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Curbing Executive Compensation: A New Tax Scheme

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INTRODUCTION

In 1916, Henry Ford faced a legal battle with shareholders in Ford

Motor Company (including, most notably, the Dodge brothers) over a plan to end the company's practice of giving special dividends.[1] The Dodge brothers wanted to force the company to continue giving special dividends and Ford wanted to end the practice in order to use the cash to expand operations.[2] Ford, who was the President of the company, said his motivation for this shift was "to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes."[3] While the Michigan Supreme Court would eventually rule against him, Ford's plan was simple: share the success with workers through higher wages and more hiring, and with customers through less expensive cars which will earn their loyalty and their business.[4] More than ninety-five years later, Howard Schultz, Chief Executive Officer (CEO) of Starbucks, appeared on the Piers Morgan Show and asked American corporations and executives to realize the same principle—that "success is best when it's shared."[5] In the same interview, Schultz implored CEOs of American companies to put short-term profits aside and use company funds to invest in the long-term success of their country and their companies, claiming that the private sector "can't wait for Washington" to act to fix the ailing U.S. economy.[6] Given the state of the economy and the unseemly growth in executive compensation while employee wages and job growth remain stagnant,[7] it is now Washington who cannot wait to act.

This Article suggests that a first step towards action ultimately rests on the simple premise that the fruits of any successful endeavor must be shared equitably with those who gave their effort to bring about that success. In this context, equity requires that the profits of large corporate enterprises should be shared according to some positive relationship with the risk of loss and the responsibility for success. Working from that premise, it is unacceptable that the profits of large corporate enterprises are currently shared by a few and the losses are

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1 Dodge v. Ford Motor Co., 204 Mich. 459, 474 (1919).

2 *Id.*

3 *Id.* at 505.

4 *See id.* at 508 (holding that when a board of directors acts with a philanthropic motive that only incidentally benefits shareholders, the court should step in and protect the immediate interests of the shareholders).

5 Interview by Piers Morgan with Howard Schultz, Chairman, President & CEO, Starbucks Coffee Company, on *Piers Morgan Tonight* (Mar. 21, 2012), *available at* http://transcripts.cnn.com/TRANSCRIPTS/1203/21/pmt.01.html.

6 *Id.*

7 Matt Krantz & Barbara Hansen, *CEO Pay Soars While Workers' Pay Stalls*, USA TODAY, Apr. 4, 2011, http://www.usatoday.com/money/companies/management/story/CEO-pay-2010/45634384/1.

spread amongst the many.[8] The chief culprit in bringing about such an unacceptable state of affairs is the unchecked and undisrupted growth of executive compensation.[9] This Article argues that in order to reduce the current inequities of the compensation of executives as compared to employees, Congress should tax the earnings of executives in excess of 100 times that of the average employee at a rate of 90%. Such a tax will help to reduce the grossly disparate inequality of earnings between executives and average employees because executives will either make less money after taxes, will negotiate smaller compensation packages, or average employees will be paid more.

The text that follows consists of four main parts. Part I reviews the current executive compensation tax scheme as it relates to executive salaries. Part II then reviews the current executive compensation tax scheme as it relates to non-salary compensations. Part III details the shortcomings of the current executive compensation tax scheme. Part IV then argues that executive compensation should be deemed excessive if it surpasses 100 times the gross yearly wages of the average employee. Additionally, Part IV argues that executive compensation regulation through the tax code is best met by imposing a large individual tax burden on executive compensation. In conclusion, this Article contrasts this proposed legislation scheme by comparing it to the current executive compensation tax scheme.

I. THE CURRENT STATE OF TAX TREATMENT OF EXCESSIVE SALARIES

There are several provisions in the Internal Revenue Code (IRC) that attempt to limit and regulate executive compensation, but these provisions fall short of success.[10] The provisions have targeted wages in general, incentive-based pay, and large payments made to executives who are leaving the company (often called "golden parachute payments").[11] These options have been largely fruitless in reigning in executive compensation and it is important to understand where they fall short.[12]

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[8] *See* Jena McGregor, *Crazy Data Point of the Day: How Much CEO Pay vs. Worker Pay Has Grown*, POST LEADERSHIP (May 11, 2012, 1:48 PM), http://www.washingtonpost.com/blogs/post-leadership/post/crazy-data-point-of-the-day-how-much-ceo-vs-worker-pay-has-grown/2012/05/11/gIQArUISIU_blog.html.

[9] *See id.*

[10] *See, e.g.*, Pamela F. Olson, Assistant Secretary of the Treasury, S. Fin. Cmte. Testimony, Apr. 8, 2003, 6–7, *available at* http://www.finance.senate.gov/imo/media/doc/040803potest.pdf (detailing the role of the tax code in regulating executive compensation in the context of the Enron investigation).

[11] *Id.*

[12] *See generally*, Joy Sabino Mullane, *Incidence and Accidents: Regulation of Executive Compensation Through the Tax Code*, 13 LEWIS & CLARK L. REV. 486, 490-91 (June 2009).

A. IRC Section 162(a)(1) Limits Wage Deductions to Wages that are Reasonable but Has Not Been Applied in the Context of Large Corporations

Congress has directed the Internal Revenue Service (IRS) to attempt to regulate executive wages directly with two provisions in the tax code.[13] The first provision is IRC § 162(a)(1), which only allows a deduction for wages that are reasonable.[14] Courts have fashioned a two-prong test to determine whether wages are deductible under § 162.[15] First, the payments have to be intended as wages, and second, the amount of compensation has to be reasonable under all circumstances of the business.[16] To determine whether compensation is reasonable under all circumstances, courts have adopted a multifactor test that lists circumstances relevant to the issue of reasonableness.[17] The multifactor test, as laid out in *Elliotts Inc. v. Commissioner*,[18] includes the following: (1) the employee's role in the company, (2) the compensation paid to similarly situated employees in similar companies, (3) the character and condition of the company, (4) whether a conflict of interest exists, and (5) the consistency of the payments.

While some have argued that § 162(a)(1) should be used to limit the compensation paid to employees of all corporations, the IRS has only invoked this particular provision when it is attempting to recharacterize payments made to owners of closely held corporations as nondeductible expenditures.[19] For example, assume a corporation is owned and operated by one person who pays himself a wage. That wage is deductible to the corporation and is only taxed as wages to the individual.[20] If the wage is unreasonable in amount then the IRS can argue that a portion of it should be characterized as a dividend,

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[13] I.R.C. §§ 162(a)(1), (m).

[14] I.R.C. § 162(a)(1).

[15] *E.g.*, Summit Publishing Inc. v. Comm'r, 59 T.C. 833, 835 (1990).

[16] *Id.*

[17] *Id.*

[18] 716 F.2d 1241 (9th Cir. 1983); *but see* Exacto Spring Corp. v. Comm'r, 196 F.3d 833, 838 (7th Cir. 1999) (arguing that the multifactor test "does not provide adequate guidance to a rational decision" and adopting an "independent investor test" that relies on a company's return on equity calculation to determine reasonable compensation). The independent investor test looks at a corporation's return on equity and asks if an independent investor would be satisfied with such a return. In *Menard Inc. v. Commissioner*, the circuit court overturned a Tax Court ruling that $20 million was unreasonable compensation based on the company's return on equity. *See* 560 F.3d 620, 628 (7th Cir. 2009). In doing so, the court largely ignored evidence about how the executive's efforts created the company's profits and evidence regarding similarly situated companies and executives. Other circuits have used the "independent investor" standard to supplement, rather than supplant, the *Elliotts, Inc.* factors. *See, e.g.*, Beiner Inc. v. Comm'r, 88 T.C. 297 (2004).

[19] *See* Aaron Zelinsky, Comment, *Taxing Unreasonable Compensation: § 162(a)(1) and Managerial Power*, 119 YALE L.J., 637, 639 (2009).

[20] Treas. Reg. § 1.162-7(b)(1).

which is not deductible to the corporation. In that event, the amount is taxed as profit to the corporation at the time that it is earned and then taxed again as a dividend when it is distributed.[21] So, if a company pays a compensation package that violates the reasonableness terms of § 162(a)(1), the corporation is unable to deduct the portion of the payment that is unreasonable.[22]

B. IRC SECTION 162(M) SPECIFICALLY TARGETS EXECUTIVE WAGES BUT DOES NOT LIMIT INCENTIVE-BASED PAY

IRC § 162(m) is specifically targeted at executive wages in publicly traded corporations and disallows a deduction to the corporation for wages paid in excess of $1 million.[23] In 1993, § 162(m) was enacted as an attempt to reign in executive compensation that, even then, was considered out of control.[24] Since its enactment, § 162(m) has been popular for noting the failure of the tax code to have any deterring effect on executive compensation.[25] It includes a provision that allows compensation of over $1 million to be deemed reasonable if the compensation was awarded for meeting performance goals, called incentive-based pay.[26]

In order to avoid the $1 million limit, a performance goal needs to be pre-established and objective, but it does not need to be based on a positive business result.[27] While a performance goal that is "substantially certain" to occur is not eligible for the incentive-based pay exclusion from § 162(m), a goal that is merely easy to attain is eligible.[28] Ultimately, if compensation is not tied to a performance-based goal, such as the structure of incentive-based pay, or is tied to one that is not substantially certain to occur, the corporation is unable to deduct any compensation over $1 million.[29] Accordingly, incentive-based pay has become the dominant form of executive compensation in America.[30]

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[21] *See, e.g.*, Charles McCandless Tile Serv. v. United States, 191 Ct. Cl. 108, 112 (1970).
[22] *Id.*
[23] I.R.C. § 162(m) ("In the case of any publicly held corporation, no deduction shall be allowed under this chapter for applicable employee remuneration with respect to any covered employee to the extent that the amount of such remuneration for the taxable year with respect to such employee exceeds $1,000,000.").
[24] Keith Epstein & Eamon Javers, *How Bill Clinton Helped Boost CEO Pay*, BLOOMBERG BUSINESSWEEK, Nov. 26, 2006, http://www.businessweek.com/magazine/content/06_48/b4011079.htm; *see also* Gemma Lee & Hongfei Tang, CEO Pension and Deferred Compensation (Jan. 30, 2011), *available at* http://business.gwu.edu/finance/seminar/lee-tang-1-30-2011.pdf (draft article, Stillman School of Business, Seton Hall University).
[25] Epstein & Javers, *supra* note 24.
[26] I.R.C. § 162(m)(4)(C).
[27] Treas. Reg. § 1.162-27(e)(2)(i)–(ii).
[28] *Id.* § 1.162-27(e)(2)(vii); *see also* Epstein & Javers, *supra* note 24.
[29] I.R.C. § 162(a), (m).
[30] *See, e.g.*, Federal Deposit Insurance Corporation, 76 Fed. Reg. 72 (proposed Apr. 14, 2011)

II. The Current State of Tax Treatment of Non-Salary Compensation

A. IRC Sections 421–24 Offers Incentives to Executives to Accept Incentive-Based Pay Arrangements that Follow the Statutory Rules

The term "incentive-based pay" refers to payments to employees, usually high level and thus highly compensated employees, for reaching certain goals or, commonly, for improving the company's financial position.[31] It can come in many forms, such as simple cash payments, statutory incentive stock options (ISOs), nonstatutory incentive stock options (NSOs), or phantom stock options.[32] Stock options bestow upon the recipient the right to purchase stock at a certain price (the 'exercise price').[33] If the stock increases in value beyond the exercise price (presumably because of the good stewardship of the company's executives) then the recipient is able to purchase stock at a discounted price.[34] If the stock decreases in value, then the option will not be exercised (meaning the recipient will not purchase the stock at the exercise price) because the holder of the option would not purchase stock at a higher price than he or she could purchase it on the open market.[35]

Statutory ISOs are options, granted pursuant to IRC §§ 421–424, which grant tax benefits to the recipients.[36] The main allure of ISOs is that they do not result in recognition of income—meaning the recipient will not be taxed on the option when it is granted or when it is exercised.[37] Instead, the recipient can defer recognizing the ISO

(to be codified at 12 C.F.R. 372(g)) (stating that incentive-based compensation is "any variable compensation that serves as an incentive for performance); *see also* Carola Frydman & Dirk Jenter, CEO Compensation (Aug. 2, 2010), *available at* http://www.econstor.eu/bitstream/10419/46273/1/64411777X.pdf (working paper, Sloan School of Management, Massachusetts Institute of Technology and Graduate School of Business, Stanford University) (explaining several ways that corporations structure executive compensation to attempt to incentivize executives to take actions that benefit shareholders).

31 *See* Frydman & Jenter, *supra* note 30, at 9 ("Executive compensation can be used to alleviate the agency problem by aligning managers' interests with those of shareholders. In principle, an executive's pay should be based on the most informative indicator(s) for whether the executive has taken actions that maximize shareholder value.").

32 *See Types of Employee Stock Options*, CNN Money, http://money.cnn.com/magazines/moneymag/money101/lesson10/index4.htm (last visited Mar. 7, 2013); *see also Stock Options, Restricted Stock, Phantom Stock, Stock Appreciation Rights (SARs), and Employee Stock Purchase Plans* (ESPPs), Nat'l. Ctr. For Emp. Ownership, http://www.nceo.org/articles/stock-options-restricted-phantom-sars-espps (last visited Mar. 7, 2013) [hereinafter *Types of Options*].

33 *Id.*

34 *Id.*

35 *Id.*

36 H.R. Rep. 108-755, at 786 (2004).

37 I.R.C. § 421(a)(1).

income until he or she sells the stock.[38] Deferring income recognition allows the recipient of stock options to avoid paying a tax before he or she has sold the stock for cash, thereby avoiding having to sell the stock to pay a tax or paying the tax out of the recipient's personal funds.[39] Additionally, deferral allows a recipient to take advantage of the time value of money.[40] The basic concept is that, due to inflation and the potential to earn interest, a dollar is worth more today than it will be years later.[41] Therefore, paying tax with today's money is more expensive than paying tax with tomorrow's money.[42] Finally, the recipient can recognize capital gain when he or she sells the stock, which is taxed at a lower rate, rather than recognizing the value of the option as wages, which are taxed at a higher rate, when it is granted or exercised.[43] In this case, the employer is not able to take a deduction for the options granted until they are exercised.[44]

NSOs, on the other hand, include all other stock options that are not granted pursuant to IRC §§ 421–24.[45] The tax treatment of these options is instead governed by IRC § 83, as are phantom stock options and simple cash bonuses. Phantom stock options are not really options at all because the recipient does not receive the ability to purchase stock.[46] He or she is simply given a cash bonus amounting to the difference between an imagined exercise price and the actual price of the stock when the bonus is due to be paid.[47] For example, if an executive signs his or her contract when the stock price is $10, he or she may be given a cash bonus that amounts to the difference between $10 (the imagined exercise price) and whatever the stock price is at the time the bonus is to be paid.[48]

IRC § 83 makes options taxable to the employee when they are granted if there is an ascertainable value to the option.[49] If there is no ascertainable value to the stock options (meaning there is no market price available for the options) then the options are taxed as ordinary

[38] *Id.*
[39] Margaret Collins, *Deferred Compensation Lets Executive Avoid 401(K) Savings Caps*, BLOOMBERG, (June 29, 2011), http://www.bloomberg.com/news/2011-06-29/deferred-compensation-lets-executives-avoid-401-k-saving-caps.html.
[40] Daniel I. Halperin, *Interest in Disguise: Taxing the "Time Value of Money,"* 95 YALE L.J. 506, 539–41 (1986).
[41] *Id.* at 517.
[42] *Id.* at 539.
[43] I.R.C. § 421(a)(2).
[44] *Id.*
[45] *E.g.*, I.R.S Internal Memo No. 20094301F (Oct. 23, 2009).
[46] *See Types of Options*, *supra* note 32.
[47] *Id.*
[48] *Id.*
[49] I.R.C. § 83(a).

income when they are exercised.[50] In the case of phantom stock options or simple cash bonuses, the cash payments are taxed as ordinary income when the money is received.[51] In these scenarios, the payment of cash or the grant of options is deductible to the company when ordinary income would be recognized by the recipient.[52]

B. IRC Sections 4999 & 280G Impose Stringent Penalties on Corporations and Executives but Only in the Limited Arena of Golden Parachute Payments

The term "golden parachute payment" is widely believed to have originated with a man named Charles Tillinghast, who was the chairman of Trans World Airlines (TWA).[53] At the time he was hired, TWA was in financial trouble and, to obtain Tillinghast's services, it promised him large cash payments if he lost his job.[54] Tillinghast was able to turn TWA around, however, and never got his golden parachute payment.[55] The practice of using golden parachute payments expanded significantly in the 1980s as a large wave of hostile takeovers led executives to request and receive contracts that paid them large bonuses if they should lose their jobs following a change in control of the corporation.[56] Finding this behavior to be unacceptable, Congress chose to act with provisions in the Deficit Reduction Act of 1984, which enacted IRC §§ 280G and 4999.[57]

Sections 280G and 4999 were meant to work in tandem to deter corporations from offering excessive golden parachute payments.[58] IRC § 280G disallows a deduction to corporations for payments made under a golden parachute payment contract and § 4999 imposes an additional 20% tax on payments received by an executive under a golden parachute payment contract. These code provisions define golden parachute payments as contracts that provide for payment that (1) is contingent on a change of control of a corporation or its assets, and (2) is more than three times the average yearly compensation paid by the corporation to the executive over the last five years.[59] The Emergency Economic

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50 I.R.S. Publication 525 (2011).

51 I.R.C. § 83.

52 I.R.C. § 162(a).

53 Claire Suddath, *Biggest Golden Parachutes*, TIME LISTS, http://www.time.com/time/specials/packages/article/0,28804,1848501_1848500_1848418,00.html (last visited Mar. 7, 2013).

54 *Id.*

55 *Id.*

56 Peer C. Fiss et al., *How Golden Parachute Payments Unfolded: Diffusion and Variation of a Controversial Practice* (Aug. 24, 2011), *available at* http://www-bcf.usc.edu/~markkenn/papers/FissKennedyDavis_2012F.pdf (forthcoming in *Organization Science*).

57 Deficit Reduction Act of 1984, Pub. L. No. 98-369.

58 Yocum v. United States, 66 Fed. Cl. 579, 583 (2005).

59 I.R.C. § 280G(a).

Stabilization Act of 2008 expanded the definition of golden parachute payments for firms who had taken bailout funds.[60] For those firms and their executives, golden parachute payments include payments that were made in severance of employment generally instead of only payments made in severance of employment after change in control of a corporation or its assets.[61]

III. Shortcomings of the Current Statutory Scheme

A. Corporate Tax Incidence Must be Born by People, not Corporations in the Abstract

No serious discussion of the success of the current executive compensation taxation scheme can avoid the subject of corporate tax incidence. As detailed above, the majority of tax laws aiming to reign in executive compensation choose to impose negative consequences on the corporation.[62] Corporations, contrary to the musings of certain public figures and the suggestions of certain Supreme Court decisions,[63] are legal entities and not natural people.[64] They are incapable of paying taxes (as well as other essential human functions) and the burden of paying taxes ultimately falls on people. There are three possible groups of people who can be ultimately held responsible for bearing the corporate tax burden (those who bear the "tax incidence") and they are (1) laborers, through decreased salaries and layoffs, (2) capital contributors, such as shareholders, or (3) customers, through increased prices or lower quality products.[65] When one of the code provisions is invoked to limit executive compensation, it is not the corporation in the abstract that is punished but one of the aforementioned groups of people.[66]

Among academics who study the corporate tax incidence, there

[60] Pub. L. No. 110-343, 122 Stat. 3765 (2008).
[61] *Id.*
[62] Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877, 881 (2007).
[63] Citizens United v. FEC, 558 U.S. 310, 322 (2010) (analyzing the free speech rights of corporations as if they were natural people even though they are just legal entities); *see also* Adam Schiff, *The Supreme Court Still Thinks Corporations Are People*, ATLANTIC (July 18, 2012), http://www.theatlantic.com/politics/archive/2012/07/the-supreme-court-still-thinks-corporations-are-people/259995/; Jack Welch & Suzy Welch, *It's True: Corporations Are People*, WALL ST. J., (Jul. 15, 2012), http://online.wsj.com/article/SB10001424052702303740704577524823306803692.html.
[64] Jennifer Arlen & Deborah M. Weiss, *A Political Theory of Corporate Taxation*, 105 YALE L.J. 325, 332 (1995).
[65] *See generally* R. Alison Felix, *Passing the Burden: Corporate Tax Incidence in Open Economies* at 1 (Oct. 2007) (unpublished article by an economist at the Federal Reserve Bank of Kansas City); *see also* CONG. BUDGET OFFICE, *The Incidence of the Corporate Income Tax* (1996).
[66] *See* Mullane, *supra* note 12, at 534.

is no consensus on which group bears the brunt of the burden.[67] For purposes of this Article, while it may be an intriguing question, it does not matter which group is mostly responsible; it matters only that neither the executives nor the fictional corporation bear the incidence of corporate taxes.[68] A corporation cannot be held responsible because the corporate form is a legal form and exists solely to give investors and decision makers protection from the risks of doing business.[69] In exchange for this mitigation of risk (though, investors and decision makers still risk their investments and their jobs) society collects the benefits of easier entrepreneurship and investment.[70] Society does not get the benefit of a non-human entity paying taxes without consequence to its stakeholders.[71]

Executives, on the other hand, are slightly harder to pin down. Thanks to incentive-based pay, many corporate executives are also shareholders, and therefore bear some of the tax incidence in that role.[72] They are also employees, and could bear some of the corporate tax incidence in that role.[73] The best example of that is found within §162(m), which limits executives' wages to $1 million. Of course, with the prevalence of incentive-based pay and golden parachute payments, it would be laughable to propose that corporate executives bear any of the corporate tax incidence through lower salaries or layoffs like traditional employees. Importantly, while executives reap incredible benefits in their role as executives, they do not bear a corresponding burden of the tax incidence for that particular role. So, while executives may bear some of the corporate tax burden in their roles as shareholders and employees, they are more than well compensated (in the form of incentive-based pay, high wages, and golden parachute payments) for that burden in their role as executives, a role for which they do not bear a corresponding tax burden.

B. The Current Tax Scheme is Too Weak to Act as a Deterrent

The current tax scheme attempts to either decrease the after-

[67] Alan J. Auerbach, *Who Bears the Corporate Tax? A Review of What We Know* (Sept. 15, 2005), *available at* http://elsa.berkeley.edu/~auerbach/bearstax.pdf (unpublished article that was presented at the NBER Tax Policy & the Economy Conference).
[68] *Id.*; Mullane, *supra* note 12, at 502 ("[A]rtificial legal entities, such as corporations, can only act through natural persons . . . . A corporation cannot bear the burden (or incidence) of taxes; only natural persons can bear the economic burden.").
[69] Karen E. Klein, *Protecting Your Personal Assets*, Businessweek (Feb. 17, 2009), http://www.businessweek.com/smallbiz/content/feb2009/sb20090212_214790.htm.
[70] *Id.*
[71] *See* Mullane, *supra* note 12, at 502.
[72] *See* Auerbach, *supra* note 67, at 5.
[73] *See id.* at 10.

tax profits of a corporation or decrease the after-tax earnings of the executive.[74] Through IRC §§ 162(a)(1), 162(m), and 280G, the tax code either imposes a penalty or denies a deduction to the corporation.[75] Alternatively, § 4999 imposes a penalty on executives receiving golden parachute payments.[76] Sections 421–24 do not impose any penalty on the executive or the company, but rather provide tax benefits to executives if their incentive-based compensation plans follow the rules of those sections.[77] In sum, there are three code sections that impose a penalty on corporations and only one that imposes a penalty on executives, but even then, only in the limited context of golden parachute payments.

The theory behind the sections penalizing the corporation is that they will lead to decreased profits and therefore corporate boards of directors will be less inclined to offer compensation packages that run afoul of those sections.[78] Practically, however, these sections contain loopholes that allow boards of directors to draft compensation agreements in any amount without being subject to the penalty or losing the deduction.[79] In the case of § 162(m), boards of directors can simply replace wages with easy to obtain incentive-based compensation; and § 280G is only applicable in narrow circumstances that can, again, be avoided by careful drafting.[80] While § 162(a)(1) could be used to limit executive compensation in large corporations, the IRS only uses the section to limit the ability of closely held companies to deduct wages.[81] These loopholes simply make these sections too weak to have any deterrent effect. While Congress could easily fix the loopholes and rewrite § 162(a)(1) to force the IRS to use it to limit deductions for wages in the public corporation setting, there will still be the problem that individuals still need to shoulder the corporate tax incidence.

The theory behind § 4999 and §§ 421–24 is that executives will be less likely to accept compensation packages that cannot conform to those code sections. Practically, however, § 4999 is only available in the limited setting of golden parachute payments and §§ 421–24 do not impose any penalty at all, but attempt to entice executives to use incentive-based compensation in a manner that conforms to those

[74] *Id.* at 5.
[75] I.R.C. § 162(a)(1) (allowing a deduction only for wages that are reasonable); *id.* § 162(m) (limiting executive salaries to $1 million); *id.* § 280G (imposing a ten percent excise tax on golden parachute payments).
[76] I.R.C. § 4999.
[77] I.R.C. §§ 421–24.
[78] Polsky, *supra* note 62, at 890.
[79] *See, e.g.*, *id.* at 891.
[80] Andrew C.W. Lund, *Tax's Triviality As A Pay-Reforming Device*, 57 VILLANOVA L. REV. 571, 575 (2012).
[81] Zelinsky, *supra* note 19, at 639.

sections.[82] Accordingly, executives are not subject to the penalty tax of § 4999 in many circumstances and simply accept qualified (under §§ 421–24) incentive-based compensation to the extent they can before accepting additional nonqualified incentive-based compensation.[83] Additionally, any lost benefit to the executive or penalty imposed on the executive can be ameliorated if a corporation agrees to gross-up an executive's compensation package.[84]

"Grossing-up" is a common occurrence in salary negotiations.[85] An executive wants to be paid a certain amount after taxes, such as after § 4999's 20% tax or the loss of the benefits bestowed by §§ 421–24, and a corporation takes that amount and grosses-up to come to a salary figure that will pay the executive his requested after-tax amount.[86] Essentially, through grossing-up, the corporation pays the extra tax, instead of the executive, and § 4999's attempt to deter executives from requesting parachute payments and §§ 421–424's attempts to entice executives into certain incentive-based pay arrangements fail.[87]

It is assumed that the problem of grossing-up executive compensation—so that executives do not lose any tax benefits or face any tax penalties—is solved through the arm's length negotiating process.[88] The theory is that corporate boards will not want to gross-up because that would be against shareholder interests.[89] Boards represent shareholders who want to keep compensation levels low to maximize return on their investments.[90] Executives want their compensation levels high because it is in their interest to make as much money as possible.[91] Furthermore, if a board is offering unacceptable (or excessive) compensation, it will be replaced by the shareholders.[92]

This thinking has two main flaws. First, a member on a board of

[82] James M. Bickley, *Employee Stock Options: Tax Treatment and Tax Issues*, CRS 2 (June 15, 2012) *available at* http://www.fas.org/sgp/crs/misc/RL31458.pdf.
[83] Lund, *supra* note 80, at 574.
[84] Len Boselovic, *Executive Jet Use, 'Gross ups' Alive, Well*, Pittsburgh Post–Gazette, Mar. 30, 2012, *available at* http://www.post-gazette.com/stories/business/news/executive-jet-use-gross-ups-alive-well-298750/.
[85] *Id.*
[86] Frederick D. Lipman & Steven E. Hall, Executive Compensation Best Practices 89 (John Wiley & Sons 2008).
[87] *See id.*
[88] Lucian Bebchuk & Jesse M. Fried, *Executive Compensation as an Agency Problem*, 17 J. of Econ. Perspective 71, 72 (2003).
[89] *See* Mullane, *supra* note 12, at 513–14.
[90] *Id.* at 536.
[91] *Id.* at 513.
[92] *See generally* Lucian Bebchuk & Jesse Fried, Pay Without Performance: The Unfulfilled Promise of Executive Compensation (Harvard Univ. Press 2004) [hereinafter *Pay Without Performance*].

directors is likely to have a skill set similar to an executive because of the skills required to make top-level business decisions.[93] In fact, a corporate board of directors is usually comprised of many executives. In either event, it is in board members' individual best interests to ensure that compensation levels paid to executives are as high as possible because their own skills or services will be more valuable.[94] This is the same interest as the executive and, when parties have the same interests, they are not negotiating at arm's length.[95] Second, shareholders are often a poor guard against excessive compensation.[96] As a group, they are often large, disorganized, and only indirectly (through pension managers or stock brokers) involved in the decision making process.[97] While executives may not get everything they want in compensation negotiations, the fact that they share many of the same self-interests as corporate boards, and that shareholders are a poor guard against excessive compensation, certainly gives them a lot of leverage.

The heart of the injustice in executive compensation is that, while economic times are good, executives are paid handsomely and laborers are, at best, paid adequately. When the company takes a turn for the worse, however, executives continue to receive large salaries and workers are laid off.[98] Nowhere has this been more evident than during the 2008 Financial Crisis. With wages essentially stagnant and a high number of citizens unemployed, executive pay rose a whopping 27% in 2010 from already high levels in 2009.[99] The same companies who apparently lack the financial wherewithal to raise wages or hire new workers at the lowest levels and salaries of their business, have found the means to reward executives with incredible raises. Additionally, companies who cut benefits for employees because of the claimed expense continue to pay for perks, such as free tax preparation or personal use of corporate jets, for their executives. It is unacceptable for the American workforce to be exploited in this manner. It is equally unacceptable for the American workforce to devote efforts to creating the profits that pay executive salaries (and to suffer the cost of layoffs when times turn bad), and then not be able to share in those profits. Therefore, it is important that the tax be levied against the right person.

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93 *Id.* at 65.
94 *Id.* at 75.
95 *Id.* at 74.
96 *See* Nathaniel Popper, *C.E.O. Pay Is Rising Despite the Din*, N.Y. TIMES, (June 16, 2012), http://www.nytimes.com/2012/06/17/business/executive-pay-still-climbing-despite-a-shareholder-din.html?pagewanted=all.
97 *Id.*
98 *PBS NewsHour*: *In a Weak Economy, Why is CEO Pay on the Rise?* (PBS television broadcast, Oct. 4, 2011) *available at* http://www.pbs.org/newshour/bb/business/july-dec11/ceopay_10-04.html (report by Margaret Warner).
99 *See* Krantz & Hansen, *supra* note 7.

IV. THE PROPOSED SOLUTION

With tax laws aimed at curbing executive compensation, the question of how corporate executives are continually allowed to consume extravagant compensation packages remains. The current tax scheme seeks to increase the tax incidence on corporations and executives who agree to excessive compensation packages by enough of a margin to discourage such activity but has failed to successfully discourage the behavior.[100] The current scheme suffers from two fatal flaws. First, the tax laws generally reduce the after tax incidence of the wrong party. Second, the scheme is too weak to have a deterrent effect.

A. GOALS OF A NEW TAX SCHEME

The hodgepodge of taxing options and their collective impotence in curbing excessive executive compensation has left many unsatisfied with the state of executive compensation,[101] and many others wondering if the tax code is the right vehicle for curbing excessive executive compensation at all.[102] Since the tax code has been impotent when it comes to curbing executive compensation, other areas of the law should be considered to accomplish that goal.[103] The provisions seeking to limit executive compensation, however, have flaws that are correctable.[104] This Article has argued that the provisions outlined above are either so lenient as to have no deterring effect, or they are aimed at the wrong taxpayer. Furthermore, using the tax code provides an opportunity to avoid direct regulation that could negatively affect the ability of companies to exercise free business judgment in deciding what to pay executives. Thus, any attempt to regulate executive compensation through the tax code should (1) be significant enough to have a deterring effect, (2) be aimed at the right taxpayer, and (3) protect the free exercise of business judgment.

1. CREATING A TAX LAW THAT IS STRONG ENOUGH TO BE A DETERRENT

A revised tax scheme should effectively deter such excessive compensation packages from being offered and accepted. Here, the lessons from the many failed attempts to regulate executive

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[100] *Id.*

[101] *See, e.g.*, Richard A. Posner, *Are American CEOs Overpaid, And, If So, What If Anything Should Be Done About It?*, 58 DUKE L.J. 1013, 1027 (2009) (arguing that executive compensation is still a significant problem).

[102] *See* Mullane, *supra* note 12, at 489.

[103] Lund, *supra* note 80, at 586.

[104] *See* Meredith R. Conway, *Money For Nothing and The Stocks For Free: Taxing Executive Compensation*, 17 CORNELL J. OF L. & PUB. POL'Y 383, 424–27 (2008) (arguing that the executive compensation tax scheme has not met its policy goal and thus some changes could significantly help).

compensation through the tax code will be of a great help. First, those tax laws which attempt to penalize the corporation—for example § 280G, § 162(a)(1), and § 162(m)—have failed because the corporation is either willing to pay the tax penalty, able to offer compensation packages that avoid the penalty altogether, or the IRS does not use the statute to reduce executive compensation in the public corporation setting. Second, attempts to entice executives to refuse excessive compensation packages through beneficial treatment or through penalties have failed because executives are not willing to limit themselves to only tax beneficial compensation and they can request that the corporation structure the compensation package to account for the tax penalty. To be a strong deterrent against excessive executive compensation packages, a new tax scheme needs to not only be free from loopholes but the rates also need to be high enough to discourage artfully structuring the package so that the corporation bears the burden.

To ensure that the new tax scheme is free from loopholes, it will be important to define the term "executive compensation" as broadly as possible. As was discovered with § 162(m), if one element of executive compensation is exempt from the tax then executive compensation will simply gravitate towards that element. When Congress enacted § 162(m), it exempted incentive-based pay and now the vast majority of the excessive compensation packages are structured around incentive-based pay.

In a new tax provision, the term "executive compensation" should include every benefit a corporation bestows upon an executive. In addition to wages and incentive-based pay, this should include any perk such as retirement packages, stock options, private use of corporate assets like planes or property, and free tax preparation. Corporations should still be free to offer, and executives free to accept, these forms of compensation, but if their collective value exceeds 100 times that of the compensation package offered to the average employee, then the executive must pay the 90% tax.

2. Creating a Tax Law that is Aimed at the Right Taxpayer

For a tax law to be effective at changing behavior, the tax incidence must be placed on the person or party making decisions regarding that behavior. For corporations, it is traditionally assumed that the corporate board of directors is the party that ultimately decides what the compensation package for executives will include.[105] In a traditional arm's length negotiation, the board of directors would either pay a salary

[105] *Pay Without Performance*, *supra* note 92, at 24.

that an executive candidate is willing to accept or will find another executive candidate that is willing to work for less compensation.[106] As mentioned previously, however, executives and boards of directors do not actually negotiate in a traditional arm's length manner and the executive has more power to decide his or her own compensation.[107]

Indeed, under the traditional arm's length negotiation model corporations do not need additional encouragement to keep executive compensation low.[108] The interest of the corporation is always to make executive compensation as low as possible, while still obtaining and retaining top talent. Imposing additional penalties on the corporation, which would actually be borne by capital-contributors, laborers, and customers, will not aid in the effort to reduce executive compensation because these groups are already properly incentivized to do just that. The problem is that those groups simply do not have enough control over executive compensation negotiations to keep them in check. Laborers and customers usually do not even have a seat at the table during negotiations. Boards of directors represent capital-contributors and have self-interests that are more aligned with the executive than with shareholders or customers. Essentially, due to the amount of the executive's control over the negotiation and lack of control by the alternative bearers of the tax incidence, the current tax law is trying to alter the executive's behavior by taxing the corporation.

3. Creating a Tax Law that Protects the Free Exercise of Business Judgment

In many ways the inherent nature of a tax accomplishes this goal. A tax makes an activity more expensive but does not wholly forbid the activity the way a direct regulation might.[109] This allows individual actors the freedom to exercise discretion in deciding whether the activity is worth its expected reward. For example, a tax would not accomplish this goal if the tax rate were 100%. In that case, the character of the tax is much more like a direct regulation that, for example, places a ceiling on compensation. Essentially, it is important for the new tax scheme to maintain its integrity as a tax and avoid serving as a direct regulation in order to protect the free exercise of business judgment.

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[106] Bebchuk & Fried, *supra* note 88, at 73.
[107] *Id.*
[108] Jim Sciutto, *CEO Pay Grows Even As Companies Slump*, ABC NEWS (Apr. 21, 2012), http://abcnews.go.com/WNT/story?id=131100&page=1 (showing that even with slumping performance, companies still have incentives to grow executive compensation).
[109] Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2596–97 (2012) (explaining that several characteristics of the individual mandate in the Affordable Care Act led to the conclusion that it was a tax rather than a penalty, including whether it may be a reasonable financial decision to pay the tax and engage in the activity being taxed).

B. TWO BALANCING QUESTIONS

Finding the right definition of "excessive" executive compensation and the right rate at which to tax it requires balancing the aforementioned goals of a new tax scheme. First, this new tax scheme needs to define excessive executive compensation in a way that preserves the strength of the law but does not take away the ability of corporations to offer, or of executives to accept, any compensation level that the two parties feel properly compensates and incentivizes an executive. Second, this new tax scheme needs to find a rate of tax that is strong enough to be a deterrent and prevents corporations from grossing-up compensation, but does not completely prevent an executive from receiving at least a portion of every dollar earned.

1. FINDING THE RIGHT DEFINITION OF "EXCESSIVE"

a. FINDING THE RIGHT REFERENCE POINT

The point at which executive compensation becomes excessive is essentially important for any law seeking to curb excessive executive compensation.[110] There are several options available for determining when executive compensation becomes excessive.[111] First, a new tax scheme could define excessive compensation in relation to the then-current market rate of pay. For example, a new law could say that executive compensation becomes excessive when it is greater than 10% of the then-current market rate of pay for the executive's position. The amount of control executives enjoy over their individual compensation levels, however, means that executives have a lot of control over the market rate of executive pay. Accordingly, defining excessive executive compensation by referencing the then-current market rate of pay gives executives too much control over the definition of "excessive" and would significantly weaken a potential new tax law.

Alternatively, the new tax scheme could define excessive executive compensation by referencing a set amount.[112] For example, a new law could say that executive compensation becomes excessive when it is greater than $10 million. This option, however, would decrease the ability of firms to freely exercise their business judgment in deciding what to pay and how to properly incentivize their executives.

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[110] Posner, *supra* note 101, at 1014.
[111] *Id.* at 1015–16.
[112] Cristopher D. Jones, *The Million-Dollar Question: Has Congress Missed the Mark with I.R.C. § 162(m) Compensation Deduction Caps?* 4, (Apr. 30, 2012), *available at* http://ssrn.com/abstract=2048810 or http://dx.doi.org/10.2139/ssrn.2048810 (unpublished paper by a Graduate Tax Scholar at Georgetown University Law Center).

Accordingly, this Article suggests defining excessive executive compensation by referencing the pay of the average employee within the corporation to determine the rate at which executive compensation becomes excessive. Referencing what excessive executive compensation is by using employee compensation as a comparison will protect the free exercise of business judgment because it will always be a company's prerogative to decide on what to compensate the average employee. Essentially, the company can control the definition of excessive (and thus can control whether their executives have to pay the additional tax) by controlling the compensation of the average employee.

Because executives decide employee compensation levels, they will enjoy a large amount of control over the definition of excessive executive compensation.[113] Referencing the pay of the average worker to determine excessive compensation, however, means that if executives exercise their control in a self-serving manner (i.e. increase the amount of compensation they can receive before it becomes subject to the penalty tax), they will also be benefiting the average employees by increasing their pay. This result would address an overarching policy goal of decreasing inequity in the corporate compensation system. Indeed, much of the outrage over executive compensation stems from comparing the amount given to executives to the amount given to the average employee. So, if employee pay increases with executive pay, then the perception of injustice within the compensation system will also decrease.

b. Finding Where Compensation Becomes "Excessive"

The level at which executive compensation exceeds the compensation of the average employee at a fair amount is a harder question. Deciding what rate executive compensation can exceed that of the average employee fairly is, to borrow a phrase from the 2008 Presidential debates, a lot like nailing Jell-O to a wall.[114] The mere fact that nailing down a rate is difficult, however, should not detract from the important task of restoring equity to corporate compensation schemes. In this pursuit, there are principles that can be used as guidance.

A recent study finds that executives currently make 185 times (a ratio of 185:1) that of the average employee.[115] Considering that 80%

[113] *See Pay Without Performance*, *supra* note 92, at 47.

[114] *See, e.g.,* Daniel J. Morrissey, *Courts Should Curb Executive Pay*, The Nat'l Law J, Aug. 15, 2011 (discussing Citigroup's CEO's severance and the difficulty in determining whether it was a waste of the company's assets).

[115] *See One of Twenty Facts About U.S. Inequity That Everyone Should Know: CEO Pay, available at* http://www.stanford.edu/group/scspi/cgi-bin/fact2.php (citing Economic Policy Institute, *The*

of Americans believe that recent executive compensation levels are too high,[116] the level at which executive compensation can exceed compensation of the average employee must be lower than that. With 185 times established as the current ceiling, finding a floor is the next step. One of the main justifications for the greater difference in executive compensation is that executives bear greater responsibility for the success of a corporation than the average employee and they are often more highly educated, skilled, and experienced than the average employee. Therefore, it would be inappropriate to define excessive executive compensation as any amount greater than the average employee (a ratio of 1:1).

Now, finding a rate between 1 and 185 that is potentially "fair" will necessarily involve some arbitrary line drawing and an acceptable number may need to be found with some amount of trial and error. Any legislation going forward, however, needs to employ an amount between those numbers that not only takes into consideration the nature of the executive's position, the skills and assets the executive brings to the table, and the need to protect the free-exercise of business judgment, but also contemplates the need to reduce the large inequities in corporate compensation structures.

This Article suggests that setting the rate that executive pay may exceed average employee pay at 1:100 before it becomes excessive. This number is drawn based on the above principles, while still allowing corporations the freedom to offer very high compensation packages to their most important employees and for those employees to accept those packages without fear that it will be deemed excessive. It also significantly decreases the current inequity of the system.

Defining excessive executive compensation as any amount paid to an executive that exceeds 100 times that of the average employee will surely not please everyone. There will certainly be a group who feels that there is no such thing as excessive executive compensation.[117] They believe that the compensation negotiated between an executive and a board of directors can never be excessive because it is negotiated at arm's-length between parties with competing interests.[118]

This thinking has several flaws. As discussed above, the interests of corporate boards and executives are too similar for negotiations to

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State of Working America (2011)).
[116] Rik Kirkland, *The Real CEO Pay Problem*, CNN Money (June 30, 2006), http://money.cnn.com/magazines/fortune/fortune_archive/2006/07/10/8380799/ (reprinted from *Fortune* magazine).
[117] *See Pay Without Performance*, *supra* note 92, at 15.
[118] Bebchuk & Fried, *supra* note 88, at 73.

really be at arm's-length,[119] and shareholders are a poor guard against excessive executive compensation.[120] In addition to those significant problems, the protections mentioned above offer no safeguard to the non-executive employees of a company. Neither a board of directors' self-interest nor its fiduciary duty is aligned with ensuring the average employees share in the profits those employees helped create and the same certainly holds true with executives.[121] Of course, a company needs to make sure its employees are sufficiently motivated to do a good job, but that is not the same as making sure that employees share equitably in the fruits of their labor.[122] The latter is a strong interest of society in general and, therefore, the government.[123]

Alternatively, others may argue that defining excessive executive compensation as any amount paid to an executive over 100 times that of the average employee is too high. Indeed, in recent years several members of Congress have attempted to introduce legislation that will cap executive compensation at twenty-five times that of the average employee.[124] Also, in other countries the rate at which executive compensation eclipses average employee compensation is lower.[125] For example, British Petroleum (BP) and Barclays (both corporations in the United Kingdom) pay executives sixty-three and seventy-four times that of the average employee, respectively.[126] While those who advance this argument may admit that executives are more important than the average worker, they may not believe that executives are 100 times more important than a group of employees who are essential to a corporation being in business.

While one may be sympathetic to this position, there are two problems with its rationale. First, is that it is very hard, maybe impossible, to tell just how much more valuable an executive is to a

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[119] *See Pay Without Performance*, *supra* note 92, at 24.
[120] *See* Boselovic, *supra* note 84.
[121] *See generally* Eileen Appelbaum & Larry W. Hunter, *Union Participation in Strategic Decisions of Corporations*, *in Emerging Labor Market Institutions for the Twenty-First Century*, Nat'l Bureau of Econ. Research (Univ. Chicago Press 2004).
[122] *Id.*
[123] *See* Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, Book 1, Chap. 8, 70 (1776) ("No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable. It is but equity, besides, that they who feed, clothe and lodge the whole body of the people, should have such a share of the produce of their own labour.").
[124] *See* Income Equity Act of 2007, H.R. 3876, 110th Congress (2007).
[125] Dana Ely, *Is an American CEO Worth 10 times a British One?* Baltimore Sun (July 12, 2011), http://articles.baltimoresun.com/2011-07-12/news/bs-ed-ceo-salaries-letter-20110711_1_american-ceo-median-worker-salary-ratio.
[126] Brian W. Heineman, Jr., *Executive Compensation: The Case for Reductions*, Bloomberg Businessweek (Dec. 2, 2011, 10:30 AM), http://www.businessweek.com/management/executive-compensation-the-case-for-reductions-12022011.html (reprinted from *Harvard Business Review*).

corporation than the average employee.[127] It is likely impossible to find a rate that is completely and certainly fair. There is currently no rationale that will lead to a rate which will certainly be the correct or fair rate of executive compensation.

Second, the nature of our democratic union is one of compromise.[128] Some may believe that there is no such thing as excessive executive compensation, while others may believe that executives should not be compensated much, or perhaps any, higher than the average employee. While it is not unreasonable to feel (as opposed to *know*) that executive compensation that is 100 times that of the average employee is excessive or unfair, it is best to compromise at a position which gives corporations and executives wide latitude in deciding on compensation schemes.

2. FINDING THE RIGHT TAX RATE

Similarly, the amount of the tax is also a hard question. Deciding on an amount sufficient to prevent executives from asking for excessive compensation plans is not an exact science. There are, however, principles that can guide us in this decision. First, one of our main goals is to protect the free exercise of business judgment. This means that corporations should be able to offer, and executives able to accept, any compensation package they can agree upon. For that to happen, the executive must be able to receive from the corporation at least a portion of any salary he or she negotiates. The aim of this tax scheme is not to wholly forbid an executive from receiving compensation that exceeds 100 times that of the average employee; it is simply to strongly discourage it. Therefore, a tax of 100% of every dollar in excess of 100 times the wage of the average employee would be inappropriate and the amount of the tax needs to be lower than that. Of course, the current tax rate of 35% (for wages over $388,500, which most executives receive)[129] is not high enough to act as a deterrent since executives currently continually request excessive compensation packages while having to pay that tax rate. Therefore the tax rate needs to be greater than 35% but less than 100%.

A 90% tax would serve as a strong deterrent for excessive compensation packages because executives would not reap much benefit from excessive compensation. Additionally, 90% is steep enough that it will make it hard for corporations to agree to gross-up

[127] *See* Morrissey, *supra* note 119.
[128] *See* THE FEDERALIST No. 51 (James Madison) ("Ambition must be made to counteract ambition. The interest of the man must be connected with the constitutional rights of the place.")
[129] 2012 Tax Table, IRS, *available at* http://www.irs.gov/pub/irs-pdf/i1040tt.pdf; *see also* Lee & Tang, *supra* note 24, at 37.

compensation. Also, free exercise of business judgment is still protected because executives could still receive a portion of any compensation offered to and accepted by them. They simply have to pay a certain tax rate on those earnings. Finally, it is important to remember that this rate can be completely avoided as long as employee salaries increase comparatively with executive salaries.

If excessive executive compensation has been defined as any amount paid above 100 times that of the average employee, it will decrease the current inequity of the corporate compensation system, while still giving plenty of latitude for corporations and executives to decide on a compensation package without coming within the terms of the tax. The tax will be levied on individual executives because corporations have not shied away from bearing negative tax burdens with regard to executive compensation and because the expense of a tax levied on a corporation is born by shareholders, customers, and labor instead of executives who receive the compensation. The tax will be 90% of every dollar in compensation that is excessive. This will provide a strong deterrent for executives against demanding and accepting excessive executive compensation and will be high enough to avoid corporations offering to gross-up compensation so that executives do not have to pay the tax. Overall, using the tax code in this manner will decrease excessive executive compensation while still allowing corporations and executives to bargain for any compensation package they desire.

Conclusion

There are many problems with the current scheme of executive compensation taxation that limit the ability of the tax code to curb excessive compensation. The current code provisions include too many loopholes and are generally too weak to act as an effective deterrent. Additionally, the current tax scheme does not place the tax burden on the party whose behavior it is trying to change. It too often attempts to penalize the corporation, or more accurately a corporation's shareholders, employees, and customers who ultimately bear the burden of double taxation, instead of executives who have the lion's share of control over salary negotiations. Furthermore, the current tax scheme relies too heavily on the traditional arm's length negotiation process to ensure a reasonable compensation package. The ability and incentive of the corporate board to meaningfully negotiate a compensation package that is not excessive simply doesn't exist. Ultimately, these problems have combined to produce a wholly ineffective regulatory tax scheme that fails to meaningfully curb excessive executive compensation.

In response to these current shortcomings, this Article concludes that Congress should adopt an entirely new tax scheme that is free from the aforementioned problems. Such a tax scheme should recognize that executives hold a disproportionate amount of control over salary negotiations by reallocating the tax burden to the executive instead of the corporation, which is how the current tax code is set up. Additionally, the new tax scheme should exist free from debilitating loopholes and demand that "compensation" is defined in the broadest possible terms. This Article proposes that Congress continue to protect the free exercise of business judgment by avoiding a 100% tax rate; while at the same time protecting the strength of the tax with a high rate of 90%. By imposing a 90% tax on amounts earned by executives that exceed 100 times the average employee, the inequities of the corporate compensation system will be reduced. If executive salaries and worker salaries are brought closer together then the inequality in compensation between the two groups will decrease. Furthermore, if the worker salary increases proportionately with executive salaries then both groups will get to share equitably in the continued success of the firm.

The ultimate goal of the new tax scheme should be to reduce the inequities in the current system of corporate compensation. Accomplishing such a goal will advance the principle that those who work to create profits should get to share equitably in the same. Executives and employees should share those profits through incomes that are reasonably proportionate to their efforts to create them. Accordingly, this goal is not necessarily about wealth redistribution from those who earn high incomes to those who do not but rather to prevent wealth redistribution from those who earn low incomes to those who already earn high incomes. A revised tax scheme that strongly and effectively deters excessive executive compensation is a solid first step in that direction.