

**Appendix E - UNIVERSITY HONORS PROGRAM
SENIOR PROJECT - APPROVAL**

Name: Becky Cassill

College: Business Department: Accounting

Faculty Mentor: Dr. Daniel Murphy

PROJECT TITLE: Politics + Effects of Tax Reform in the 1980's

I have reviewed this completed senior honors thesis with this student and certify that it is a project commensurate with honors level undergraduate research in this field.

Signed: Dan Murphy, Faculty Mentor

Date: 5-9-01

General Assessment - please provide a short paragraph that highlights the most significant features of the project.

Comments (Optional):

The Politics and Effects of Tax Reform in the 1980s

Rebecca L. Cassill

Senior Project

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Since the adoption of the 16th Amendment to the Constitution, the once simple tax code has become lengthy, ambiguous, and complex. Laws that were originally passed to raise tax revenue have witnessed the effects of 20th Century history and the powerful persuasion that accompanies politics. However, the decade of the 1980s was the most significant period in the shaping of tax policy; four major tax reform acts were passed through Congress, leaving large imprints on the code that is followed today. The tax legislation of 1981, 1982, 1984, and 1986 and the politics behind such legislation mark one of the most intriguing and politically volatile periods in this federal revenue sector. The purpose of this paper is to study the motivation for and politics behind this legislation and the results of its implementation.

Brief History of the Income Tax

The founders of the United States, familiar with taxation problems from England, wrote in the Constitution (Article I, Section 8, Clause 1):

Congress shall have the power to lay and collect Taxes, Duties, Imports, and Excises, to pay the Debts, and provide for the common Defense and general welfare of the United States; but all Duties, Imports, and Excises shall be uniform throughout the United States.

The Constitution forbade direct taxes, taxation per head or by land (Conlan, Timothy, Margaret Wrightson, and David Beam. Taxing Choices – The Politics of Tax Reform. Washington, DC: Congressional Quarterly. 1990, 16). Therefore, to pay for the cost of the nation, revenue was raised primarily by customs receipts and a variety of taxes on goods such as spirits, sugar, snuff,

and legal instruments (Conable, Barber. Congress and the Income Tax. Norman: University of Oklahoma Press. 1989, 34).

The first form of an income tax emerged in 1864 during the Civil War. The tax only affected the wealthiest citizens, imposing a 3 percent tax on income up to \$10,000, a 5 percent tax on income over \$10,000, and a \$600 exemption. Even during the Civil War, representatives and citizens debated over the issue of progressivity, the concept that wealthier individuals should pay tax at a higher rate. The debate continues today: should people pay according to what they make, or are higher rates punishing the rich for being rich and reducing incentives to create more wealth?

The income tax was repealed immediately after the Civil War, but advocates emerged again in 1894. President Grover Cleveland enacted a small income tax of 2 percent for individuals and corporations, including a \$4000 exemption. However, the income tax was legally questioned in *Pollock vs. Farmers' Loan & Trust Company*. The Supreme Court ruled in 1895 that the income tax was direct, and therefore, unconstitutional (35).

Proponents of an income tax continued to rally, and in 1909 President Taft compromised; he would support and enact a 1 percent tax on corporations in exchange for support of a Constitutional income tax amendment. Although the 1 percent income tax failed in court, the Amendment was ratified four years later (Conlan 17). The 16th Amendment states: "Congress has power to lay and collect taxes on incomes from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration" (Conable 36). Woodrow Wilson, the current President in 1913, quickly sent a bill through Congress, and an income tax became law on March 1, 1913 (Conlan 17).

The first income tax instituted a 1 percent rate on individuals and corporations, and the tax was upheld in Court by the subsequent case *Brushaber vs. Union Pacific Railroad Company*. By 1920, 5.5 million tax returns were filed, a small number in comparison to the U.S. population of 106 million. The Revenue Act of 1928 rearranged the tax code, originally only 14 pages long. The organization and numbering of 1928 remained intact until the next reassessment of the code in 1939.

The income tax maintained relatively low rates until the Great Depression and the New Deal (Conable 37-38). Although rates occasionally dropped, World War II brought broad-based reforms, including a maximum rate of 79 percent in 1936. The arrival of WWII also ushered in the use of withholding from payroll checks and an increase in the number of tax returns filed. In fact, the number of returns doubled from 1940 to 1941, from 1941 to 1942, and again from 1942 to 1945 (Conlan 17). Taxation in the World War II era was accompanied by the slogan 'Class tax to a mass tax' (Steuerle, Eugene. *The Tax Decade*. Washington, D.C.: Urban Institute Press. 1992, 13).

Tax rates dropped after WWII, but quickly increased again for the Korean War. After the War, the percentage of the GNP from federal taxes has maintained relatively stable – 7.1 percent in 1964, 9.5 percent in 1969, and 9.6 percent in 1981 (13).

The tax code has always been subject to the influence of politics. The tax code was revised in 1939, and it received other significant changes in 1954. A Republican majority under President Eisenhower led Congress through major tax reform in 1954 in which rates decreased, corporate rates were scheduled for reduction, and excise levies were cut 50 percent. Furthermore, the act revised the Internal Revenue Code by rearranging provisions, standardizing terminology, and merging normal and surtaxes. The Bureau of Internal Revenue became the

Internal Revenue Service, and many sectors of government saw reductions and incentives (Conable 40).

The income tax continued to become one of the largest sources of revenue, as more and more of the population faced taxation. Whereas only 5 percent of the US population were subject to tax in 1939, the number had grown to 73 percent by 1960. The increase in the number of citizens filing offered revenue for government spending without necessarily having to pass new legislation – it was a “dream come true” for the government (Conlan 19). Taxpayers also faced increasing state and local taxes and Social Security taxes, while corporations saw a decrease in their rates in an effort to promote business expansion (Steuerle 15-16).

Tax Legislative Process

Tax policy is the result of actions taken by elected representatives in Congress and the agendas of the executive branch; in short, the Internal Revenue Code is a document that reflects years of politics. One tax bill must pass through two committees, both houses of Congress, a conference committee, and ultimately the President before any changes are made to tax law.

Because the Treasury Department, including the IRS, fall under the authority of the President, the executive branch often creates legislation of its own. This legislation is then offered to members of Congress to present and push through the House of Representatives and the Senate. Ronald Reagan often exercised this power throughout the 1980s.

House of Representatives Ways and Means Committee

As stated in the Constitution, all bills pertaining to revenue must initiate in the House of Representatives. Therefore, tax legislation enters Congress and is immediately funneled into the

Ways and Means Committee. The House Ways and Means Committee was first established in 1789 as an ad hoc committee when Thomas Fitzsimmons of Pennsylvania said, "Revenue of \$3 million will enable us to provide every supply necessary to support government...if we wish to have more particular information on these points, we ought to appoint a committee of ways and means" (Conable 13). The committee was charged with finding the ways and means to run the central government (6), and Fitzsimmons became the first chair.

The committee became the first standing committee in the House of Representatives under William Smith, handling all issues of financial concern pertaining to the United States. Fortunately, some of the legislation was relegated to both the Committee on Appropriations and the Committee on Banking and Currency after the reorganization of Congress in 1865 (13).

Membership on the Ways and Means Committee has been highly selective, and members chosen are those in 'safe' seats where re-election is usually guaranteed. The committee has been dominated by a long history of a Democratic majority in the House, and the title of Chair was at one time considered the ad hoc majority leader. The Ways and Means committee held the significant power of appointing other members to committees (serving as a "committee on committees"), and membership has included seven presidents and eight vice-presidents (14).

The history of the Ways and Means can not be mentioned without the recognition of Wilbur Mills, Chairman of the committee from 1958 to 1974. He was said to have "held the pen for all legislation that was written by the Ways and Means Committee during his fifteen-year reign as chairman" (Birnbaum 18). Born in 1909 in Arkansas to a wealthy family, he attended Hendrix College and later Harvard Law. He practiced law in Arkansas briefly before running and getting elected to Congress in 1938. Mills led the committee by consensus and campaigned for his legislation on the House floor to ensure a successful passing. (Conable 17). He also had

the luxury of working under fairly weak Speakers of the House and the privilege of House “closed rules” which limited debate and amendments to bills on the floor from committee (Birnbaum 106).

Rumored to have been an alcoholic, and later said to have taken various painkillers for his back, Mills left his imprint on the committee of 25 members (15 Democrat, 10 Republican) and on the House of Representatives. One of the most scandalous incidents involves being pulled over by the Washington, D.C. Park Service on October 10, 1974. Mills had reportedly been at a party for a friend and was driving neighbor Mrs. Eduardo Battistella home. Mrs. Battistella, known better as a stripper at the Silver Slipper nightclub under the name Fanne Fox, tried to jump out of the car. Once pulled over, she actually jumped into the Tidal Basin that runs in front of the Jefferson Memorial. Mills was said to be a frequent visitor to the Silver Slipper and to have had a long relationship with Fanne Fox. Wife Polly Mills had stayed at home that night due to a broken foot (www.washingtonpost.com). Wilbur Mills ultimately retired to serve in a Washington, D.C. law firm (Conable 17) before passing away in Searcy, Arkansas on May 2, 1992 (bioguide.congress.gov).

During this period, the ranking Republican John Byrnes also influenced the legislation of the committee. A graduate of the University of Wisconsin in 1938, he actively worked with Mills in the markup and passage of legislation (Conable 17).

The Democrats began to pursue accountability from the powerful Ways and Means committee in the 1970s. In the Legislative Reorganization Act of 1975, the committee lost the ability to appoint other members to committees but also gained 12 members. The new committee was composed of 23 Democrats and 12 Republicans charged with creating substantial legislation.

Mills retired during this period, making Al Ullman the new Chair of Ways and Means. Ullman struggled with changing this committee from a self-standing and powerful group of legislators to one accountable to the majority party. With the increase in size, Ullman created subcommittees, each with their own staffs. Because members often served on multiple subcommittees, the influence of staff rose as each became more responsible for technical tax knowledge (19-22). Ullman pushed for a value-added tax (VAT), a reform used widely throughout Europe. However, the value-added tax was not popular in Congress or in Ullman's home state of Oregon, and he ultimately lost his seat in the 1980 election (23).

Dan Rostenkowski became the new leader and Chair of Ways and Means in 1980s, and he successfully transformed the committee into one with a balance of influence and accountability (25). He reduced the authority of the subcommittee chairs, asking that the various staffs report to him directly. Rostenkowski built a central staff with specialized technical expertise. In fact, staffs of the Treasury and the highly regarded Joint Committee on Taxation began to wane in influence as the Ways and Means staff grew to 78 majority and 18 minority workers (25).

Rostenkowski learned about politics from Chicago Mayor Richard Daley. He grew up in the 'Polish corridor' (Conlan 88) of Chicago and attended both St. Johns' Military Academy and Loyola University (bioguide.congress.gov). After serving in the Korean War, Rostenkowski was elected to the State House of Representatives and State Senate prior to serving seventeen terms in Congress.

Rostenkowski was known for his looming figure, his affinity for back-door compromises, and his involvement in the Chicago political machine. Even after years in the House, he talked often with Mayor Daley; some even said that Rostenkowski received this committee assignment

from Daley's assertion of power. Rostenkowski originally was climbing the leadership ladder in the House to become Speaker, but he surprised many by accepting his assignment on the powerful Ways and Means committee. He actually accepted his position because the committee had the power to appoint others, not because of its involvement with fiscal legislation. He was initially uninterested with details of tax legislation, although his work on the Tax Reform Act of 1986 exhibits the change in his leadership (Conable 25).

The Ways and Means committee still meets in the Longworth Building (Birnbaum, Jeffrey and Alan Murray. Showdown at Gucci Gulch. New York: Random House. 1987, 121). However, bill mark-ups are often held, as during the Tax Reform Act of 1986, behind closed doors. This allows representatives to make necessary, and often political, decisions. Barber Conable, the ranking Republican on Ways and Means said, "Ways and Means bills rarely could be painted boldly in black or white. Because of their complex contents, they usually were shrouded in grey..." (76). Rostenkowski and the Ways and Means committee played an integral role in the tax reform of the 1980s.

Upon leaving the Ways and Means committee, tax legislation is taken to the House floor. Bills here have the fortune of usually limited amendments and debates, a procedural process as granted by the Committee of Rules. Once passed, a bill is then sent to the Senate.

Senate Finance Committee

The Senate Finance Committee initially receives the bill once passed in the House. The committee traditionally has as a secondary role in drafting legislation since it has already withstood the political pressures of the House. However, from 1970 to 1981, 37 percent of all tax expenditure modifications originated either in the Finance committee or on the Senate floor

(Conlan 137). Because the committee is seen as the “last chance” for special interests groups, the twenty members are usually the target of expensive and extensive lobbying efforts. For example, in 1986, the average Senator received \$800,000 in PAC contributions; a member on the Finance committee received approximately \$1 million. Furthermore, members are often invited to give an average of 23 speeches, earning about \$39,146 in honoraria per year (138).

The Senate Finance members are perhaps more responsive to such heavy lobbying efforts. In comparison to the executive branch and the House, the Senate creates more tax legislation that loses money for the federal government with a 1:4.24 ratio. Basically, for every dollar the Senate votes to increase revenue, it loses \$4.24 (in comparison with 1:1.17 in the executive office and 1:1.34 in the House).

The Senate Finance committee was lead for many years by Democrat Russell Long before Republicans gained control of the Senate in 1980. Long, born in Shreveport, Louisiana, attended school there as well as in New Orleans and Baton Rouge before earning an undergraduate and a law degree from Louisiana State University. He served in WWII prior to filling a Senate seat from December 1948 until January 1987 (bioguide.congress.gov).

During his leadership, the Senate Finance committee was known for poking many loopholes in the federal tax code. The committee, therefore, has been seen as a “historical pressure point for clientele agitation, and it has been an unwavering supporter of tax incentives favoring myriad causes for as long as most can remember” (138). In 1980, Republican Senator Bob Dole became Chair for only five years before Senator Robert Packwood of Oregon earned the prestigious position.

Packwood was born in Portland, Oregon and completed an undergraduate degree at Willamette University. After finishing his law degree at New York University, Packwood

returned to Oregon where he practiced law and soon became a representative in the State legislature. He served in the Senate from January 3, 1969 until his resignation on October 1, 1995. Packwood's leadership would lead the Finance committee through one of the most significant pieces of legislation: the Tax Reform Act of 1986.

Once passed from committee, a bill is brought for presentation and debate in front of the Senate. The Senate, known for more relaxed rules of debate than their House counterparts, also show less deference to their committee decisions. Often a bill released from committee will pass in Senate after several hours of debate and hundreds of amendments.

The Joint Committee on Taxation (JCT)

To reconcile differences between a bill passed in the Senate and one passed in the House, legislation is taken to the Joint Committee on Taxation. Conference members from both the Ways and Means and the Finance committees meet to formulate a bill acceptable to both bodies of Congress. Once the legislation is written in conference, the bill is then sent to both houses to be voted on once again.

The JCT has its own staff, known for its technical expertise. It is a highly professional and nonpartisan group of economists and tax attorneys available to serve both houses and both committees. Traditionally, the committee has most often provided technical support to the Ways and Means committee, assisting to draft legislation and committee reports. The JCT also estimates budgetary and revenue effects, a difficult and tedious task (Conlan 90).

The JCT has been led by Laurence Woodworth (who left to work for the Carter Administration), Bobby Shapiro and Mark McConaghy (who both left to work for Price Waterhouse), David Brockway, and Ronald Pearlman (Conable 28). The committee views itself

as guardians over the federal revenue system, holding the responsibility to help in resisting the influence of special interest groups on the tax code (Conlan 90).

Although the influence of the group diminished as the partisan staffs of Ways and Means and Finance developed, the JCT staff continues to possess both superior technical knowledge and powerful effects on the legislative process. A disgruntled House Democrat once remarked, "If I really wanted to influence the way the law was written, I would have applied for a job on the Joint Tax or Ways and Means staff" (120).

Major Tax Legislation Before 1981

As income tax rates grew in the post-WWII years, Congress passed several significant pieces of legislation and reform. Tax policy also began to develop many specific characteristics that would formulate the future reform changes.

In 1969, Treasury Secretary Joseph Barr testified before Congress, unveiling that 155 taxpayers with incomes over \$200,000 had not paid any taxes in 1967. Of these 155, twenty were millionaires (Birnbaum 14). In response to this scandalous report, Congress passed legislation aimed to close loopholes and limit preferences. Conable, a member of Ways and Means during 1969 said, "I thought we closed most, if not all, those loopholes identified at the time as scandalous" (45). The legislation also imposed a new minimum tax on previously tax-free income, reduced the maximum marginal individual rate from 70 percent to 50 percent, added new tax relief provisions (Conlan 29), and repealed the investment credit (Birnbaum 14).

The Nixon Administration proposed legislation in 1971 to cut individual income taxes and offer provisions to stimulate business expansion. As a result, Congress re-instituted the Investment Tax Credit, provided new and more rapid write-off provisions for industrial

machinery and equipment, and promoted exports with the Domestic International Sales Corporation (DISC) provision (Conable 46).

Despite the title of Tax Reform Act of 1976, some sought to have the word “reform” removed due the extent that the legislation catered to lobbyists. Rather, the 1976 act was referred to as the “Lawyers’ and Accountants’ Relief Act,” a name attributed to the amount of provisions and loopholes created (Conlan 30). While the intent was to shut down tax shelters, the act actually increased the minimum tax rate, extended the investment tax credit, revisited DISC, created provisions for real property valuation, extended the time for estate tax liabilities, and restricted generation skipping with estate taxes (Conable 47-48). The tax code was only becoming more convoluted as the number of provisions and tax expenditures grew.

Finally, President Carter offered tax legislation in response to his campaign promises in 1978. Because the original draft elicited fierce response, the administration created a new proposal that would cut taxes by increasing the standard deduction (49-53). The ultimate outcome of the 1978 Tax Reform Act once again signaled the power of lobbyists (Birnbaum 16); it expanded tax breaks to help a variety of groups, including farmers, teachers, Alaskan natives, railroads, the Gallo winery, and even two Arkansas chicken farmers (15). Capital gains treatment was enhanced by a reduced rate of 28 percent from 35 percent.

Changing Tax Bills and the Effect on the Economy

As representatives became more responsive to constituent and special interests, the bills of 1969, 1971, 1976, and 1978 were characterized by a proliferation of new tax preferences. After the “loophole scandal” was discovered, many constituents complained to their own Congressmen about how they were specifically treated unfairly. Acting in response to the voters,

representatives often added provisions which would appease their districts to current fiscal legislation. With each new exemption, deduction, exclusion, and credit, the tax base quickly narrowed and tax rates became steeper to compensate. Income tax revenue changed as more exclusions for health and pensions were utilized, nontaxable public transfer payments (Social Security) grew, itemized and standard deductions increased, and tax credits expanded (Steuerle 18).

One of the most significant problems in the late 1970s was the issue of "bracket creep." Although nominal wages increased with soaring inflation, real wages did not. However, the income tax brackets were not adjusted for inflation, causing many lower and middle class workers to move up in tax brackets. These taxpayers were faced with more of the tax burden although the brackets remained static (Conable 44). Ultimately, the tax rate of the poor increased from 0 percent in 1978 to 2.85 percent in 1981 (Steuerle 20-21).

Despite the new provisions, taxpayers still did not view the reform acts as advantageous to their individual situations. Taxpayers only saw reform when their bottom line on tax returns was less than in previous years, an accomplishment that rarely occurred. Reform seemed like a euphemistic cover for new loopholes (Conable 40-42).

Corporations also faced varying levels of tax rates, with some firms paying no tax to others paying in excess of a 100 percent marginal rate. As a result, the tax shelter industry grew rapidly, helping corporations to dodge the tax laws and therefore retain more profit (Steuerle 34).

The economy leading into the 1980s faced a looming deficit, high inflation, and a recession that seemed endless. It is in this economic slump that four significant pieces of tax legislation were proposed and passed in an effort to assist the economy.

The 1981 Economic Recovery Tax Act (ERTA)

President Reagan ran on the idea of tax reform, and he intended to fulfill his campaign promises once in office. Known as an advocate of simplicity, Reagan created a tax package with two key sets of numbers: 10-10-10 and 10-5-3. The first sector of the tax package reflected a tax rate reduction plan as drafted by Jack Kemp and William Roth. The Kemp-Roth plan advocated cutting rates by 30 percent over 3 years, or a 10 percent across-the-board rate cut each year for three years. Secondly, Reagan supported a Jones-Conable plan (named after freshman Democrat Jim Jones and ranking Republican Barber Conable) which presented a plan of accelerated depreciation. Major capital outlay items could be depreciated within 10 years (buildings), 5 years (machinery and equipment), or 3 years (automobiles) (Conable 55).

Conable and Jones had actually drafted their plan based on research from the American Council for Capital Formation. The founder of this program was the influential lobbyist Charles E. Walker, a Texan and former deputy Treasury secretary under Nixon. In 1978, Walker organized the Carlton group, a gathering of important lobbyists each Tuesday morning at the Washington, D.C. downtown Sheraton-Carlton Hotel. Over breakfast, the group created the “biggest business tax break ever adopted” (Birnbaum 16) – the Accelerated Cost Recovery System of depreciation. To offer legitimacy to the theory, Walker created the American Council which provided appropriate research and support for the new depreciation theory.

When Reagan approached Walker to serve as his campaign tax advisor, Walker saw the perfect opportunity to implement the 10-5-3 plan. Later he will claim that Reagan simply didn't realize the financial constraint he was placing on the nation with the adoption and support of the ACRS system (17).

While the House Ways and Means Chair Rostenkowski drafted his own form of tax legislation in 1981, Ways and Means committee members Conable and Kent Hance began to create legislation on behalf of the President that included both the rate cuts and the depreciation changes. A bidding war soon erupted between the two bills, as both Rostenkowski and the President accepted numerous amendments to the various pieces of legislation. The President even expressed concern over the format the tax legislation was taking; to calm his fears, corporate giants flew into DC from all over the United States during the "Learjet Weekend" to assure the President of his tax proposals (Birnbaum 18). The Rules Committee allowed Conable and Hance to present their alternative piece of legislation in front of the House, and with the help of lobbying efforts by Reagan, the alternative won 238-195. Rostenkowski was crushed and surprised by the unusual turn of events.

The Senate quickly passed the bill, and the two committees met in conference to resolve the differences. Meeting Friday afternoon at 4:00 p.m. until 8:00 a.m. the following morning, the tax legislation ultimately offered a \$280 billion tax cut (Conable 55-58).

What did ERTA do?

The primary objective of ERTA was to stimulate economic growth and improve the equity of the tax system when it became law on August 13, 1981. For individuals, ERTA accomplished a 23 percent reduction in taxes over 33 months. The maximum tax rate was reduced to 50 percent, and the maximum tax rate on long-term capital gains was reduced to 20 percent. For businesses, ERTA encouraged increased levels of capital formation through accelerated cost recovery, investment tax credits, and research and development incentives (The Economic Recovery Tax Act of 1981. New York: Price Waterhouse. 1981, 9).

What political effects did ERTA have?

Despite the positive changes for individuals and corporations, ERTA was expensive. Although the Treasury, the Joint Committee on Taxation, and Congressional Budget Office generated accurate cost estimates during the creation of the bill, the Reagan Administration's figures (as compiled by the Office of Management and Budget) reflected a more positive outlook for future economic conditions, and therefore, created a false security with ERTA (Steuerle 52). The bill was expected to cost approximately \$750 billion, an amount that would only exacerbate the already looming deficit (Conlan 33-34).

The deficit did grow. Currently at \$79 billion in 1981, the deficit jumped to \$128 billion in 1982 and \$208 billion in 1983. The president's tax plan had only been a very short-term success in perception.

Furthermore, the plan had caused a riff with House Ways and Means Chair Rostenkowski. Once crossed, the Chicagoan never forgets. He would vow to never be defeated again as he was in 1981, a promise that he was able to fulfill.

The Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982

The 1981 tax cuts left a loss of revenue that could not be ignored. ERTA led Congress to the greatest peacetime tax increases in United States history. Ultimately, TEFRA would raise \$98 billion in three years, half of which was generated from corporations (Birnbaum 31). The Reagan administration would call these increases "revenue enhancement measures" to mask the problems they created in 1981 (Conable 62).

TEFRA was largely constructed by Senate Finance Committee Chair Bob Dole, viewing this legislation as an opportunity to show leadership. His package created revenue by raising tax rates and closing loopholes in the tax code. He managed to circumvent the rule of starting bills in the House by tacking his provisions onto a different House-sponsored bill that had already been sent to the Senate (Birnbaum 31).

Lobbying throughout the construction of the bill was fierce. During one Senate Finance mark-up, a staff member looked out to the hallways and stated, "There's wall-to-wall Guccis out there" (32). Thus, the hallways in the Dirksen Senate building and the Longworth House Building came to be known as "Gucci Gulch."

Rostenkowski and the Ways and Means committee could not decide on an appropriate tax bill. The committee constantly argued, specifically over oil and gas tax breaks. Instead of presenting their own bill to the full House, the Ways and Means committee voted to go straight to a conference committee, using Dole's bill as the primary basis for change. The conference committee met on a Friday night 7:00 p.m. until 9:30 the following morning. The conference reconvened at 2:00 Saturday afternoon and met again until 2:00 a.m. (Conable 63-64). A final piece of legislation was adopted by the House and the Senate shortly thereafter.

What did TEFRA do?

Essentially, TEFRA tried to make-up some of the lost revenue from ERTA. It closed loopholes, increased excise taxes, but ultimately tried not to touch rates (Conlan 34). The bill also cut back on accelerated depreciation, expanded unemployment insurance (Conable 63-64), reduced medical and casualty deductions, beefed-up the alternative minimum tax, and changed withholding on interest and dividends (The Tax Equity and Fiscal Responsibility Act of 1982).

United States: Ernst & Whinney. 1982, 1). The bill restored approximately \$27 billion that had been extracted by ERTA in 1981. Furthermore, TEFRA was written with stricter compliance and collection procedures to punish the thousands of taxpayers who circumvented the system and their tax obligations (Steuerle 60).

What political effects did TEFRA have?

TEFRA was able to generate higher revenues, but simply by increasing taxes instead of substantially reducing or reforming many expenditures. Usually, expenditure cuts were simply promises in the future to reduce government spending, vows that were rarely kept but often utilized in the legislative process.

Furthermore, the President expressed his “change of perception,” believing now in the importance of reducing tax expenditures. While he had earlier proclaimed the changing of tax loopholes and benefits was a ‘liberal myth’ (61), he began to realize the benefits of assessing the many exclusions and credits as areas of potential reform. This change would characterize the other substantial pieces of tax legislation under his administration.

Finally, Dole emerged as a political fiscal leader. Despite the traditional routes of legislation, Dole had successfully crafted a bill that helped to reduce the deficit and the pitfalls from ERTA. Furthermore, his bill was used as the primary basis for the Conference Committee, signaling the bipartisanship and lack on consent within the Ways and Means Committee. Rostenkowski was still adapting to his new leadership role.

The Deficit Reduction Act of 1984 (DEFRA)

DEFRA was a bill that would once again help to alleviate the severe deficit of the 1980s. In 1984, Dole convinced Reagan to once again ask for tax increases, allowing Dole to draft yet another piece of legislation (Birnbaum 32-33). The bill would raise approximately \$50 billion over three years.

Dole's plan was again sent to the House Ways and Means Committee, but Rostenkowski had gained control of his belligerent group. He exercised full power, establishing a coalition and making deals within committee membership: he would support the recommendations of the subcommittees if the respective leaders would accept his actions in the conference committee. In essence, Rostenkowski promised his vote to subcommittee chairs Sam Gibbons, Jake Pickle, Charles Rangle, and Pete Stark in return for their unquestioning support during conference (Conable 66-67). It was an alliance that proved successful.

What did DEFRA do?

Despite many proposals, DEFRA had a limited effect. It repealed the DISC-FISC (Foreign International Sales Corporations) provisions to 30 percent, specified withholding tax on foreign investments, addressed cafeteria plans (options of fringe benefits), and liberalized regulations for foundations (69). Furthermore, the bill terminated the moratorium concerning non-statutory fringe benefits and created reductions in Medicare and Medicaid (74-75). The bill once again increased compliance measures (Steuerle 66), increased excise taxes, made some corporate transactions taxable, and restricted tax-exempt leasing. DEFRA attacked tax straddles and abusive or fictitious tax shelters, extended depreciation lives for real property, and made accounting changes to create a more consistent code (67).

What political effects did DEFRA have?

The deficit had grown significantly by 1984. First, the reductions of the 1981 bill had taken effect, losses that were only exacerbated by the recession in the early 1980s (Steuerle 66). DEFRA did provide some deficit reductions estimated at \$108 billion by 1990, but the deficit had been estimated to remain at approximately \$170 billion (Birnbaum 32-33). President Reagan began to minimize his role in tax politics, leaving Congress and the legislature to create reform independently of executive intervention (Steuerle 66). Once again, Dole had assumed leadership in the legislation, but Rostenkowski was finally able to exert influence as well.

The Tax Reform Act of 1986

The most significant piece of legislation throughout the 1980s was the Tax Reform Act of 1986. Even today, accountants and tax lawyers talk about the importance and significance of this event which changed most of the tax code to what is now followed.

The Tax Reform Act started as a line in President Reagan's 1984 State of the Union address. Fearful that Democratic Presidential candidate Walter Mondale would push tax reform for his own party platform, Reagan was forced to confront the tax issue. Reagan stated,

Let us go forward with an historic reform for fairness, simplicity, and incentives for growth. I am asking Secretary Don Regan for a plan of action to simplify the entire tax code, so all taxpayers, big and small, are treated more fairly. And I believe such a plan could result in that "underground economy" being brought into the sunlight on honest tax

compliance; and it could make the tax base broader, so personal tax rates could come down, not go up (Birnbaum 40-41).

Reagan's call to action was taken very seriously by Donald Regan, the current Secretary of the Treasury. Born in Cambridge, Massachusetts, Regan attended school at Harvard before joining the United States Marine Corps and serving in World War II. After the war, he joined Merrill Lynch as an account representative, working his way to partner in 1954; he became the Chairman and CEO only twelve years later. Reagan nominated him for Secretary of the Treasury in 1980, and he was sworn into office on January 22, 1981 (www.ustreas.gov). He ultimately headed the Cabinet Council in Economic Affairs and would serve as the President's chief economic advisor.

Regan immediately began work within the Treasury Department, creating a small group of administrators who began to sift through and virtually re-write the tax code. Their changes reflected years of experience and frustration.

Regan wanted the process to be unchallenged and secluded from the knocks of lobbyists. Therefore, all meetings were private, and all papers were collected before anyone left the room. Exclusions, exemptions, credits, and deductions which were essential for some special interests were completely thrown out. The committee paid no attention to political ramifications, but instead drafted a tax code that would be simple and would also provide rate reduction. A key component of the change was revenue neutrality, the idea that the final changes would neither create nor lose revenue for the government. Therefore, any change that lost revenue would have to be balanced by one which would generate funds. The plan, formally known as Treasury I, left no loophole unexamined.

On November 26, 1984, Reagan and Assistant Secretary for Tax Policy Ronald Pearlman presented Treasury I to the President and his closest advisors (Birnbaum 62). The plan was not well-received. It included the end to deductions for state and local taxes and for entertainment expenses, a monumental corporate tax increase, fewer and lower income tax rates, and significant cuts to special interests.

Tax reform seemed as if it would end here. Instead, Chief of Staff James Baker and Reagan had decided on a significant personnel change which would salvage the tax reform: a switch in positions. Baker, a Texan native, graduated from Princeton and practiced law in Houston. He helped with Ford's campaign in 1976 and then decided in 1980 to end George Bush's presidential campaign; Bush was soon selected for Reagan's running mate. Baker was later selected as Chief of Staff. He was exhausted in his current job, and he preferred a different position which would place him in the Cabinet; Reagan wanted to have more influence on the President, and this switch provided the perfect opportunity.

Baker's move to the Treasury immediately brought politics back into the pure Treasury I reform. Baker, an experienced and skillful politician, realized that many of the Treasury I changes would anger so many special interests that few representatives would vote in favor of the reform. Baker, with Assistant Secretary Darman, began to comb through the legislation, replacing key loopholes and removing others. Baker knew that the new plan, Treasury II, would not appease everyone; however, it was a positive move to balance politics and reform.

Once completed, Baker and Darman presented their work to the President, this time with Reagan as the Chief of Staff. Treasury II included an increase in the capital gains taxation, a decrease in oil and gas provisions (a hard hit to Vice-President George Bush of Texas), and different tax rates. Birnbaum states, "it retained many tax breaks, but it ended or reduced many

others and brought the top tax rate dramatically to 35 percent. Most important, the new plan had the full support and approval of the President of the United States. With Ronald Reagan solidly behind it, tax reform could not longer be ignored” (94).

Legislation Moves to Congress

Shortly thereafter, the bill was sent to the House of Representatives and the Ways and Means Committee. The committee immediately faced large lobbying efforts. Rostenkowski used the summer of 1985 for committee hearings, during which hundreds of special interests and even New York City Mayor Mario Cuomo (who opposed the elimination of the deduction for state and local taxes) expressed their concerns with the legislation and how the specific changes would create chaos in the economy. Representatives did not receive positive responses at home, either, where citizens and constituents were skeptical, especially since the reform was supposedly “revenue neutral.”

On Saturday, September 7, Rostenkowski led the committee members to a retreat in Virginia. The members talked about the drawbacks of the bill and also held a preliminary vote. Rostenkowski was not encouraged; during the retreat he issued a “call to arms” to his members, begging their support and their work for reform.

While the members initially cooperated, Rostenkowski quickly ran into many problems. The lobbyists in Gucci Gulch were attacking any representative they could, and members began to utilize the rules of the private mark-up to make reform even more difficult. Finally, on October 15, the committee voted to expand the deduction to banks for bad debt reserves, losing \$7.6 billion in revenues over five years. The amendment was a low-point, Rostenkowski was embarrassed, and tax reform appeared dead again.

Rostenkowski let the vote for the banks simmer for several days in the news. Committee members were publicly humiliated for caving into special interests without reforming taxation for the middle and lower incomes. After several days, Rostenkowski used his influence on individual members to find out what sections of the new legislation were of concern. Using promises from these committee members and cooperation from others, the Chair reconvened the committee. The members voted to reverse the vote on banks in exchange for the retention of the state and local tax deduction.

For the next month, members were divided into working groups to tackle all of the reforms suggested in the bill. Various committee members led the groups, often compromising and voting quickly on key points. The biggest issues were saved for the end, and on Friday, November 22, the committee was scheduled to complete their mark-up and vote on the legislation.

In the late hours of Friday, the Joint Committee on Taxation reported that the bill, which had successfully achieved revenue neutrality thus far, was in fact creating a \$17 billion loss. The previous estimates had included an error, and the loss could not be avoided. The committee worked until 3:30 a.m. to fix the error and ended the mark-up with a final vote which would send the bill to the House floor.

House Republicans were not supportive of the bill. As the minority party, their representation on the Committee had not been respected. They had lost many key loopholes for business and special interests. When the bill was scheduled for the floor, Republican leadership under Trent Lott began to campaign to vote down the rule which would simply allow the bill to be considered on the floor. On December 11, the Republicans successfully defeated the rules motion, surprising all legislators.

The “ambush” was due in part to the lack of support President Reagan had not contributed throughout the process. Secretary Baker was rarely present at the committee mark-up sessions, and in his eyes, the bill fell extremely short of the recommendations he and the President had made. The rules vote was an important sign that it was now time for Reagan to throw his support if he truly wanted any significant tax reform during his administration.

On December 16, Reagan made the unusual trip down Independence Avenue to the Capitol. Meeting with GOP members, he heard their concerns and complaints. However, he was also able to earn their support for tax reform. The White House had been challenged to find 50 Republican votes, and they spent two days securing the promise they had made.

On December 17, the House passed the Tax Reform Act. Speaker Tip O’Neill gave a moving speech, asking members to vote for the necessary reform. When he led the voting, Republicans failed to stand and ask for a recorded vote. The bill passed the House on a voice vote.

A Trip Through the Senate

Bob Packwood, the Senate Finance Chair, was not excited about the reform that landed in his lap. However, he also knew that the Republican-controlled Senate had to fulfill the challenge to continue tax reform and pass meaningful legislation.

Instead of allowing hours of hearings and mark-up by members, Packwood decided to write his own legislation after talking to members. He scheduled approximately 70 hours of meetings with each committee member to learn what they individually wanted and what was necessary to secure each individual’s affirmative vote. On March 19, 1986, Packwood presented his bill to the committee.

Once again, the legislation was not well-received. Although he had succeeded in including a lot of provisions for the committee members, he had also excluded other significant loopholes that members weren't willing to give. For the next month, committee members "played Santa Claus for almost everyone who asked" (Birnbaum 200). They wrote in hundreds of exclusions and exemptions, and rarely did the committee actually raise any revenue to counter-act the losses. On Friday, April 18, a vote was scheduled for the most significant provisions that Packwood wanted to eliminate. Before the committee meeting, it appeared that Packwood simply didn't have the votes he needed.

Packwood entered the mark-up room, frustrated and dismayed. He said, "I don't want to give any impression that we have any idea of quitting. But I did not want to run the risk of killing this bill. What I was afraid of today is that if we held votes, it would be the end of the bill" (202). It seemed as if reform had died once again in committee.

After he dismissed his committee, Packwood and his aid Bill Diefenderfer decided to eat at the Irish Times, a favorite Capitol saloon known for cheeseburgers and beer. The two men were dejected at their loss; it seemed that the finger would be pointed at Republicans (specifically Packwood) for failing to support tax reform. Over lunch and two pitchers of beer, Packwood tossed around the idea of a bill so simple and astonishingly different that members might actually support it: a bill that made tax rates so low that Senators would not object to loosing loopholes. The idea was similar to the tax plan that Senator Bill Bradley had presented several years earlier.

Packwood and Diefenderfer returned to work excited about their revolutionary idea. Packwood enlisted the help of the JCT to draft a bill which would lower rates to 15 and 25 percent. On April 24, Packwood called the Finance members into a room and handed them two

packets of information. The first was a short summary of Bill Bradley's plan which was created on the idea of low rates. Bradley was surprised, since the Democratic reformer had only faced opposition within his committee until now. The second packet was Packwood's revolutionary proposal which closely resembled Bradley's.

The members were initially enthusiastic. The plan of using low tax rates to appease the absence of loopholes had worked. However, the plan quickly leaked into the news, and special interest groups began to call Packwood, questioning the legislation and complaining about its implications. The next day, Packwood called a press conference to address all concerns.

However, Packwood dodged most of the questions. Instead, JCT's Chief of Staff David Brockway was forced to answer most questions and take the blame for the reform. He was unprepared for the "staff bashing." Brockway and Packwood were left to recreate the legislation, placing some important loopholes back into the code. On April 29, the two men revealed another plan that still had low rates but also included some significant loopholes.

The committee spent the next week in mark-up. Packwood constructed a key group of Democrats and Republicans who initially sifted through the revenue-raising proposals and supported specific exclusions. The key group acted as a coalition, voting in block for the reforms they liked and voting against the amendments of others. Even Russell Long, the Democrat leader who had helped to create a lot of the exclusions, jumped in support of the bill and urged his colleagues to do the same. On May 7, the bill passed committee unanimously.

The Senate rules of debate are different than those of the House. A member can rise at any time to offer amendments or debate on the bill. Senators can filibuster, or discuss a subject for as long as they choose. Rostenkowski and the leaders on the Finance committee feared such liberties might be taken with their own tax bill, changing the legislation to cater to the special

interests and “pork” of each Senator. Therefore, in the weeks prior to the scheduled debate, Rostenkowski and Bradley worked together to form an alliance between 32 Senators; this alliance agreed to vote against any and all amendments. Furthermore, any amendment that was offered had to be revenue-neutral; it would have to generate money to pay for the expenditures that Senators proposed.

Because of these two factors, only few amendments were proposed. Even legitimate amendments were swiftly debated, and the 1,498 page bill was passed on Tuesday, June 24 with a vote of 97-3 (252).

Reconciliation in Conference

The bill was quickly sent to the Conference committee because the Committee Chairs wanted to have a bill ready for a vote prior to the August recess. Rostenkowski and Packwood faced the obstacle of reconciling the two bills – where the Senate bill had used low rates, the House had created revenue by eliminating deductions.

The conference moved fairly quickly, with Rostenkowski serving as the Chair and the committee meeting behind closed doors. However, there were many key issues the two sides could not agree on, and the members seemed to grow more weary and restless with each day of haggling. With the impending recess deadline approaching, Senator Long suggested on August 12 that the two chairmen work on the bill and then report back to the committee. This would allow Rostenkowski and Packwood to negotiate the details and major issues without the long delay and the exhaustion of committee.

For the next week, Rostenkowski and Packwood worked endlessly, compromising many points. Finally, on Saturday, August 16, the Conference Committee met again. The two leaders

handed out the final legislation, but many of the members were concerned. Everyone took a short break, and the two leaders assessed the support of each of the committee members. As the afternoon became late, the two leaders phoned each other, bargaining details and points in the bill.

At 9:30 p.m., the conference committee met again in an open meeting, the only public forum other than the first time the committee convened. Some members indicated that there was no immediacy for passing the bill so quickly, but Senator Long stated clearly that the present was the perfect opportunity to pass “the best revenue bill in fifty years” (282).

The conference report was passed by a voice vote with only two members dissenting. The members were able to enjoy a long recess prior to the final votes in September. On Thursday, September 25, the House passed the bill; two days later, the Senate also passed the new version (284). President Reagan signed the reform into law on Wednesday, October 22. He called the legislation ‘the best antipoverty bill, the best profamily measure, and the best job-creation program to come out of the Congress” (Conlan 1).

What did the TRA do?

The changes from the TRA were extraordinary. The reform cut rates for individuals and companies at the cost of repealing and curtailing deductions and credits. Individuals now only fell into two rate schedules of 15 and 28 percent, easier than the previous twelve schedules (Baker and Hostetler. *Highlights of the Tax Reform Act of 1986*. Boston: Warren, Graham, and Lamont, Inc. 1986, 1). The standard deduction was increased, and the personal exemption doubled. Corporations were taxed at 34 percent, raising taxes approximately \$120 billion by 1991 for this sector. Tax shelters were abolished, and low rates for capital gains were removed.

Taxpayers lost deductions for IRAs, sales taxes, and interest on purchases. A new alternative minimum tax was implemented, the investment tax credit was repealed for property placed in service after 1985, the General Utilities Doctrine was removed, and restrictions were placed on the deductibility of tax shelter losses (Tax Reform – 1986. US: Ernst & Whinney. 1986, I).

What political effects did TRA have?

The passage of the TRA increased the popularity of President Reagan and brought visibility to many of the key players. However, shortly afterwards, the Iran-Contra Scandal was uncovered, and Reagan began to suffer from the public outrage.

Dan Rostenkowski continued to serve as Chair of the Ways and Means committee until 1994. He was then indicted on seventeen counts and demoted from Chair; he supposedly stole \$50,000 in cash which he disguised as stamp purchases, placed fourteen people on the payroll for jobs such as photographing at weddings and mowing the lawn, bought personal gifts from the House gift shop, and used campaign funds to lease cars for personal use (www.time.com, June 13, 1994). He lost re-election in 1994. He was later found guilty for two counts of mail fraud in 1996, and he served a 17-month jail sentence (www.bartleby.com), fifteen months in a Wisconsin minimum-security prison, and two months in a Chicago halfway house. He has since been working as a corporate consultant and occasionally offering political commentary on Fox. He received a pardon from President Clinton in December 2000 (www.chicagotribune.com).

Bob Packwood continued to serve as Chair of the Finance Committee until the Select Committee on Ethics recommended his expulsion from the Senate. He resigned from Senate and from the Chair's position on October 1, 1995 (bioguide.congress.gov). He had been accused of sexual misconduct with 17 women, tampering with his diaries to obstruct evidence, and

attempting to use his connections to secure his wife a job. In 1996, the Justice Department submitted a letter stating that they would not attempt to prosecute him for his actions which had resulted in resignation (www.cnn.com). Packwood is currently working in Washington, DC in consulting.

Don Regan continued as Chief of Staff until 1987. On February 26, 1987, Regan learned that Howard Baker would be replacing him as Chief of Staff. This replacement ended a long history of dislike with First Lady Nancy Reagan (www.quickchange.com). He was said to have gotten even with the First Lady by disclosing some of her peculiar habits (such as consulting a “star gazer”) in one of his books (www.resnet.trinity.edu).

James Baker has always been a close ally of Bush. He ran his 1988 presidential campaign and then served as Secretary of State. He was credited for running George Bush’s 1992 Presidential campaign “into the ground” (slate.msn.com). He is currently advising merchant banks and assisting the United Nations, although he was one of several Republican supporters who traveled to Florida during the November 2000 elections in support of George W. Bush.

Why Were the 1980s the Decade of Reform?

Most Americans are quick to say that the tax code is anything but simple, clear, and fair. However, most Americans often state that tax reform usually brings about little change for the average citizen and countless benefits for the wealthy. Even during the 1980s, tax reform drew only a fair amount of attention from the general public.

Tax reform is often a sticky mess that elected representatives avoid. The tax code is extremely long and complicated, a document that few representatives have the time to read,

much less understand. Staffers and experts are given the responsibility to read and interpret what has been created to offer changes through Congress.

Even the key players during the 1980s offered little help or experience. President Reagan only rarely used his popularity and leadership to help push tax reform – and he only stepped in when it appeared that reform was almost dead. Packwood and Rostenkowski were fairly inexperienced leaders, as seen in the struggles they constantly faced when trying to reach consensus. Elected representatives are often wary of reform because it usually takes the form of cuts in exemptions, credits, deductions, and exclusions – areas which can affect constituencies as well as campaign donors.

So why did the 1980s become the decade of tax reform? All characteristics of reform point to a difficult process in which returns are few and insignificant. Several factors played a key role in manifesting such significant changes.

First, the state of the economy was so terrible that some action had to be taken. The deficit was the largest in the history of the United States, and inflation continued to increase as the effects of government spending from the Vietnam War began to float through the economy. Perhaps politicians thought that using a fiscal change in tax rates would help to give the economy the boost that it needed.

Secondly, the tax burden had become increasingly unfair as bracket creep and inflation forced middle and lower-income families into higher brackets. Taxes had, in only twenty years, become a burden on a majority of the population, a change from the pre-World War II “class tax” perception. Perhaps constituencies had become so vocal to their representatives that the representatives had no choice but to provide reform.

Thirdly, President Reagan wanted to designate his administration by significant tax reform. He often told stories of how he would pay a 90 percent tax when he was an actor; a series of tax reforms would provide more popularity and favor with the populus.

Fourth, the effort involved both Democrats and Republicans. Once tax reform is introduced, neither party wants to be known as the one that let reform die. Treasury II was the result of the Republican Treasury's work; Congress was split with Democrat leadership in the House and Republican control in the Senate. Both parties, specifically Rostenkowski and Packwood, learned quickly to work together to provide benefits for all.

I believe that reform was so popular as a result of many of these factors. Reform was the culmination of political leaders searching for recognition as well as an effort to control economic troubles of the country. Often, political leaders are assessed by the public based on the state of the economy; perhaps leaders viewed this reform as the opportunity to both make a name for themselves and to improve the economy so that public perception of government was better.

The 1980s were, without a doubt, a significant decade of political tax reform. However, the tax code is constantly changing and evolving; in fact, since the reform act of 1986, Congress has passed multiple pieces of tax legislation. While individual and current rates have remained basically the same, Congress continues to re-work many of the changes made in 1981, 1982, 1984, and 1986.

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