Statement of Bob Packwood
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Hearing on "Getting to Yes on Tax Reform: What Lessons Can Congress Learn from the Tax Reform Act of 1986?"
February 10, 2015

The concept of tax reform is quite simple. If you assume that a country has an income of $1,000 and that the government needs $100 to run on then a 10 percent tax will produce the $100 needed. But now suppose that the government also allows taxpayers to take all kinds of deductions for things like charitable contributions and home mortgage interest. After all of the deductions are taken what remains is called the "taxable income." In our hypothetical country let's say that's now only $500. If the government still needs $100 to run on, the tax rate now has to be 20 percent to raise the needed funds.

Early in 1985, the Ways and Means Committee of the House of Representatives started having extensive public hearings on tax reform. They were numerous and extended over a long period of time, giving opponents of tax reform plenty of opportunity to gather, plot, organize, and attempt to kill the bill.

Almost all the Republicans were opposed to the bill, not so much on substance, but procedural. They felt they had been left out of the drafting of the bill. A fair number of individual Democrats were also opposed because of diverse provisions they thought adversely affected a particular interest in their state. As a result not long after the bill came to the floor of the House of Representatives it had to be pulled before it would fail. But President Reagan contacted the Republicans and urged them vote for the bill saying that while he'd veto it in its current form, the Senate should have a chance to work on it. Acquiescing to their party leader, Republicans rallied and the bill passed the House; albeit by a voice vote. No one wanted their fingerprints on it.

In the spring of 1986, the Senate Finance Committee started working on the bill sent to us by the House of Representatives. There was no enthusiasm for what we were doing. It was not big enough. Not strong enough. There was no grandeur. Support dwindled to the point that at noon on Friday, April 18, 1986, I exercised the chairman's prerogative and adjourned the committee saying that we were permanently done with this bill!

Friday, April 18 – 1:30 p.m.

I called David Brockway [Chief of Staff of the Joint Tax Committee – the fulltime professional group that advises Congress on taxes] I asked him to come back with a bill with a 25 percent top rate. He said we would have to get rid of the mortgage interest deduction. I said what about 26 or 27 percent.

Friday, April 18 – 2:30 p.m.

I met with Secretary of the Treasury Jim Baker and his principal aide Undersecretary of the Treasury, Dick Darman ….I had nothing but theory to give them at the moment. They, of course, liked the theory, but more or less said where do we go from here.

Tuesday, April 22 – 6:00 p.m.

David Brockway stopped at the office with his figures for 25, 26 and 27 percent top rate for individuals. His briefing gave me the outlines of what I needed to present to the committee.

Thursday, April 24 – 7:30 a.m.

Again and again I played with numbers balancing the attraction of the low rates versus the opposition we would get from eliminating certain deductions. I wanted a balance that would achieve the following:

1. Bring Democrats on board by getting rid of loopholes. This would bring in lots of money.
2. Bring the Republicans onboard by using the money raised to lower rates.
3. Bring economists, editorialists, and others onboard who wanted to get rid of deductions and achieve lower rates. They would also applaud the simplicity of the plan, an added bonus.

Thursday, April 24 – 9:30 a.m.

I called the committee together and presented the outline of what was possible. I still had no bill to show them, just concepts.

Diary, Thursday, April 24 – 9:30 a.m.

"Chafee thought it was wonderful. Bentsen spoke approvingly. Bradley spoke eloquently and forcefully. Danforth said it was the only chance for reform. Wallop said he liked the idea."

As I worked I recalled how the House of Representatives had almost floundered because of the yearlong public meetings allowing time for opponents to gather and oppose. They were already organized and I did not want to give them time to try and kill the Senate bill as well. If we wanted to pass this bill, it would have to be bipartisan, and work would need to be done in closed meetings and quickly.

A small closed meeting with a bipartisan group of Senators was our only chance. I wanted the intellectual leaders of the committee on both sides. If I got them with me, I'd have the rest of the committee.

I made some calls. On the Democratic side Pat Moynihan, of New York and my closest friend in the Democratic Party, Bill Bradley, of New Jersey the guru of tax reform in the Senate, and George Mitchell, of Maine, a relatively newer member of the committee, but one I found so sharp that you could see "leadership" written all over him. On the Republican side Jack Danforth, of Missouri, John Chafee, of Rhode Island, both liberal Republicans, and Malcolm Wallop, of Wyoming, a very conservative Republican, and well regarded by other conservatives. Would they be willing to meet with me in closed meetings starting next Tuesday to see if we could fashion a bill acceptable to the President. To the man – they agreed.

To stay ahead of the curve, starting Tuesday April 29, I met with staff every morning at 7:30. We discussed the details of whatever portion of the bill were to be discussed with the core group of the committee I'd put together. An hour later, at 8:30, the core group of Senators met and we strategized how to get the full Finance Committee on board with what we were planning. We would meet every morning thereafter, save Sunday, from Tuesday, April 29 to Tuesday, May 6.

Tuesday, April 29 – 8:30 a.m.

We agreed that from time to time we might invite some other Senator in if we wanted him for a specific purpose, but that the seven of us would form the loyal band. We decided that if any four of us could agree on something to be put in the bill all of us would agree. A smart decision, and one that was never used unfairly, I don't recall that there was ever a vote that broke four Republicans and three Democrats. I do, however, remember a couple of votes where I fell in the minority.

Diary, Tuesday, April 29 – 6:45 p.m.

"Met with Baker and Dick Darman, Bill Diefenderfer [my Finance Committee Chief of Staff]… Darman loves the plan. Baker is worried about the elimination of passive losses and what about those oil rigs and what about those limited partnerships in drilling for oil. Bill and I in essence said, oh, Jim, shut up. Here we are talking to the Treasury Secretary – shut up. Here you've got a plan. All we need you to say is we think it is wonderful. We'll get it to the President. Jim, we're going to wrap this up by Sunday.

….You put in one pro forma appearance before the Senate Finance Committee Republicans and get your little tail out to Tokyo or wherever it is the President is going to be meeting. And leave Darman here to take care of the strategy and the details and we'll have this done before you get back, but don't start niggling and quibbling over minuscule details. Well they left pretty happy because it is a victory if we get it. It is like

Disraeli and the Corn Laws. It doesn't matter what you win. It is that you won."

Diary, Wednesday, April 30 – 8:30 a.m.

"I've still got to solve Bentsen's [Senator Lloyd Bentsen of Texas] problem about passive losses... With that I can get Lloyd."

Diary, Wednesday, April 30

"...Talked with Norm Winningstad [founder of Floating Point Systems] who is terribly upset about the elimination of capital gains and had a note from Tom Bruggere [founder of Mentor Graphics]. ...He is terribly upset about the elimination of capital gains.... two of our more successful high-tech firms. God, leadership exacts a toll, but I don't mind the flak. I'll mind it if I can't get the result. I'm willing to stop the buck here, but I want to get a result."

Diary, Thursday, May 1 – 8:30 a.m.

"A downer – The core group. Boy, was it exciting. Moynihan, Bradley, Chafee, Danforth, Wallop, Mitchell – we're on our way. We are agreed and with Bentsen onboard we were sensational. Lloyd came in and said he couldn't agree to the passive income provisions. Nobody said a word.

There were 20 seconds of silence. Lloyd said, boy, I wished I had never come in. It did take all of the wind out of our sails. I went from Mt. Everest to Death Valley in 20 seconds."

The problem with what Lloyd Bentsen wants is two-fold:

1. In this bill we have eliminated for everybody the very provision that Lloyd wants us to put back in solely for oil and gas.
2. If we put it back in for oil and gas alone, it's not a big revenue loser. If all the others who are losing this kind of provision get wind of it, they'll want to be included again and that loses so much money that the bill would be dead.

Thursday, May 1 – 2:00 p.m.

If the Senate agreed on our bill, we would need to come together with the House of Representatives to create one document that could pass both chambers. There were vast differences between the two bills. Danny Rostenkowski was Chairman of the House Ways and Means Committee. We had tangled earlier over another bill in conference. I was unjustifiably belligerent. I wondered if that would make the conference on this tax bill difficult. He quelled some of my fears by making a generous gesture.

Diary, Thursday, May 1 – 2:00 p.m.

"Back again to tax reform in closed session. Was interrupted by a phone call from Danny Rostenkowski. Bless his soul. He said, "Pal, I've been thinking of coming over there, without fanfare, without press, just to say 'I've been through it. I know every day you go through troughs and you're on hills and I've been bleeding for you but I think what you've got in terms of tax reform is the best thing this Congress has seen in ten years. You get that through the Senate and between the two of us, we're going to put out a bill that for a generation or longer America will look to as a pinnacle.' God, I appreciated it."

Diary, Friday, May 2 – 7:30 a.m.

"Brockway, et al. God are these session valuable for me so I can be one jump ahead of the core group."

Diary, Friday, May 2 – 8:30 a.m.

"The core group. And are these sessions valuable, so that the core group can be one jump ahead of everybody else."

The staff at 7:30 and the core group at 8:30 continued to meet in my office in closed meetings every morning. The open Finance Committee meetings followed later, but basically all the full committee did was mark time while the core committee worked. Even though we tried to keep our work secret, there are no secrets in Washington. Word was getting out. You could tell it by turnout of spectators at the committee meetings. On Monday, attendance was spare. By Friday, so many people jammed into the committee room that speakers had to be set up in the hallway so the overflow could hear.

Diary, Friday, May 2 – 10:30 a.m.

"Back to the backroom with all of the members….. I ducked into Bill D's office to call Jack Rosenthal at The New York Times. He is my old friend from Grant High School. I said, Jack, do you have any idea what we're going on tax reform. He said, well, kind of a vague idea and I sensed that the vague idea he had was where we were several weeks ago and he didn't like what we were doing, but was polite enough he didn't want to say it. I said, Jack, I don't know if you are up to speed, but as I recall from your editorials you like Bradley-Gephardt. What we are now working on is Bradley-Gephardt and I need some help from The New York Times with a good editorial. He said, well, I first need to find out from my people what it is you're doing. I said fine. If you need to find out anything here, call Bill Diefenderfer and here's the number. I then called Steve Rosenfeld at The Washington Post and told him roughly the same thing. He was a little more up to speed in what we're doing, but not much more. He didn't seem too receptive, but at least I made my pitch."

Shortly thereafter, "Bill D. had gotten back to me and said he had talked with Rosenthal. They are going to do a New York Times editorial Sunday, called Packwood-Bradley-Gephardt. I think even Bill was surprised that I was able to pull that off."

Late Friday afternoon, May 2, I announced to the committee and the lobbyists, "We're done for the day. In fact we're done for the weekend. The Finance Committee is not going to meet this weekend. It's too nice of a day. You all ought to be out sailing or playing golf." Raucous cheers. I said, "We'll see you all next week."

I told everyone, that is, except the core group. I told them we would meet Saturday. I didn't want the other committee members, or anybody else, to know we planned to meet however.

Not a lobbyist or committee member, other than the core group, showed up Saturday. A success.

It was on that long, hot day that we made all the final decisions. Brockway needed two days to get the final draft back to us. We knew we could finish by Tuesday or Wednesday. I thought we were done – but not quite – the oilies wanted another bite of the apple.

Diary, Tuesday, May 6 – 2:30 p.m.

"The oil state Senators lead by Boren, Bentsen, Russell Long, and accompanied by Bob Dole and Heinz… joined together with Baucus, Pryor, and Malcolm Wallop. Just enough to demand that we give an exception for working interest for oil."

We'd worked hard to eliminate this type of exception for all other businesses. They wanted it back for oil and gas.

I had no doubt I could beat the oilies in committee at worse 12 to 8, probably 13 to 7, and if I leaned on people 14 to 6.

Diary, Tuesday, May 6 – 10:00 p.m.

"… they were willing to give away immense quantities of money to get their little working interest provision which costs $700 million if you give it to those who are active in the oil industry or $1.4 billion if you allow non-active partners… I could see this whole thing becoming unraveled. We were going to give up great things for small things. We were going to give up closing loopholes worth $50 billion, lower rates, better corporate depreciation and a lower corporate rate. Everything for the sake of $1.4 billion and I resolved that at this stage the time for compromise had come. I called Lloyd Bentsen and said, 'Lloyd, let me lay out a deal for you. You get working interests and you support the rest of the package.' He said it sounded like a good deal to him."

He then added as an aside, "If there's a vote on this, Bob, I'm sure I can count on your vote." I said, "Lloyd, you absolutely cannot count on my vote. I'm going to vote against it, but I will get you votes to pass it."

I knew – or at least sensed – something that the other members had not yet grasped. Our problem was not going to be in committee. The bill would pass. The problem would come on the floor. Our Achilles' heel in this bill was going to be the individual retirement accounts – IRAs. Through several years of research, we had discovered that the IRAs did not increase the total savings in the country, they simply resulted in upper-middle and upper income people shifting their savings to the tax preferred individual retirement account. IRAs were immensely popular and I knew that on the floor there would be a very close vote to restore what we had taken out. If this happened and IRAs remained the same, our bill would lose so much money it would die. To keep IRAs out, I needed the oilies in. I made the trade.

Diary, Tuesday, May 6 – 8:00 p.m.

"I called the members together at 8:00 p.m. in the backroom and we stayed in that backroom until 11:30 p.m."

It was in this three-and-half-hour period that all of the final important decisions were made.

Diary, Tuesday, May 6; 10:45 p.m.

"We gradually hammered it down to the end. It's clear. We voted on working interest in the group. I voted with Bradley. The oil people won 11-9, fortunately, because we would have had no deal without them. I had the best of all possible worlds. I was opposed to them and yet they won so we could have the deal. I rapped the gavel and we went out to the committee room."

Just before the final vote started, however, George Mitchell – one of the strongest members of my cabal – wanted to make a statement.

Senator Mitchell.

"Mr. Chairman, I think it ought to be clear that what we are doing here is establishing one rule for every American business, every American interest except oil and gas, and then a special rule for those in the oil and gas business.

An American who invests in a project involving real estate, under legal circumstances identical to those with another person who invests in oil and gas, with be treated differently and to his disadvantage.

An American who invests in an extractive industry, an American who invests in any other business but oil and gas, even though under identical circumstances, will be treated in a wholly different fashion, and those who invest in oil and gas will be treated in a preferential fashion even though the circumstances are identical.

I can see no justification for that. No rational basis has been offered. No standards by which such a distinction can be made has been suggested. All we are saying is that we are going to give special treatment to one industry and one category of persons and everybody else will be treated differently."

Of course George Mitchell was right. Without speaking to any of the core group of six who so fully supported me I made a deal with Bentsen and I had yet to explain to the others why. They would later learn my reasons, but I couldn't tell them yet.

After eleven closed meetings over seven days, seven of the core group and four of the full committee – final passage came – 20-0! We had raised the taxes significantly on corporations and rich individuals. They would pay more and middle income and the poor would pay less, and we accomplished all this while at the same time lowering the top corporate tax rate from 48 to 34 percent and the individual tax rate from 50 to 27 percent. The bill was revenue neutral and was as progressive as the existing tax law.

Not a bad week's work.

We concluded with a champagne party in Bill Diefenderfer's office.

Dick Darman placed a phone call to Jim Baker who was in Tokyo with Ronald Reagan at one of those multi-nation economic meetings. I, of course, heard only Darman's end of the conversation.

"Jim, just tell him to shut up. He's going to like this bill, but he's got friends who aren't going to like a lot of this bill. Don't let them get to him before I have a chance to get to you and explain everything that has happened. Let me emphasize again. He is going to like this bill."

MAJOR AMERICAN COMPANIES PAYING ZERO OR LESS IN FEDERAL INCOME TAX, 1981-83

Company	Profits (in millions)	Federal Income Tax (in millions)	Tax Rate
General Electric	$6,527.0	-$283.0	-4.3%
Boeing	$1,530.0	-$267.0	-17.5%
Lockheed	$1,085.0	$0	0%
General Dynamics	$ 930.8	-$70.6	-7.6%

Time Magazine, November 26, 1984

INDIVIDUALS

"A total of 230 of the nation's wealthiest individuals paid no federal income taxes in 1975."

The Associated Press, March 3, 1977

" The Internal Revenue Service says 198 couples or individuals with incomes above $200,000 used deductions and credits to wipe out all their federal income-tax liability in 1980."

The Associated Press, November 16, 1982

"Almost 30,000 couples and individuals with income tax above $250,00 paid little or no federal income tax in 1983, the Treasury Department said Thursday."

"As many as 306 people who earned over $1 million paid no tax."

The Associated Press, August 1, 1985

"Consider the 28,000 persons whose 1983 incomes were $1 million or more. More than 300 of them paid not a dime in taxes."

The Los Angeles Times Mirror, August 6, 1985

"...55,000 taxpayers with incomes exceeding $250,000 paid a lower percentage of their income in federal taxes than the average middle-income family of four."

"Perhaps even more striking, 3,170 taxpayers who earned more than $1 million in 1983 paid virtually no tax at all. At least 1,900 of these high earners paid no tax at all."

Time Magazine, August 12, 1985

**10 BIGGEST REVENUE RAISERS
IN THE TAX REFORM ACT OF 1986
(revenue increase in $ billions)**

	Provision	Revenue Gain – FY 1987-1991 Total	Individual	Corporate
1.	Repeal investment tax credit	$143	$24	$119
2.	Impose uniform capitalization rules (e.g., require manufacturers to delay deductions for more of their expenses until they get paid for the goods they make)	$32	0	$32
3.	Strengthen minimum tax	$30	$8	$22
4.	Limit interest deductions (e.g., consumer interest)	$29	$29	0
5.	Repeal second earner deduction	$27	$27	0
6.	Limit IRA deductions	$24	$24	0
7.	Eliminate passive loss deductions (the $23 total is a net of $36 increase for individuals and $13 cut for corporations)	$23	$36	-$13
8.	Repeal sales tax deduction	$21	$20	$1
9.	Impose 2% floor for deduction of employee business expenses (e.g., union and professional dues)	$19	$19	0
10.	Restrict depreciation	$13	$5	$8

Source: The Bluebook for the Tax Reform Act of 1986 (published by Joint Committee on Taxation)