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*From the Editor:*

## Is Taxing the Rich a Matter Of Fairness or Necessity?

*By Jeremy Scott — jscott@tax.org*

Taxes are generally a win-win issue for Republicans. Since the Reagan administration, the GOP has steadily and consistently advocated lower taxes, and the public has agreed with the party. Democrats have steadily changed from a party in favor of big government and necessary taxation into one that favors just slightly smaller tax cuts than their conservative opponents. President Obama, however, believes he has found a tax issue on which he can score points off his Republican challenger: the taxation of the wealthy. Taking advantage of Mitt Romney's low effective tax rate, Obama has pushed hard to link raising taxes on upper-income taxpayers with fairness.

But notions of tax fairness, while important, are completely arbitrary, according to Joseph Thorndike. While there might be economically optimum tax rates, there is no objectively correct ''fair share'' that each taxpayer should be paying, Thorndike argues. Tracing the history of several major tax reform efforts, he finds that most tax debates, particularly those concerning tax increases on everyone, are framed in terms of fairness concerns. The American public has generally been willing to sacrifice to pay for wars or endure needed tax increases, but it frequently wants assurances that high-income individuals are doing their part, Thorndike says. Ultimately, all tax systems rely on a variety of arbitrary opinions, intuitions, and prejudices, he concludes. (For his analysis, see p. 1573. For coverage of a Tax Analysts conference on the taxation of the wealthy, see p. 1570.)

There is some belief that any tax reform effort that deals with the deficit will involve tax sacrifices by everyone, not just upper-income earners. The Republican Party, of course, has yet to make that concession, but Democrats have been more than willing to talk about how increased revenues must be present in a reform package. The problem is that to accomplish the goals put forward by deficit hawks and tax reform advocates, the United States would need to raise significant amounts of new revenue — probably much more than can be found with just higher effective rates on people like Romney and Warren Buffett. Thorndike is undoubtedly correct that policymakers will have to find a way to sell that ''inevitable'' rise in taxes to a very skeptical public. But will fairness arguments really work in 2012? If taxpayers are faced with the reality of paying higher taxes in the current economic climate, will they really be persuaded to accept them just because tax rates also rise for their wealthy neighbors?

### Sports and Tax

The Major League Baseball season is approaching its halfway point, and most teams are starting to experience a boost in attendance and interest as summer vacations begin. While most fans focus on the standings and how their favorite players are performing, many front office employees have to focus on a more arcane topic: how player payroll interacts with various luxury taxes imposed by sports leagues to control spending. Edward McCaffery writes about how luxury taxes are used by MLB and the NBA to raise revenue for redistribution to poorer teams and control rich franchises' behavior (p. 1646). He points to three lessons that can be learned from sports luxury taxes, including how those taxes identify relevant social harms, how they apply generally, and how they work. He concludes that the MLB and NBA luxury taxes could be a model for progressive taxation in the United States.

One of baseball's prize teams, the Los Angeles Dodgers, was recently purchased for a record price of more than $2 billion. Robert Willens says that the nominal amount of the transaction should not be taken at face value (p. 1661). Willens points out that the acquisition of a professional sports team and its assets carries with it significant tax benefits, including the ability to use section 197 amortization. A properly structured transaction can secure amortization deductions for virtually the entire purchase price, including the value assigned to media rights, he writes.

### Commentary

The Supreme Court's decision in *Home Concrete* was a major defeat for the government, which now has to consider how to revise regulations issued to combat omissions of basis. While the holding was a win for taxpayers, many practitioners are concerned that there isn't much to be learned from the case. (For coverage, see p. 1565.) In fact, the decision was disappointing in every respect, except that the

taxpayer prevailed, according to Patrick Smith (p. 1625). The case raised important questions regarding *Chevron*'s applicability to regulations, the scope of *Brand X*, and the authority of the IRS to issue retroactive regulations, but it didn't answer any of them, Smith writes. He points to the lack of a majority of justices in favor of the regulation's invalidity and the Court's decision to avoid ruling on procedural and retroactivity issues as major disappointments.

It is possible that the Supreme Court will have decided whether to strike down the healthcare reform law by the time readers are perusing this issue. After holding everyone in anticipation last week, the Court is expected to release its decision early this week. Assuming the mandate is upheld, Jordan Barry and Bryan Camp look at how the IRS might enforce it (p. 1633). After analyzing the statute, the authors find that recalcitrant taxpayers can only really be forced to pay the penalty if they are entitled to receive refundable tax credits that exceed their net tax liability. The healthcare reform law specifically limits the IRS's ability to collect the penalty, which means that the mandate is really not all that mandatory in practice, Camp and Barry conclude.

By a voice vote, a House panel approved a bill that would freeze IRS spending at current levels. Democrats strongly objected to the Republican-backed plan, arguing that starving the IRS of funds only increases the budget deficit. (For coverage, see p. 1584.) Jeff Trinca agrees. In his analysis of IRS funding, Trinca argues that perennial underfunding of the agency results in a significant loss of revenue for the federal government (p. 1642). Trinca illustrates the number of tax debts that are sitting in IRS accounts receivable and shows how they might be collected with help from the Financial Management Service. He concludes that underfunding the IRS costs taxpayers nearly $1 billion a year.

On May 14 a Tax Court memorandum opinion characterized as debt the preferred equity held by Hewlett-Packard in a foreign special purpose vehicle. According to Jasper Cummings, Jr., the decision is important because it calls into question the commonly assumed equity treatment of preferred stock issued by an SPV (p. 1665). Because the decision was a memorandum opinion that will not be published in the official Tax Court reports, the court presumably applied settled legal principles to the facts, Cummings writes. Nevertheless, the case is important because Hewlett-Packard took advantage of the law as written, and the entire problem in the case is because of how the IRS drafted the foreign tax credit regulations, according to Cummings.

Independent contractor agreements are common throughout the business world, and the drafting of these agreements may seem to be a simple task for any lawyer. But an independent contractor agreement should be written with great care, especially considering that many tax authorities frequently attempt to recharacterize contractors as employees, Robert Wood writes (p. 1655). While it is not necessary to have a written agreement with every employee, businesses should have a precisely drafted contract with every independent contractor, Wood advises. Too many practitioners rely on form agreements in these cases, but an ideal contract will detail the specific position and responsibilities of each independent contractor, he concludes.

Kip Dellinger analyzes how the treatment of compensation can be a tax position for purposes of section 6662 (p. 1649). Responding to an article by Wood and Christopher Karachale on S corp compensation, Dellinger analyzes the recent furor over unreasonably low compensation paid to S corp owners and how the IRS can solve the problem without a legislative remedy.

This week's 40th anniversary retrospective features two articles from 1997. In the first, Erik Jensen humorously suggested that *Tax Notes* should consider changing its name to increase its respectability in the academic community (p. 1619). He suggested going with the name *Harvard Tax Journal*. In the second article, Lawrence Axelrod explored how the new check-the-box rules might make consolidated returns obsolete (p. 1620). ■

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