of capital income, including integrating taxes at the corporate and individual levels); *see also* Edward D. Kleinbard, *The Business Enterprise Income Tax: A Prospectus*,106 TAX NOTES 97, 98 (2005)[hereinafter *The Business Enterprise Income Tax*](describing the BEIT as a means of minimizing the role of tax considerations in business thinking, by implementing, among others, a single tax system); *but see* Alvin Warren, *The Business Enterprise Income Tax: A First Appraisal*, 118 TAX NOTES 921, 926 (2008) (…).

148. Warren, *supra* note 147, at 98.

149. *Id*.; Warren, *supra* note 147, at 97-98; Kleinbard, *Rehabilitating the Business Income Tax, supra* note 147 at 36.

150. Kleinbard, *Rehabilitating the Business Income Tax, supra* note 147 at 36

151. *Id*.

152. *Id*.; Warren, *supra* note 147, at 921, 925.

153. *See Rehabilitating the Business Income Tax*, *supra* note 147 (discussing the fact that the BEIT is able to achieve a comprehensive and consistent taxation of capital income and reduce tax-planning incentives, by integrating taxes at the corporate and individual levels, ensuring that all income is taxed once); *but see* Warren, *supra* note 147, at 921, 928 (2008) (arguing that the BEIT perhaps does not achieve all of its goals and purposes).

154. *See Rehabilitating the Business Income Tax*, *supra* note 147 (discussing the logistics and implementation of the BEIT); Kleinbard, *The Business Enterprise Income Tax:*

the BEIT creates an ability to pay issue, forcing taxpayers who lack sufficient liquidity to sell their investment to pay the tax bill.[155] If the investment has lost value, ultimately the taxpayers recognize that loss when the investment is sold because of basis adjustments, but the taxpayers with a lower ability to pay would still be forced to sell their investment because of this nuance in the proposal.[156] Further, not all of the tax rates in the BEIT are progressive; if excess distributions are made, those distributions are taxed at a flat rate.[157] To promote vertical equity, the proposal would have to be amended, however, to provide for progressive rates on excess distributions.

The BEIT also does not resolve how to address tax-exempt investors.[158] The BEIT makes suggestions for numerous options regarding tax-exempt shareholders, including taxing them or excluding them altogether, but does not advocate a particular position.[159] Moreover, the BEIT simply exempts foreign investors from taxation.[160] It is unclear how these changes could affect revenue.

Finally, other integration proposals such as business activities tax (BAT), the consumption tax, the value-added tax (VAT), and the flat tax propose taxing income at flat rates. As a result, they would not serve to promote vertical equity.[161]

The Deduction for Dividends

A corporate deduction for dividends distributed is another alternative that could create vertical equity in corporate tax policy while not affecting the accredited investor rules.[162] This method of integration leaves the

A Prospectus, supra note 147, at 100 (expanding further on the BEIT); *but see* Warren, *supra* note 147, at 921, 929 (arguing against the presumption that decreases are illusory).

155. *Id*.

156. *Id*.

157. *See Rehabilitating the Business Income Tax*, *supra* note 147 (distinguishing between flat and progressive taxes); *but see* Warren, *supra* note 147, at 921, 927 (providing an alternate interpretation of the BEIT's flat and progressive tendencies).

158. *See* Kleinbard, *Rehabilitating the Business Income Tax, supra* note 147, at 36 (explaining the fact that BEIT would not affect tax-exempt investors is not a flaw with BEIT).

159. *Id*. at 36-38.

160. *Id*. at 36.

161. *See generally* Cunningham & Engler, *supra* note 33 (proposing an integrated corporate and income tax as a consumption tax, as well as explaining other versions of VAT and flat taxes as solutions to the corporate integration issue). However, because the article does not recognize the current lack of equity in the corporate tax as a result of accredited investor standards and the corporate tax rate, these solutions do not serve to address vertical equity issues.

162. The dividend deduction method had been enacted earlier in the history of the corporate income tax. However, it was short lived and was enacted during a different

underlying corporate tax in place, allowing Congress to continue to use the corporate tax as a tool to regulate or control corporate behavior. The corporation calculates its corporate tax and then is permitted a deduction for any dividend distributions it paid. Any earnings that are retained are typically still taxed in a dividend deduction proposal, and shareholders must pay a tax on the amounts they are distributed. If the tax on the shareholders is progressive, this method can eliminate the regressive nature of the corporate tax with respect to the amounts that are distributed, because just like equity in other types of investments, corporate equity would only be subject to a single layer of tax. Another benefit of choosing an integration method that leaves the corporate tax in place is that corporate earnings are not able to escape taxation entirely by using the estate tax. Without a corporate income tax, a shareholder could hold onto stock as it appreciated in value and receive a step-up in basis to the fair market value at death, allowing the corporate income to escape taxation.[163] If a shareholder seeks to use the estate tax to circumvent the corporate tax, the earnings left in the corporation will be taxed because they are not distributed.

Despite those benefits of a dividend deduction, it is possible that tax-exempt and foreign shareholders could escape all taxation on their share of corporate earnings because the tax at the corporate level is eliminated for distributions. This method is often criticized because of the difficulty in taxing foreign investors.[164] If the dividend deduction were chosen as the integration method, this special class of taxpayers could be subject to a direct tax and subject to withholding or completely excluded from tax. Another critique of the dividend deduction integration method is that it could put pressure on corporate managers to make distributions of earnings to shareholders, because the corporate tax only applies if earnings are retained; if they are distributed, there is a deduction.[165] A possible solution is to provide an allowance for capital investments, such as deductions for depreciation and research and development credits.

The American Law Institute (ALI) has lent its support in the past to a

economic time. *See e.g.* STAFF OF THE JOINT COMM. ON TAXATION, BACKGROUND MATERIALS ON BUSINESS TAX ISSUES PREPARED FOR THE HOUSE COMMITTEE ON WAYS AND MEANS TAX POLICY DISCUSSION SERIES (Doc JCX023-02) (2002), *available at* http://www.jct.gov/x-23-02.pdf (discussing foreign and domestic taxation).

163. 26 U.S.C. § 1014 (2014).

164. *See* U.S. DEP'T. OF THE TREASURY, *supra* note 48, at 107 (explaining why a dividend deduction is against US policy).

165. *See* Bank, supra note 1, at 535 (explaining why it is beneficial for shareholders to allow managers to retain earnings); *see also* Mark P. Gergen, *supra* note 63, at 156 (explaining that where shareholders pay the initial tax, managers are indifferent to reported income).

dividend deduction method of integration, suggesting that dividends on newly issued shares receive some degree of tax relief.[166] The ALI's proposal was restricted to newly issued equity because a deduction on previously issued equity could create a windfall for earnings already built into stock existing at the time of enactment.[167] Moreover, the ALI did not suggest a complete dividend deduction, which might create pressure on corporations to distribute excess or extraordinary dividends to take advantage of the deduction.[168] The Treasury Department has also raised the possibility of integration through partial dividend deduction. In 1984, it recommended 50% corporate deduction for dividends paid.[169] The subsequent Presidential tax proposal the following year included a 10% corporate dividend deduction.[170] Neither proposal received the support of Congress or businesses.

The partial deduction for dividends would serve to lower the tax burden on corporate equity investments, but it would not completely alleviate the lack of vertical equity because the accredited investor standards would still permit high-income taxpayers to invest in equity that non-accredited investors could not at a lower tax burden. In addition, while the partial deductions would lower the rate, it would not lower them enough to create a progressive tax system when compared with the effective rates on other business entities.

A full dividend deduction would meet the goals of vertical equity. The income generated by the corporate investments would be taxed at individual taxpayer's personal income tax rates, which would be progressive. This single layer of tax, mirroring how the income generated from pass though entitlements is taxed at the personal income rates, would mean that the distortion created by the accredited investor standard would no longer prevent vertical equity. Because the tax burden on these investments would now be progressive, the regressive nature to the corporate tax policy would be eliminated. The difficulty to enacting a dividend deduction is, similar to the BEIT, how to treat tax-exempt and foreign shareholders. The dividend deduction method of integration would result in an increase in the competitiveness of the United States.

In addition, this integration method is likely to garner opposition from

166. American Law Institute, *supra* note 91, at 328; Alvin C. Warren, Jr., AM. LAW INST., Integration of the Individual and Corporate Income Taxes, Reporter's Study of Corporate Tax Integration (1993).

167. *Id. at 330;* see also Thomas D. Griffity, 23 SANTA CLARA L. REV. 715, 739 (1983) (explaining the problematic windfall).

168. American Law Institute, *supra* note 91, at 330.

169. U.S. DEP'T. OF THE TREASURY, *supra* note 82, at 124.

170. *See* STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 162, at 47 (explaining the history of dividend tax deduction proposals)

corporate managers because of the tax that would remain on retained earnings. If a corporate income tax deduction for dividends were enacted, corporate managers might spend as much money as possible to avoid being forced to make distributions and retain control over corporate earnings, even to the detriment of the corporation. For example, corporate managers might seek out expenses that are deductible immediately, rather than capital expenditures, which might be a wiser investment in the long run, to avoid paying taxes on retained earnings. A solution could be to create a capital investment and cash reserve fund that is exempt from the corporate income tax until the capital project is sold, or as long as the cash is reserved for certain types of expenses such as employment contracts, research and development, or other preferred expenses.

4. Issues with Integration

Rationales made by observers for why corporate integration proposals fail include speculating that resistance to corporate tax integration proposals emanates not only from corporate managers, but also from industries that benefit from two layers of tax (i.e. investment banks, accounting firms and others that profit from creating corporate income tax shelters), and tax-exempt shareholders.[171] Another possible reason why the two layers of tax on corporate income continue is a fear of the unknown. While inefficient and cumbersome, it is familiar and has withstood economic upheaval, and there is risk involved in changing the corporate income tax structure. Although the ideal time for a significant change in corporate tax policy is during an economic recovery, such as the dramatic policy changes made following the Great Depression,[172] it can be an intimidating proposition because of this aversion to risk.

Hesitancy to adopt an integration tax policy also results from the perception that the general public disapproves of corporate integration.[173] It is conceivable that the public perceives the integration of corporate and shareholder taxes as a "corporate tax break" and overlooks the reality that individual taxpayers ultimately bear the burden of the corporate income tax while corporations are simply a conduit to collect it.[174] "The public is

171. *See* Doran, *supra* note 32, at 521 (explaining opposition to changing double taxation).

172. *See, e.g.*, Revenue Act of 1936, ch. 690, Pub. L. No. 74-740, 49 Stat. 1648 (establishing a major tax overhaul on corporations); *Hearings on H.R. 12395 Before the S. Comm. on Fin.*, 74th Cong. 93 (1936) (statement of M.L. Seidman, chairman, Tax Committee, New York Board of Trade).

173. *See* Brauner, *supra* note 7, at 593 (arguing that it is hard to change taxing policy because of popular sentiment).

174. The number of accredited individual investors was estimated to be between 5 and

typically in favor of taxing corporations, yet they are frequently confused about who bears the burden of the tax."[175] The public tends to prefer the corporate tax to other alternative ways to raise revenue, viewing the corporate tax as a way to address cynicism about corporate tax behavior.[176]

Furthermore, the lack of vertical equity has been absent from the integration debate. As a result, the general public is ignorant to the high tax burdens applicable to corporate investments, in contrary to the low tax burdens faced by higher income taxpayers, who are accredited investors with the choice of other investments options unavailable to most of the general public.[177]

Another reason there has been little momentum to actualize and integrate corporate income tax is that, in addition to generating revenue, the corporate income tax is also a valuable tool for Congress to control corporations. Congress can influence the governance of corporations and maintain oversight of corporate management by providing tax incentives and disincentives to corporate managers.[178] Nevertheless, whether these attempts at regulating corporate behavior have been successful and merit the additional complexity and tax burdens the corporate income tax carries is questionable. Consider, for example, the regulation of executive compensation, which has been ineffective.[179] The tax rules are generally ineffective at influencing the compensation practices in corporations, which makes the government relatively powerless unless the compensation package somehow violates securities laws.[180] Congress can use the corporate tax to encourage investments in retirement accounts by establishing many types of retirement accounts as tax-exempt entities.

Ultimately, the corporate income tax may exist today not because it represents the best corporate tax policy, but because abolishing the

7.2 million people prior to enactment of Dodd–Frank Wall Street Reform and Consumer Protection Act, *supra* note 13, at 413, which decreased the number of accredited investors by excluding the primary residence from the calculation of net worth; *see* Shane, *supra* note 84 (discussing number of accredited informal investors).

175. Clausing, *supra* note 4, at 419.

176. *Cf.* Thorndike, *supra* note 85, at 360 (discussing the public's support of the corporate tax).

177. *See* JOINT ECON. COMM., *supra* note 35, at 2 (explaining that the public does not realize who bears the burden of taxes); see also David Weisbach, *supra* note 54, at 218 (explaining it is individuals, not firms, who bear the burden of taxes).

178. *See* Avi-Yonah, *supra* note 62, at 1245-49 (explaining the regulatory role of corporate tax).

179. *See generally* Meredith R. Conway, *Money for Nothing and the Stocks for Free: Taxing Executive Compensation*, 17 CORNELL J. L. PUB. POL'Y 383 (2008) (discussing Congress' attempts to tax executive compensation).

180. *Cf. id.* (discussing the ineffectiveness of Congress' attempts to rein in executive compensation).

corporate income tax would be controversial and, therefore, a politically unpopular position to take.[181] Although such a change would create vertical equity and remove the regressive nature of corporate tax policy, the general public does not recognize that the corporate income tax is primarily borne by the shareholders or individuals and not by the corporate entity.[182] Additionally, corporate managers are likely to oppose any such proposals because they risk losing the benefits of the corporate income tax, including control over retained earnings as well as industry specific tax breaks that many corporations seek from Congress.[183]

CONCLUSION

Corporate tax policy is outdated and no longer accurately affects the wealth it was enacted to tax. Instead of taxing the intended wealthy, the corporate tax burdens lower income taxpayers with an unfairly high tax burden, while those with higher incomes are able to avail themselves of lower tax burden investment choices. This is a violation of the fundamental tax principle of vertical equity. Because non-accredited investors are limited to investments in corporate entities, by the accredited investor standards, the higher tax burdens imposed under the tax code violates principles of fairness. Meanwhile wealthy and high-income taxpayers can choose between investing in corporations or investments with lower effective tax rates.

Corporate tax policy combined with the accredited investor standards cause distortions in individual and business' behavior and investment choices and penalize ordinary taxpayers. Furthermore, corporate tax policy has become complicated and difficult to navigate and administer. The tax rates are prohibitive, causing the United States to lose competitiveness. Integration of the corporate and income taxes can resolve these issues, creating vertical equity and reducing regressivity while increasing the competitiveness of the corporate tax policy of the United States. Many of the integration proposals made to date focus on the taxation of tax-exempt entities and foreign persons, as well as the interests of corporate managers to the detriment of the fairness to non-accredited investors. Many of the models of integration ignore the lack of fairness and vertical equity in

181. *See generally* Avi-Yonah, *supra* note 62, at 1211 (explaining the general public's reticence to changing the corporate tax); *but see* Brauner, *supra* note 7, at 629 (arguing that the assumption that the assumptions regarding the purpose of corporate taxes are incorrect).

182. *See* Avi-Yonah, *supra* note 62, at 1211 (explaining the generally held view that the public views corporations as bearing the burden of corporate tax).

183. *See* Sunley, *supra* note 74, at 622 (explaining the business communities' opposition to changing the tax laws).

current corporate tax policy, while others are under the perception that integration many actually reduce vertical equity. Despite these misconceptions, most integration policies, with some slight modifications, can achieve these goals and serve to increase vertical equity.

Corporate investment is subject to two layers of tax. At current rates, this is a flat tax. In addition, because the burden of the corporate tax typically falls on labor, it is a regressive tax that violates vertical equity.[184] Moreover, the corporate rate itself is so high that the tax has a tendency to be regressive because it is the only tax rate available to non-accredited investors, while high-income accredited investors have other investment choices that include investments subject to a single tax rate.[185] Even if that single rate is at ordinary income levels, the accredited investor bears a 35 percent burden while the non-accredited investor bears a 44.75 percent tax burden on an investment in an otherwise identical business. This imposes an additional 9.75 percent tax on the non-accredited investor merely because he does not have a high enough income level to select the more tax-efficient investment. The inequity is magnified if the companies earn capital gain income, giving the accredited investor a fifteen percent tax rate, which is 29.75 percent lower than the tax rate of the non-accredited investor. Hedge funds, partnerships, limited liability companies, and a variety of other business choices are only available to accredited investors who earn high incomes or have a certain amount of wealth. This makes the double tax on corporations unfair from both a vertical and a horizontal equity standpoint.

Finally, to address the vertical inequity and the loss of revenue, this proposal suggests that all investment income be subject to progressive, ordinary income tax rates. With essentially a single layer of tax, the tax burden to non-accredited investors would significantly decrease while those with higher income levels would see their effective tax rates increase, raising revenue and promoting vertical equity.

184. *See* GENTRY, *supra* note 56, at 32, 35 (explaining that corporate tax generally falls on labor).
185. *Id.*