INTERVIEW WITH RONALD A. PEARLMAN

by Jasper L. Cummings, Jr., Washington, DC, and Alan J.J. Swirski, Washington, DC

INTRODUCTION: On November 9, 2000, Jack Cummings and Alan Swirski interviewed Ronald A. Pearlman. He began his law practice in the Interpretative Division of the Office of Chief Counsel in 1965. After four years with Chief Counsel, he practiced law in St. Louis for 15 years. In 1983, he became Deputy Assistant Secretary for Tax Policy, and became Assistant Secretary in 1984. After another stint in private practice, Mr. Pearlman became Chief of Staff of the Joint Committee on Taxation in 1988. Mr. Pearlman is now a tax professor and director of the graduate tax program at the Georgetown University Law Center.

Q Many people consider the 1986 Code to be the high water mark of good tax writing in recent times. Do you agree, and how did that come about?

A I do agree; however, because I was so involved in Treasury's work on tax reform, I realize that I am biased. Certainly the legislation was not perfect. But, as the end product of an effort to fundamentally examine the income tax system and implement a broadened tax base with lower rates, I believe the Tax Reform Act of 1986 was very positive reform. Incidentally, Treasury I, the initial report to the President, even though 16 years old, remains relevant. Not only did it include a valuable discussion of basic tax policy principles and a detailed analysis of the income tax; it also included a summary of consumption tax alternatives and an in-depth analysis of the value-added tax. In fact, Treasury I gently suggested that as part of revenue-neutral legislation, some form of sales tax, such as a value-added tax, might be used to remove some of the pressure on the income tax. This suggestion from 1984 is a less-developed version of Professor Michael Graetz's more recent proposal to combine a value-added tax with a modified income tax.

The 1986 Act did not result from any single factor but, rather, from a confluence of factors. Strong leadership by the President, the two Secretaries of the Treasury, and the leadership of the tax-writing committees was very important. The fact that Secretary of the Treasury, Donald Regan, released Treasury I in spite of the controversial nature of many of the proposals was a very important early step. For any Treasury Secretary faced with an array of important fiscal issues to devote the time that Don Regan devoted to the development of Treasury I and then to stand behind the report following its release is quite impressive. Obviously, following the release of Treasury I, the President could have killed it. We used to speculate that if we were to send Treasury I to the White House in the morning, it might come flying back over the fence in the afternoon. I think there are two reasons that it did not. First, Jim Baker had replaced Don Regan as Treasury Secretary shortly after the release of Treasury I. Although Secretary Baker had reservations about many of the Treasury I proposals, he understood the economic and political potential of tax reform. Thus, instead of killing the effort, he set out to develop a revised set of proposals. This effort resulted in the President's proposals to the Congress, sometimes referred to as Treasury II. The second reason tax reform did not die within the Administration was the interest of the President. We had a number of very interesting meetings on Treasury II with President Reagan during the spring of 1985. We reviewed all of the important proposals with him and engaged in substantive discussions with him on many of them. I was taken by his interest in the specifics during those discussions and the considerable political courage he subsequently displayed by approving proposals that we knew would be very controversial. Credit also has to go to Dan Rostenkowski. He demonstrated his commitment to tax reform through his willingness to start the deliberative process in the Ways and Means Committee after the President released Treasury II and by resuscitating the proposed legislation following a critical committee vote on bank debt reserves during markup. I left Treasury following approval of the tax reform legislation by the House and, thus, had no direct involvement with Senator Packwood during deliberations in the Senate. But, it is clear from a review of the process in the Finance Committee that he too exhibited very strong leadership. I would be remiss if I did not comment on the extraordinary work, in my view historic work, by the various staffs. By recalling the quality of Treasury I, you can understand my abiding regard for the Office of Tax Policy staff and the IRS people who assisted us. The work of the Joint Committee, Ways and Means and Finance staffs under the intense pressure of the legislative environment also was outstanding. There were many individual efforts that led to a successful conclusion. Of course, there were other factors: the very serious individual tax shelter problem, publicity indicating that a

number of multinational corporations were paying no or very little U.S. tax, and the design of the legislation that resulted in substantial reductions in individual and corporate tax rates. When all is said and done, perhaps the stars just happened be properly aligned in a way that enabled passage of the 86 Act. It truly was an amazing time; no question about it.

I must add that working with Dan Rostenkowski during my time in government was particularly memorable. I had a number of wonderful experiences with him, but I always will particularly remember a brief incident relating to tax reform. I am not certain of the date. I think it must have been during the fall of 1984, shortly after Treasury I had been released. I attended a Ways and Means Committee markup on a relatively minor tax bill. For some reason, the markup was held in H-208, the Ways and Means Committee caucus room in the Capitol. The room is very small and, on that day, it was crowded with Members, staff and the press. I had a somewhat tense exchange with the Chairman over a provision in the pending legislation that the Administration opposed. Of course, he won and I lost. Near the end of the conference, the Chairman's staff director told me that the Chairman wanted to see me after the markup in the small anteroom at the rear of the caucus room. Now, picture this anteroom. I think it was nothing more than a converted hallway, perhaps four or five feet wide, with doors on each end. There was virtually no furniture; the space was too narrow. The primary seating was a padded bench along one wall. I walked in, sat down on the bench, and waited for the caucus room to clear. Shortly thereafter, the Chairman came in and closed both doors. All that I could remember at the time was our earlier verbal exchange. Rostenkowski is considerably taller than I and is quite an imposing figure. At that moment, he appeared to be about eight feet tall. I anticipated receiving the wrath of the leader of a powerful House committee for having objected to the pending Committee action. Instead, he sat on the bench next to me and said, in effect, "*You don't realize what tax reform is going to be like on the Hill. You don't know how contentious and how pressure-packed the process is going to be. I just want to let you know there are times when I won't be able to help you. But, if I can, I will. If you need help, tell me.*" And that was that. Two minutes and it was over. Throughout the summer and fall of 1985, as we participated in a very contentious process in the House, I recalled that brief encounter with the Chairman in the H-208 anteroom. There I was, a Treasury representative in a Republican administration listening to the Chairman of the Ways and Means Committee in a House of Representatives controlled by the Democrats say, "Trust me; if we can do the right thing—if we can achieve the proper tax policy—we will."

Q You served as Chief of Staff of the Joint Committee on Taxation from 1988 through 1990. Would you describe for us the interrelationship between the JCT, the House and the Senate tax writing committees, and the Treasury?

A Relationships vary. At the Joint Committee, relationships with Members of Congress and the other staffs depend particularly on the personalities of the chairmen and ranking members of the tax-writing committees, relationships among the committee members, and the relationships between the House and Senate and between the Congress and the Administration. Of course, the personalities of the individual staff members were important. On the whole, during my tenure, I think the Joint Committee enjoyed very cordial relations with members of the Finance and Ways and Means Committees and their staffs. Everyone had a job to do, and each staff brought considerable value to the process. My impression is that Members, their personal staffs, and the Ways and Means and Finance staffs value the substantial expertise of the Joint Committee staff. As you know, most members of the Joint Committee staff have been around for quite a long time. As a result, they have substantial legislative experience and an invaluable collective institutional memory. They know how to analyze substantive issues and draft legislation and supporting documentation in very demanding circumstances. On the Hill, even though the various staffs represent different constituencies and, on occasion are required to take different positions, we rarely viewed ourselves as totally separate. Indeed, if an outsider were to join a typical meeting of the various staffs, most of the time it would have been impossible to determine who was on what staff.

Relationships between Treasury and the Joint Committee also have varied. When I was at Treasury, we had a very good relationship with the Joint Committee staff. For example, our revenue estimators interacted with the Joint Committee revenue estimators on their own without anyone else being involved. The two staffs did not always reach the same conclusion, but David Brockway and I thought it was important for all of the estimators to have access to the most current data and to be able to discuss the relevant theoretical issues without interference from others who might have specific policy objectives. Regular and cordial interaction between the Treasury and the Joint Committee and tax-writing committee lawyers also was the norm. Treasury participated in drafting sessions, and I think we were included in most caucuses and other Member meetings. To my knowledge, we always were included in markup sessions and in House-Senate conferences. Unfortunately, unfettered interaction between Treasury and the Hill is not always possible. While I was a member of the Joint Committee staff, there were occa-

sions when Treasury was excluded from drafting sessions and certain Member meetings, including meetings between the Ways and Means and Finance Chairmen during conferences on bills. This situation did not accurately reflect the personal relationships or professional respect among the Hill and Treasury staffs. Rather, it simply was a time when the political relationships between the Democrats in Congress and the Administration were somewhat strained, and, unfortunately, broader politics interfered. To my knowledge, most of the time, the Treasury and Hill staffs are able to work together by staying out of the political fray.

Q What Code provisions, other than the '86 Tax Reform, generally, that were passed on your watch do you consider to be good examples of "tax reform" that have worked out well in practice?

A It is hard for me to respond to your question without mentioning the broad reforms of the 86 Act, such as base broadening, but I will mention a few specific provisions, including some from 1986.

I think the Section 382 net operating loss legislation was good tax reform that has worked out reasonably well in practice. The section is very complex, perhaps unduly so, but it addresses important tax policy issues involving the proper utilization of net operating losses. I probably am one of very few who think the uniform capitalization rules are good tax reform since they represent an important contribution to the goal of more accurately measuring business income. After an initial period of adjustment, I think they too have worked out reasonably well in practice. I arrived at the Joint Committee shortly after the enactment of Section 2036(c), the estate freeze rule, and it was under fire. I lived through the period when full repeal seemed to be a real possibility. To the credit of the various tax staffs, and particularly to Mel Thomas of the Joint Committee staff, we were able to develop a set of fallback proposals that was not perfect but that I believe was an improvement over the pre-Section 2036(c) law. Finally, let's not forget the tremendous impact that reduction in individual income tax rates coupled with the reintroduction of the standard deduction and increases in the personal and dependent exemptions in 1986 had on the fairness and simplification of the tax system for millions of lower and middle income taxpayers. Those of us who tend to focus on business tax issues sometimes forget the importance of individual tax reform.

Q Do you consider the influence of "special interests" in tax legislation to have increased or remained the same over the last 20 years, and how has it changed?

A It seems as though the influence of special interests has increased over the past 20 years, but I am not certain the perception is accurate. One of the topics on my research agenda, which I hope to get to as soon as I am a couple of weeks ahead of my students, is to go examine more carefully how the legislative process has changed. I am particularly interested in examining the Wilbur Mills and Russell Long eras to see whether our memory of a better tax legislative process during those earlier years is accurate. Something tells me that upon closer examination, we might find that the special interests were alive and well in those bygone days and that the "sausage factory" was as messy then as it appears to be now. This was certainly the case 17 years ago, when I arrived at Treasury. I suspect the reason that we might consider the influence of special interests to have increased is that there is a more visible lobbying industry in Washington. There certainly are more well-trained, sophisticated tax lawyers involved in legislative activity, more sophisticated grass roots lobbying, and, of course, more substantial campaign financing. Do the special interests have greater influence? I am not certain that they do.

Q Do you foresee fundamental income tax reform in our lifetimes? To inform that question, do you see international or business changes as pushing the U.S. toward a fundamentally different type of tax system?

A The term "fundamental tax reform" carries some baggage, and so it is important to define it. If what you mean is the enactment of a consumption tax, I need to tell you a brief story. In 1984, during our work on Treasury I, I bet Secretary Regan five dollars that the United States would have a value added tax within five years. As you can see, my ability to predict even on the short-term, let alone in our lifetime, is not very good.

I prefer to think of fundamental tax reform more broadly, as an opportunity to examine seriously our tax system. I think such a reexamination is likely to occur in the not-too-distant future. The internationalization of business and the increasing mobility of people and capital undoubtedly will influence the debate. Even though maintaining an income tax in a global economy is challenging, particularly a tax on business income, I do not think the U.S. will reject the income tax entirely in favor of a consumption tax. I believe most Americans consider the income tax to be a fair way to finance the Federal government, and I doubt the electorate would agree to the explicit exemption of income from capital from tax. However, I also think we need to have a "pull the income tax out by its roots" public debate. Once we do, then if my prediction is accurate, we can proceed to a serious discussion of how to improve the income tax. I believe that discussion should include consideration of an additional revenue source, such as a value-added tax. The revenues from such a new tax might be used to lower income tax rates or increase the

present zero rate; provide relief from other troublesome provisions of present law and thereby take some pressure off of the income tax as suggested in Treasury I; or ease the regressivity of the employment taxes.

Q You have gone from legislative work to practice to teaching law and back and forth a couple of times. What valuable perspectives do practitioners and academics have to offer to the process of tax law writing and interpretation? Can think of any examples of an academic idea that has actually been implemented into an important piece of tax legislation?

A My wonderful colleague at Georgetown, Professor Martin Ginsburg, was one the important participants in both the subchapter S and installment sale legislation of the early 1980's. Although I do not want to understate Marty's skills as a practitioner, I understand that his contributions as an academic were quite significant in the development of that legislation.

Another example of academic influence is the work of Professor Daniel Halperin, formerly of Georgetown and presently of Harvard, on the theory of the time value of money. Tax policymakers have placed much more emphasis on time value of money principles since Professor Halperin began writing on this topic. In short, I believe that academics can have a huge impact on the development of tax policy by reason of the power of their intellect (yours truly excepted) and their ability to conceptualize without getting mired in the details of practice.

The practitioner's role in the legislative and interpretive processes also can be quite important. Practitioners are in the best position to accurately evaluate the impact of proposals in the real world—on real people and on real transactions. The challenge is for practitioners to define and make clear the role they seek to play when offering advice. I remember suggesting to the Tax Section leadership during development of the 1986 Act that we needed and sought the Section's input on how proposals would operate in practice in order that we might try to simplify and otherwise improve the technical quality of the legislation. In the same discussion, I said that we were working to implement policy decisions made by the President, and later by the Ways and Means Committee, and, thus were not particularly interested in having the Section's technical input tainted by its views on the merits of the policy decisions. During that time, those practitioners who understood the value of their technical input and were willing to put their policy views on hold had much greater influence. Some practitioners responded positively and constructively; others did not.

Q Do you think the "tax shelter problem" requires more and more tightly worded rules and regulations or does it require more and more vaguely worded anti-abuse rules?

A I consider the "tax shelter problem" as a two-tiered problem and as requiring both broad and narrow rules. At the "broad" level, I have long thought the marketing of a fair number of aggressive interpretations of the law is based either explicitly or implicitly on the audit lottery. To the extent I am correct, I believe the answer lies in increasing the likelihood of audit, among other things, through expanded disclosure. For several years the Tax Section to its credit has urged the Treasury and the Service to require such disclosure by regulation or other administrative action to the extent possible under present law. Both organizations deserve credit for their recent administrative activity. To the extent additional legislative authority for disclosure is needed, or if a more meaningful nondisclosure penalty is appropriate, as I believe may be the case, then Congress should act. It is hard for me to believe that taxpayers and their representatives can seriously quarrel with return disclosure, even if, for the sake of completeness, the rules require the disclosure of certain legitimate transactions, particularly if the penalty for nondisclosure is not linked to the accuracy related penalties. Why shouldn't a revenue agent have the opportunity to form her own view of a transaction?

Also at the "broad" level, I believe in anti-abuse rules, even though I recognize they may reduce transactional efficiency. Taxpayer confidence in our tax system is what sets the U.S. apart from many other countries. Anti-abuse rules cause taxpayers and their advisors to be somewhat more cautious when operating on the "cutting edge." I believe the law should encourage such caution. Thus, to the extent a legislative endorsement of a judicially developed anti-abuse rule, such as the economic substance doctrine, might cool the current tax shelter climate, I would consider such legislation appropriate. For example, I think a legislative confirmation of the economic substance doctrine could be crafted very broadly and in a manner that continues to leave the application of the doctrine to the courts. For example, I would encourage a single sentence of legislation stating simply that whenever a court determines that the economic sub-

stance doctrine applies, the degree of economic substance must be meaningful. I would leave to the courts the determination of when the economic substance doctrine is applicable and what "degree of economic substance" means in particular circumstances. If this statement raises questions about particular transactions based on specific tax incentives, such as the low income housing credit, let the transactions be identified. Congress easily can provide protection if appropriate.

At a "narrow" level, there are instances in which more tightly worded rules also make sense. When the Service finds a loophole in the Code or an infirmity or ambiguity in a regulation that results in taxpayer responses which seem inconsistent with the sensible operation of the statute, a tightly worded statutory amendment or modification of the regulation might be all that is necessary to correct the problem. The recent Section 357(d) legislation, in my opinion, is a good example.

There is no simple answer to your question regarding broad or narrow rules or to the broader question of how government should respond to aggressive tax planning. Therefore, I do not think it is particularly productive to look for a magical one-shot solution. Taxpayers may be expected to take aggressive interpretative positions no matter what form of tax system is in place and no matter how specific or how general the law may be. It is the Internal Revenue Service's duty to analyze reported positions and seek to enforce fairly the law through administrative pronouncements, litigating positions, and the imposition of civil and criminal penalties when appropriate. Should Treasury determine that the Service does not have sufficient statutory authority to stop an abusive transaction, it should promptly inform the Congress. Sometimes corrective legislation will be forthcoming, sometimes not. Too often I think Treasury waits too long before conceding that corrective legislation is necessary. The private sector also has an obligation—simply put, not to hide the ball. I am convinced that rules requiring full disclosure, providing the Service a reasonable opportunity to evaluate the merits of the taxpayer's reporting position, will have a dampening effect on tax shelter activity without precluding taxpayers from taking aggressive interpretative positions that they believe are defensible. ■

MEMBERS REACT TO **ABA JOURNAL ARTICLE**

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expressed by the ABA. I would regret letting my membership lapse after 20 years."

"I would appreciate receiving your views."

Martha, I share Mr. Shaff's concerns about some of the positions the ABA adopts. In completing the annual survey on the ABA's legislative priorities, I found I do not agree with some of them as a policy matter, nor would I rate them as priorities. I fear that is a view shared by many ABA members. I know several attorneys who have resigned from the ABA over positions the ABA has adopted. I know others who remain members despite disagreement with ABA positions because they value their membership in one of the sections—and can ignore the rest of the ABA—or because they believe the best way to affect the organization's policies is to remain a member and work to change them.

I realize that control of the policies and priorities of the organization is not vested in you as President, but I would urge you to use your position to ensure that the views of the many members of the bar who do not agree with positions we know to be controversial are fully considered. I also urge you, in setting the ABA's legislative priorities for the coming year, to consider the addition to the list of issues of more general importance to the majority of Americans and with which there is much agreement. In considering legislative priorities, it is important to recognize that the fact that a position is of general interest and not controversial does not mean that necessary legislation will be enacted. Consequently, ABA support of such positions can be important. Were we to include even one such item in the list of legislative priorities, we would signal to dissatisfied ABA members that we are listening to them and addressing their concerns.

As significant, we would indicate to the public that the ABA understands and is willing to speak for the interests of all Americans.

Thank you for your consideration.

Warmest regards,
Pam Olson