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GETTING TO "YES" ON TAX REFORM: WHAT LESSONS CAN CONGRESS LEARN FROM THE TAX REFORM ACT OF 1986?

HEARING

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FOURTEENTH CONGRESS

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GETTING TO "YES" ON TAX REFORM: WHAT LESSONS CAN CONGRESS LEARN FROM THE TAX REFORM ACT OF 1986?

TUESDAY, FEBRUARY 10, 2015

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:17 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Orrin G. Hatch (chairman of the committee) presiding.

Present: Senators Grassley, Crapo, Thune, Isakson, Coats, Heller, Scott, Wyden, Stabenow, Cantwell, Nelson, Menendez, Carper, Cardin, Bennet, and Warner.

Also present: Republican Staff: Chris Campbell, Staff Director; Jim Lyons, Tax Counsel; Mark Prater, Deputy Staff Director and Chief Tax Counsel; and Caleb Wiley, Professional Staff Member. Democratic Staff: Adam Carasso, Senior Tax and Economic Advisor; Michael Evans, General Counsel; Kara Getz, Senior Tax Counsel; and Todd Metcalf, Chief Tax Counsel.

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM UTAH, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will come to order.

Today's hearing is about the need for tax reform and what lessons we can learn from the Tax Reform Act of 1986, the last successful overhaul of the United States tax code.

We have before us today two former Senators who were key to that effort. I do not know why they call you former Senators. I think you are always going to be Senators to me. I look forward to hearing your thoughts and advice, and I think we all do, during today's hearing.

Before we engage meaningfully in tax reform, we need a clear vision of what we want success to look like. A vision is not a specific system of rates, deductions, or credits. Instead, a vision is how we want to change the opportunities for American families and the rewards that Americans receive from their labor, entrepreneurship, and investment.

A successfully reformed tax system will help make America the best place in the world to work, conduct business, invest, and prosper. A successfully reformed tax system will be one that provides economic growth and is simple and fair. This more than anything else should be our vision for tax reform.

The landmark Tax Reform Act of 1986 was developed by then-chairman Bob Packwood through a careful and methodical bipartisan process that relied heavily on member input. Senator Bradley was a key part of that process. I do not want to leave out Congressman Rostenkowski and a whole raft of others in the White House at that time, but these two were the two great leaders in the Senate at the time.

Over the last few weeks, we have begun a similar process that we hope will yield a similar result: tax reform legislation that both parties can support.

The 1986 Act, signed into law by President Reagan, reformed a costly and complicated tax system into a simpler one with lower tax rates for American households and businesses, affording them greater personal prosperity. Over time, our tax system has once again become costly and complex. It is impeding growth, standing in the way of shared prosperity, and placing American workers and businesses at a distinct disadvantage.

Put simply, it is past time for Congress to stand up once again to fix our broken tax system. If you have been around Washington over the last few years, chances are you have already heard me talk about tax reform. I have been making the case for tax reform on the Senate floor, here in the Finance Committee, in public appearances, in written materials, and in private conversations.

In December, the Republican staff of this committee produced a comprehensive report outlining the need for tax reform and providing some direction to our overall efforts. I am sure everyone here has read that report cover to cover. [Laughter.] I have already publicly laid out seven principles that I believe should guide our tax reform efforts. I will not go into much detail on each principle today. Instead, I will just talk about them briefly.

The first principle is economic growth. Tax reform, if it is done correctly, should promote growth and significantly reduce economic distortions that are present under the current income tax system.

The second principle is fairness. The income tax base, which has become riddled with exclusions, exemptions, deductions, and credits, should be as broad as possible. Tax reform should broaden the tax base by eliminating or reducing a number of tax expenditures, along with lowering tax rates and removing distortions.

The third principle is simplicity. Taxpayers and businesses spend over 6 billion hours a year complying with tax filing requirements, with annual compliance costs in excess of $171 billion, which is more than the gross domestic product of New Zealand, for instance. Simplifying the tax code will result in greater clarity and compliance and will free up resources for families, job creation, and other productive uses.

The fourth principle is revenue neutrality. Tax reform should be revenue-neutral and not an occasion to raise taxes on American households or businesses. Federal revenues already exceed their historic average as a share of our economy, and greater revenue should not be an objective of reform.

The fifth principle is permanence. The Joint Committee on Taxation lists almost 100 provisions in the tax code that will expire over the next decade. This is unacceptable. Families and businesses should be able to plan for the future without wondering if the tax code is going to change from year to year.

The sixth principle is competitiveness. The combination of a high corporate tax rate, worldwide taxation, and the temporary nature of some tax incentives makes American companies less competitive when compared to their foreign counterparts. Tax reform should reduce burdens on businesses large and small to allow them to more effectively compete on the world stage.

The seventh principle is the promotion of savings and investment. Many aspects of our current tax system discourage savings and investment, thereby hindering long-term growth. Savings and investment help build the capital stock, providing fuel for economic growth that generates prosperity for American workers and businesses.

These seven principles are the guideposts I will use when looking at tax reform proposals.

I think we are going to have an interesting hearing today. We have two really great former leaders, Chairman Packwood and Senator Bradley, to see what advice they can give us as we undertake our tax reform efforts in this Congress.

I did read "Showdown at Gucci Gulch," and it gives some indication as to how difficult this really was. If anything, it may be even more difficult today because of the messes that have occurred since, none of which you deserve to be blamed for.*

[The prepared statement of Chairman Hatch appears in the appendix.]

The CHAIRMAN. Senator Wyden?

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON

Senator WYDEN. Thank you very much, Chairman Hatch.

As Chairman Hatch noted, the Finance Committee is joined this morning by two legislators who were at the heart of the last major overhaul of the U.S. tax code in 1986. Chairman Packwood spent more time than anyone figuring out how to make the numbers in tax reform work. That is the tough work of legislating.

Senator Bill Bradley was the intellectual godfather of the reform plan that broadened the base, closed loopholes, and kept progressivity in the code. Senator Bradley lit the fire that got the Reagan administration invested in reform, and I do not think anyone would question my judgment that Senator Bradley had, by a wide margin, the best jump shot in the Senate Tall Guy Caucus.

Now, if there is one obvious similarity between 1986 and today, it is that people are quick to say that tax reform is absolutely impossible. Americans say Congress cannot organize a 2-car parade—there is no way they can come together on major economic legislation.

So what happened 3 decades ago needs to happen again: turning the impossible into the possible.

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*For more information, *see also,* "Background Information on Tax Expenditure Analysis and Historical Survey of Tax Expenditure Estimates," Joint Committee on Taxation staff report, February 6, 2015 (JCX–18–15), *https://www.jct.gov/publications.html?func=startdown&id=4705*.

The Congress and President Reagan came together to pass the 1986 Tax Reform Act based on what I call principled bipartisanship. One side wanted to flatten the tax code. The other side wanted to close loopholes and guarantee that the tax code treated everyone fairly. Both sides said, "We are going to set aside the partisan attacks and look for common ground," and each side came away with the feeling that it had upheld its principles.

When President Reagan signed the bill into law, he called it a historic overhaul of our tax code and a sweeping victory for fairness. He continued, and I quote here, "It is also the best anti-poverty program, the best pro-family measure, and the best job creation program ever to come out of the Congress of the United States."

Those same objectives ought to guide the Finance Committee and the Congress as they work again to modernize our tax system. Reforming the tax code is always a herculean task, but the same strategy of principled bipartisanship can work once again. The Congress can turn the impossible into the possible.

However, policymakers need to recognize that the process is going to look different. Not every part of a 30-year-old game plan for tax reform can work today. China and India are now superpowers in the global economy, which is a much bigger factor in the tax reform debate. The gulf between wage earners and the top of the income ladder has widened, and America is at its best when a rising tide lifts all boats, and it should be obvious that making that a reality once again is going to take some hard work.

The status of the middle class in Oregon and across America is at the top of the list of compelling issues for tax reform to address. It is fundamentally unfair that a middle-class wage earner could pay a higher tax rate than an affluent person whose earnings come entirely from investments.

The tax code should not be used to punish the wage earner in America. And many tax incentives for college education and retirement savings are simply out of whack. The support those incentives provide does not always get to those who need it the most, and that ought to change.

Another challenge is making America more competitive in the global economy. Today you often come away saying that our country is trying to win a road race in a 30-year-old car. Our competition meanwhile trades up to more efficient models. America has not done enough to drive innovation at home, and, worse, the tax provisions for research and development expire year after year.

In 1986, there was not a lot of talk about the tax code, for example, in a clean energy future for our country. That is something else that has to change this time. And finally, modernizing our tax code has to be done in a fiscally responsible fashion. Tax reform cannot become an exercise at slashing rates at any cost.

The biggest lesson from 1986 is that tax reform is possible when Democrats and Republicans set partisanship aside, come together, and focus on shared principles. Over the years I have talked frequently with Senator Bradley about how tax reform is always totally, completely, and thoroughly impossible until that moment when it happens.

The Finance Committee today has two experienced, knowledgeable witnesses who are going to help us get closer to that point today.

Chairman Hatch, thank you. And I look forward to our witnesses.

[The prepared statement of Senator Wyden appears in the appendix.]

Senator MENENDEZ. Mr. Chairman?

The CHAIRMAN. Yes?

Senator MENENDEZ. If I may have a point of privilege just for a moment. And I thank the chair very much.

I have an intelligence briefing on Iran, but I wanted to come to join the committee and its leadership in welcoming the most outstanding U.S. Senator New Jersey has ever had to represent it. Not only does he have a great ability to shoot a 3-point shot effortlessly, but the intellect that Bill Bradley possesses and his willingness to pass the ball to fellow teammates made him a consummate successful U.S. Senator here and in New Jersey.

So I have read his testimony. I look forward to the Q&A so we can engage in some of it, and I appreciate him and Senator Packwood joining us.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. I think that was a pretty good outline of our Senator.

Our first witness is Bob Packwood. Senator Packwood was first elected to the U.S. Senate in 1968 and served the people of Oregon in this body for 26 years. He was chairman of the Finance Committee from 1985 to 1987 and presided over this committee's efforts to draft and pass the Tax Reform Act of 1986. He made a pivotal difference in this, as did our other witness.

He also served as chairman of the Commerce Committee for 4 years. Prior to his time in the Senate, Senator Packwood practiced law in Portland, OR for 10 years. He was elected to serve for 3 terms in the Oregon State Legislature.

He received a bachelor's degree in political science from Willamette University in Portland, OR and a law degree from New York University Law School.

We feel honored to have you here today. We know you can help us in many ways to understand some of the difficulties we are going to have to get through, and hopefully give us some advice on how to get through them.

Our second witness is another great human being whom I greatly admire and admired before he came to the Senate. That is Senator Bill Bradley. Senator Bradley represented the people of New Jersey here in the Senate for 3 terms, beginning in 1979.

As a member of the Senate Finance Committee, he played a pivotal role in the drafting and passage of the Tax Reform Act of 1986. Of course, prior to his time in the Senate, Senator Bradley was a great professional basketball player. He is a two-time NBA champion and a member of the Basketball Hall of Fame.

Senator Bradley holds a bachelor's degree in American history from Princeton University and a master's degree from Oxford University, where he was a Rhodes Scholar. He is the author of seven books on American politics, culture, and economy, and currently hosts "American Voices," a radio show highlighting the remarkable accomplishments of both famous and unknown Americans.

We welcome you, Senator Bradley, as well. We thank both of you for being here today, and we look forward to your testimony.

Senator Packwood, you go first.

STATEMENT OF HON. BOB PACKWOOD, FORMER CHAIRMAN, COMMITTEE ON FINANCE, PORTLAND, OR

Mr. PACKWOOD. And Senator Bradley also holds the record for the most points ever scored in the basketball playoff in Portland, OR when he scored, what, 64 points?

Mr. BRADLEY. Fifty-eight. [Laughter.]

Mr. PACKWOOD. Mr. Chairman, when I was contacted, everyone asked, how did you do it in 1986, and are there any parallels to today? There are some, but the circumstances were different.

In our era, fairness was the issue, not income inequality. In the next to last page of my statement, you will see a list of newspaper stories about people who paid no taxes at all. There were industries, defense industries, at the time of the Reagan buildup that not only paid no taxes, they got money back, and the public and the members of Congress could not understand how wealthy corporations and wealthy individuals could pay nothing. It was not fair. So that was the premise we were operating under at the time.

You will find in my statement, on occasion, the word "diary." That means that it was taken specifically from my diary at the time.

Now, what happened? Of course, tax reform is not a new idea. Stanley Surrey, who was President Kennedy's Assistant Treasury Secretary for Tax, came up with the idea of tax expenditures. You can lower taxes if you get rid of them.

Bill Bradley and Dick Gephardt, in their fair tax plan, said the same thing. The studies known as Treasury I and Treasury II all said the same thing. We all knew how it worked. We all knew that you could lower the rates if you could get rid of deductions. It was just pure mathematics.

The House had public hearings for a year in 1985, and they had a lot of individual votes on things as they went along, and they picked up enemies. They picked up barnacles because, with some of those interest groups, they lost their votes. And there are lots of single-issue groups, and I do not mean the NRA or Right to Life, but if you touch mortgage interest, you have the realtors; if you touch inside buildup, you have insurance companies; if you touch 501(c)(3) charitable contributions, you have every organization in the country opposed.

And the problem with the House bill was that they had enough of these barnacles attached to the bill when it finally came out of committee that the votes were not there on the floor to pass it.

It would have failed but for the fact that Ronald Reagan literally came up on the Hill, met with the Republicans and said, "Please vote for this bill. I will veto it if it passes in this form, but send it to the Senate and see what they can do." With that, enough Republicans changed their vote, and the bill passed, although you would never know if they changed their vote because it passed on a voice vote in the House.

It came to the Senate. And in those days the Senate did not get going as quickly as you have gotten going now. We did not get going until mid-February or March. I finally started having some hearings on this bill, but we did not need many hearings because, in the summer of 1985, we had had about 30 hearings on the subject of tax reform just in case the House would pass something, because if they passed it, I knew we would have to act relatively quickly, and I did not want to have a lot of hearings at the same time.

So we pretty much cleared the deck of hearings. But there was one thing that caught my mind at the time of the hearings. I would ask witnesses how low the tax rate would have to be before they did not care whether there were any deductions. Oh, 30 percent, 20 percent, 25 percent—it was always in that range. I did not think much about it at the time, but I was intrigued that almost every witness I would ask, that is what I would get.

Well, all right. We come to the spring of 1986. I am, frankly, making no progress in committee. We are not making the bill any better, we are not making it any worse. We just are not getting anyplace.

So on Friday, April 18th, I simply adjourned the committee and said, "We are done with the bill." Somebody said, "You mean we are done for the day?" I said, "No, we are done with the bill. It is the end of this bill." And at that stage, I called—and this is where things moved so rapidly.

I called David Brockway, who was then the Chief of the Joint Tax Committee, and said, "Give me three bills: 25 percent, 26 percent, 27 percent high." He said, "At 25 percent, you will have to get rid of mortgage interest."

And, Bill, I remember you saying how much trouble mortgage interest gave you on your bill. So I asked him, "What about 26 percent?" That was Friday.

The following Tuesday he comes and he gives me three—not bills, they were not in bill form, but three plans as to how you could get to 25 percent, 26 percent, 27 percent. And I looked at them, and then I was delayed for 2½ days because at this stage, up came fast-track for the Canada Free Trade Agreement. It was one of those things where the President cannot move unless you give him fast-track authority. And there was a deadline. If Congress had not acted by—this was Tuesday—the next Wednesday at midnight, he got it.

The House had not acted. It fell on our side to take care of it. I thought it was a slam dunk. I was sure we were there. It turned out I did not have the votes. I was missing one, and it was Spark Matsunaga from Hawaii, who was mad that the President had not answered his letter on macadamia nuts. And I had to get over that hurdle and bring him around.

We finally succeeded in doing it, but it was Thursday before I was done.

Then on Thursday, I presented to the committees at the same time, our committee, just the outlines—we have no bill—just the outlines of what might be possible, and they seemed to like that.

So I thought to myself—the meeting was over and I was getting toward the weekend, and I was thinking at this stage, "How are we going to do this?" And I thought the only way it could be done was bipartisan, quickly, and behind closed doors. Bipartisan because I could see any bill that was utterly partisan on the Republican side would have no success with the House Conference. Any bill that was not done quickly, but hung out like the House bill had been, would pick up enemies all along the way. And it would have to be done behind closed doors.

It was helpful to have the President on board at the start. It was not critical, but it was helpful to have him basically tilting the same way we were going to go in the Senate.

On that weekend, on Saturday and Sunday, I called six Senators—Bill Bradley, George Mitchell, Pat Moynihan, Jack Danforth, John Chafee, Malcolm Wallop—and I said, "Would you be willing to meet in my office starting next Tuesday at 8:30 to see if we can work out a bill that will be satisfactory to us and the President?" Every one of them said, "yes."

And then passed, starting that Tuesday, the most extraordinary experience in my life in politics. We met from Tuesday to Tuesday, and Bill was at every meeting. In fact, they were all at every meeting, every morning at 8:30. I would meet with staff at 7:30 and this core group, a cabal as I called it, at 8:30, and we would work out what we thought should be in the bill.

We had one or two open committee meetings, but basically the committee was just marking time waiting for us to finish. And you could tell, although the meetings were behind closed doors, there are no secrets in this town and word was getting out we were having the meetings, but no one exactly knew what it was we were doing.

But on the Thursday between these two Tuesdays came a phone call that became very important in this whole process, and I will read it to you because it is from the diary.

"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 and without fanfare, without press, just to say I've been through it. I know every day you go through troughs and 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 Congress has seen in 10 years. You get this through the Senate and between the two of us, we're going to put out a bill that for a generation of Americans will look like a pinnacle.' God, I appreciated it."

What he was saying, what the Ways and Means Committee chairman was saying was, write this bill in the Senate, which Ways and Means does not say very often.

We continued our meetings through Friday and then we had a public meeting Friday afternoon, and I said to everybody, "We are done, and we are not going to meet this weekend."

By this time, the hallway was packed with lobbyists. We had speakers out there. "Committee, we are done, we are not meeting at all this weekend"—cheers and huzzahs. And then I said to the core group, "But we will meet tomorrow."

Bill had already planned—you went to Kentucky that night for a speech, canceled your trip to the Kentucky Derby, and came back to be with us the next day. On that Saturday, the seven of us met all day, from about 8:30 to around 4:30 or 5 in the afternoon, and that tied up all the last of the things we needed.

Joint Tax needed a couple of days to get it together, but they would have it for us Monday or Tuesday, and we were ready to go on Tuesday night, until I finally had to make an odious deal with the oilies to get their support—not in committee, we could have beaten them in committee, but to get their support for something we needed desperately on the floor, and if we lost this particular issue on the floor, the bill was dead.

And that was it. We voted that night. Most of the committee had not ever seen the whole outline of the bill or the whole bill until that night. And so from Tuesday to Tuesday, the seven of us worked. That night the bill was adopted 20–0.

Now, can you do the same thing now in this committee? Here are the things that would be critical. It is helpful to have the President on board, to have him with you from the start. But at a minimum, you have to make sure that he is not against you or gives the impression that he is not sure if he is going to support it or he has some questions, because you are not going to get your members to take tough votes on things that the President might veto if you put them in the bill. So at a minimum, he must say, "I am open; send me a good bill."

Two, I think you are going to have to do it in much the same way we did, which is behind closed doors, but that is not uncommon in the House and the Senate even today. Do it behind closed doors and try to do it quickly and present it in one grand bill. We did it combining both corporate and individual into one bill and then used the money we raised from them to lower tax bills for everybody else.

If you look on the last page of the statement, you will see who the major groups were we hit. It was almost all corporations and rich individuals. And do it in one bill so that people do not have to pick out a particular thing that they do not like and are forced to vote against.

You give them this. You give them the whole bill, and I think they will go for it. So that is what we succeeded in doing, and, believe it or not, by hitting business as hard as we did, raising their taxes about $140 billion, we managed to lower the corporate rates from 48 percent to 34 percent, lower the individual rates from 50 percent to 27 percent, and keep the bill revenue-neutral.

You can do it, but, Orrin and Ron, the two of you are going to have to make an agreement as to what you are trying to get. And the thing I like about the fact that it is the two of you doing it—Ron, you may recall about 10 years ago we ran into each other in the dry cleaners, and you were working on tax reform then.

I know, Orrin, you have crossed party lines many times. I remember you working with Ted Kennedy on things. You both showed a willingness to work across party line on some occasions when it did not please your parties too much.

So it can be done, but it can only be done if the majority and the minority at the start are on the same page.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. That was fascinating. We are very fortunate to have that overview.

[The prepared statement of Mr. Packwood appears in the appendix.]

The CHAIRMAN. Senator Bradley, we would love to hear from you.

STATEMENT OF HON. BILL BRADLEY, FORMER MEMBER, COMMITTEE ON FINANCE, NEW YORK, NY

Mr. BRADLEY. Thank you very much, Mr. Chairman. It is always a pleasure to be on a panel with Senator Packwood. He is an extraordinary leader, and he ran the committee with great effectiveness not only on tax reform, but on a whole series of other issues.

This is also a first for me: the first time I have been in this room since December 1996. I notice it has not changed.

But what I would like to do is, I would like to give you a few thoughts about structure and provide amplification on two things that Senator Packwood said.

First, what is the ideal income tax system? I believe the ideal income tax system is a system that provides the greatest number of people the lowest rate. And in terms of principles—and these were the principles that I think we used in 1986 to determine what was in, what was out—one was efficiency. It is a basic threshold question for members of the Finance Committee. And the efficiency point is, I believe, that the market is a more efficient allocator of resources than is a member of the Ways and Means Committee or the Finance Committee. So that is one principle.

The second principle is an equity question: horizontal equity. Equal incomes should pay equal taxes, not somebody has the same income, and next door somebody is using loopholes to reduce their tax rate.

Third is fairness, which is essentially vertical equity, and that is, those who have more should pay more; in other words, the progressive nature of the system.

And fourth, do whatever you can to make the system less complex. We live in a time where few people fill out their returns and where tax fraud is estimated to be yearly $80 billion to $100 billion.

So those are the principles—efficiency, equity, fairness, simplicity—and you measure everything against those principles.

Now, what do you need to pass tax reform? Drawing on our experience, I think you need at least six things. The first thing you need is the exact thing Senator Packwood said. You need a President who is going to put his prestige and clout on the line to drive things through when the inevitable obstacles appear.

Second, you need a Treasury Secretary who is the President's designee to deal with it every day, and you need a Treasury Secretary who has an incredible person who constantly monitors that.

Of course, in 1986 the President was Ronald Reagan, his Secretary of Treasury was Jim Baker, and his assistant was Dick Darman, all of whom played critical roles in this. And I cannot tell you how important it was to have a Treasury Secretary who could speak for the President so I did not have to run back to the White House all the time to check this or check that.

In fact, as Bob remembers, we had gotten down to the critical strokes at the end of this process. There was some difference of opinion, and Jim Baker was in the room doing the negotiating because he knew enough of the substance and had paid attention to it. I remember him convening a meeting during the period when there was Treasury I and Treasury II, which were things that Ronald Reagan tasked the Treasury Department to do, and he convened a meeting with Jack Kemp at his house with me and I think Bob—a few other people.

I think it is important to know the longer-term journey of tax reform. One of the reasons I ran for the Senate was I wanted to reform the income tax system. I remember reading an article by Milton Friedman many years before when I was a basketball player about how you could have a tax system with a 16-percent rate, and I thought that was pretty interesting. And I have read all of Stanley Surrey from Harvard, Joe Pechman at Brookings.

And I remember in 1984 I went to Walter Mondale, who was the candidate for President for the Democrats, and tried to convince him to do tax reform. I said it could take the issue away from the Republicans: they were out there talking about tax cuts, here you could talk tax cuts and equity.

He had been a member of the Finance Committee, and Charlie Rangel was his advisor on this issue, and I think the combination of those things made him unwilling to take what he thought was the big risk for a hopeless cause. And so it passed.

However, as everyone in politics knows, nothing is secret, and it leaked that maybe Mondale would be doing tax reform. And so that is when Ronald Reagan, in the middle of the campaign, called for a study by the Treasury Department, which was Treasury I. And it so happened that the people at the Treasury Department in the tax area were really great people. And so they took the charge seriously, and they produced a document that was an outstanding document, laying out the boundaries and the parameters and the specifics of what tax reform is.

Naturally, when you throw it out there, as I had experienced when I threw out the Bradley-Gephardt bill in 1982, you throw out something specific and everybody chews on it. So everybody chewed on Treasury I and how terrible this is and how terrible that is and you ended up having Treasury II, and Treasury II accommodated some of those interests, stiff-armed others, but it was an improvement over Treasury I.

And so that is how the Treasury Department got involved, and you absolutely need a commitment from the Treasury Secretary. So you need the President, and you need a Treasury Secretary who likes it, knows it, and can cut the deal for the President.

The third thing you need is the chairmen of Ways and Means and Finance to want to get this done, to see that some of their own political interests are served by getting this done. And Bob mentioned Dan Rostenkowski. In 1981, we passed a bill which President Reagan put forward the first year cutting rates 30 percent, and Dan Rostenkowski ended up being labeled as the king of special interests.

And so I think that what he saw in this was an opportunity to seize the good government mantle and push forward with a challenge that would make him a historic chairman of Ways and Means. I think the Senate was very fortunate to have Bob Packwood as the chairman, because I do not know specifically what your political interests were, but I sense that it was that you wanted to do something that no other chairman of the Finance Committee had ever done before, and you wanted to do something that would affect 100 million Americans in a positive way and potentially change the way we think about taxes.

Without Bob Packwood and Dan Rostenkowski and Jim Baker and President Reagan, this would never have happened. You have to have those parts in place, and then you have a chance.

Then the fifth thing you need is maybe a zealot. That is the role I played in 1986. I did nothing but talk about tax reform for 4 years. Every speech would be about tax reform. It got so bad—I remember I was on a Sunday morning interview show that was recorded on a Thursday night and rebroadcast on Sunday.

At that time, my daughter was about 8 or 9 years old and she had a girlfriend of hers staying with us, and I said, “Hey, Teresa, dad is going to be on TV,” because the guy said, “Eyewitness News conference with Senator Bill Bradley.” “Stick around, dad is going to be on TV.” So she elbowed her friend and said, “Come on, let’s go; all he is going to talk about are loopholes.” [Laughter.]

And, indeed, that was all I talked about for 4 years. And I also tried—I recognized I did not have the power. The power was with Bob Packwood and Dan Rostenkowski. So I had to be supportive in any way I could, and I tried to play that role.

The sixth thing that you need if you are going to get it passed is, you need a committed, knowledgeable staff. I remember Bob’s staff—absolutely first rate. And the key thing in this is that they can cut the deal on a lot of issues, and everybody knows they speak for the chairman, and they say the same thing to everybody. They do not say one thing to one person and another thing to another. But they keep their word, just like the Senator keeps his or her word.

So I think that those are the six things that you need. You need a President who is committed, you need a Treasury Secretary who is committed and knowledgeable, you need the chairman of the Ways and Means Committee and the chairman of the Finance Committee, you maybe or maybe not need a zealot, and then you need to have a staff that is competent and honorable and has absolute integrity.

The last thing I think you need, and this is probably the most important—it was epitomized by a visit that we made to the White House to meet President Reagan. I was a Democrat, kind of a junior member, and I was not invited a lot to the White House to meet with President Reagan, but there I was seated around the table in the West Wing.

If you recall, each of us around the table could tell the President what we thought about tax reform. He was listening mainly, not talking. So when it came to me, even though he had made his commitment and even though he had made his position clear, I said, “Mr. President, I know you are interested in tax reform which means lower rates, because, when you were an actor, the rates were 90 percent.”

He kind of nodded. And I said, “Mr. President, I am interested in tax reform because, when I was a basketball player, I was a depreciable asset.” [Laughter.]

Which, in fact, I was. In other words, what that story says is, there has to be something for each party in a deal. It cannot be all one-sided. There has to be something for each party. Each party has to know what they want, and then, if they do, there is a chance to get something done.

I will only make two other quick comments. Bob talked about writing the bill in a short period of time with seven people. Again, the only reason that happened is because Bob Packwood wanted it to happen. He was the chairman. If I had called seven people, they would have said, "Yes, okay, meet you in the cafeteria tomorrow or the next day or 2 years from now." But when the chairman called, you showed up.

So it was because of him that that committee, that small committee of committees, worked. But he also mentioned that when we were headed down the path the House took for a long period of time, we had 30 hearings about tax reform. Bob presided over every one. I was at every one. And we asked questions of every witness, and the question that he mentioned was one of them, which was, "How low would the rate have to go before you would give up this, that, or the other thing?" And I asked, "How low would the rate have to go before you give up capital gains exclusion?"

In the latter, the answers came back—if you were from Silicon Valley, the witness would say, "I do not care if the rate is 10 percent, we still need a differential for capital gains, because that will affect capital appreciation and capital formation."

But a lot of other people came in—I do not want to say just Silicon Valley—but there was a certain kind of person who said, "No matter what, you have to have a differential."

Other people said, "Well, you know, if you got the rate down to about 28 percent, 29 percent, we would give up that differential for capital gains." And that is indeed what we did. We got the rate to 28, and that 28 percent was the rate that applied to both capital and earned income.

So, Mr. Chairman, with those thoughts, I would thank the committee for the opportunity to come back to the room once every 25 years.

[The prepared statement of Mr. Bradley appears in the appendix.]

The CHAIRMAN. Well, we are honored to have both of you here, and I think anybody listening to this has to realize that you went through a very trying time—very difficult. Congress was split. You had a Republican President.

I just want you both to know how much I respect and appreciate both of you.

Let me just ask this question. According to CBO, revenues as a percentage of GDP have averaged 17.4 percent over the past 50 years. Revenues in 2014 were 17.5 percent of GDP, trending up to 18.3 percent of GDP by 2025.

In other words, taxes are higher now than their historical average and headed even higher. Since taxes are already higher than average and raising revenue in tax reform makes enacting it less likely, should we not do tax reform on a revenue-neutral basis?

We will start with you, Senator Packwood.

Mr. PACKWOOD. I would much prefer you do it on a revenue-neutral basis, although I would combine both corporate and individual into one bill, and then you have a little more wiggle room using either side of that equation to be able to reach your revenue neutrality.

The CHAIRMAN. Bill? Senator?

Mr. BRADLEY. We, of course, did it revenue-neutral. I think the times today probably might require some additional tax, but I believe that that is something that the committee has to work out itself.

If you really do thorough tax reform, what you find is—at least we found that upper-income Americans will pay a higher percent. For example, we cut the rate from 50 to 28, and yet the top 5 percent paid a higher percent of the total tax revenue after that reduction than before.

The CHAIRMAN. Well, the U.S. is one of five major economies operating on a worldwide tax system, meaning it currently taxes the income of its companies wherever that income is earned, even if it is not in our country.

Currently, companies have the option of bringing the profits they earn back to the U.S., but they face a tax of 35 percent, minus foreign tax credits. Those businesses would rather not pay these additional taxes, so they keep their earnings abroad, deferring the additional tax. Current U.S. law allows companies to defer the tax indefinitely.

President Obama's proposal released in this year's budget would substantially limit deferral, since it imposes a minimum tax of 19 percent.

Now, do you think we should go to a territorial tax system with base-erosion protections like almost all other major countries or not?

Mr. PACKWOOD. Mr. Chairman, I have thought so for the last 30 years. We are often saying we have to compete overseas, and there are advantages they have. And one of the advantages they have is territorial taxation. I think we ought to go to the system that the rest of the principal industrial countries use, which is, if you invest overseas and you make profits overseas and you pay your taxes overseas, you can bring back whatever profits you have to this country and they are not taxed. I think that is a good system.

The CHAIRMAN. Senator Bradley?

Senator BRADLEY. Of course, when you have profits overseas and you are taxed in a particular country at the rate that that country charges, all of those taxes are deducted against your liability in the United States—the tax credit. So I think you have a clear view of how this works.

The President has proposed two things, I think. One is a 19-percent tax on the deferred income going forward and a 14-percent tax as a toll on the tax if it is paid abroad. I think that the committee will have to work its will on that.

I think that the territorial tax makes sense in terms of the overall picture, but in reality you are going to have to figure out, is there some other way—because I do not think that is going to happen—is there some other way that you could bring the money back? And I think embodied in the President's proposal of the 14 percent is the possibility that maybe it is not 14, maybe it is 10. Maybe it is not 19, maybe it is less.

But somewhere in there—like where do you give up capital gains, at what rate—there is a willingness to bring the capital back.

The CHAIRMAN. My time is up. Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

The two of you have told an inspiring story this morning about bipartisanship on a major economic issue, and, colleagues, we just looked up the vote that attests to what happened. It was 97–3, the original vote coming in the Senate, and then on the conference report it was 74–23, and in the House it was more than two-thirds. So this kind of work paid off.

What I would like to start with is asking you about the process, because as far as I can tell, in this effort to promote bipartisanship every step of the way, you said, we are going to use the normal process, because the normal process in the Senate really promotes bipartisanship. And you have to have 60 votes, and certainly neither side today has 60 votes. So you use the normal process, and it really forces bipartisanship.

The alternative is to use what is called reconciliation, which, in effect, is 51 votes. If one side now has 51 votes, they could have their way on tax reform.

My question to both of you is, either one who wants to start, is it your view that using the normal process, which you all used in 1986, was helpful, and is it your assessment that using the normal process helps promote bipartisanship? Either one of you.

Mr. PACKWOOD. Absolutely, but for a variety of reasons. One, every member of this committee ought to have misgivings about reconciliation and using it to jam as many things into a bill as the majority wants because they are not sure they can get it passed any other way. What that lends itself to is, more and more, the decisions moving up to the leadership.

In my era, let alone now, even in Lyndon Johnson's era, no Majority Leader would have ever thought of taking a bill away from committee. Reconciliation just holds out that plum and says, "Use it this way."

No. I would much prefer the regular order, for a couple of reasons. One, it stilled the arguments against it. We had no chance. We did not get to offer the amendments. There was a time limit. And if you win it in the normal process, you have a lot better credibility than if you have jammed it through in reconciliation.

Senator WYDEN. Senator Bradley, can you top that?

Mr. BRADLEY. No. But I will have a comment or two. Your question was what, Senator Wyden?

Senator WYDEN. Normal process. The normal process inviting bipartisanship, reconciliation going more of a partisan track.

Mr. BRADLEY. I think the way that we did it, I would agree with Senator Packwood 100 percent that the normal process is better. It also has to do with what is the clout of the committee in the larger Senate.

We had agreement among members of the committee that whenever a vote would come up on the floor, none of the committee members would break from the bill that was reported out of the Finance Committee and would stay with the committee bill.

And that was a point of personal anguish for me, because in the committee, as it related to what Senator Packwood referred to as the oilies, Senator Packwood was the chair at that time and Senator Russell Long of Louisiana was the ranking member, and he had a few interests in the oil patch.

I, of course, was going to go after it. We had to go after that. We could not leave that out. We were meeting in secret back there and we had a vote in the back room, and it was 11–9 against me. And I viewed that—this was in the back room. If there was one Senator who was taking it public, he would not vote that way.

So I did not raise the issue in the committee, the full committee, and I saw Senator Long's head go like that, and I called for the vote, and the person whom I thought would switch did not switch. And right up there against that wall afterwards, Russell Long got a hold of me and said, "If you ever do that again." [Laughter.]

But life went on, and the screw turned. We got to the Senate floor, and then Republican Senator Lowell Weicker offered the exact amendment that I had offered in the Finance Committee. But because we had a deal that we were all going to stay together, I voted against my own amendment.

So the clout of the Finance Committee in the Senate as a whole is instrumental in getting a bill passed, because most of the other Senators do not know a whole lot about taxes. They have a few opinions about this, that, and the other thing, but to the extent that you can speak clearly, authoritatively and hang together, you will not need to have any kind of reconciliation.

Senator WYDEN. Senator Hatch said I could ask one other question, because this was a remarkable feature of the 1986 bill, and I think it would be helpful for the committee to know how you two got to common ground in 1986.

In 1986, you were able to say that income from wages and income from capital were treated equally. Senator Bradley talked a little bit about his views on that. But I think it would be very helpful to know how you two reached that judgment that by today's standards would be remarkable. In fact, today people say that if you could just reduce the difference between the way income from capital and the income from wages are treated, that would be a huge reform.

How did you two in 1986 get to common ground on treating wage income and capital income the same?

Mr. PACKWOOD. Well, realize we wanted to keep the same progressivity that we had in the existing law, but we were going to lower the rates tremendously. So in order to make sure that the very wealthy still were roughly in the same progressivity incline, we had to get rid of capital gains at a differential. It was as simple as that.

In fact, it did not even really bother the committee that much. It was a small issue. Malcolm Wallop had some misgivings about it, and I would say to his credit, we agreed. Remember, Bill, we made the rate the same, but we did not put it as a separate section of the bill because Malcolm Wallop said if we put that in the bill and got rid of the words capital gains, then pretty soon Congress was going to start to raise the rates, and capital gains would go right up with them.

Now, it turns out he was right. But it was to make sure our progressivity was the same.

Mr. BRADLEY. Just a little addition to that. I exactly agree with what Senator Packwood said. There was a provision in the bill—since we got to the magic number of 28 for both capital and earned income—that said if the general rate ever went higher than 28 percent, the capital gains rate would be 28 percent. In other words, you would never tax capital higher than 28 percent.

I remember, it might have been 4 months after the passage of that bill, people were in saying, we need a differential in capital gains. And my point was, if you take a differential in capital gains, you are going to end up with a much higher general rate, and, indeed, that is precisely what happened when President Clinton came in. The capital gains differential went back in, and the rates went to 39 percent.

It seems to me that there is a lot more coherence in a bill with a lower rate that treats capital and labor the same.

The CHAIRMAN. Thank you. Senator Grassley?

Senator GRASSLEY. Thank you both for coming. I want to start with something you both touched on in your opening statements, but I want to get more specific. So I will start with Senator Packwood, but I will ask Senator Bradley a similar question.

It deals with the process and presidential involvement.

Senator Packwood, do you think tax reform would have happened if President Reagan had not made tax reform a priority in his administration? And a follow-on then: is it not going to take at least that much commitment or involvement from President Obama with his own party in Congress to get a tax reform bill enacted?

Then for Senator Bradley, could you share your thoughts on the importance of presidential leadership in accomplishing tax reform?

Senator Packwood?

Mr. PACKWOOD. Well, President Reagan was immensely helpful. If you are asking me, is it absolutely essential that the President be there from day 1 and pushing, I do not know. It is like saying this committee could not reach its own conclusion without the President. But it was very helpful.

One morning there was a small breakfast at the White House. It was just Danny and me and the President, the Vice President, and Jim Baker. It was before the bill—the bill had passed here, but before conference. And the President took Danny and me aside right at the end, and he said, “If you can keep this bill revenue-neutral and you can get the rates that you have got,” he says, “you may count on my support no matter how you get to those rates.”

So that is how critical it was. We knew we had his backing, absolutely. But Bill touched on something, and that was about the Treasury. Jim Baker was up to his neck in the negotiations with us, as was especially his Assistant Treasury Secretary Dick Darman, because in the last 7 days that I talked about where this was all done, Baker was not here. He was in Tokyo with the President on one of those economic multinational meetings, and all of the final negotiations for the administration were done by Darman.

In the last paragraph of my testimony, you will see an interesting exchange on the phone with Darman calling Baker in Tokyo and telling him what to tell the President.

So is it critical? I do not know if it is critical. Is it immensely helpful, and was it immensely helpful? Yes.

Senator GRASSLEY. Senator Bradley?

Mr. BRADLEY. I think presidential leadership is essential. I believe that there are so many times when things happen where you need to be able to get the White House's clout, and that can be manifested through the Treasury Secretary. It is not you talking to the President all the time.

I also would say, going back to my anecdote, I think the President was viscerally in favor of lowering tax rates because, when he was an actor, he had a 90-percent rate—90 percent. And I was viscerally in favor of this because I was a depreciable asset as a basketball player.

In other words, closing loopholes had traditionally been what Democrats were for. Lowering rates was traditionally what Republicans were for. The question is, can you bridge that divide and bring something together? The answer is "yes." But if Ronald Reagan had not said, "I put my imprimatur on this," it would not have happened.

Mr. PACKWOOD. And Bill has touched on something right there, Senator Grassley. Democrats wanted to get rid of unjustifiable deductions. Republicans were not adverse to going along with that if they could use the money to lower the rates. And as President Reagan had said, "I am not signing unless it is revenue-neutral." If you got rid of a lot of deductions and produced a pot full of money, you could not raise revenues with this bill; you had to use it to lower rates.

But you had a willingness on both sides for different reasons to want to reach the same conclusion.

Senator GRASSLEY. My last question deals with something we have to tackle here in a basic way. So both of you, in your view, how important was it in getting support for its passage that the 1986 bill was a comprehensive tax reform package rather than focusing only on business or, on the other hand, individual reform?

Mr. PACKWOOD. For us, it was critical, because we needed a lot of the money we raised from business—do not confuse rates with revenue. We raised an immense amount of revenue, more than we were raising from businesses before. But we lowered the rates and we used a lot of their money to lower rates for individuals, and we mixed the two of them up.

I would have misgivings about trying to do just business and then later on try to do just individual. I think you are better off to try to do both of them at once in one big bill. And I want to use the word "grandeur" again. You come out with a big bill that you have agreed upon, and if you do—and it touches the point Bill and I have talked about—before the bill ever gets to the floor of the Senate, you are going to have immense newspaper support, academic support across the board, liberal or conservative, and you will be glad, in retrospect, that you combined it all in one.

Mr. BRADLEY. I agree you should combine both corporate and individual, because if you just do corporate, it is not like you are going to have an easy path if you do anything that is serious.

For example, when we did the individual and corporate, essentially the business community split. A large percentage of the business community was for the reform. Another segment of the business community was against reform.

Guess what was the dividing line? What tax rate they paid. If they paid less taxes because the rate went from 50 to 28 percent, they were for it. If they paid up more, they were against it. But the key was constructing a coalition that included a significant part of business, and this is where Bob was brilliant. So I would argue that that is very important.

You also might get to a point where you have more flexibility if you do individual and corporate, because they both are essentially two sides of the same coin. For example, you might decide that you want to cut the corporate rate to 10 percent or 15 percent and you might want to offset that by increasing the taxes on the individual side, on dividends and capital gains. That is what they do in Denmark, for example.

You would not have that flexibility if you did not have both individual and corporate put together in the same bill.

The CHAIRMAN. Thank you, Senator.

Senator Isakson?

Senator ISAKSON. Thank you, Mr. Chairman.

Thanks, both of you, for being here. I was a real estate guy in 1986 and had a development company and a brokerage company. So I have a question for both of you.

First of all, thanks for being on the nine who voted against selected treatment in terms of passive loss. I think that is right. Both of you voted against that, if I am not mistaken. Oil and gas won; real estate kind of lost.

But looking in a rearview mirror, could some transition have been applied to those investments made prior to 1986 so that the tax treatment could have continued and the tax treatment on passive loss been prospective rather than a claw-back? Did you ever think about doing that, or, if we go into something like that again, could we do it that way?

Mr. PACKWOOD. We did not think about it at the time. And he is absolutely right. If there was an industry that we hit, it was real estate. And we drove the S&Ls out of business, which were one of the principal financers of real estate. And we did it retroactively.

We found passive losses such a grievous way for rich people to shield their money and pay very little taxes, we got rid of them.

But, Senator, you are absolutely right. The real estate industry was hit hard, and the oil industry got a particular favor because of a deal that I made because I was going to need their votes later on on the floor on a particular issue.

Senator ISAKSON. Senator Bradley?

Mr. BRADLEY. I agree that the real estate industry paid more. If you phase it in, of course, you have not as much revenue and you also skew the distributional tables. But in regard to real estate, keep in mind, that was at a time when there was, I would say, real estate investment that was not based on the need for apartments or office space, but was based upon the individual taxpayer getting a tax deduction offset against all his other income or her other income.

I had a call sometime in this period from Paul Volcker, who was then the Federal Reserve Chairman, and he said, "You know, I really like what you guys are doing up there." And I said, "Why is that?" And he said, "Because I cannot get at these banks who are simply throwing money at uneconomic real estate investments, and it has to be through the tax code."

So I think that is one of the reasons, at least for me, that I felt we were on strong ground.

Senator ISAKSON. I think you did the right thing, because there was abuse. My point was, if you could have transitioned prospectively in terms of the treatment of passive loss rather than clawback, you might have prevented the collapse of the savings and loans and the creation of the REITs, which is basically what the ramifications were.

Mr. PACKWOOD. I think you are right.

Senator ISAKSON. One other question I have——

Mr. BRADLEY. Well, I would not say that the savings and loans collapsed because of the Tax Reform Act.

Senator ISAKSON. No. It was the last straw, I guess.

Mr. BRADLEY. Yes, maybe that is a better way to say it.

Senator ISAKSON. My other question is, did you consider in 1986 or have you thought since about going to a retail sales tax or a consumption tax instead of a progressive income tax?

Mr. PACKWOOD. I have, and I have often thought to myself, what kind of a deal could be made between the Republicans and the Democrats that would result in some increased revenue? And I thought, what happens if the Democrats were to offer this to the Republicans? We will go to an electronic funds transaction tax, which I prefer to a VAT or a retail sales tax, and we will cut in half the corporate and individual income tax, and you will allow the tax, however, to produce an additional $500 billion in revenue.

And now the Republicans are thinking, wow, cut the income tax in half and the corporate tax in half, and we have always kind of supported a consumption tax anyway. Is that kind of a deal possible?

We will go to it one day, there is no question in my mind. The danger of any kind of a consumption tax is—and this is where Republicans are more afraid of it—it is so easy to raise. Need a little more money? You raise it half a percent.

Take a look at your sales taxes in different States that started at 1 percent or 2 percent 30 years ago, and they are now at 8 percent or 9 percent. Look at the European value-added taxes. I do not know if any major country in Europe is less than 20 percent on the value-added tax.

But to answer your question, yes. If you could combine it, I think there is a possibility that—I can maybe see the Republicans shaking their heads—you could possibly make an argument for some increased revenue in exchange for dramatic reductions in corporate and individual taxes.

Senator ISAKSON. I am out of time. But really quickly, Senator Bradley, I would love to hear your comment.

Mr. BRADLEY. I think that what Senator Packwood said about an electronic transfer tax is extremely interesting. If I were the chairman, I would task the Joint Tax Committee to do an analysis of that in terms of revenue that could be generated, because you have to know what revenue you are going to generate before you decide how you want to spend it.

On the consumption tax issue, in my testimony, I make a suggestion. Basically, the point is that we should tax less those things we like, such as wages, and tax more those things which are bad for us or dangerous, such as pollution, for example. And I think here, there could be a very interesting tradeoff between employment taxes, Social Security, Medicare, and unemployment, and a gasoline tax, or a tax on things like volatile organics, or sulfur dioxide, or lead, or nitrous oxide, or whatever.

It is just a numbers game. And if you did that, it would have profound impact. For example, if you were able to dramatically cut both individual and corporate Social Security employment taxes, you would, in essence, be giving individuals a tax cut and corporations a tax cut at a time when jobs are needed.

The fact that there is this 15-percent hurdle is—it affects different industries in different ways. For example, if you are a McKinsey, or Microsoft, or Google, and you want to hire real talent, you pay more because you really need that talent. So you pay more to offset the employment tax.

If you work in a lumber yard in Oregon or somewhere where there is a surplus of labor, you do not pay them more to offset. So the irony is that it ends up hitting the lower-paid guy in the struggling industry more than it hits the person who is in the consulting or technology industry.

So reducing those employment taxes has many benefits. For example, the 24 million people or 25 million people who are working part-time now could very well be brought into the workforce. You could find people who were not working, who could be brought into the workforce. So that is the good news.

The question is, what are you going to use to provide the money to do that? And I know the committee has looked at it. It is probably not possible, but who knows. They said tax reform was not possible in 1986.

You could take a $1 gasoline tax or you could take a carbon tax and use all that money to reduce those employment taxes, and I think the net benefit would be greater job creation and economic growth.

It would hit certain sectors more than others, obviously, but let us just take the $1 gasoline tax. Never, could it be offered, would be a better time to do it than now when prices are where they are. But let us say you phase it in, as you suggested you do on the other things. If you phased in a gasoline tax over 5 years and the automobile industry was going to improve the auto mileage efficiency, at the end of that 5 years, since the individual would be getting more miles with less gasoline, they would be paying no more for gasoline with a $1 tax that could be used to reduce Social Security taxes and employment taxes than they are paying now without that.

The CHAIRMAN. Senator Nelson?

Senator NELSON. And we could also, Senator Bradley, improve the roads and bridges that are crumbling.

This has been a fascinating discussion for me, and thank you very much. I take your ideas and try to put them into today's politics.

Offsetting, lowering employment taxes, and going after something like nitrous oxide, that is much more difficult today because of the climate debate that is going on, getting the votes.

I think about what you said, Senator Packwood, that President Reagan was so critical in tamping down the opposition among Republicans in the House. Well, how are you going to get President Obama to tamp down that opposition today just over the kneejerk reaction of some Republicans to the word "tax"?

So it is hard for me to make the transition from your success in 1986 to today, and it really puts a real burden on the shoulders of our chairman and ranking member.

Mr. PACKWOOD. Well, that is why this committee—at least in Bill's and my era, there was much more nonpartisanship in the Senate than there apparently is today.

I cannot tell you whether or not you can put it together, but in 1986 it appeared to us just as difficult to put it together as it appears to you now. There are different issues than we had then. And nobody can make the right circumstances. You cannot buy them, you cannot wish them, you cannot coerce them.

All you can do is be around when the circumstance comes and hope you can take advantage of it. As I say, maybe there is a possibility. But if, at the start, we are going to have the Republicans say no bill if there are any revenue increases total, and if the Democratic position is no bill unless there are some revenue increases, then you might as well spend your time working on the Asia Pacific Trade Agreement or something like that.

Senator NELSON. Our problem thus far, since a lot of your success, has been we are in this kind of herky-jerky, patch at the 11th hour mode. Tax extenders are an example.

Do you want to give us your thought about how we overcome this illogical approach to taxes? Do you have to do it in the overall global kind of big deal in order to get it done?

Mr. BRADLEY. Tax extenders are a lobbyist's Full Employment Act.

Senator NELSON. Yes.

Mr. BRADLEY. You have to bite the bullet and make some decisions. What should be permanent and what should not be permanent? And there are always questions of revenue, so you want it to go out 1 year or 2 years, but not 3 years or 4 years, because that would affect the revenue.

I just think that the practical reality is that people would probably say extenders are necessary, but they are necessary only because fundamental choices are not made about the tax code. What kind of tax code do you want? What do you want in, what do you want out——

Senator NELSON. Right.

Mr. BRADLEY [continuing]. Not what do you want in this year, because then we all know that means you are lobbied every year about the same thing and, quite frankly, it becomes boring, I would think. You know the arguments before they come in.

On your earlier point about nitrous oxide, you would be cutting some taxes, like Social Security. Recall a couple of years ago you cut the Social Security tax, and then there was a quiet deal where you let it go back up, and nobody said anything about it. Not one party attacked the other party. Well, that is the kind of thing you could get here with the employment tax reduction and the increased taxes on essentially pollutants or gas or carbon.

Mr. PACKWOOD. I have mixed feelings about extenders. If you make some of these permanent, you are going to play hell ever getting rid of them when the time comes you think you ought to get rid of them.

At least with extenders you are forced to look at them and think, should this be kept, and then, of course, everything falls apart and you extend them all. But let us say you made them all permanent. Now, you do not have to look at them until somebody says, "I wonder if we should look at this one." So you kind of pay your money and take your chance on it.

Senator NELSON. Thank you.

The CHAIRMAN. Next is Senator Coats.

Senator COATS. Well, Mr. Chairman, this has been fascinating for me. I am a rookie Senator sitting—I cannot use the basketball analogy, but I can use a baseball analogy—in the left-field bleachers here with my friend from Nevada. They had to extend the rostrum here to accommodate the three of us.

The CHAIRMAN. That is the right-field bleachers.

Senator COATS. Well, if you are at home plate, I figure I am in left field. [Laughter.] Although I would prefer to be in the right field.

Nevertheless, having had the opportunity to serve with these two distinguished former Senators, just sitting here listening to them talk through the process has been fascinating.

So often we take an issue and we start with the substance of the issue, and nobody pays attention to the process until everything comes to a grinding halt because the process was not set at the beginning in terms of, what is it going to take to get from here to there? So it was fascinating to me that both of you outlined the principles of the process that you had to work through in order to accomplish the goal.

It occurs to me, Mr. Chairman, that a buy-in of the committee with the principles up front would prevent us from being seduced away either through ideology or through special interest group pressure on particulars. Well, all right, I can get behind you unless you exclude this or include that—that traps us from getting from the batter's box all the way around to home plate.

So I just thought it was a fascinating lesson in history here. And I had the great pleasure of serving with both of you, being in the House in 1986, but watching what was happening there as a somewhat neophyte member of the House. And now all of a sudden we have this opportunity, sitting here thinking, could this really be done, and what you have left with us is "yes."

If we as a committee can avoid the pitfalls of making prejudgments as to what ought to be in and what ought to be out and look at how we could accomplish something of enormous impact for the future of America, for a whole generation—I think that is what we are looking at here—what a legacy that would be to you, Mr. Chairman, to the ranking member, to all of us on this committee.

It appears to me that there are some stars lining up here between the House and the Senate, given the personalities, the experience, and the background of the leadership of the Ways and Means Committee, as well as the Finance Committee here.

There is a question mark in terms of where the occupant of 1600 Pennsylvania Avenue is starting from, relative to their situation, and relative to their income level and the things that cause them the eureka moment to say, yes, I want to get on board that.

To me, it seems like—I am just going on here—but it seems like the real challenge here is to address the question of how a lower rate and cleaner product can result in the kind of growth and the dynamic economic impact from something that we would do, and where that money should go.

Should it go back into government for expenditures, perhaps, appealing as that might be? How many roads could we pave and how many bridges could we fix, or do we let the market determine how that capital is better invested?

It is really not asking the question. If the panelists want to comment on that, I was actually making a statement. I am over my time here.

Mr. PACKWOOD. A comment only in one sense. Senator Wyden, you may remember my predecessor, for whom you worked at one time, used to use the expression, "Give me control of the procedures of democracy, and I will control the substance of democracy."

Dan, this process in 1986 was not really a planned procedure. The House pretty much ceded us the right to go ahead and write the bill, and if we wrote it the way Danny liked it, they would adopt it. But I was not making any progress following normal procedures. It was only when the thing was not moving at all that I came up with this idea about half a dozen of us getting together in secret as quickly as possible.

And in that group we had four Republicans and three Democrats. We had an agreement. If any four of us could agree on something, it would be put in the chairman's mark. I recall no vote that was four Republicans, three Democrats. I recall a number of votes where I was on the three side of a vote. But we had that agreement. It was that bipartisan, in that sense, but it was not planned.

Nothing else had worked, and yet the circumstance was there to make something work, and that is how it happened.

I do not know if the circumstance is here. You feel it. You do not plan for it. It arrives, and I am not sure I know how to make it arrive.

The CHAIRMAN. I am trying to get that feeling. [Laughter.]

Senator Carper, you are next.

Senator CARPER. Thank you, Mr. Chairman, Senator Wyden.

To Chairman Packwood, to my friend Bill Bradley, it is great to see you. It is just great to see you. I was talking with Brian Selander the other day, whom you graciously sent to me when you withdrew from the presidential race, sent him to Delaware, signed him up to my Senate race. And one of the reasons why I am here today is because of that kind of gift, along with Sean Barney and a couple of others who came as well. So thank you for all of them. Now I serve on this committee where you both once provided great leadership.

A couple of years ago, we had a hearing on the issue of deficit reduction, and we had a bunch of really smart people here to talk to us that day too. One of them was Alan Blinder. He had previously been Vice Chairman of the Federal Reserve, as you may recall. He is back now teaching economics at some school in New Jersey; it starts with a "P." [Laughter.]

In his testimony, he said to us, he said, in terms of deficit reduction, "The 800-pound gorilla in the room on deficit reduction is health care costs." He said, "If we do not get our arms around that, we are doomed." And he said more than that, but that was the sum and substance of what he said.

We had a chance to ask questions. It came to be my time to ask a question. I said, "Dr. Blinder, you say health care costs are the 800-pound gorilla in the room. If we do not get our arms around that, then we are doomed." And I said, "What is your advice to us?"

He sat there for a while and thought, and then he finally said, "I am not a health economist, I am not an expert on that stuff, but," he said, "this would be my advice to you." He said, "Find out what works. Do more of that." That is all he said. "Find out what works, and do more of that." I said, "You mean, find out what does not work and do less of that?" And he said, "Yes."

We are happy you are here, and we are looking to find out—and you have given us some ideas of what worked all those many years ago. And one of the keys is, it is clear to me in what you are saying here, leadership is the most important ingredient in any organization. Whether it is a basketball team; whether it is a military unit in the Navy, Army, Air Force, Marine Corps; whether it is a college or university or business, the most important ingredient is leadership.

And we cannot pass laws to create leadership, but every now and then people come along and provide great leadership.

Just talk about leadership, the importance of leadership here, and what our leaders in this committee and in the Senate especially, what we need to be doing, please.

Mr. BRADLEY. Well, as I said earlier, leadership starts from the President, the Treasury Secretary, the chairman of Ways and Means, and the chairman of the Finance Committee. That is the leadership structure. If any one of those is not on board, it is not going to happen.

I would also make the point, when Senator Packwood talked about the seven people in the room, voting 4–3, whoever voted—he lost sometime, I lost sometime—but four Republicans, three Democrats, that was fun. Legislating is fun with the right people. You can do something very important, and you can enjoy what you are doing because you never know what is coming around tomorrow, if you are in that kind of negotiation.

It requires you to know what you are talking about, and I just hope you guys are having that much fun.

Senator CARPER. Fun would be good around here.

Mr. PACKWOOD. I have to tell a humorous story about Bill, because——

Senator CARPER. Remember I only have a little bit of time. So I hope it is a short story.

Mr. PACKWOOD. I am sorry. Go ahead.

Senator CARPER. No, no. Go ahead. If you could, just answer—I would love to hear the story about Bill—the question about leadership. I think what Senator Bradley told us is very important, right on.

Mr. PACKWOOD. Well, all of us in politics have seen natural leaders. Some of them are inside leaders, like Lyndon Johnson. Some are outside leaders, like Ronald Reagan. But everybody in the Senate—this is a small fraternity. We all know who are the standout leaders.

We knew in my era that Scoop Jackson and Sam Nunn on defense were good for 7 or 8 votes in a tight vote anytime. We knew that Dick Lugar on foreign policy was good for 6 or 7 votes. They were leaders in their area.

All of you on this committee know who the half a dozen leaders of this committee are. I do not know who they are, but you know, and certainly the ranking member and chairman know who they are, and a coalition of those can be put together.

But the key is not, do you have the leadership, but does the little leadership group agree on the goal that they want to reach? If they do not agree on the goal, no quantity of leadership is going to make any difference.

Senator CARPER. Thank you. The second question deals with—you did all this work in 1986. No sooner was the ink dry on the legislation that you labored on for all those years, then we started changing it. We started changing it a whole lot over time.

Did you ever think at the time that we would see this kind of change that quickly and to such an extent? And did you ever think at the time about, what can we do to sort of preserve what we have, at least for a while?

I do not know how many changes we have seen, but I am told like 15,000 or something, maybe more, since 1986. But should we be thinking about—should we be looking for some way to preserve for a while at least what work we are going to do, or is that just a fool's errand?

Mr. BRADLEY. Tom, that was a real lesson for me. Obviously, one Congress cannot buy another Congress. You can pass something—which I thought and I think Bob did and people generally—as significant as tax reform, and it can be like a sandcastle on the edge of the sea. It could be washed away the next year, which means you have to be humble when you do these things. I do not think there is an institutional fix to make things permanent.

Maybe the reason this was not permanent was that this was not something that bubbled up from the country saying, you must do this. This was something that happened because people who had responsibility on this committee assessed what was the right thing for the country.

Senator CARPER. My time has expired, I am afraid. Thank you.

The CHAIRMAN. Senator Heller?

Senator HELLER. Mr. Chairman, thank you. Thanks for holding this hearing.

I want to begin by thanking our distinguished guests for being here today. As a relatively new member of the Senate and a new member of this committee, it is great to get this historical perspective. So thank you very much for taking time.

Mr. Chairman, I want to also thank you and the ranking member for being committed to this effort. I know it is not going to be easy, but it is good to see that there is real work, real work moving forward, and I appreciate your seven priorities, and I share those with you and look forward to getting that done.

To our witnesses, the further you get out here in left field, the more general the questions. But the good news is, it is good to know that both of you started where I am today. So there is hope for the future.

I want to move to 5 years ago and the Bowles-Simpson proposal. Did either of you testify or have an opportunity to have any input on that particular proposal?

Mr. PACKWOOD. I did not. I was not called as a witness. I followed it very carefully in the press, but I was not a witness before that commission.

Senator HELLER. Can you give me any perspective on what you thought of that report?

Mr. PACKWOOD. Well, I thought the report was excellent in the sense of, here is where this country is going if we do not do something. I have often put it—when I speak, I put it in a different version.

I am less concerned about the deficit than I am about the increased spending. If you are rich enough, you can afford a deficit. As long as you stay rich, you can afford to pay the interest on the debt. But I look at spending, and the figures are not necessarily good from a century ago, but as best we can tell, a century ago, all of the governments in this country—Federal, State, local, water districts, fire districts—spent about 10 percent of the gross domestic product.

Today the same governments spend around 40 percent of the gross domestic product, and that same pattern has been true, by the way, in all the major industrial countries. They just started at a higher point a century ago than where we were.

But, if you look at the Simpson-Bowles report and you see what is coming in Medicare, Medicaid, Social Security, that 40 percent figure is going to go up, and the debate we ought to be having in this country is, not is there a deficit, of course there is. You can debate, if you want, can we afford to carry it? I think we can. But do you want this country to eventually spend 45 percent, 50 percent, 55 percent of all the available assets in this country on government?

That debate does not get discussed very often, because it gets mixed up with the deficit.

Senator HELLER. Thank you.

Senator Bradley, I would pose the same question to you.

Mr. BRADLEY. No, I was not—I did not testify. I always talked to my buddy, Al Simpson, but we did not spend a lot of time talking about taxes.

Senator HELLER. He is one of my favorites, Alan Simpson. When I was in the House, I was on the Ways and Means Committee, and Dave Camp was my chairman. As you know, Bowles-Simpson was dead on arrival. Camp came up with a proposal last year and, as you are well-aware, it got no hearings and, frankly, was dead on arrival.

What did we learn? What lesson did we learn from these efforts?

Mr. PACKWOOD. You are discouraged. I have read the Camp proposal. I thought it was a good proposal. I thought it covered a lot of the bases that needed to be covered. And you are right: it was dead on arrival.

I am not going to badmouth the President, but it irritated me that he appoints this commission, and, as soon as its report comes out, he just gives it the back of his hand. Well, that practically kills it right there. But I thought the commission did a first-rate job.

Mr. BRADLEY. I think Camp had some interesting ideas. What happened? He kind of started too late. People knew he was going out the door, and he did his own thing and put something specific forward, which is a necessary prerequisite. Remember Treasury I, Treasury II, the two bills I put in, you have to put out something specific, because then the interests chew it up and you figure out what can be swallowed and what cannot.

So I just think that you need to see the total picture. I think he did a very good job of thinking through tax policy and coming out with a coherent package.

The CHAIRMAN. Senator Bennet, you are next.

Senator BENNET. Thank you, Mr. Chairman.

What a great privilege to have both of you here. I was thinking back, actually, as Senator Packwood was talking, to, believe it or not, John McPhee's book "A Sense of Where You Are," a book about Senator Bradley when he was playing basketball at Princeton.

He sort of asked the question, how could this, maybe not the best athlete that we have, maybe not the best of this or that, succeed so well at what he was doing? And I think, in terms of tax reform, Senator Packwood interestingly said, the opportunity appears to do it.

So with that in mind, I took a look at "Showdown at Gucci Gulch" in advance of your arrival, the first chapter, and I think it is worth the historical perspective.

The authors wrote—and I would just sort of ask you to respond to it for us: "The groups with an interest in the existing tax system were well-organized and ready to defend their tax breaks at a moment's notice. The populous who stood to benefit from lower rates were unorganized and diffuse. Furthermore, Congress was a slow and cumbersome institution"—that is not true anymore, of course [laughter]—"that usually made only piecemeal incremental changes. Tax reform proposed something very different—a radical revamping of the entire tax structure. There was a tremendous inertia in Congress that resisted any such sweeping change. As a result, the conventional wisdom in Washington held that tax reform was destined to lose, and the conventional wisdom had plenty of history to back it up. Tax breaks, after all, had always been part of the currency of Congress."

This passage, I would say, is even truer today than it was 30 years ago as a description of where we are. Just in 2014, Federal lobbying totaled over $3.2 billion.

I wonder if you could take us inside that room that you talked about and tell us a little bit, as Senators, how you were able to overcome these interests and the pressures that you faced, and how we as Senators should think about that in the arc of our careers on this committee.

Mr. PACKWOOD. Well, if you are talking about the little cabal of seven of us, the pressures were not really that great on us. We knew what had to be done. We wondered, can we swing it, will it work? But I do not recall any one of us saying, I am not going along with this if X is in this bill or if X is not in this bill.

So those pressures were not on us. I know what you mean about the interest groups, and that is what happened to the House bill. They had a lot of individual votes on each of those little parts, and if it is your part and you hate that, you are against the bill. You do not care what is in the rest of it, you hate the bill, and there was enough of that.

That was not the case in the Senate. The Senate bill just did not happen that way. That Senate bill was written in those 7 days, and we did not have any hearings. Suddenly it was like Minerva, born fully formed. Here on the last night does the committee see the whole bill for the first time and vote for it 20–0.

But had they had to vote on individual little sections—in fact, I will give you this. The reason I made this deal—I never told Bill why I did this. The reason I made the deal with the oilies and gave them what they wanted when nobody else got it and we had taken it away from everybody else and I gave it back to them—Bill was furious, George Mitchell was furious, because I had not bounced this off my little group because it was the night we were voting anyway.

The reason I did it is because the biggest issue I was going to face on the floor—when this came out of committee 20–0, it was going to pass, but there was one issue, and it was the IRAs.

On the IRAs, there were not two sides. There was not a great clamor about tightening up the IRAs. The clamor was on the other side about more, more. And, as you will see listed in my testimony, the IRAs, as I recall, were about a $24-billion pickup.

Well, on the Senate floor, this IRA amendment came up, and I won it 51–48, and 19 out of the 20 oily Senators voted with me. And had I not made that deal, I would have lost a couple of them. And had I lost a couple, I would have lost on the IRAs and lost the bill.

Senator BENNET. Senator Bradley?

Mr. BRADLEY. The reality is that tax reform was failing until the Packwood counteroffensive. And it was not like this just sprung forth from the head of Zeus, right? We had had 30 hearings. The substance had been thoroughly chewed over by the committee.

So it was familiar territory. It was just put together in a different way.

Senator BENNET. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Thune? Wait a minute. Let me just see here. I am sorry. It is Senator Menendez first.

Senator MENENDEZ. Mr. Chairman, thank you.

Thank you both for your testimony, which I read at length.

I think we all agree we need to simplify the tax code and make it more economically efficient. But I always think that before we go about the task of comprehensive tax reform, we need to agree what are the end goals that we are trying to achieve so that we can direct our focus.

I mean, I know that some of my friends here argue that we should focus solely on corporate tax reform and profits and stock market gains, and I think I have heard you both say that you really need to do it all at the end of the day in order to make it effective.

Senator Bradley, do you believe it is enough for tax reform to be focused on increasing GDP, on the stock market, on corporate profits, or should we also have the goal of ensuring economic growth as part of it, particularly if it is felt by as many Americans as possible? Is that the type of goal we should be looking forward to?

Mr. BRADLEY. Yes. You want the economy to grow, and you want everybody to benefit from that. And when we did this bill, as I said earlier, we had four principles, and these are the things you should consider.

First, that the market is a more efficient allocator of resources than we are or the Ways and Means Committee or Finance is, in figuring out whether we ought to do this activity or that activity. Second, equal incomes should pay equal tax. It is not fair to have your neighbor pay less because they have a particular tax benefit. Third, those who have more should pay more—the progressive principle. And fourth, if you can simplify it, please simplify it.

To me, those are the four principles: the economic issues; economic growth, obviously; progressivity would say you would want people to move up; and you would want to say to the people at the top, "You have to pay a little bit more."

So I think those are the principles that I would use going forward.

Senator MENENDEZ. I think that my question suggests—at least I view it that it is not an either/or proposition. In fact, fairness and equity in the code actually help reduce the burden on low- and middle-class working families.

It is not only morally desirable, but economically good policy, because about two-thirds of our economy is fueled by consumer spending, and certainly low- and middle-income families have a higher percentage of their income that they need to spend on goods and services.

So in that respect, I think that it makes eminent sense to be looking at how the consequences of reform deal with them, not just with the corporate taxes, because I think it will fuel spending that will help private-sector profits.

Senator Packwood, at the end of your testimony, you included a statistic that in 1983, at least 1,900 people who earned $1 million or more paid no Federal tax, and that fact was due to a myriad of special interest loopholes that were clogging the arteries of the tax code before 1986.

As you noted in your testimony, the product that passed the Finance Committee 20–0 and would later become law raised the taxes significantly on corporations and rich individuals. They would pay more, middle-income people and the poor would pay less.

So we have now a situation in which the average New Jersey family that makes $65,000 per year pays a higher rate than the wealthiest 400 Americans who make an average of about $270 million per year.

So, from your experience, what impact does inequity have on the public's perception of tax code fairness, and would you agree that a focus of reform should be to eliminate the loopholes and preferential rates that have allowed the wealthiest to steadily reduce their effective tax rate over the past 30 years?

Mr. PACKWOOD. There is no question that the public is aware of the inequality. In 1986, they were not, and the issue was fairness. How did these people avoid paying any tax at all or how do major corporations that are making profits in the defense industry get money back? And that just irritated everybody, and that was a driving goal for us.

Inequality today is obviously a much higher goal, preference, issue, than it was 30 years ago. What I am hesitant about is not, do you want to fix that? The longer I had been in life and the longer I had been in the Senate, the less confident I was that what we were going to do would necessarily get us to what we wanted.

And that is why I agree with Bill, the market is a better allocator. If you want to somehow undo the inequality, I think that is legislatively doable. If you can get both sides to agree on that, that is perfect. But it was not what drove us in 1986.

Mr. BRADLEY. I might say that, in terms of the middle class, we need good-paying jobs, more good-paying jobs. So that is tough to get at through the tax code, but not impossible.

So I will share with you one of my hobbyhorses. Infrastructure investment is desperately needed. In a tough budget, you cannot do it in the size that we would like to do it. But there are people who have money—Chinese, Singaporeans, Koreans, in the Persian Gulf—large sovereign funds, I mean, hundreds and hundreds and hundreds of billions of dollars, and they have to decide what do they do with that money.

I asked any number of them, "Why don't you invest in infrastructure in the United States?" In other words, they would play the role the British played in the 19th century. And they would say, "Well, there is this one provision in the tax code, and the provision in the tax code is section 892, and that says that if you are a foreign government and you invest in stocks or bonds, you do not pay tax on that." Very simple—extend that to infrastructure and you could very well find a significant amount of money for infrastructure coming from sovereign funds.

Senator MENENDEZ. Thank you.

The CHAIRMAN. Great. Senator Thune?

Senator THUNE. Thank you, Mr. Chairman.

Thank you all very much for being here. I was a staffer back in 1986 when this was done last time and a great admirer of the hard work that went into it and the ultimate result.

There are some things that are very different. This is a different time. I think this is a different place probably than it was back then. And the one thing you already noted too that I think really made a difference was the involvement, active engagement of the President in the process.

Remember Treasury I and Treasury II, the big books that they sent up here and how hard they worked to try to get that across the finish line. To me, it seems like to do anything really big and consequential in this town, you really need presidential leadership. So I hope that we will get that.

I just want to ask a couple of quick questions with regard to a couple of the issues that you batted around back at that time. One had to do with whether lower rates or more favorable cost recovery provisions ought to be the focus of tax reform and which of the approaches is better for economic growth. I think that was a part of the debate.

The question, I guess, is, do you believe lower rates paired with longer depreciation schedules was the right policy choice, and how do you suggest we ought to approach that question today?

Mr. PACKWOOD. I do not know how you ought to approach it today. We clearly felt that lower rates were the most desirable thing we were doing. Depreciation was a major difference in interest between the House and the Senate on that when we had to go to conference.

But I am not going to advise you as to what you ought to do on this. I would just say, lower rates, in my mind, keep it revenue-neutral, but as I say, there might be something you can work out on that to increase revenues. But lower rates were what was driving me.

Senator THUNE. How about the issue of cap gains at the time going at the same rate as ordinary income? And we have since then gone back to the differential. What do you think about that? In your view, as you look back on it, was that a good thing?

Mr. PACKWOOD. Yes, I think it was. I remember Bill talking just a moment ago about the hearings we had, and that fellow would say you had to have a differential. If the regular rate was 30 percent, it had to be 15 percent, and if it was 20 percent, it had to be 10 percent.

So I asked him, I said, "If there was no income tax, would you have to have a subsidy to invest, because there is no differential," and he had never been asked that question and did not know how to answer it.

But I think you could do very well if you have a low rate with capital gains being the same rate.

Senator THUNE. This has been alluded to a little bit already today too, but there has been some discussion about what are the goals of tax reform. One of the things I think that separates us here, which makes it kind of hard, is that there are folks who look at this as an exercise to raise revenue. That is something the President obviously wants to do.

A lot of us believe that the best way to get revenue is through greater growth and that the goal of tax reform ought to be, how do we generate economic growth in the economy, which lifts everybody's boats and addresses a lot of those income disparity issues that were mentioned earlier as well?

So speak a little bit about growth as an objective, a goal of tax reform and how you think that plays into the deliberations that should occur here.

Mr. PACKWOOD. Growth—obviously everybody wants growth. But I remember Russell Long, who was chairman of this committee for 16, 17 years, in one meeting going, "I have been here for 30 years." He says, "Three times we have put the investment tax credit in in tax reform. Three times we have taken it out in tax reform. Now you tell me, when is it reform, and when does it work to help the economy?"

I think a lot of us do not know exactly what works. I do know there are all kinds of industries that want things that say this will work, but I do not think we are necessarily smart enough to know.

Senator THUNE. Senator Bradley, you have talked a lot about growth. Tell me your views on that.

Mr. BRADLEY. Well, I think you can have growth and equity. I think growth you get, in part, through the lower rates, but also, in part, from clearing out the code of all of this underbrush that prevents the economy from growing because it subsidizes one segment as opposed to another.

I think that if you are going to deal with the equity question, I think the way to do that is with the Earned Income Tax Credit. I think the President's proposal on the second earner credit is pretty interesting.

You can do things in the code that are structural, that are not special interest, that will allow you to deal with equity at the same time you are lowering the overall rate, and to me, that is the key.

Senator THUNE. Thank you, Mr. Chairman.

Senator Bradley, you are a credit to basketball players everywhere.

Mr. BRADLEY. That is a big compliment coming from you, Senator.

Senator THUNE. Thanks, Mr. Chairman.

The CHAIRMAN. Senator Scott, you are up.

Senator SCOTT. Thank you, Mr. Chairman.

Thank you both for being here today with us and providing us insight from 1986 in how you brought together what at times seemed to be impossible. And I will tell you that sitting here, as a relatively new Senator, it seems relatively impossible for the two sides to come together as well. So your insight has been valuable to all of us.

Just for a point of reference, I think this is Treasury II and this is Treasury I [holding up two thick, bound books] during the years that you guys found the will to make things happen, and these are about 6 years of the President's proposals [holding up a stack of thin pamphlets].

My first question really for both of you all is, how do we find common ground, when finding a serious partner towards real tax reform appears to be missing in the seriousness of the presentations and the proposals, number one? And the second part of that is, we have heard from both our chairman, Senator Hatch, and Senator Thune about a revenue-neutral position. When you start the conversation, as well, talking about achieving several hundred billion dollars more of revenue versus the position of neutrality, how do we bridge that chasm?

Mr. PACKWOOD. I do not think Bill and I can tell you how to bridge that gap. If the positions are irrevocable—revenue/no revenue—that gap cannot be bridged.

Senator SCOTT. I kind of agree. Senator?

Mr. BRADLEY. If you cannot bridge that gap, then spend some time doing something else. I think, however, that the question is, can you put together a small group of people on this committee who have sufficient clout within the committee, as Bob said earlier, so that you could actually, if you chose, spend the time to come up with something that was pretty good?

I mean, more taxes—you have to figure out which taxes. The tradeoffs that I offered with the consumption tax versus cutting the Social Security and employment taxes, that is not something we are going to decide. That is something that you have to decide.

As I said earlier, all I know is that we did not have room with seven people—when you are making votes and doing things and affecting this part of the economy and that, that is a lot of fun. If you are just coming in and having your two sides make your statements, that cannot be too much fun.

Senator SCOTT. It cannot be too much fun is correct. I am looking for other things to do with our time, so I thought about playing basketball, but I am too short and built for football.

The good news is that Senator Hatch, on the other hand, has taken a fairly inventive and creative approach to making sure that we find some common ground, working across the aisle and looking for sweet spots, and he has put together some working groups that I think may be very beneficial going forward.

One of the areas that I have a great passion and interest in, as an entrepreneur for the last 15 years, is why simplification of the tax code actually benefits all. I think, Senator Bradley, you said that tax loopholes are ways for politicians to spend money without having to go through the appropriations process, and the more opportunities that politicians have to spend money without going through the appropriations process, the more complicated and difficult the tax code becomes.

When I started my business, I will tell you that I did not think about loopholes as they relate to starting a business. I thought about creating jobs and making a profit and changing the lives of family members and employees.

I would love to hear you chat just a little bit about the notion of simplification—either of you esteemed gentlemen. Talk about the notion of simplification and the natural outcome of allowing money to find its best place through the private sector.

Mr. BRADLEY. When I was speaking about this every day for 4 years, I went on the David Letterman Show. That is when he was late, late. And I took out a card and said, "You ought to be able to do your income tax on this card." Now, that is not quite true, but we do know that the vast number of Americans have income from wages, interest, or dividends.

Guess who has all that information other than the individuals? The IRS. The IRS, for the bulk of Americans, could do the return based on that, send it to the people, and the people could either sign it or they could say, “No, I want to have another accountant do it.” That would be a dramatic simplification.

Mr. PACKWOOD. In 1986, I had a younger person on the Joint Tax Committee who is gone—I cannot remember who it was now—give me just a ballpark estimate, not spend time on it, what you could do with a flat tax, which is certainly simple. And he said, at that time—it took him a few days—you could have a flat tax—this is the individual side—of 11 percent and raise the same amount of money that we are now raising.

But, of course, that meant that a widow with two kids who paid no taxes would now pay $1,100 in taxes. So I said, “What about if you exempt families of four under $30,000, just exempt them?” He came back in a couple of days and he said 19 percent, but it slightly tilts toward the rich. And I was curious about “slightly.” He said, “You realize that when you are going to get rid of every deduction that mankind conceivably has, you are mainly talking about people who are rich, not the poor?” Just Sally who works at the mill who fills out a 1040–EZ and does not have any deductions is not adversely affected.

He said, “But I think if 19 percent would be the norm, you could keep the same progressivity and do it at around 17 percent on the low end, 20 percent in the middle, and around 23 percent on the top.”

Now, this is a top-of-the-head thought of his, but it is worth running if you want to see what you could do, and then, Senator, you have a simple tax.

How much did you earn? You are in the 20-percent tax bracket. You do not get any deductions. That is simple.

The CHAIRMAN. That is interesting.

Senator SCOTT. Thank you.

The CHAIRMAN. Thank you, Senator.

By the way, we have had over 30 hearings on this over the last 4 years.

Mr. PACKWOOD. I do want to tell just one quick story about Bill, because it was cute.

The CHAIRMAN. Sure.

Mr. PACKWOOD. The President signed the bill. The signing ceremony was going to be, say, on a Wednesday. Bill was in Portland at a noontime luncheon, a fundraiser for a Democratic candidate for Governor. Then he was going to catch the plane back for the signing ceremony.

My campaign manager was a tough woman. She says, “You are up for election this year. You are not going back. You will not get any publicity back there anyway.” But Bill was going.

Well, Portland was socked in. He could not get a plane out in the afternoon. He called Seattle. “Can I drive to Seattle to get a plane out?” No. “Can I get a charter plane to San Francisco?” Nothing is flying out.

And I was having a press conference the next day at 7:30, and the President was going to call me after he finished signing. I said, “Well, Bill, we have a press conference tomorrow morning if you would like to come.” He said, “No, I am going to get out.”

Early the next morning, he calls my hotel and he says, "Where is that press conference?" And he comes and the President talks to me and the local network affiliates are there. And the President talks to me, and I chat a bit.

And I said, "By the way, Mr. President, Bill Bradley is here, and you know how valuable he was for us on this. I kind of wonder if you could say a few words to him." So he comes on, and he speaks to Bill.

Now, the thing that irritates me, he makes national television from appearing on the local affiliate in Portland, and I do not get covered nationwide. [Laughter.]

Mr. BRADLEY. The more relevant point is, it was because of my respect for Bob Packwood that I decided in the middle of his campaign to join him in a press conference about tax reform. [Laughter.] I think that has probably not happened a lot recently.

Mr. PACKWOOD. That was well done.

The CHAIRMAN. Well, I have a lot of respect for both of you. You have both been great Senators, and you both have done an awful lot for this country, and we are very proud of you.

Senator Wyden has one more question.

Senator WYDEN. I am going to be very brief. And thank you both for that simplicity discussion, because I have thought for a long time that this insanely complicated tax code plays right into the hands of the special interests and the lobbyists, and it is going to be even more challenging today than it was in 1986. We have been talking about "Gucci Gulch," and there are these wonderful descriptions in "Gucci Gulch" about the lobbyists who would wait in line outside the Ways and Means room for a phone booth.

Well, today a lobbyist is going to sit in the back of the room and set in motion a tweet that is, in effect, probably going to go to millions. Maybe they are going to be able to tweet directly to millions from the back of the room.

So simplicity is going to be hugely important, and I think there are some contenders for how to do it, and Senator Bradley mentioned one in his testimony with respect to the information that the IRS has and giving the citizen an option of, in effect, having the IRS mail something. It would not be required, it would just be an option.

The postcard concept, in effect, you can almost put a tax return on the back of a W–2, and that is something worth exploring.

We will be following up with the two of you on the idea that if you triple the standard deduction—and a number of Senators of both political parties are interested in a significant increase in the standard deduction—people itemize. So that is another possibility.

But just know we are going to follow up with you on the simplicity issue.

I want to wrap up with one last question, and that is, is there one thing you regret about what happened in 1986 that you would counsel us on in terms of what to do for the future? In other words, it is always easy to kind of think about what is possible today in the abstract, but you two went through it.

Is there anything you regret and you would like us to change? I know that one thing that I regret about 1986, and I was just a junior, junior Congressperson, is—Senator Bradley is right when he says no current Congress can permanently bind a future Congress from unraveling it. But you can make it really hard. I mean, you can put people through multiple votes and the like. I can think of some things.

But you two went through it. Is there anything you regret, one thing that you would tell us to be careful about?

Mr. PACKWOOD. Well, I regret the odious deal I had to make with the oilies, which was totally unjustified and given to them when no other business got it, but I needed their votes on the floor. And what they wanted did not cost very much money, and the IRAs were $24 billion.

But do I wish I did not have to put that in? You are right. But that is one of those decisions you make on the spur of the moment. I made it the night we were doing the final markup, and I did not bounce it off my group of six because I knew they would vote against it.

So I would rather just put it in and have them mad than have them vote on it and put it in and think I had double-crossed them.

Senator WYDEN. Senator Bradley?

Mr. BRADLEY. Even in this world of great equality among Senators and among the group of seven that Senator Packwood talked about, there was still the chairman's prerogative, and I think that nobody questioned that because we had been through the whole process.

Do I regret anything? I regret that the bill lasted only a short period of time. As I said, it was a humbling experience, sandcastles at the edge of the ocean, and only a commitment from members of this committee and from Presidents, succeeding Presidents—I mean, President Clinton had a totally different idea of taxes. He liked to spend through the tax code, and, therefore, that helped unravel it.

The differential on capital gains came back. We no longer treated capital and labor the same, which was what we did. The rate went up to 39 percent. There were infinite numbers of hiding places for little provisions, my favorite being the one that says if you rent your house for 2 weeks, you pay no tax on that income.

There was once a Senator from Georgia on this committee who had a lot of friends who had big houses around the Masters Golf Tournament. These things happen, right? But I do not regret that, that was before my time.

But I do think that you have to find some way—I regret that it did not last. That is what I would say.

Senator WYDEN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you to both of you. Senator Packwood, you have one of your top staffers here—at least one I know—who was with you at the time, if you care to introduce——

Mr. PACKWOOD. Bill?

The CHAIRMAN. Yes.

Mr. PACKWOOD. Bill Diefenderfer, stand up.

Mr. DIEFENDERFER. I barely can, sir.

The CHAIRMAN. That is what tax reform does to you. [Laughter.]

Mr. PACKWOOD. Bill was the chief of staff of the Finance Committee at the time, and I have often said that bill was not my bill, this was our bill. He was absolutely critical in this, and especially critical in dealing with the administration and with Dick Darman. But it would not have passed but for him.

Mr. BRADLEY. And I agree with that.

The CHAIRMAN. He is still legendary. I want to thank both of you. This means a lot to me personally, and I have admired both of you for a long time as premier legislators, as people who really care for people, and who both are extremely intelligent.

So this has meant a lot to me, and I appreciate it.

With that, we will recess until further notice.

[Whereupon, at 11:30 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Prepared Statement of Hon. Bill Bradley, Former Member, Committee on Finance

The income-tax system is unfair (equal incomes don't pay equal tax), inefficient (the market knows better where to put capital than do members of the Finance or Ways and Means Committees), and overly complex (few people fill out their own returns, and tax fraud has reached between $40 billion and $70 billion per year). By cutting tax rates and eliminating most of the nearly $1 trillion in individual and corporate tax loopholes, we do two things simultaneously. We allow people to keep more of each additional dollar they earn, and we deal a blow to the special interests. As Justice Oliver Wendell Holmes, Jr. said, "Taxes are the price we pay for civilization."

The government subsidizes many activities by allowing you to pay less tax if you do them. Buying a home is an example. There, the government allows you to reduce your taxable income by the amount of your mortgage interest and property taxes, which means you pay tax on less income. These tax savings are the government subsidy to home ownership. In any tax reform it would be possible to protect such middle-class "tax expenditures"—that is, deductions, exclusions, and credits; besides mortgage interest, these include charitable contributions, state and local taxes, health insurance, and pension buildup—even as we lowered tax rates. In a system with just three rates, these items could be deductible only against the bottom two; everyone would thus get the subsidy, but for the wealthy it would be worth less. For example, if the rates were 10, 20, and 30 percent, a dollar's worth of deductions would save, at the most, twenty cents in taxes for someone in the 20-percent bracket and ten cents in taxes for someone in the 10-percent bracket. Those in the 30-percent bracket would still get the deduction, but it would be worth only twenty cents. They could not deduct it against the top rate of 30 percent.

In the 1986 tax reform, we cut rates to 15 and 28 percent and eliminated about $30 billion per year in loopholes, and the wealthy, even though the top rate was reduced from 50 percent to 28 percent, ended up paying a bigger percentage of the total income taxes collected.

There are rates that everyone, including most of the wealthy, can agree are fair. I believe that the best tax rate is the lowest tax rate for the greatest number of Americans. Increasing the earned income tax credit assures lower-income working Americans that they, too, can keep more of each dollar they earn. By eliminating most of the tax deductions, exclusions, and credits (now worth $911 billion), we could reduce rates, make the system fairer, and raise revenue. By simply reducing these "expenditures," or tax subsidies, in the tax code, we could spend more through appropriations for education, health, and pension security.

In addition, by increasing the minimum wage and the Earned Income Tax Credit, we could further reduce inequality and give people incentives to work. And more IRS agents and better computer systems would increase tax collection from the wealthy. Commissioner Charles Rossoti says that for an investment of $296 million the service could collect $9 billion more annually.

Another tax innovation would be aimed at people who have only wage, interest, or dividend income and take no itemized deductions. There is no reason for them to fill out tax returns; the IRS has all the information about them that it needs, and it can prepare individual tax returns from those W–2 and 1099 forms and send the returns to the taxpayers. If taxpayers wanted to fill out their own forms at that point, they could; more likely, they would simply sign and return the prepared forms. Not having to pay a tax preparer would amount to a kind of tax cut. California put such an initiative on the ballot in 2004, but groups such as H&R Block with a vested interest in the current system managed to kill it.

If one were bolder, they could take on an even more ambitious and complex tax reform—moving taxation away from work to pollution and natural resources. In general, we ought to tax less whatever we need, such as wages, and tax more whatever is dangerous to us, such as pollution, resource depletion, trans fats, and tobacco. In this vein, we could implement a $1-per-gallon gasoline tax (or an equivalent carbon tax, which is a tax on any energy source that emits carbon dioxide) or equivalent taxes on other major air pollutants: volatile organics, nitrogen oxide, lead, sulfurous dioxide, and particulates. These taxes could be phased in over five years, with the revenue going to reduce employment taxes (Social Security, Medicare, and unemployment insurance) for employees and employers alike. The gasoline or carbon tax would encourage the nation to reduce its dependence on insecure sources of foreign oil, and with payroll taxes now amounting to 15 percent of labor costs, the lower employment taxes would be an incentive for businesses to hire workers. Given where the price of oil is today, there never was a better opportunity to enact such a tax.

Such a shift in taxation—away from jobs and toward pollution, energy, and natural resources—will draw many of the 24 million part-time employed into the full-time workforce and millions more who are not in the labor force will now be more likely to find a job. After a few years of adjustment in the case of a gasoline or carbon tax, cars would be more fuel-efficient, so consumers would pay what they used to pay for the same amount of driving, and the broad middle class would continue to pay lower employment taxes. The result would be increasing demand for goods and services; shrinking dependency payments such as unemployment compensation or welfare; lowered social costs such as crime or avoidable illness; and a more equitable tax system—one that encourage rising employment.

Reducing employment taxes also makes sense on grounds of competitiveness and equity. Employment taxes now hit our most successful companies hardest. A company such as Microsoft or McKinsey need talented people desperately. As a part of the company's compensation package they have to pay enough salary to offset the employment taxes on the employee. If they don't assume the tax costs, the employee can go somewhere else. Meanwhile at a lumber yard where there is an excess of labor the lumber company doesn't have to pay higher wages and the bulk of the employer's taxes hit the worker. Perversely, it is the lowest paid workers and the companies most essential to economic growth that are hit hardest by employment taxes.

Better yet, if politicians wanted a comprehensive and fair way to reduce the deficit and invest in health care, education, and pension security, they could combine income tax reform and gasoline- or pollution-tax increases with a reduction in employment taxes, a 10-percent cut in defense spending, a 30-percent cut in what the federal government spends on corporate subsidies such as mining and digital spectrum, a limit on the corporate deduction for the most expensive medical plans, and a cut in farm subsidies—which today go to only 25 percent of American farmers, with $7 billion of the total $14 billion going to the richest 3 percent, including large agribusiness.

In addition, the budget process should be governed by the pay-as-you-go budget rules that existed in the 1990s. Under those rules, any tax cut or spending increase had to be offset by a spending cut elsewhere in the budget. Finally, the entire federal budget should be on the Internet with keyword accessibility. For example, if you searched for "breast cancer" or "housing" you would be directed to all the places in the federal budget where money is spent for those purposes. That way, citizens could have the information with which to understand the trade-offs in taxes and spending and hold their legislators accountable.

The key to passage of these measures would be to have them all in one package, so that choices—between more money for health care, education, and pension security, on the one hand, and spending cuts and higher taxes on the other—could be made clearer. If we included spending cuts or increases in one bill and tax reform in another, the connection between what we were giving up in tax increases would be lost and what we were getting in spending increases. The debate should be about the whole, not the parts. Issues such as sharing the burden fairly between the young and the old, and trade-offs between weapons systems and health care, or corporate welfare and human welfare, would be clearly set out.

PREPARED STATEMENT OF HON. ORRIN G. HATCH,
A U.S. SENATOR FROM UTAH

WASHINGTON—Senate Finance Committee Chairman Orrin Hatch (R–Utah) today delivered the following opening statement at a committee hearing examining the lessons from the Tax Reform Act of 1986:

The committee will come to order.

Today's hearing is about the need for tax reform and what lessons we can learn from the Tax Reform Act of 1986, the last successful overhaul of our nation's tax code.

We have before us today two former Senators who were key to that effort. I look forward to hearing their thoughts and advice during today's hearing.

Before we engage meaningfully in tax reform, we need a clear vision of what we want success to look like. A vision is not a specific system of rates, deductions, or credits. Instead, a vision is how we want to change the opportunities for American families and the rewards that Americans receive from their labor, entrepreneurship, and investment.

A successfully reformed tax system will help make America the best place in the world to work, conduct business, invest, and prosper. A successfully reformed tax system will be one that promotes economic growth and is simple and fair. This, more than anything else, should be our vision for tax reform.

The landmark Tax Reform Act of 1986 was developed by then-Chairman Bob Packwood through a careful and methodical bipartisan process that relied heavily on member input. Senator Bradley was a key part of that process.

Over the last few weeks, we've begun a similar process that we hope will yield a similar result: tax reform legislation that both parties can support.

The 1986 act, signed into law by President Reagan, reformed a costly and complicated tax system into a simpler one with lower tax rates for American households and businesses, affording them greater personal prosperity. Over time, our tax system has once again becomecostly and complex, impeding growth, standing in the way of shared prosperity, and placing American workers and businesses at a disadvantage.

Put simply, it is past time for Congress to stand up once again to fix our broken tax system.

If you've been around Washington over the last few years, chances are, you've already heard me talk about tax reform. I've been making the case for reform on the Senate floor, here in the Finance Committee, in public appearances, in written materials, and in private conversations.

In December, the Republican staff of this committee produced a comprehensive report outlining the need for tax reform and providing some direction to our overall efforts. I'm sure everyone here has read that report—cover to cover.

I've already publicly laid out seven principles that I believe should guide our tax reform efforts.

I won't go into much detail on each principle today. Instead, I'll just talk about them briefly.

The first principle is economic growth. Tax reform, if it's done correctly, should promote growth and significantly reduce economic distortions that are present under the current income tax system.

The second principle is fairness. The income tax base, which has become riddled with exclusions, exemptions, deductions, and credits, should be as broad as possible. Tax reform should broaden the tax base by eliminating or reducing a number of tax expenditures, along with lowering tax rates, and removing distortions.

The third principle is simplicity. Taxpayers and businesses spend over six billion hours a year complying with tax-filing requirements, with annual compliance costs in excess of $170 billion, which is more than the gross domestic product of New Zealand. Simplifying the tax code will result in greater clarity and compliance and will free up resources for families, job creation, and other productive uses.

The fourth principle is revenue neutrality. Tax reform should be revenue neutral and not an occasion to raise taxes on American households or businesses. Federal revenues already exceed their historic average as a share of our economy, and greater revenue should not be an objective of reform.

The fifth principle is permanence. The Joint Committee on Taxation lists almost 100 provisions in the tax code that will expire over the next decade. This is unacceptable. Familiesand businesses should be able to plan for the future without wondering if the tax code is going to change from year to year.

The sixth principle is competitiveness. The combination of a high corporate tax rate, worldwide taxation, and the temporary nature of some tax incentives makes American companies less competitive when compared to their foreign counterparts. Tax reform should reduce burdens on businesses, large and small, to allow them to more effectively compete on the world stage.

The seventh principle is the promotion of savings and investment. Many aspects of our current tax system discourage savings and investment, thereby hindering long-term growth. Savings and investment help build the capital stock, providing fuel for economic growth that generates prosperity for American workers and businesses.

These seven principles are the guideposts I will use when looking at tax reform proposals.

I think we're going to have an interesting hearing today.

I look forward to hearing from Chairman Packwood and Senator Bradley to see what advice they can give us as we undertake our tax reform efforts in this Congress.

I will now turn it over to Senator Wyden.

PREPARED STATEMENT OF HON. BOB PACKWOOD, FORMER CHAIRMAN, COMMITTEE ON FINANCE

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 sessions 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 doing 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 led 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, will 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 FEDERL 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 $250,000 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 or 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

10 BIGGEST REVENUE RAISERS IN THE TAX REFORM ACT OF 1986—Continued

(revenue increase in $ billions)

Provision	Revenue Gain—FY 1987–1991 Total	Individual	Corporate
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	$5	0
10. Restrict depreciation	$13	$5	$8

Source: The Bluebook for the Tax Reform Act of l986 (published by Joint Committee on Taxation).

QUESTIONS SUBMITTED FOR THE RECORD TO HON. BOB PACKWOOD

QUESTION SUBMITTED BY HON. ORRIN G. HATCH

Question. I wanted to ask you about the Tax Reform Act of 1986 and in particular its suitability for today. Numerous commentators say that the Tax Reform Act of 1986 was a wonderful piece of legislation, and it's too bad that the tax code doesn't look like that anymore. My question is: Should we indeed go back to that? That is, if the Tax Reform Act of 1986 was so great, should Congress just have an up or down vote on that? No amendments allowed? I am not necessarily advocating that, but it does make me wonder. I realize there is a lot both sides of the aisle would lose with the Tax Reform Act of 1986 simply being re-enacted, without any amendments. For example, most Republicans would not like losing the preferential tax rate for capital gains and some of the exceptions to the subpart F rules such as the Active Financing Exception. Most Democrats would not want to lose the 10 percent tax bracket or the many refundable tax credits that have worked their way into the tax code over the years. But there would be much that both sides could be happy about. For example: There would only be two individual tax rates, 15 and 28 percent. That would be a lot better than the six rates we have today, which effectively range into the mid-40s. The corporate rate would go down to 34 percent (not nearly enough, in my opinion, but slightly better at least than the current 35 percent).

We would get rid of the deliberately hidden marginal tax rate increases known as PEP and Pease. Numerous tax expenditures that clutter and complicate the code would be eliminated. Again, I want to emphasize that I am not necessarily advocating this. But I would want to know why, if the Tax Reform Act of 1986 was so great, then why not simply re-enact here in 2015, word-for-word, the Tax Reform Act of 1986?

Answer. Reenacting the 1986 Tax Reform Act is an interesting idea. First thing I would do is ask the Joint Tax Committee to do a revenue estimate. Remember that in 1986 we lowered the corporate tax rate from 48 to 34 percent and still managed, over a 5-year period, to increase taxes on business by $140 billion. We then used that money to lower individual rates. You can imagine how much fat there must have been in the corporate tax code at that time if you could lower their rates from 48 to 34 percent and still raise $140 billion.

In any event, I don't have now an exact idea of all of the major changes that have been made in the act since that time, but probably scores of minute ones that collectively might add up to some money.

A perfect example: The 1986 act eliminated deduction of the state sales tax. Years later it was put back in.

If you reenact the 1986 Tax Reform Act you will pick up a lot of money by eliminating deduction of the state sales tax.

You see the questions I would have. For a matter of pride, I would love to have it reenacted. Please put my name on it as it the Packwood Re-Reform Tax Act of 2015.

QUESTIONS SUBMITTED BY HON. DEAN HELLER

Question. In your witness testimony, Senator Packwood, you discuss the tough trades you and the committee had to make in order to keep tax reform moving forward. Looking back, is there anything significant you would have done differently?

Answer. We had no choice but to follow the procedures we adopted. Without them there would have been no tax reform bill. The bill had almost died in the House. Only President Reagan's personal intervention caused the bill to pass the House. And he promised he would veto it if it came to him in form that it passed the House. He said, however, give the Senate a chance to work on it and let's see what happens. With that the House grudgingly passed it. Ironically, it was on a voice vote. No one wanted their fingerprints on it.

In the Senate for the better part of a month I was making no progress. The bill wasn't getting worse. It wasn't getting better. We were more or less treading water. It was time for a Hail Mary. These were in the days when you could work across party lines. I asked six Senators—three Democrats and three Republicans—to join me in my office at 8:30 a.m. every morning in secret meetings to see if we could reach some kind of an agreed compromise. I picked the intellectual heavyweights of the committee on both sides. If I had them with me, they could bring the rest of the committee members. The Democrats were George Mitchell, of Maine—later Majority Leader—Pat Moynihan, of New York, and Bill Bradley, of New Jersey. The latter had been the Democratic guru on tax reform for a number of years. On the Republican side I picked Jack Danforth, of Missouri, John Chafee, of Rhode Island, and Malcolm Wallop, of Wyoming. We met for only seven days and in those seven days we worked out the bill that we wanted.

The problem was the oil industry wanted a specific provision put back into the bill that had been taken out for every business in America. They controlled seven, maybe eight, votes on the committee. I could have beaten them in committee, but then would have lost their support and the bill would have passed committee 12–8 or 13–7 rather than 20–0. But more importantly I needed their vote on the floor of the Senate on what I knew would be the only amendment I might loose and if I lost it, the bill was dead.

That amendment involved IRAs (Individual Retirement Accounts). We had severely limited eligibility for IRAs. As you can imagine, there wasn't any overwhelming public constituency for limiting IRAs only fierce objection from every side. When the tax bill was on the floor, an amendment was offered to restore the IRAs to the present law. I defeated the amendment 52–48. Without the oil Senators that amendment would have passed. The revenue loss would have been so great that the bill was dead.

So, yes, there is nothing different I could have done then. The key now is can you put together the same kind of bipartisan coalition—and especially a coalition of the leaders on the committee in both parties. If not, I see no hope of a bill becoming law that it passed through with purely Republican votes. It would either be filibustered or if passed, vetoed.

Question. As you are aware, one of the great stories of the Tax Reform Act of 1986 is when President Reagan came to the hill to make a personal plea to his own party to keep tax reform alive. The following day the House passes the bill by voice vote. In your opinion, can tax reform happen without presidential leadership?

Answer. The President's support was absolutely critical on the bill, but it was not necessarily his personal support. Jim Baker was his Secretary of the Treasury. Everyone knew he spoke for the President. He and his principal aide, Under Secretary of the Treasury Dick Darman, were heavily involved in the negotiations in the Senate as we were working on the Senate bill. The irony is, however, in that seven-day period when the bipartisan group was meeting in my office, the President and Jim Baker were overseas at one of those multi-nation economic meetings. Dick Darman carried all of the weight for the Administration during those seven days. But we all knew he spoke for the President. The support was critical.

I see no likelihood of a bill passing without Presidential support. The support could be in the form of a powerful Treasury Secretary that could speak for him, and you knew the Treasury Secretary did speak for him. But if a President attempts to tell the Congress, "You folks work on it and I'll take a look at what you pass." Nothing will pass. You're going to ask Members to make very tough votes. They're not going to do it if they think in the end the President will not support the bill.

PREPARED STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON

If there's one obvious similarity between 1986 and today, it's that people are quick to say tax reform is impossible. They say Congress can't organize a two-car parade—there's no way they can come together on major economic legislation. So what happened three decades ago will need to happen again: turning the impossible into the possible.

Congress and President Reagan came together to pass the 1986 Tax Reform Act based on what I call principled bipartisanship. One side wanted to flatten the tax structure. The other side wanted to close loopholes and guarantee the tax code treated everyone fairly. So they set aside the partisan attacks, looked for common ground, and each side came away with the feeling that it had upheld its principles.

When President Reagan signed the bill into law, he called it an "historic overhaul of our tax code and a sweeping victory for fairness." He continued, ". . . it's also the best antipoverty bill, the best pro-family measure, and the best job-creation program ever to come out of the Congress of the United States." Those same objectives should guide the committee and Congress as it again works to modernize our tax system. Reforming the tax code is always a Herculean task, but the same strategy of principled bipartisanship can work again today. Congress can turn the impossible into the possible.

However, policymakers need to recognize that the process will look different. Not every part of a 30 year-old game plan for tax reform can work today.

China and India are now superpowers in the global economy, which is a much bigger factor in reform. The gulf between wage earners and the top of the income ladder has widened. And America is at its best when a rising tide lifts all boats, and it should be obvious that making that a reality once again will take work.

The status of the middle class in Oregon and across the country is at the top of the list of compelling issues for tax reform to address. It is fundamentally unfair that a middle-class wage earner could pay a higher tax rate than an affluent person whose earnings come entirely from investments. The tax code should never punish wage earners. And many tax incentives for college education and retirement savings are out of whack. The support those incentives provide doesn't always get to people most in need, and that ought to change.

Another challenge is making the U.S. more competitive in the global economy. Today, the U.S. is trying to win a road race in a thirty-year old car. Our competition, meanwhile, is trading up to more efficient models. America has not done enough to drive innovation at home, and worse, the tax provisions for R&D expire year after year.

In 1986, there wasn't a lot of talk about the tax code and a clean energy future in the United States. That has to change.

And finally, modernizing our tax code must be done in a fiscally responsible way. Tax reform cannot become an exercise in slashing rates at any cost.

The biggest lesson from 1986 is that tax reform is possible when Democrats and Republicans set partisanship aside, come together and focus on shared principles. Over the years, I've talked with Senator Bradley about how tax reform is totally, entirely, completely impossible—right up until it happens. The Finance Committee has two experienced, knowledgeable witnesses who will help us get closer to that point today.

COMMUNICATIONS

Statement for the Record for:

Getting to "Yes" on Tax Reform:
What Lessons Can Congress Learn From the Tax Reform Act of 1986?
Tuesday, February 10, 2015

ATTN: Working Group on Savings and Investment

The following statement is submitted by The ESOP Association located at 1726 M Street, NW, #501, Washington, D.C. 20036, phone 202–293–2971. The person who drafted the following statement is J. Michael Keeling, President, The ESOP Association, email *michael@esopassociation.org*.

The ESOP Association is a 501(c)(6) business trade association with approximately 2,800 members. Its mission is to educate and advocate for broad-based employee ownership among U.S. Employees via the ESOP model.

The statement begins below:

For Chair Crapo and Ranking Member Brown, and members of the Tax Reform Working Group on Savings & Investment:

This statement provides a brief history of employee stock ownership plans (ESOPs) and evidence that the ESOP model of employee ownership is spot on with six of Chair Hatch's seven principles for comprehensive tax reform, and arguably exceeding the seventh principle.

The seven principles for comprehensive tax reform are:

1. Economic Growth;
2. Fairness;
3. Simplicity;
4. Permanence;
5. Competitiveness;
6. Promoting Savings and Investments; and
7. Revenue Neutrality.

What Is an ESOP?

Unique among ERISA plans, an ESOP, by law, *must be* primarily invested in the highest class of stock of the plan sponsor and the stock may be acquired with borrowed funds. In practical terms, the plan sponsor may take on "debt" to acquire shares of the sponsor, and not be engaged in a prohibited transaction if the shares are acquired by the ESOP trust at a price no greater than the fair market value.

Brief History of ESOPs

The ESOP model of employee ownership actually has its roots in a compensation practice from the 19th Century. (A recent book, ***The Citizen's Share,*** Blasi, Freeman, and Kruse, Yale Press, wrote a very convincing case, pages 1–56, that our founding fathers, such as Washington, Jefferson, Adams, Hamilton, et al., believed in broad ownership of productive assets as being essential to the survival of a democracy. President Lincoln's views, as evidenced by the Homestead Act, were also in sync with our founding fathers' views.)

As the U.S. economy moved into the industrial age, corporations with nationwide reach, and large numbers of employees emerged—Procter & Gamble, Montgomery

Ward, and others. Leaders of these companies realized that some employees would work for many years, reach an age requiring retirement, and retire with no income. There was no 19th Century safety net for retirees, and leaders of a number of national firms decided to set aside company stock for the employees to have when they retired, and to "cash in."

After World War I, and the ratification of the 16th Amendment to the Constitution authorizing a national income tax, Congress recognized that taxing income was not so simple, and that many issues had arisen because the basic definition that income is anything of value received by an individual, and the general rule that an income tax should tax anything of value.

In response to questions of what income should be taxed, Congress developed the very first true income tax code, the Code of 1921.

In developing the Code, those firms that were setting aside stock for their retiring employees came to the House Committee on Ways and Means and asked—"Is the stock set aside for an employee's retirement taxable when set aside, and is the value of the stock an employer's compensation cost?"

The Ways and Means Committee decided no, it was not current income to the employee, but would be taxed when the employee realized the previously deferred income; and yes, the set aside was compensation, and thus a cost of business for the employer and thus deductible for income tax purposes.

Thus, the first deferred compensation plan recognized by Congress was the "stock bonus plan," the forerunner of today's ESOP.

Fast forward to post War World II and owners of privately-held businesses began to consider how to "exit" their businesses and "cash" in their non-tradable stock in the company they started and which had become successful because of the hard work of the company employees. While somewhat lost in history due to the fact that until the mid-1970s private letter rulings were not public documents, an owner in Alaska, followed by others, obtained permission from the IRS, in a non-public letter ruling, that the company could "buy" his stock with borrowed money, have the stock placed in the company's stock bonus plan, and have the stock allocated to the employees as the debt was paid off.

A true visionary in San Francisco, California, Dr. Louis O. Kelso, developed a comprehensive economic philosophy in using such a method for funding stock bonus plans to expand ownership in a capitalistic society and to facilitate capitalization of for-profit businesses. He and his law firm colleagues led the way in expanding the use of this method blessed by the letter rulings, and many correctly note that the first "ESOP" was the sale by exiting shareholders of the *Monterrey Press* north of San Francisco in 1957 to an ESOP.

By the mid-1950s, many, both conservative and liberals, were seeing abuses in the area of pensions, or tax qualified deferred compensation plans, which the tax laws sanctioned and encouraged. Evidence was overwhelming that some pension funds were investing in organized crime activities. Then there was the collapse of major U.S. employers, leaving employees with no retirement income as promised. As a result, a drive in Congress to "reform" the tax and labor laws governing tax qualified deferred compensation plans, or "retirement savings plans," led to the enactment of ERISA in 1974.

During Congressional work on these "tax qualified deferred compensation plans," a major influence on tax policy of that era, Senator Russell B. Long, long time chair of the Senate Committee on Finance became a champion of the economic philosophy of Dr. Kelso, and made sure the new ERTSA law sanctioned ESOPs.

His support for the ESOP model grew stronger with each passing year, and his leadership led to major enactment of tax laws promoting the creation and operation of ESOPs. The bulk of these laws passed in 1984, in legislation referred to as DEFRA, and the perfection of those laws was in the Tax Reform Act of 1986.

Many of these laws of the 1980s remain in the Code, and were evidenced and endorsed repeatedly by the Finance Committee members in hearings, and tax law legislation of the late 80s through the late 90s, even after Senator Long retired in 1987.

To be noted, a major partner with Senator Long promoting ESOPs in the 80s through 1988, was former President Ronald Reagan, who often spoke of his view that widespread ownership of productive assets was the core of maintaining equitable wealth ratios in a capitalistic society.

And, after Senator Long retired, his successor in the Senate, former Senator John Breaux, led the expansion of ESOP law in the 1996–1997 tax bills permitting S corporations to sponsor ESOPs. Since Senator Breaux's work to expand ESOPs, the number of 100% ESOPs that are S corporations has exploded. (There are out of the estimated 10,000 ESOP companies, an estimated 3,000 are 100% ESOP.)

In sum, the work you are doing is part and parcel of a long, supportive policy of the Finance Committee's developing laws to have average pay employees, or workers if you will, be owners as being good for the employees, good for their employer, and good for the well-being of our economy and democracy.

ESOPs and the Seven Principles

1. Economic Growth: The laws, most originating in the Committee on Finance, that encourage the creation and operation of employee owned companies utilizing the ESOP model, are not industry specific; thus unlike many special tax rules that benefit certain taxpayers, there is no one area of the economy to claim, or discredit the claim that law x, or y, or z, caused the industry, or set of industries, to grow and provide more jobs.

But there is considerable evidence that ESOP companies outperform similar conventionally owned businesses in terms of profitability, productivity, sales, job sustainability, with the jobs in the United States.

One macro statistic that underlies the view that ESOP companies are more likely to be providing growth arises from data from the General Social Survey of 2010 that employee stock owned companies laid off employees at a rate of less than 4% during the Great Recession of 2008–2010, whereas conventionally owned companies laid off employees at a rate of greater than 12%. While one can do some speculation why as a rule employee stock owned companies were able to keep average pay employees on the payroll during the Great Recession, a common sense view would be that these companies were performing better than conventionally owned companies.

Any economist would agree that the more people work and have income, the more the economy can grow, as people with money from their jobs, buy things—from big ticket items such as a car, to a small ticket item such as chewing gum.

And, as Attachment 2 displays, there is a law, that originated in the Senate, 90 Stat. 1520, Pub. L. 94–455, Section 803, that clearly states Congress has passed laws to encourage ESOPs in order to strengthen the free enterprise system because the method of creating ESOPs solves the problems of securing capital funds for necessary capital growth. Capital growth and economic growth are interchangeable.

Attachment 1 summarizes the data that the reason Congress passed laws to encourage capital, or economic growth, has been met over the past 40 plus years. In fact, given the experience of this nation with the limited number of ESOP companies, a strong case can be made that there should be more employee owned companies via the ESOP model if the Congress wants to see more economic growth, particularly in the global economy in which we live.

2. Fairness: The core attraction of ESOPs is having policy to increase the wealth of average pay employees, not just the already wealthy, without "taking" from those who have wealth and who may have done the most to create successful businesses that provide jobs and opportunity. The fairness attraction of "shared" ownership is a fact, as noted by leaders from George Washington to Abraham Lincoln to Ronald Reagan, and many others.

3. Simplicity: The primary beneficiary of employee ownership via the ESOP model, the average pay employee, does not face complexity of any significance due to the fact she/he has a share of ownership of the company where she/he works because of participation in an ESOP.

Certainly, when the employee owner cashes out of an ESOP, she/he faces the matter of paying taxes on his/her money. And to claim the ESOP model is too complex for the company sponsor of an ESOP compared to its benefits would be a stretch.

4. Permanence: Congress, both House and Senate, have consistently maintained for over 40 years the core laws, and benefits of ESOP. Yes, during the second half of the 1980's, Congress tweaked some of the 1984/1986 special tax benefits for ESOPs, but *all* the key benefits were maintained. In the late 1990's, Congress added law to permit S corporations to maintain ESOPs. This 1996/1997 pro-ESOP law was tweaked in 2001 to stop anyone from creating a flim flam S ESOP, but the S ESOP law's intent is still maintained.

And is the permanence of ESOP law an oversight by the Congressional tax committees? No, as evidenced by fact that the Tax Reform proposal released February 26, 2014, by former Chair of the House Ways and Means Committee, Dave Camp after over a year of closed door review of current Federal tax law, did *not* alter any specific ESOP law. And evidence is strong that the majority members of Ways and Means were presented options by staff to diminish ESOP tax laws, as staff did so for *all* special tax laws, as is the standard procedure in a tax reform effort.

5. Competitiveness: Years of research, by reputable academics and think tanks, make an overwhelming case that ESOPs are more competitive than conventionally owned companies. As already noted Attachment 1 provides more details about the macro data evidencing that employee owned companies are more competitive, but highlights are: In *Shared Capitalism at Work,* edited by two Rutgers University professors—Blasi and Kruse—and a Harvard professor—Freeman—it was evidenced that employee owned companies had harder working employees that work harder, had a low turnover, had greater job security, better labor management relations; work by Dr. Brent Kramer in his dissertation for City University of New York evidenced that majority employee-owned companies, using size and sales comparables, had an over 8% average of more sales per employee; and in the late 20th Century, in a review of closely held ESOP companies, which are the majority of American businesses, for over a decade, with 1,100 ESOP companies compared to similar 1,100 conventionally owned companies, evidenced that the ESOP companies had better sales, and were more likely to remain in business over an eleven year period.

6. Promoting Savings and Investments: Data collected by various researchers in the field of retirement savings indicated that on average, ESOP account balances are greater than other retirement savings, in defined contribution plans. Data collected from ESOP companies collected each year by The ESOP Association indicates the average account balances—keeping in mind averages are for those relatively "new" employee with only a few years of allocations to their accounts, and, for example the balances of long-term employees of ESOP participants, is over $200,000, whereas data released by a variety of retirement savings researchers indicate average balances in the popular 401(k) plans to be approximately $85,000. (While anecdotal, and thus not impressive to "researchers" the author of this document, Michael Keeling, President of The ESOP Association has visited personally in over 500 ESOP companies the past two decades, and has heard many, many times of distributions from ESOPs to average pay employees in the $500,000 to $1 million plus range.)

7. Revenue Neutrality: There is no way, based on the historical methods used by government revenue estimators, by employees of the Executive and Congressional branch of our government, not to says special ESOP tax benefits are revenue losers to the tune of around $2 billion each year.

But, once it became evident that during the Great Recession that employee stock owned companies laid off people at a rate of less than 4% compared to conventionally owned companies that laid of employees at a rate of more than 12% in the same time line, one had to step back and say, "Wait a second—what if there had been no employee stock owned companies during the Great Recession, and the companies all laid off employees at a rate of more than 12%, how much money would Uncle Sam not collect—in other words, how much money did ESOP companies save Uncle Sam during the Great Recession as ESOP companies had more people paying income taxes, Social Security taxes, and Medicare taxes in the 2010 period?" Using an average income tax rate of 8% for the average pay worker, the National Center for Employee Ownership calculated that these ESOP companies, by keeping people at work, because they are more competitive, put into Uncle Sam's Treasury over $14.5 billion more than if they had worked for those companies with 12% plus lay off rates, or approximately seven times more revenue than the $2 billion revenue loss because of the ESOP laws encouraging the creation and operation of ESOP companies.

Yes, ESOP tax benefits may not be revenue neutral, but the fact is that ESOP companies pay a lot more to Uncle Sam than conventionally owned companies because ESOP company employees are more likely to have sustainable jobs triggering tax payments to Uncle Sam.

Thus to say ESOP laws are hurting Federal revenue collection is not supported by solid evidence gleaned from the General Social Survey of 2010.

Conclusion: Laws to promote the creation and operation of employee owned companies through the ESOP model are more than justified because ESOP laws meet the seven criteria set forth by Chair Hatch to use when judging, are the laws good for America? Bottom line, ESOPs are more productive, more sustainable, with jobs controlled by U.S. interests, providing better retirement savings for average pay workers than other savings plans, and making our nation more competitive.

ATTACHMENT 1

Employee Owner Impact on Corporate Performance—Positively Overwhelming Evidence ESOP Companies More Productive, More Profitable, and More Sustainable, Providing Locally Controlled Jobs

- During the Great Recession, employee stock owned companies laid off employees at a rate of less than 3%, whereas conventionally owned companies laid off at a rate greater than 12%. (Data source: 2010 General Social Survey.)
- Because employees of ESOP companies were four times more likely to retain jobs during the Great Recession, Federal government recognized savings of over $14 billion in 2010 compared to tax payments foregone by laid off employees of conventionally owned companies; in other words for every $1 in tax expenditures to promote employee stock ownership, the Federal Government collected $13 in taxes. (Data Source: 2010 General Social Survey analyzed by National Center for Employee Ownership.)
- A survey of 1,400 ESOP companies in 2010 evidenced the average age of the companies' ESOPs were 15 years, and the average account balances for employees were nearly $200,000, much higher than data reported for average 401(k) account balances. (The ESOP Company Survey, 2010, of The ESOP Association's Corporate members.)
- According to 2012 General Social Survey, 13% of employees of employee stock-owned companies were thinking of seeking employment elsewhere, whereas 24% of the employees of conventionally-owned companies were considering leaving their current job.
- In the summer of 2014, the Employee Ownership Foundation released results from the 23rd Annual Economic Performance Survey (EPS) of ESOP companies. Since the Employee Ownership Foundation's annual economic survey began 23 years ago, a very high percentage, 93% of survey respondents, have consistently agreed that creating employee ownership through an ESOP was "a good business decision that has helped the company." It should be noted that this figure has been over 85% for the last 14 years the survey has been conducted. In addition, 76% of respondents indicated the ESOP positively affected the overall productivity of the employee owners. In terms of revenue and profitability—70% of respondents noted that revenue increased and 64% of respondents reported that profitability increased. In terms of stock value, the majority of respondents, 80%, stated the company's stock value increased as determined by outside independent valuations; 18% of the respondents reported a decline in share value; 2% reported no change. The survey also asked respondents what year the ESOP was established. Among those responding to this survey, the average age of the ESOP was 16 years with the average year for establishment being 1998.
- More than half of the ESOP companies have two retirement savings plan (primarily a 401(k)), whereas more than half of all companies have no retirement income savings plan. (Analysis of forms 5500, and Bureau of Labor Statistics by the National Center for Employee Ownership, funded by the Employee Ownership Foundation.)
- The average ESOP company (less than 200 employees) has sales $9 million more per year than its non-employee owned comparable competition (June 2008 Dissertation, Dr. Brent Kramer, CUNY.)
- A study of 1,100 ESOP companies over eleven years compared to 1,100 comparable conventional owned companies evidenced the 1,100 ESOP companies had better sales, more employment, and were more likely over the period to remain independent businesses by 16%. (Most detailed study of ESOP companies by Dr. Joseph Blasi, and Dr. Douglas Kruse, tenured professors, Rutgers University School of Labor and Management, 1999.)

ATTACHMENT 2

This Is the Law!

90 Stat. 1520, Pub. L. 94–455

(h) INTENT OF CONGRESS CONCERNING EMPLOYEE STOCK OWNERSHIP PLANS.—The Congress, in a series of laws (the Regional Rail Reorganization Act of 1973, the Employee Retirement Income Security Act of 1974, and the Tax Reduction Act of 1975) and this act has made clear its interest in encouraging employee stock ownership plans as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees. The Congress is deeply concerned that the objectives sought by this series of laws will be made unattainable by regulations and rulings which treat employee stock ownership plans as conventional retirement plans, which reduce the freedom of the employee trust and employers to take the necessary steps to implement the plans, and which otherwise block the establishment and success of these plans. (Pub. L. 94–455, 90 Stat. 1520)

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STATEMENT FOR THE RECORD

Senate Finance Committee

February 10, 2015

"Getting to 'Yes' on Tax Reform: What Lessons Can Congress Learn from the Tax Reform Act of 1986?"

Chairman Hatch and Ranking Member Wyden, thank you for the opportunity to submit this statement for the record regarding the importance of comprehensive tax reform that includes both corporations and pass-through entities.

During the Senate Finance Committee hearing on February 10, 2015, the Honorable Bob Packwood and the Honorable Bill Bradley discussed their views on tax reform and whether Congress should focus on business-only reform, individual-only reform, or comprehensive reform that addresses corporations of all sizes as well as individuals. Both witnesses expressed the opinion that comprehensive tax reform is imperative due to the way the corporate and individual tax codes are intertwined. As Mr. Bradley rightfully acknowledged, they are two sides of the same coin.

NFIB is the nation's leading small business advocacy organization, representing 350,000 small business owners, and we commend the Committee for starting the tax reform discussion and actively working to make reform a reality. According to an NFIB study of small business owners on taxes and spending, eighty-five percent of our members agree that Congress should reform the tax code.[1] However, NFIB shares the views of Mr. Packwood and Mr. Bradley that tax reform should be accomplished in a comprehensive manner.

Seventy-seven percent of NFIB members,[2] and seventy-five percent of small businesses across America,[3] are organized as pass-through entities and pay their taxes at the individual rates. These pass-through businesses employ a majority of the private sector workforce and comprise over half of all net businessincome.[4] These busi-

[1] *Taxes and Spending: Small Business Owner Opinions*—NFIB Member Poll, NFIB Research Foundation.
[2] *Taxes and Spending: Small Business Owner Opinions*—NFIB Member Poll, NFIB Research Foundation, Washington, DC, March 2013.
[3] *Tax Complexity and the IRS*—NFIB Member Poll, NFIB Research Foundation, Washington, DC, Volume 6; Issue 6; 2006.
[4] *An Overview of Pass-Through Businesses in the United States*—Tax Foundation Special Report No. 227, Tax Foundation, Washington, DC, January 2015.

nesses are critical engines in our nation's economy and simply cannot be ignored in the tax reform process.

Mr. Packwood and Mr. Bradley also mentioned the importance of Presidential leadership if tax reform is to be successful. While we agree, we also have concerns with President Obama's recent comments surrounding "business" tax reform. This broad term does not provide much insight into what the President is willing to consider in a tax reform package. Moreover, we are concerned that this approach leaves America's main street businesses behind. Given President Obama's past reluctance to lower individual rates, one can only assume that his version of "business" tax reform is a package that solely addresses the corporate tax code. Given President Obama's recent statements, as well as the tax writing committees' presumed desire to produce legislation the President could support, we have concerns that the path to common ground will lead to tax reform that falls on the backs of small businesses.

As you know, there are numerous credits and deductions in place that both corporations and pass-through entities can claim. Tax reform seeking to lower the corporate tax rate would likely eliminate most, if not all, of these credits and deductions in an effort to offset the lowered rate. In doing so, that endeavor would actually raise the effective tax rate on pass-through businesses by eight percent since they would lose these credits and deductions without receiving a lower rate.[5] This would lead to an unlevel playing field in which pass-through entities would struggle to fight and compete with much larger corporations. While we do believe the corporate tax rate should be lowered, we do not believe Congress should be picking winners and losers in the business community. It is vital that tax reform benefit businesses of all sizes, not just the largest corporations.

Supporters of corporate-only tax reform may argue that pass-through entities can simply switch their filing status to become a C corporation; however, that is not a viable solution for small businesses looking for both rate relief and simplicity. There are many administrative and operational costs that pass-through businesses could incur if they choose to change their filing status. Additionally, S corporations who opt to change their status and become C corporations generally must wait five years before being permitted to return to S election.[6] According to an NFIB Member Ballot, eighty-nine percent of NFIB members oppose being required to convert to a C corporation in order to have the same tax rate as large corporations.[7]

We believe the best type of tax reform for small business owners and the economy is pro-growth reform that lowers both corporate and individual rates, simplifies the code, and enables business owners to keep more of their money to reinvest and grow their businesses. Small businesses are the backbone of our economy and the federal government should not hinder their abilities to hire new workers and create lasting jobs. As the tax reform discussion moves forward, we urge the Committee to take steps to ensure that small businesses have a seat at the table. We look forward to continuing to work with you on this issue.

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[5] *Long-run macroeconomic impact of increasing tax rates on high-income taxpayers in 2013,* Ernst & Young, July 2012.
[6] This would rise to ten years without Congressional action on tax extenders.
[7] NFIB Member Ballot, volume 565, August 2014.