Summary: Wolf discusses the history of capital gains tax policy from the 1940s through to the 1990s and the effect on the timber industry. Highlights include how the policy could be a subsidy for the forest products industry, congressional maneuvering, the role of Senator Bob Packwood, and abuse of the law by the timber companies.

Hall: Monday, November 13, in the archives of the Mansfield Library at Missoula, Montana, and today we'll be talking with Bob Wolf about capital gains tax policy.

Bolle: The timber industry worked very hard on the capital gains tax recently and on the basis that it would help forestry and range management and, as a long-term public problem, that they're involved with, tree growing. And of course when it was repealed that was one of the reasons. One of the others was misuse of the capital gains policy. We're beginning to hear again about the benefits to timber from capital gains, but I think we ought to remember some of the problems that occurred when we were involved in the middle of this thing. What do you think?

Wolf: I think first we need to go back to the beginning of the income tax law, (not the beginning) in 1920 when, by treasury letter, the Treasury Department decided that when timber was sold where the owner did not use it in his trade or business, did not regularly make sales, and sold it outright, that it was eligible for capital gains, because other goods and things were eligible for capital gains. A company that used timber to make furniture couldn't claim capital
gains, or a company that made automobiles couldn't claim capital gains on the wood used for wooden wheels or the metal it used to make cars. That was not in accord with tax policy. It didn't make sense to treat the raw materials that way.

So from roughly 1921 till 1944 the only people who could get capital gains were those who passed those three tests, which meant that a sawmill that also owned timberland couldn't get capital gains nor could a person who regularly sold timber, who was in the business of doing it. In 1943 President Roosevelt submitted to Congress a tax package designed to put WWII on a pay-as-you-go basis. This engendered a significant amount of controversy.

Oddly enough, most of the very conservative Democrats and the Republicans were opposed to having the war on pay-as-you-go policy, because it meant taxing profits that might accrue from the manufacture of the goods of war. And this thing was debated back and forth in '43 until '44 when a bill was finally passed and sent to the president.

When you look at the hearing record of that tax law, you discover that Weyerhaeuser came in and testified on an excess profits provision that had nothing to do with capital gains on which they sought tax relief. The people who testified seeking capital gains benefits were some people from Georgia who were turpentine farmers in effect. They were big turpentine growers. They slashed the trees and got the turpentine and then after the turpentinining life of the tree was over, it was cut for lumber. They were the leaders of the testimony. You have to bear in mind that the Senate committee was chaired by George of Georgia, so these people were carefully selected to come in and testify as small landowners (even though they were not) and that they were disadvantaged by the tax law.

A treasury ruling in 1941 on coal had held that when coal was sold on a per-ton basis, it was not an outright sale. There was retained interest. These people argued that when timber
was sold on a per-thousand-board-foot basis, it might be construed that there was a retained interest. Therefore they would not be eligible for their capital gains anymore because their sales (they alleged) were sporadic and occasional.

In any event, the House did not adopt any amendment dealing with capital gains for these circumstances, but the Senate did. The Senate language was so expansive that it struck all three of the restrictions, so the timber industry now could get capital gains. Not only could it get capital gains on the timber it owned, but if it had a cutting contract with Farmer Bolle, Farmer Bolle could get the capital gains that he traditionally had gotten. But if the company could show that it hadn't paid the fair market value to Bolle, or it had advanced in value since they bought it, they too could get capital gains.

In capital gains you hear the term "long-term." The holding periods have been from six months to two years, so it's not a long-term proposition. Capital gains never has gone only to people who held an asset for years and years, such as timber, and grew it.

Bolle: But it also got onto public buying timber *P

Wolf: Oh, yeah, because it was a cutting contract and applicable there. Then there was capital gains that could be gotten on public timber which you bought at a low price at the government's appraised price, and then you said it was really worth more and so you got a capital gains on that.

In 1944, this provision was put in. Franklin D. Roosevelt vetoed the tax bill because it didn't have much of his pay-as-you-go concepts in it. In fact, it had become a Christmas tree of special interest benefits and Roosevelt castigated it soundly. Barkley of Kentucky differed with the President and gave one of the leading speeches on the override of the veto and the Congress did
override the veto. Barkley said that the president fashioned himself as a timber grower because he grew a few Christmas trees at Hyde Park, but you couldn't compare those spindly little pines with an oak or a spruce, which took generations to grow. Those were not the same and he said we would never give them for Christmas trees, but we ought to give them to those who had for generations nurtured the trees and grown them.

Bolle: That would be all right if that had been done.

Wolf: Overlooking the fact that this provision did much more than that. Also, in 1954, an amendment to the code added Christmas trees and made them eligible for capital gains. [chuckle] So Barkley's prediction that they would never apply to Christmas trees fell apart.

In 1961 when Kennedy became president, the question came up in the administration of repealing the capital gains provision for timber. Dr. Laurence Woodworm was the chief of staff of the Joint Committee on Internal Revenue Taxation, which wrote all the tax laws and did all the staff work on the writing of tax laws. He and I were neighbors and longtime friends. Larry was a believer in improving the tax laws and making them more equitable wherever possible, and he had been in intimate discussions with Secretary Dillon on the kind of reforms that the Kennedy administration might propose (in terms of what might fly and what might not fly, and what some of the major problems might be that deserved attention). Capital gains [were] on Larry's list, timber capital gains, as a tax subsidy that deserved to be repealed.

He asked me if I would be willing to talk to Secretary Dillon about the matter. I told him that I could only do that if Senator Anderson, who was then the chairman of the Senate Interior Committee, said I should do so. Anderson was also a member of the Finance Committee. So
Larry called Clint and said that he'd like me to go down and talk to Secretary Dillon with him on this issue. And would he agree? Anderson agreed and then called me in and told me, "You're perfectly free to express your views to Secretary Dillon with a clear understanding that you're not expressing *my* views." I said, "Obviously, I wouldn't express your views on that or any other matter, but on that basis I'll go do it." He said, "You just go ahead. Go down there with Larry and tell them what you think."

So I got down there and met with Secretary Dillon and his staff, maybe a dozen people in the room, and Larry introduced me. I explained the pros and cons of changing the tax law and the kind of opposition that it would engender from the forest products industry and how it worked. [I explained] how the small landowner has always gotten it and the '44 revision opened it to corporations. If they were going to change the corporate tax structure, this might be a tax subsidy they would want to wash away. But there was going to be great opposition from the forest products industry to it.

I remember Secretary Dillon, who, as you know, is a Wall Street investment banker, laughing and saying, "Yes, I'm familiar with the special interest pleadings." [Laughter] He was getting mixed suggestions from his staff. Some were saying, "Let's include it." Some were saying, "Let's exclude it." Dillon turned to his staff and he said, "I think Mr. Wolf has made a persuasive case that it's a tax subsidy. We need to close up loopholes. We'll include it in the president's message." So that came up in that package. But the Congress did not adopt it. The timber industry mounted a significant battle over it.

A couple of decades later I'm in a different job, I'm working with the Congressional Research Service. Senator Bob Packwood had gotten a bill in which was called the Investment Tax Credit Bill, which he got enacted over the opposition of Rostenkowski, who thoroughly
objected to it. Rostenkowski is now the chairman of Ways and Means, but at that time [Rostenkowski] was chairman of a subcommittee dealing with miscellaneous tax laws, so he happened to be dealing with this thing. Congressman Ullman of Oregon was chairman of the Ways and Means Committee and he favored the Packwood proposal. The timber industry was opposed to the Packwood proposal; it had been suggested by a fellow by the name of John Stevens who was then with International Paper Company as one of their vice presidents. He's now the executive vice president of Roseburg Forest Products in Oregon. He had suggested this as a device to provide a tax relief to small owners to encourage them to plant trees. It was designed to provide a 10 percent tax credit and amortization of your expenditure for reforestation over seven years, so you're getting a double dip in effect.

You could spend up to $10,000 a year on reforestation and get a tax credit. But when you looked at the anatomy of the small landowner, there were very few small landowners who would ever spend $2,000 on reforestation because of the small size of their holdings. At any rate, Packwood got this through over Rostenkowski's objections, because of Al Ullman's engineering on it. It's my understanding that Rostenkowski never forgave Packwood for this. [chuckle] That was on the books, and as soon as the Reagan administration came to power, (this was put through in the Carter administration) it was attached to about three bills before it went through. One of them was something on chickens and feathers imports. It finally went through on something dealing with the importation of carillon bells from the Netherlands. [laughter] That's wrong. It failed on that too. It went through on the Boat Safety Act of 1980. [laughter] Packwood tacked on three different things before he got it through. But that was what it went through, was the Boat Safety Act of 1980, which Carter was going to veto and then for some strange reason he signed.
Reagan's now president. Packwood decides he wants to up the tax credit to $25,000 a year. You could spend $25,000 a year and get it. I was over at the hearing that the Senate Finance Committee held on this. Packwood was chairing it and Buck Chapaton was the assistant secretary of treasury for tax policy. (Larry Woodworth is dead by now, it happens.) [Chapaton] was the assistant secretary of treasury for tax policy for Reagan, and he comes up and testifies and I'm sitting next to William Condrell, who is the staff director of the Forest Industry Committee on Taxation, which does their lobbying.

Chapaton says that the forest products industry is the most tax-favored of our industries and doesn't deserve any further tax subsidies. I thought Bill Condrell would go right through the ceiling. [Chuckle] He turns to me and he says, "We're going to have to educate Chapaton," and I turned to Bill and I said, "You, not me." That wasn't my job, for one thing. But of course Bill Condrell never knew of my role earlier either.

But anyway, that bill failed. The Reagan administration opposed it and Packwood couldn't move it. Then Gephart and Bradley came along with their tax reform package, which the Reagan administration did not pick up on at first. I did some work for Gephart but more for Bradley, at their request, on the capital gains issue. Bradley's view was that if you reduced taxes generally and wiped out all the tax subsidies, we'd have a better tax system. He had asked CRS to do some work on a list of things and I was the one who did the work on capital gains. I wrote a very extensive paper for him as well as for Rostenkowski on the capital gains issue, which was used, apparently, quite extensively by them.

Hall: We have a copy of that in our files, shouldn't we?
Wolf: You may not. I don't think you have one. I can provide one to you. May 10, 1982 memo to Senator Bill Bradley enclosed.

Hall: I think we ought to have one to go with the interview.

Wolf: Yeah. I can provide that to you. I have some at home ... [laughter]. I sort of saved some of my papers.

Hall: Oh, that's good.

Wolf: And then there were a lot of subsequent discussions, particularly with Ava Feiner and Gina Despres on Bradley's staff, who was handling (and still handles) his tax stuff. At any rate, the tax bill was dead centered for while and then it moved back and forth. Finally the logjam was broken and to everybody's surprise Packwood, who then chaired the finance committee, backed off on capital gains and gave in to Bradley. But they retained the 1980 investment tax credit and the industry was just, as I understand it, very miffed at Packwood on his giving away their tax benefit.

But there were a lot of ox that were gored when the '86 Bill was passed, and you are correct. Now we're back in 1989 with the president saying, "We need to restore capital gains." Ed Jenkins in the House (who's from Georgia) put together a group and got a lot of people saying, "We're going to provide it for timber," all over again.

Now the 1986 revision did take capital gains away from the small landowner also. It wiped out the whole provision. But what Jenkins omits pointing out is that the 1980 law is still
on the books, and so they can get the reforestation investment tax credit. There's a valid, substantial difference of opinion among people over whether we should give tax subsidies to people under certain circumstances. The problem that I've always seen, personally, with timber capital gains is that some foresters have argued that the benefit helps forestry, but there's nothing in the law that requires that you use the capital gain to promote better forest management. You can spend the money on anything you please.

Bolle: I've seen no proof that it's happened, and, in fact, it seems to me that the biggest abuse was in the buying of the Forest Service here at least, the buying of national forest timber and being able to gain on that value of timber was increased. Do you have any examples of that?

Wolf: Oh, yeah. I told you about the one in 1953 in that GAO report, the Kaibab Lumber Company, but the IRS records are generally not available to the public. But there are thousands of them. In fact, I never was able to retain the data, but Dr. Woodworth had data in 1960 showing companies, in fact some of it is highlighted in 1961 hearings on tax reform, but he had the absolute data, company by company, showing that there were some companies that paid no tax because they got so much capital gains on their timber. With a good tax accountant you can massage your account so that you lose money on selling lumber and make it on cutting timber. [chuckle] But, for instance, I recall Georgia Pacific and Weyerhaeuser were in that category, that they were claiming all their tax benefits from capital gains and reducing their taxes tremendously in the process. There were others who paid no tax at all because of their capital gains on timber. Weyerhaeuser would have done it on wholly owned timber. They didn't buy that much federal timber. But there were other companies that depended solely on federal
timber, who I recall being in that list, who showed appreciable capital gains. The only way they could have gotten it was on federal timber contracts. So if the argument is that the capital gains should go to the company, or to the landowner, to help him improve his forest management, then they should be tied to a requirement that they do so, not that it be an open-ended type of thing. That's where the foresters, as they argue this capital gains thing, make no impression upon tax experts who know the realities of the tax law.

Now it may appeal to a member of Congress who either wants to ignore it or doesn't know it, who believes something that he's told because he thinks somebody's telling him the truth. Any tax expert will tell you that it doesn't matter what the capital gains area is, there is no requirement that you use your benefit for some specific purpose. In fact, there's a very good argument the tax people make against using the tax law to achieve social purposes or economic purposes.

Bolle: I think it's a very good argument because it seems we do this, and then never test to see if it works.

Wolf: Yes.

Bolle: It stays an idea. And I think in this case, I don't see where it has any benefit at all.

Wolf: Yes, but once I tell you that if you do certain things, I'm going to reduce your taxes and you have to spend your money on something, it may turn out that I'm forcing you to spend your money on something that's totally uneconomic. And now we don't change the tax law and you're
still putting your money into building widgets for which there's no market.

Questioner: All the experiments I've seen or trials and tests using taxes like that to improve forestry just haven't worked.

Wolf: In any event, that in essence is my involvement in the capital gains thing. The other thing I would mention, though, is there's another program called FIP, the Forest Incentive Program, which is a subsidy program in which landowners get a grant of money and they participate either with money or in kind and they plant trees on their land. That was enacted, as I recall, in 1972. When the Department of Agriculture issued its regulations for the operation of the program, at the behest of the timber industry which raised un-shirted hell about it, they said that FIP money could only go to landowners who could prove that their land could grow in excess of 50 cubic feet of wood per acre per year.

I've always thought it was rather interesting that the timber industry [wanted] a tax subsidy to go to landowners who had to grow over 50 cubic feet of wood per acre per year but doesn't give a darn about the Forest Service selling timber from land that will grow only 20 cubic feet of wood per acre per year.

Bolle: That's interesting. There were people advocating that the Forest Service go to 50.

Wolf: Yes.

Bolle: That was closer to the break-even point.
Wolf: Well, I argued that, based on the industry position, that *P

Bolle: I think that industry ought to support that.

Wolf: Well, oddly, they don't. They don't. But this whole interlocking area of capital gains is just one part of tax subsidies for forestry. It's the same as other arguments of tax subsidies of various sorts for natural resources or other issues. But this is the way in which the timber one works, and while you certainly could get someone who might dispute it, the facts are that the capital gains tax subsidy, as it existed prior to the 1986 law, was something that everybody could get who handled the timber contract from the landowner on to the second buyer, and therefore it was widely abused.

There isn't any tax subsidy that exists that people are going to pass up. They weren't doing anything unlawful using it. It was a bad public policy that had been written. Another group, though, that had a significant impact on the '86 reform, was a group called Citizens for Tax Justice, which was a labor-financed group in Washington, D.C. The staff director is a fellow by the name of Robert McIntyre and his analyses of companies that didn't pay taxes, which included several major timber companies, was another significant factor in helping Bradley convince Packwood that the timber industry didn't need this tax subsidy. Citizens for Tax Justice's publication (I've got a copy with me; I think it's over at the motel.) listed, for those years prior to '85, companies that paid no taxes for one year, two years, three years, four years, five years and several of the major timber companies were in that listing.
Bolle: Some regard it as a measure of success.

Wolf: Oh, yeah. Yes. All of us would like to avoid paying taxes. [laughter] That's why we have a national debt of the size we have. We've spent more than we've collected. Now it's $3.2 trillion. Does that cover the tax subject, Arnie?

Bolle: I think so.

Wolf: Do you have any taxing questions?

Hall: No, I don't. That about covered it.

[End tape]