EXECUTIVE SESSION

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WEDNESDAY, SEPTEMBER 27, 1978

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United States Senate,

Committee on Finance,

Washington, D.C.

The Committee met, pursuant to recess, at 10:20 a.m. in room 2221, Dirksen Senate Office Building, Hon. Russell B. Long (Chairman of the Committee) presiding.

Present: Senators Long, Talmadge, Byrd, Nelson, Gravel, Bentsen, Haskell, Matsunaga, Moynihan, Curtis, Hansen. Dole, Packwood, Roth, Laxalt and Danforth.

The Chairman. The first order of business, Mr. Stern, you had better explain to us about this allocation of outlays under the Second Concurrent Budget Resolution, would you please? Does everybody have a copy of this sheet here?

Mr. Stern. We are distributing right now, Mr. Chairman, a sheet that has an explanation on one side and a table on the other. If you look at the table, the Budget Act requires that, after each passage of a Budget Resolution, each Committee must allocate the amount that it has under existing and new legislation by certain broad categories.

The Chairman. I was just informed that the Secretary will have to leave shortly to attend a meeting of the International

Monetary Fund. I think I have better call on him.

Mr. Stern, we will come back to that.

I would like to ask the Secretary to explain how this bill is looking at this point, from the Treasury point of view, because the Secretary obviously is concerned about the fiscal impact of the bill, both the first year, current year, and future years.

So if you would not mind explaining, Mr. Secretary, what the problems are, as far as Treasury is concerned.

Secretary Blumenthal. Thank you very much, Mr. Chairman and members of the Committee. I appreciate this opportunity to show, although my colleagues have shown in detail how we feel, but I did want to say, make a statement.

First, on the overall size, I know you want to get the total revenue impact of this bill within the confines of the Budget Resolution for fiscal 1979. I am sure that you will accomplish that.

From the point of view of the Administration, the impact on the fiscal years '80 and '81 is equally important. What we would like to avoid is a situation in which the bill is structured in such a way that you fit in with the '79 budget -- for example, even in calendar '79, in the last quarter of the calendar year, you have a substantial impact on increasing revenue loss which impacts fiscal '80 and, even more in '79.

As we look at what you already seem to have decided, it would appear that that is, in fact, in danger of happening.

For fiscal '80, for example, even after allowing some reduced capital gains realization flow-back, we see at the moment that, whereas you are all over fiscal '79 by $1.7 billion, it jumps to $5 billion over the amount that we would like to see by 1980 and $6 billion by '81. That is essentially because of two factors.

One, the very liberal capital gains tax reductions that you have. They begin to show up; and the ADR, the change that you have made, the increase from 20 to 50 percent, I believe it is that you have made, that also mounts up very heavily to give you the amount of the ADR load. That is only $231 million revenue loss in 1979, but for 1981, $1.7 billion.

If you would take the 70 percent capital gains tax exclusion which I will comment on separately before counting, reduces that to $328 million in '79, over $3 billion in '80.

May I summarize at this point -- the out years as well as '79 will weigh heavily on the President's mind as he ponders this bill because he is committed to try to get that budget deficit down as much as possible.

The Chairman. That $3 billion estimate that you are mentioning for future years in capital gains, is that a static estimate?

Secretary Blumenthal. That is static. As I indicated, without the induced effects, and we have done, as we said we would, a careful analysis to see what kind of induced effects we think are appropriate and roughly, I think, we have come up and Mr. Sunley can explain that in detail, with an estimate that indicates that roughly one-third of the induced effects may be deducted from that. When we talk about $3 billion, it may turn out to be $2 billion.

In any case, the proportions of $200 or $300 million in '79 jumping to $3 billion the following year shows you, I think, the direction in which things are moving in the out years.

The Chairman. You might give us your reaction, too, in regard to the indexing item. We are going to be talking about that further, I think.

Secretary Blumenthal. That is one of the items I had on my agenda to mention.

I very clearly indicated my extreme concern with indexing of capital gains taxes in the testimony which I gave before the full Committee, and I want to emphasize that very strongly. I would really not be in a position to recommend to the President accepting a bill that has indexing for one kind of tax in it, or the capital gains tax in it.

Senator Roth. Would you support it for everything?

Secretary Blumenthal. No.

Let me be very clear on this. We are strongly opposed to all kinds of indexing because it introduces -- it just makes getting rid of inflation that much more difficult. It builds inflation into the structure of our economy, and we have a tough enough time as it is with inflation.

Senator Hansen. This is not to be taken as an admission that you do not think you can handle inflation?

Secretary Blumenthal. Not at all. To the contrary, it is an admission that we would be able to handle inflation less well if you had indexing in the tax system.

On top of that, if you index for one particular type of income, namely for capital gains, you are discrimination against everyone else. You have everything in that direction. It has impossible administrative problems attached to it.

It is, for this reasons, that we are very strongly opposed. I would have to say the President could not accept a bill like that.

Senator Roth. If you are against indexing, are you against cost of living increases such as that agreed in the case of the Postal Workers?

Secretary Blumenthal. Well, nothing is fully logical, Senator. I personally think --

Senator Moynihan. Or Congressional salaries.

Secretary Blumenthal. That is right.

I am against this kind of indexing everywhere. It exists in some places. When it comes to pay for certain people, it has become a part of the scene and I regret that, because it makes inflation fighting that much more difficult. But I certainly do not want to see it extended into the tax system, and the Administration has not indicating it opposes the indexing of the cost of living increase adjustment in either private or public pay. That has not been the position.

Senator Roth. You could make the same economic arguments, could you not?

Secretary Blumenthal. You could.

That is why I say nothing is fully logical, I am afraid, but I certainly strongly oppose extending that to the tax system as a major new step. This has been around for awhile. We would not want to extend it to the tax system.

Might I say, that is on indexing. I want to say a word on capital gains and the minimum tax, Mr. Chairman. I would have to reiterate a point that has been made publicly for some time by the Administration and by me, which is expansion of capital gains tax cuts. That is a deepening of the preference for capital gains tax income, as far as taxation is concerned, over what is presently applicable.

It depends very much on how it is done and I would have to say, in that regard, a 70 percent exclusion factor, in my judgment, would not be acceptable. I certainly could not recommend that to the President. I think it would be very difficult for him to accept.

It would mean that, in fact, the maximum tax rate for capital gains tax income for a taxpayer in the 70 percent bracket would be 21 percent, and I do not think that that would be acceptable.

Senator Nelson. Mr. Secretary, may I ask a question? What is the ballpark figure that might be aggreeable? 28 or 30 percent maximum?

Secretary Blumenthal. I really am not in a position to say what is acceptable. I was trying to indicate to you that 70 percent would not be. I think it depends on, really, a package on the rest of the bill as well, Senator Nelson. For example, it depends on what kind of minimum you agree on.

Senator Nelson. Let us assume a minimum tax that would be acceptable to the Administration and a capital gains tax which had a maximum tax in the 28 to 30 percent area?

I realize you have to look at the whole area, and all kinds of things might make it full, but I am trying to make up my own mind, what kind of maximum with an acceptable minimum tax the Administration would find acceptable.

Secretary Blumenthal. I would say, Senator Nelson, that there has been a lot of talk about what was attempted in the Kennedy tax cut. At that time, there was an effort to reduce the capital gains tax rate and there was added to it, as a part of that package -- which did not pass -- capital gains at death.

If you have the kind of 28 to 30 percent that you are talking about on capital gains, then you had a minimum that the Administration found acceptable and you had capital gains at death, maybe that would be a package that the President might accept.

As I understand it -- and it gives me an opportunity to make that point -- not only is there no disposition on the part of the

Committee to go in the direction of capital gains at death, there even appears to be a very strong disposition to postpone, if not reverse, the carryover basis provisions that are presently in the law without any effort to clean up the problems that have arisen with regard to that.

Now, reversing, of course, on that part of the Code, at the same time, in which you make a substantial reduction in capital gains taxes, is unlikely to be something that the President is going to have an easy time to accept.

Senator Hansen. Mr. Secretary, if I may make an observation, as I recall one of the studies -- I do not recall whether it was Milton Feldstein's, or whose -- showed that actual capital gains that were reported on which taxes were paid were about $4.1 billion. If they were to discount, if what inflation had done was to be considered, and the so-called gains discounted by inflation, instead of $4.1 billion gains, it would have been a $1.1 billion loss. Keeping in mind also that the average asset is held about 7.9 years, it seems difficult for me to be persuaded by the arguments you have made that we ought not to have this 70 percent exclusion.

As I recall, when President Kennedy made his proposal, he did not speak about a minimum tax, and that has been added to the legislation, and of course, as a part of it now, while we recommend doing away with the add-on tax, there will be an alternate tax which I think certainly counters the point that we ought to have capital gains -- or that we ought not to postpone the implementation of the tax that Senator Byrd sponsored.

Secretary Blumenthal. As I understand it, Senator Hansen, in the Kennedy proposals there were a number of other things, such as the elimination of the capital gains for real estate, timber, and so forth -- making all of those ordinary income, which made it different. The Feldstein study, I believe, showed that they were real gains, even after allowing for inflation in the upper brackets for income.

Senator Hansen. I am talking about total. Am I in error on the figures?

Mr. Sunley. The Feldstein capital gains study on inflation, what he indicated was that we have about $4 billion -- I may not remember the numbers exactly, Senator Hansen-- $4 billion in capital gains reported on income tax returns from corporate stock. That is after the 50 percent exclusion.

He said that, if you, in addition to the 50 percent exclusion that we offset any inflationary gain, then the nominal gain that is included in the tax return would be turned into a loss; and therefore, instead of raising some revenue from the capital gains tax, we would lose revenue.

He also reported in that paper, however, that if instead we had an exclusion for the inflationary element of capital gains and did not tax the real gain with an additional 50 percent exclusion, then that would raise an additional $1 billion in revenue for Treasury.

We have to be very careful whether we are talking about an inflation adjustment in addition to the 50 percent exclusion, or an inflation adjustment instead of the 50 percent exclusion. In fact, there were real gains realized that year.

Senator Hansen. Only to the extent of $1 billion, am I right?

Mr. Sunley. $1 billion if you have both an exclusion and an inflation adjustment. If, in fact, we had just an inflation adjustment that year, the total amount of capital gains subject to tax would have been greater than what you had under the 50 percent exclusion.

The amount of tax raised, I believe-- the number, in his abstract, the one that has been picked up by the press and we have seen always quoted is that having an inflation adjustment in addition to the 50 percent exclusion would reduce Federal taxes by $500 million. However, if we only had an inflation adjustment, and since we have made an adjustment for inflation we ought to tax the real gains, since that is one of the justifications that is often made for the exclusions, then, in fact, we would have had $1 billion more in Federal tax revenue.

I refer you to table 4, if you have a copy of his piece.

Senator Hansen. It seems to me that there are many factors worthy of consideration. All I can say is, as far as I am concerned, I think we have come up with a pretty workable, sensible provision. As you suggest, you would recognize the one-third feedback. If the static loss were $3 billion, you say -- if I understand you, Mr. Secretary -- that you would not anticipate more than two-thirds of that amount; I mean, you could discount that by one-third.

Secretary Blumenthal. The maximum that you can come up with.

Senator Hansen. I have no further questions, Mr. Chairman.

Senator Danforth. Have you stated the Administration's position on the alternative minimum tax?

Secretary Blumenthal. Not in detail, but I will be glad to state it.

As we see the minimum tax, as the Committee has been favoring it, it does, indeed, increase the amount of tax for those individuals who show all the regular income and have very high capital gains. It does, at the same time, however, increase the opportunity to shelter income from taxes.

For those many individuals who have substantial income, other income, and then preference income other than capital gains -- that is, from accelerated depreciation or from depletion, or what have you. So that you are really providing increased opportunities for sheltering by virtue of that change as it is drafted at the moment.

We would prefer, in order to have a realistic minimum, to have an alternative minimum for the capital gains portion as you have it, but to leave the rest as it has been in the House bill which is you have the add-on rather than the alternative. By virtue of the fact that you have a maximum tax rate of 25 percent, you achieve that result, and since you want to keep the 25 percent, I would suggest that the best way to fix it up is to have the true alternative minimum for capital gains income, but leave it as it is in the House bill for the other kind of preferences.

Senator Roth. According to the Secretary, according to the figures given to us by the Joint Committee, practically every working American faces a substantial tax increase both in the years 1978, 1979. For example, in the case of the individual-- a family of four who has an income of $15,000, the tax increase, between Social Security and inflation, would be $92. In 1979, it would be $74.

In the case of a family of four who has an income of $17,500, the tax increase due to Social Security and inflation would be $79 in '78 and $99 in '79.

In the case of a family with $20,000 income, $203 during the current year; $179 during 1979.

What is going to come out of this Committee, it appears to me -- and I am pretty certain that is right -- is that there is going to be an effort made to offset the Social Security and inflation increases for 1979 only. This is a very important point -- one year only. So that, in effect, what this Committee is saying to much of working America, the $15,000 and $20,000 and the $30,000, is that you are going to have to absorb the tax increases of 1978.

My question to you, is that satisfactory to the Administration, that these working people absorb that increase?

Secretary Blumenthal. No, it is not in the sense that if you could achieve a better distribution of the tax cuts, individual tax cuts so that you put more of the revenue that you have available for the taxpayers between $15,000 and $50,000. We would prefer that.

I think one way of doing that is to pursue the thought that I had expressed, is that the capital gains 70 percent exclusion may be too rich, going too far. That would provide you with some revenues.

There are other things that you have voted on that really benefit certain special groups that you might want to reconsider and put into this particular category. We would certainly like to see that approved.

Senator Roth. Mr. Secretary, I think really to offset it, as I understand it, it is the position of the Chairman and a number of others -- I am not arguing at the moment for the 70 percent specifically -- there is a feeling that the capital gains, as far as revenue, there is an argument as to how much that is going to cost the government.

So that, while there might be some savings, it certainly would not be substantial enough to offset the increased costs for 1978.

The thing that puzzles me, there is really only one way of doing it that I am aware of, and that is to make the commitment now for a two-year cut for the working people. If you are really going to offset that 1978, I do not think you can make that much savings by doing away with some of the changes talking about.

Would you, under any circumstances, support our making a commitment now, this Congress, to a two-year cut that would offset both these years so that middle America will not be facing a major increase?

Secretary Blumenthal. I think the responsible way to deal with future tax cuts, either for individuals or for businesses, is to match these against cuts in expenditure or cuts in savings in other areas for tax revenues involved, rather than to make a commitment now to do something in the future without having faced up to the implications of it elsewhere.

We would not be in favor of it.

Senator Roth. I do not want to extend the debate, Mr. Chairman, but I just want to make one comment.

By waiting until next year, what we are really going to be talking about next year is 1980 and there will be an additional tax increase that year. No question about it, everybody agrees, and it is very substantial, because of the increase in Social Security, inflation, whatever that may be.

I think your own Administration would agree to at least 7 percent. I think the point that has to be underscored is if we do not do something now for all practical effects, we are saying that the 1978 tax increases due to Social Security, due to inflation, is going to be absorbed by those making probably $12,000 or higher, that there are some very substantial tax increases that this Committee is not doing anything about as far as the current year is concerned.

Thank you, Mr. Chairman.

Senator Byrd. Mr. Chairman?

The Chairman. Senator Byrd.

Senator Byrd. Mr. Secretary, with your great background, not only in Treasury but in the private sector, what do you think should be the effective date for whatever capital gains legislation this Committee may enact, if the Committee tentatively decided on November 1, with the thinking that if it were delayed until January that there would not be much activity in the market for those two months,

An individual for whom I have a very high regard and who has been proved right in regard to the market a great deal of the time in the past says that if we do that out of the declining market, make it effect November 1 on a declining market, that it would tend to substantially depress the market.

I do not have enough knowledge of the market to know whether that is correct or incorrect. I am wondering what your view is?

Secretary Blumenthal. Well, I think, Senator Byrd, that it hinges heavily on what kind of capital gains tax cut the Congress votes, and which is enacted. We do not favor going as far as this Committee seems to be heading. If there is a big difference, then I think whether it is November 1 or January 1 makes no difference because you are going to effect the market for that period of time, with people either holding back or going forward.

If you do not have that difference --

The Chairman. Would you suspend for one moment? There is a roll call vote going on in the Senate, and I would think that maybe some of the Senators would want to start right now and head over there to vote and come right back, as rapidly as you can.

I will wait for the five bells myself, but we can work in rotation, if some will leave right now.

Go ahead, Mr. Secretary.

Secretary Blumemthal. If the difference is between what is now in effect and what is in the House bill, it is relatively inconsequential. Then what would be the case after this law is enacted, it would not make much difference. But if it is large, obviously it would be a problem.

Senator Byrd. Do you mean if the House proposal were accepted it would not make too much difference?

Secretary Blumenthal. I do not think so.

Senator Byrd. If the Senate proposal were accepted, you feel that it would or would not?

Secretary Blumenthal. I think then, if you look at individual transactions and they impact on the market, clearly you would want to go November. If you think they make an impact on the market, there is an argument about how much individual capital gains transactions really do affect the market over a short period of time, but if you feel they do, if that is your judgment, if the experts feel that, obviously you would want to go to the November 1 date, in order not to have a bad situation for two months.

Senator Byrd. But to balance out the bad situation for two months, are you running a risk of substantially depressing the market?

Secretary Blumenthal. I really do not think that there would be enough transactions to depress the market over the remaining three and a half years thereafter. I do not really think -- the market is too big for that. I do not really think it would have that kind of impact.

Senator Byrd. Thank you.

Senator Danforth. Mr. Secretary, it sounds to me that we are heading for a veto on the theory -- it would seem to me that the best that could be said of the bill in its present form is that it is a substantial reduction of capital gains taxes, yet this is exactly what bothers the Administration, and I am wondering if maybe we would do a service just by killing the bill right now, not reporting it out, with the theory that maybe we could come back and work something out so that next year we could have a better bill.

I was wondering, first, is the Administration considering, in any event, a new tax bill at the beginning of next year and, if so, do you feel that -- you know some of our interests on this side. With respect to maybe at least a couple of years -- you do not want indexing, but some sort of 6 percent bracket expansion for more than one year and something with respect to corporate rates beyond what the House did, and we know your concerns about capital gains and the minimum tax and the cost.

If we just saved the revenue this year and came back another year, how would that strike you?

Secretary Blumenthal. I think the economy would really be in some difficulty. The Administration wants a tax bill it can accept. That is the first preference, clearly the first preference. But the Administration does not feel that it must accept any bill just to have a bill. That is the second fundamental point.

We have been very much impressed and, in fact, I have consistently used that argument in our discussions in the Administration that the business community and the investors, apart from individuals hit by inflation, the business community and investors need an early indication of direction and early relief from taxation incentives.

The corporate rate coming down, investment tax credits, and whatever you do on capital gains, that those are positive factors for the economy and the business community, investment community, is waiting for those. To have those go by the board and start over next year would not be a good thing, in our judgment. We would much prefer to have a positive bill.

The course of the economy now, as far as we can judge it, is an acceptable one with a rate of growth at 3.5 percent in real terms, which will allow us to impact inflation. If we do not have a tax bill -- you know, it all depends.

If you could act in a month, it would not make much difference, but if you take six or nine months you may get increasing rates of unemployment.

Senator Danforth. Would it not be traumatic to pass a tax bill that we do not like much anyhow and the President would veto? It would be better to start from scratch next year, would it not?

Secretary Blumenthal. If you think you could come up with a better bill. I am not sure you can come up with a better bill, the way you have defined the problem.

Clearly it is traumatic -- you pass a bill you do not like, the President vetoes it, that is a traumatic experience. I am here to try to avoid that.

The Chairman. Mr. Secretary, we have to go and vote. Since you have to attend the International Monetary Fund, this would be a good chance for you to slip out of here.

Secretary Blumenthal. I appreciate the opportunity.

The Chairman. Thank you very much.

We will be back as soon as we vote.

(A brief recess was taken.)

The Chairman. Gentlemen, let me just discuss a little bit the fiscal squeeze problem that we are in and try to move us a little bit towards resolving that before we talk about any further amendments, some of which are expected to cost some money.

There is a real big item of trying to squeeze this bill inside the budget that has to do with the capital gains item. I am not talking now about the capital gains in future years. I am talking about capital gains from what we are looking at in the first fiscal year. And we need -- Treasury is willing, and they have been willing as the Secretary indicated, to put about one-third feedback in there, and that helps. But, even so, we are putting in about 1.4 in that first fiscal year on the item of the $400 million, even though on the housing and minimum tax and the capital gains generally.

It would help us to stay within the budget restraints if we stayed with the old minimum tax while we changed the capital gains tax to where it would be on the 30 percent rather than on 50 percent of the gains during the last two months of this year.

If we leave the old minimum tax the way it is for the remainder of this year, that would tend to work out this way, that the small number of people who tend to be the heavy hitters, who make the big transactions would find, for purposes of the minimum tax, they would probably be in better shape to make that transaction before the 1st of January rather than after the 1st of January.

It is a fine point, but that is how it would tend to fall. Then, with regard to those that would pay less minimum tax during January under the new minimum tax that we would put in effect, they would stay -- it would be more to their advantage to make their transaction after January.

So what it would mean is that there would be an incentive for capital gains and more incentive on those, the big people who have a lot of tax shelter than it would those who do not have so many tax shelters. And really, I think, in terms of simplification in comparison to confusion, while we would break the capital gains in November, it would add a lot of difficult confusion to have a minimum tax read one way up to November and another way the last few months of the year.

It would help with the budget and that is an important point. Also, for purposes for certainty and avoiding confusion, it would leave the old minimum tax in effect until January 1.

I would hope that we could agree on that, that the capital gains tax rate changes as of November 1. The minimum tax, the new minimum, would go in effect. The capital gains tax would change November 1. The new minimum tax would go into effect January 1.

Senator Curtis. I want to ask a question about this. Does that mean that we would leave in the $100,000 lifetime exemption for the sale of a house?

The Chairman. That is a separate item.

Senator Curtis. I am for taking that out.

Mr. Shapiro. What you could do is take that out of the minimum tax. It is a very small item in the minimum tax.

Senator Curtis. I am opposed to the provision. It is highly discriminatory.

The Chairman. I suggest we take the housing thing separately. I think we could reach a decision on that separately. That is a big item. It ought to be handled separately.

The first thing is the effective date of the new minimum tax. I would urge that there be a January effective date on the minimum tax. It would help with budget problems.

It also helps in terms of taxpayer certainty as to what the law is. It is one thing to change your capital gains taxes in November. If you have one minimum tax you have to comply with for ten months and another for two months, it will add confusion.

Senator Bentsen. Do I understand that the minimum tax would then apply to the excluded part of the capital gains from November 1st to December 31st?

The Chairman. That is right.

Senator Hansen. That is an add-on tax now, that would stay in effect -- excuse me, I did not mean to interrupt you.

Senator Bentsen. So that, on that basis, if we accepted the House 50 percent exclusion, there would be no change; but if we took ours of a 70 percent exclusion, there would be some cut in the capital gains tax. Some.

Senator Curtis. Would the staff state what is involved here briefly?

Mr. Shapiro. What you have right now in present law is the minimum tax that applies in 1978. That is an add-on tax. Under the House bill, they made their capital gains changes and the minimum tax changes effective January 1.

The Finance Committee has already agreed to provide a 70 percent exclusion effective November 1.

Senator Curtis. What?

Mr. Shapiro. The new 70 percent exclusion will be January 1, where the House is November 1. Then there is a question of your minimum tax. You have agreed to an alternative minimum tax. The House has an add-on plus an alternative minimum tax, effective January 1.

If you were to provide the alternative tax beginning November 1, you would have an add-on tax for the first ten months and then an add-on for the next two. That would add complexity. The question is, what do you do with the minimum tax?

There are a number of alternatives that can be considered. The one Senator Long is suggesting is the simplest, which would meet the Budget Resolution problems, which is to continue the present minimum tax this year, which would have the effect of having your 70 percent exclusion go into effect November 1; the excluded capital gains would go into the minimum tax for this year.

Senator Curtis. In other words, the tax relief relative to capital gains would go into effect November 1st?

Mr. Shapiro. That is correct.

Senator Curtis. But when they carry over the capital gains consequence into the minimum tax for the transactions of November-December, they would be under the existing minimum tax?

Mr. Shapiro. They would get a break on the capital gains and then the same situation would apply to the extent of the minimum tax application.

Senator Curtis. What was the effective date in the House action for capital gains?

Mr. Shapiro. January 1.

Senator Curtis. Which year?

Mr. Shapiro. 1979.

Senator Curtis. They were going to stop all transactions between now and January?

Mr. Shapiro. It would have the effect of stopping certain transactions.

The Chairman. It seems to me that the arguments are in favor of the minimum tax, changing it to January 1. Let me explain why. One, it helps with the budget. That is my point. That is an important item.

Number two, it is easier for the taxpayer to comply with. There is going to be horrible confusion if he has to work with two different minimum taxes in the same tax year, one of which is an add-on tax and the other is an alternative tax.

Three, it is simpler to administer for the same reason.

Four, in this case, the taxpayer gets a choice, in effect. If he wants to come under the new minimum tax, he can wait until January 1 to make his contract effective. If he is satisfied he comes under the old minimum tax, then he can make his contracts effective before January 1.

So, from the taxpayer point of view, he gets his choice by simply delaying a couple of months. But it is easier to administer, easier to comply with, and helps with the budget. If you have all of that going for you, why should we not do it that way?

Senator Roth. How much do you save, Mr. Chairman?

Mr. Shapiro. Approximately $200 million.

The Chairman. You have all of that going for you, gentlemen. It makes room for someone else's amendment on the bill.

Senator Bentsen. What it means, Mr. Chairman, as I run over these numbers, let us say we had a compromise with the House.

Instead of a 70 percent exclusion or a 50 percent as they have it, we went to a 60 percent exclusion. That would mean that you would have a 28 percent maximum tax in the 70 percent tax bracket. That would mean the other 60 percent would be subjected to the 15 percent preference tax.

That gets you to 32.2. Is that right?

Mr. Shapiro. You would also have a deduction for one-half the regular taxes.

Senator Bentsen. That is true.

The Chairman. All in favor, say aye.

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it.

Senator Curtis. While we are talking about the minimum tax, what have we done on corporation minimum tax?

Mr. Shapiro. On the corporation minimum tax, you have not made a decision on that as yet.

Senator Curtis. What did the House do?

Mr. Shapiro. The House took capital gains out of the corporation tax.

Senator Curtis. Took it out completely?

Mr. Shapiro. Did the same thing for corporations that they did for individuals.

Senator Curtis. They did not repeal it?

Mr. Shapiro. They took capital gains out as a preference item for purposes of the minimum tax.

Senator Curtis. My question is, what did they do about minimum tax on corporations?

Mr. Shapiro. They left the existing minimum tax in the law, but took the capital gains preference out as a preference item. Capital gains would not be included in the minimum tax.

Senator Curtis. Was there still an add-on tax on corporations?

Mr. Shapiro. Let me point out that the purpose of an add-on tax for corporations does not have the same significance that it does for individuals, because corporations, the tax structure is generally flatter and in the corporate tax rates, you have a flat rate which, in present law, is 30 percent and what you agree to is 28 percent.

Let me point out that there is a full offset, whereas in individuals, you deduct one-half of the taxes paid, in the case of corporations,you deduct 100 percent of the taxes paid in the minimum tax.

Senator Curtis. I did not want it to be something that we just neglected to take off. The staff is recommending that we follow the House language on the minimum tax for corporations?

Mr. Shapiro. At the appropriate time, we have a list of items that are in the House bill that a decision has not been made on yet to see whether or not the Committee wants to put it in the bill.

Senator Curtis. All right.

The Chairman. One other item, since the Senator mentioned it.

This $100,000 exclusion is a big budget item, is it not?

Mr. Shapiro. Yes, it is. Approximately $745 million on the calendar year and approximately $289 on the fiscal year.

Senator Curtis. Severance pay for a Congressman?

The Chairman. Here is what concerns me about the $100,000 exclusion. This Committee, in my judgment, has done a magnificent job in moving to see that all taxpayers pay a tax. If they make substantial income, they pay something.

The way I read the Treasury's study, the 22 people that paid no income tax owed no income tax. If you take a look at why they did not pay it, they did not owe us anything, and I think Treasury pretty well agrees with that.

After you reach the figure, adjusted gross income, there were deductions, such as casualty losses and state and local taxes that made a difference.

I am concerned that if we go along with what the House has done here, this one-time thing on houses, that we are going to be in a position that someone -- and it could be a public interest group, it might be the Treasury, it could be anybody -- can do themselves a study and proceed to show that 10,000 people made $100,000 and paid no income tax, and then you start breaking it down to show how you get that. Most of them were people who sold a home. If people made a $100,000 profit on the sale of the house, not all of it is a very long-term capital gain. It may be a house that they have had for a couple of years. If they made $100,000 on the sale of a house, they ought to be able to pay us a modicum of taxes.

If you look at the formula by which we tax the sale of a house by an elderly person or an elderly couple, it is a pretty good deal -- in fact, a very good deal, the way it is now. The staff has been working up a suggestion we might consider to where in so far as they pay a tax on the sale of a house that it would be a small tax, it would not be a big tax. In terms of the amount of money concerned, it would be a far smaller tax than the ordinary capital gains.

I would like for staff just to show the Committee how they think that might be done and which I think would help control the revenue cost of it and it would also help with our score-keeping, to keep a lot of people from making $100,000 or more and paying zero income tax.

Senator Roth. May I make a couple of comments, Mr. Chairman?

Of course, any tax proposal that you have, including capital gains, there are going to be those who take advantage of it, but it does seem to me that the House-passed provision dealing with personal residences does give some real benefit to peopl otherwise are not sharing.

I have said time and again -- I have tried to voice my concern about the middle class -- that one of the main investments of the average American family is his house and what has happened, because of inflation, the cost of housing has gone up very substantially, but not in real value because the dollar is cheaper.

But yet we are taxing them for a paper profit that does not amount to anything. It seems to me we are short-sighted when we are making substantial gains that I support in the capital gains reduction, we have done a great deal on the low end of the economic scale, but the real one savings that many people make in their lifetime is in their house and the ability for them to sell that house as they grow older and are about to retire can have a very substantial benefit to them upon retirement when they live on a fixed income. I think we are very short-sighted to try to do away with that.

Number one, we are not talking about adding additional money, because this is already in the $18.3 billion. Is that not correct?

Mr. Shapiro. That is correct, Senator.

Senator Roth. What we are really doing is talking about budget money, subtracting it from what the House has already acted on, and I would like to point out who this program is going to support the most. 75.5 percent of the benefits of this provision will go to the $20,000 to $50,000 family; 83 percent will go to those earning less than $50,000. These are primarily the groups that, once again, are being milked by a tax cut because they are not being helped.

You know, I would be very happy to add a provision that this does not apply to members of Congress. I will support that, and I will offer that as an amendment, because I am not trying to give any tax break to the people here, but I am saying that we have a chance to do something for people who are about ready to go into retirement, the opportunity to sell their house without paying taxes on no real gains.

I strongly dissent from any attempts to try and modify it.

Senator Bentsen. Mr. Chairman, I would like to speak in strong support of what the Chairman is suggesting. In the blue book that I studied from the Treasury of those not paying taxes that had high incomes, the 22 that did not pay anything, as I recall it, most of them resided abroad and have a foreign tax credit and were in the 50 percent tax bracket. But that never appeared in the story.

Our deep concern is confidence in this tax system. If this provision that is now proposed by the House goes into law, I think you will see a story that comes out that greatly multiplies the number who have a substantial income, even if it is not in one year, and you will never get down to the explanation that these fellows made it selling their homes.

We have a provision in the law now that allows a credit up to $35,000, I believe, that gives them that kind of a credit, and that could possibly be raised some, and then some percentage of the gain beyond that paid in tax, we would avoid that kind of a situation that we saw cited in the blue book this year.

The Chairman. It all sounds so good. Let's talk about the biggest item which was referred to back at a time when we were talking about the first taxpayer -- we thought that was at a time when this man, up in Philadelphia, a member of the Drexel family, takes a vow of poverty to join that religious order and she gives everything she has to the Church. So some Congressman says, that is not right. That would all be taxed away. There should be an unlimited charitable deduction for a case like that. Then they give the deduction.

You move down the road a few years and Treasury says that 23 percent of those who made over $5 million paid zero, absolutely nothing, in taxes. How did they get that? That is because of the Philadelphia nun. That nun should not have to pay those taxes. It is not right.

It is not right. It is not fair. It is inequitable, cruel and brutal of government to tax one who gives all their property away to charity.

And so here comes -- and all of these millionaires who put their money in a foundation. They do not pay any tax, and we have to take the brunt that we are a bunch of special-interest guys.

I did not even know how it was done. I was not around here when it happened. I had not even heard of the lady.

But here we are, looking like a bunch of bad guys, out favoring the rich and taxing the eyeballs out of the middle-income people, favoring the rich people, while they pay nothing.

The first thing you know, we will get the same thing all over again.

There is a couple that sells their home and we are going to fix it up so he does not pay anything. The result is, here comes a study a few years later that will show that 20 percent of those who made over $100,000 paid zero, and then we start explaining -- well, let me explain that.

So you go around explaining that all over the countryside. Now, if they had a little something, let them pay a little something and you will not have to go around defending on that, and we will have enough influence, perhaps, to help somebody else.

Let's see how this suggestion that the staff has worked out -- incidentally, as far as we can save something, the whole idea is to try to get enough in here so that we can cut the rates in the middle brackets, broaden the brackets and cut the rates of the middle income. Let's see how the formula would work.

Mr. Shapiro. Let me point out first that this is a formula that presently is in existing law for those over 65, so for those over 65, they get an exclusion under present law.

The Chairman. not a one-time thing. They can do it any number of times?

Mr. Shapiro. They have to be over 65. The existing law is one time. What we are suggesting, if you would take this proposal, you would make this available as many times as an individual would like.

The Chairman. To all taxpayers.

Mr. Shapiro. Yes. You put as your numerator -- see the formula at the top of the board? -- the exclusion. Present law has a $35,000 exclusion for those over age 65. What the proposal is that was suggested by some Senators is to go to a $50,000 exclusion across the board, no age limitation.

You put that over your selling price and multiply that times your gain. That determines how much of your gain is excluded.

Senator Curtis. You exclude $50,000 of the selling price and not of the gain?

Mr. Shapiro. A formula based on your selling price, and that does not apply to your gain. For example, if you look at that example, look at the formula, any taxpayer who sells the house for a selling price of $50,000 or less, the entire amount of the gain is excluded. The only time that this formula would work to reduce the gain that would be excluded is if the selling price is over $50,000.

That means the larger the selling price, the less the gain that is excluded, because they have not made it as larger.

Senator Curtis. You are doing half of what the House did.

Mr. Shapiro. Half as far as the exclusion, but let me point out, that half does not have a revenue consequence. Under the House bill, the $100,000 exclusion is $745 million and if you take the House bill and substitute $50,000 for $100,000, the revenue cost is $714 million. In the neighborhood of a $30 million difference between the exclusions.

Even if you were to take the House bill with the $50,000 exclusion, you would not have a significant revenue difference over the House bill.

This would produce a difference. Those generally in the middle-income levels who sell houses in the lower ranges would get almost as much as in the House, but if their house sells at a larger price, they would get the lesser exclusion.

However, you have to combine that with your exclusion on your capital gains in addition to your exclusion on your residence to see the full effect. That is what that example is intending to do.

Following down the example, you purchase the house for $50,000 and you sold it for $150,000. Thereby, you have a gain of $100,000 and then you plug in the formula -- $50,000 numerator is what your exclusion would be. Your denominator would be $150,000. That is the selling price.

You multiply that by the gain, which is $100,000, and that means that one-third of the gain would be excluded under this formula, so $33,000 would be excluded.

You go right below that, the line there, and you see, you have a gain of $100,000. $33,000 exlcuded under your capital gain residence exclusion. That would be $67,000 would be subject to tax. And then again you would have your 70 percent capital gains exclusion which means that only 30 percent of the $67,000 would be subject to tax. Rounding that off, for simplicity we are saying that is approximately $20,000 that would be subject to income tax, taking into account --

Senator Packwood. You continue the rollover provision in current law?

Mr. Shapiro. That is correct. This would have no change in the rollover provision. The taxpayer can continue to rollover the House, if they chose. There would be an election, to take the rollover or this, and at some time in their lifetime they would always have the availability of taking this. And, in addition, instead of a once in a lifetime exclusion, this can be taken as many times as a taxpayer would choose to.

Senator Packwood. At the momen, the other person has a rollover anda $35,000 exclusion. Is that not right?

Mr. Shapiro. The $35,000 exclusion is only available to someone over age 65.

Senator Packwood. The elderly.

Mr. Shapiro. That choice is only available to someone over age 65.

Senator Packwood. I understand that. At the moment, they have both options. They can sell the house they bought for $50,000 for $150,000. They can buy now a house for $100,000 or $80,000 which is much smaller than what they had, that they had to pay that to get it. Then the can take their $35,000 exclusion in addition and pay the capital gain on only the additional $15,000?

Mr. Shapiro. That is right.

Senator Packwood. Would this formula make that person worse off, or better off?

Mr. Shapiro. It depends on how they do it.

The Chairman. He is better off than any of that?

Senator Packwood. I am not sure he is better off.

Mr. Shapiro. The present law, you only get it once in a lifetime. This you could get as many times as you lik, but you would not be able to take both under this, a rollover plus this.

Senator Packwood. Even if you are elderly you could not take both?

Senator Curtis. The $50,000, that is just a part of your formula.

Senator Packwood. The purchase price of the house.

Mr. Shapiro. I am told that it may not make that much of a difference from a revenue standpoint, and probably just to make that available both ways.

Senator Packwood. For the elderly?

Mr. Shapiro. Across the board.

Senator Packwood. I am thinking of the people who have sold the house that they have had for 30 years and they retire and move into a smaller house. This is the only asset they have. I would much rather do nothing in the law than raise that $35,000 to a $50,000 or a $100,000 exclusion for those over 65 and not tamper with the rest of the law.

Mr. Shapiro. That is a Committee decision. If the Committee wänted an exclusion for all taxpayers like the House bill had, this is a formula that ties into existing law, and has a way of providing equity across the board. If the Committee wants to look under age 65, they would have to make that decision.

Senator Packwood. It seems to be a wiser choice. I have not heard any complaints about the present $35,000 exemption for those over 65 and I have not heard any about a rollover as you are moving upward. It is only when you finally sell it for the last time and buy a smaller house that you are hit with this capital gains.

Senator Nelson. Even a worse case, when they do not buy another house but move to a retirement home.

Senator Packwood. That is the person I am concerned about, not the 35 year old who is going to buy a bigger house. If we could skew this, I would rather make sure that that person who only gets rid of their house at the end gets a bigger break than they have now.

Senator Curtis. I want to ask you about your formula, the very first line. Where did you get that $50,000? Is that a part of the formula, or a part of the transaction?

Mr. Shapiro. It is an item that is the Committee's decision, which you want the exclusion to be.

Senator Curtis. It is not the original purchase price of the house?

Mr. Shapiro. That $50,000 in the numerator is an exclusion that you are providing for the formula under present law. That is $35,000 for those over age 65.

Senator Curtis. In your example, when you have to take a $50,000 gain --

Mr. Shapiro. That just happened in that case, Senator.

Senator Curtis. Otherwise, the person who paid $10,000 for a house and sold it for $150,000 would pay a lot less tax than the person who paid $50,000.

Mr. Shapiro. No, Senator.

Senator Curtis. That is the way it is, but if that $50,000 is your purchase price, you say that is an arbitrary figure you put up.

Mr. Shapiro. An arbitrary figure.

Your example here, a $10,000 cost, a $150,000 selling price would affect the fraction only in that the $100,000 gain would be $140,000.

Senator Curtis. Here is one thing about these people over 65. Over 90 percent of them pay no tax because they do get the double exemption and all the other things and their earnings are down and they have some retirement income that is not taxable, and they get very hard on the minimum tax, because if it is an alternative tax and their regular tax is low, so I think that if we go to this, they ought to at least have the option of taking existing law.

The Chairman. We could exempt them from the minimum tax.

Senator Curtis. I am ready to buy this if you will tell me what constitutes a residence for a farmer.

Senator Matsunaga. Back to the formula. Why do we need to complicate the formula? Why can we not just say that you are entitled to $50,000 lifetime reduction and you can deduct from gross income up to $50,000 and that is it, from capital gains, rather than making a formula such as that?

Mr. Shapiro. It is a Committee decision. One of the disadvantages to the House bill is that it says you get a $100,000 exclusion once in a lifetime, which meant that if you had two or three homes, from a larger to a smaller one, you would have to make your choice.

Thereby, some Senators have indicated an interest in expanding the House bill as a cumulative $100,000, not once in a lifetime. That brings in administrative problems. That tax payer has to keep the record as accumulating that $100,000. This, you can take on every single transactions. It is less generous than an exclusion, cumulative.

Senator Matsunaga. Why could we not have it cumulative up to $100,000? If you, in one transaction, had a profit of $50,000, a capital gain of $50,000, you would still have $50,000 left. The next transaction, you have a capital gain of $25,000. You are allowed to deduct that much until you accumulate a $100,000 deduction.

Mr. Shapiro. You have to keep those records. Let me make an observation that the Committee can consider. You have the House bill in conference, which is $100,000. One of the concerns I sense that some of the Senators are looking at the formula and it appears to be a little complicated.

Actually, it is existing law and actually, just fill in the form.

If you are concerned about the budget, which is Senator Long's premise for giving this example, that you have a budget restraint, you could provide something of this sort in your Committee bill, take it to conference, which satisfies your budget restrictions with the Senate bill, and then you have, in conference, the scope between this and the House bill.

That means you have a lot of latitude tomake provisions, even with the elderly.

There is no suggestion of taking anything away from the elderly.

Senator Roth. Mr. Chairman, one of my principal concerns are the elderly, and it seems to me that what we are saying here is that, by broadening this formula to other people, we are really not helping the older people. We are just continuing, pretty much, what they already have.

What I think is important to recognize is that, for the average family, the most important lifetime investment they have is their house, and they are forced often to sell that house when they retire, either because they cannot afford it, or because the children are grown and they do not need it.

When they sell that house, they may make a large paper gain, as I pointed out. Take your illustration of a house that was $50,000 and they sold it for $150,000. While those figures are a little high -- but that could be due entirely to inflation. Is that not correct? If they have held it a long period of time?

Mr. Shapiro. That is correct, Senator.

Senator Roth. What I am saying, why should that senior citizen have to pay taxes because of inflation? It is hurting them the most.

As Gaylord says, they may want to move into an apartment. Many are trying to move in to senior homes that provide care for them for the remainder of their life, and I think what we want to do, the emphasis here should be to take care of the elderly, those who lose their incomes and retire. They are on a fixed income, if they have anything beyond Social Security. They have a chance to sell that house. The sale of that house gives them some opportunity to lead a decent life in their retirement years.

Instead, we are taxing them and we are taxing them heavily when they make no real gains.

So let me ask you this question: what if we limited the House version -- I do not particularly like that, but limit to to those 60 years or older, excluding members of Congress?

Mr. Shapiro. Senator, you have a broad range of alternatives. You can consider limiting the House bill. What you could also do is take the House bill, and maybe $50,000, $150,000 in this formula for those over 65. It depends whether, in conference, you make some modifications of this, or do nothing. You have a broad range of options you can do for conference.

One of the concerns that Senator Long was indicating was that you have a problem with the budget in getting the bill out of the Committee.

Senator Packwood. What are the revenue estimates if you limit it to those over 65? The House bill of $100,000. Change the present law from $35,000 to $100,000.

Mr. Shapiro. On a calendar year basis, you would pick up about $500 million. On a fiscal year basis, you pick up approximately $200 million.

Senator Packwood. That is if we just change the House bill to over 65. What if we just took present law and increased that $35,000 to $100,000? What do we pick up over the House bill?

The reason I say that, I have never heard in the ten years I have been giving speeches and answering questions of any complaint, other than it is not enough, but that anybody was having a loophole or getting unjustifiably wealthy under the present system.

Senator Nelson. I agree generally with what you say. There are a couple of problems. One of them is what do you do about a widow who is five or six years younger and now has to get rid of the house, but is not yet 65?

The next one is what do you do about those people who are, in fact, retired under agreements and contracts at age 62 and so forth, and then there is one additional one that occurs to me. What do you do about the person who becomes handicapped at age 60 and has to get out? There are some tough problems in there.

Senator Packwood. Let me get the revenue estimates on this.

Mr. Shapiro. You take the Housebill, $100,000, and apply it to only age 65?

Senator Packwood. I would keep the present rollover provisions, everything in present law, and I would just change it from $35,000 to $100,000. I would like to know what the revenue estimates are on that.

Mr. Shapiro. We have rough estimates now. It is in the neighborhood of $500 million.

Senator Packwood. That you would save with the House bill.

Mr. shapiro. Meaning the House bill is $725 million across the board. We assume that $500 million would go to those under age 65.

Senator Packwood. Following the theory that if something works, do not change it, that would be my preference. If you do not want to raise it to $100,000, raise it to $75,000, just in case that $35,000 figure -- make no change as far as present law is concerned with those under 65. Whether we get intc what Gaylord suggests about widows and handicapped and revenue estimates is another point. I do not see any point in changing a system which, by and large, has worked satisfactorily.

The Chairman. Let me say a word for what is up here, just a few points. I think that we ought to keep in mind that the law that we have now about houses, it makes the transaction favored compared to other taxable gains. You do not get the rollover on the capital gains. You just have to pay it.

You sell some stock, you sell your farm to buy another farm. You have to pay it. And so -- in the second place, you do not pay on all of the capital gain. You just pay on 50 percent. We ought to make it 30 percent, and the public goes along with the idea of that tax. The capital gains ought to be a favored transaction. This is favored over other capital gains to begin with. Look how we would further favor it if we talked about -- it would still be the most favored tax transaction of anyone who pays any taxes.

Talking about number one, the present formula starts out with $35,000 up at the top. You raise that to their advantage to make about 50 percent of it. You raise it to $50,000. That helps either way in the formula.

Plan number two, instead of taxing 50 percent of the gain even after you made that reduction, you are only taxing 30 percent of the gain, so you are using the formula to reduce the 30 percent that you are taxing.

In addition to that, those people, when you tax it at the rate you have, you come up somewhere around $6,000 to $14,000 on a transaction where a person has made the cash gain of $100,000, the person in the very top bracket.

If that is the ordinary old person who is planning to move off into a retirement home, they have the advantage of income averaging; assuming they have the $14,000 to confront them, that is because they are in a high bracket to begin with.

Once they get through with their income averaging, they get that down to $10,000 so you are talking about someone who goes into that retirement home, sells $150,000 home and at the time he pays about $10,000 and he has $140,000 to move into that new residence with.

That is not a lot of taxation for somebody who was in there with $140,000 compared to a lot of these poor people who are going to walk in there with a great deal less than that, maybe nothing. Only their relatives, perhaps, to look to and help them.

If you want to say there ought to be some taxes -- furthermore, we would not have the minimum tax apply to this, would we?

Mr. Shapiro. That is correct. The minimum tax would not pick up.

The Chairman. It applies now?

Mr. Shapiro. It applies now.

The Chairman. Point number four, we take off the minimum tax. If you have given all those points, if you compare it to the way it is now -- keep in mind, a lot of these people make an income and not all of these people are old people, but if you talk about compared to two transactions, one in terms of current cash, makes $100,000 and pays zero, which is the tremendous discrimination in this form of capital over other forms of capital, and is causing all the realtors to say, look, if you have some money, put it into a bigger home. There is no better investment than a home.

That tends to distort investments. If you think in terms of how can you give these people one tremendous tax break and still have them pay a little something, you have precedent here, and it is a very favored transaction.

Admittedly, it is a somewhat more complicated one. We will have to compromise with the House if we do this, but I think we would be in a far better situation, rather than keep moving forward in this situation where more and more income escapes any taxation with a result we have to put more taxation on the rest of it and keep running afoul of this thing.

What the Roper poll said the number one thing that people are upset about is the concept that some folks make a lot of money and pays no taxes while a working man makes $10,000 and pays what he regards as a substantial tax.

Senator Matsunaga. This would, in no way, affect the additional $35,000 credit which 65 and older citizens would get.

Mr. Shapiro. This would increase it up to $50,000. They would get more than they do under present law.

Senator Matsunaga. It would be equal to all others, so that the senior citizens would have no additional benefit over a 35-year-old young man.

Mr. Shapiro. That is correct.

Senator Matsunaga. This is my concern here. With this formula, assume that the senior citizens inherited a home and lived in just one home and is just about ready to die but has to move out of that home which she inherited and sold it for $150,000. Instead of getting the $100,000 to live off for the rest of his life -- or her life, make it a widow; it would be much more tearjerking -- she gets only one-third of the $50,000.

No. Cumulative, $50,000 by this formula, or $100,000?

Mr. McConaghy. $50,000.

Senator Matsunaga. She would be getting only one-third instead of the full credit which she should be getting.

The Chairman. Senator, people will be tickled to death with this unless they have heard about the prospect of paying nothing. If somebody gets the idea that they are not going to pay anything, not one red cent, if you get them to take that and build up their expectations that they will pay nothing and then they are going to be horrified to find they are paying a tax at all.

But if you go to somebody who never heard about the idea of paying nothing and explained to them everybody ought to have to pay something, as most taxpayers think, we say, my friend, look what we did for you? In tne first place, we did this. In the second place, we did this. In the third place we did this, fourth place look what we did. Look what we did for them.

Unless they heard some other politician promise that they would have to pay no tax at all -- admittedly, we cannot beat that.

Senator Matsunaga. This would eliminate the requirement of even living five years of the eight for the elderly citizen to qualify for the $35,000. This would displace the other completely?

Mr. Shapiro. The House bill has a two out of three year requirement. This Committee can have whatever requirement you would like to.

Let me explain that, under the House bill, under present law, there is a rule that you have to live in the home five out of the last eight years before you sell it, and the House bill, in order to give you a $100,000 exclusion, brings that down to two out of the last three years.

Senator Matsunaga. What about in the case of condemntation or involuntary taking by government? Is there any provision of that?

Mr. Shapiro. As of now there is nothing in the law that deals with that.

Senator Matsunaga. I think something should be made in that connection, Mr. Chairman, in the case of involuntary taking.

The Chairman. That is all right. I am not worried about that.

Senator Roth. Could I ask about what the House version would cost if you limited it to those 60 years of age or older? I might point out, Mr. Chairman, while they are calculating this, it is my understanding that Governor Brown has adopted a similar version in the state of California. I might also point out, it is interesting, in both Sweden and Germany, that they have no tax whatsoever on your permanent residence. Those are socialist states.

I think the thing that is important to keep in mind here is that -- I think there is a great deal of merit, and I do not think that the American people object to the senior citizens being able to keep some of those savings, particularly when inflation is such a principal cause of it.

Mr. Shapiro. Senator, it is about $300 million.

Senator Roth. How much would you save?

Mr. Shapiro. The House bill is about $745, so you would save about $445 million.

Senator Roth. Could I ask what the position of the Administration is on this?

Mr. Lubick. Senator, we think that Senator Long's arguments are very persuasive, with the exclusion of the selling price combined with the generous exclusion of income averaging. We think you provide a very, very favorable treatment for housing, and it would be very hard to say that it is a hardship.

We also agree with his recommendation to eliminate the gain on the sale of a residence on a minimum tax, so that nobody would be taxed inadvertently there.

In fact, the President recommended that last January.

The question of eliminating the once in a lifetime feature in connection with the selling price would also be perfectly satisfactory and make the law much more administrable. The once in a lifetime is very difficult to administer.

So that we think that that would be a big improvement as well.

There should be some minimum period of occupancy as a residence, whether it is five years or three. It is not material, just so we do not get speculators turning over.

As far as those in the lower ages are concerned, probably there is not going to be a significant problem because usually a person in lower age is going to use the rollover because he is going to be selling his house and moving into a more expensive one.

So therefore, I would agree with Senator Nelson that you might as well lower the age for those few persons who get into a handicapped situation and perhaps have to sell involuntarily and not reinvest.

The bulk of your revenue is coming in the ages upwards of 50 or so. You also have a lot of persons whose families may have grown and who may want to move to a smaller residence which would be less costly, and therefore the rollover is not going to help them. Under present law, they are, in effect, locked in until age 65 because if they stay in their larger residence, they would avoid tax altogether.

It would seem to us that the proposal that Senator Long is suggesting meets the objectives of the Committee in doing equity and providing some incentive and some fairness in this whole area.

Senator Packwood. In the proposal that Senator Long had, is this person who has sold his house for $150,000 that they paid $50,000 for, are they allowed, before they figure their ratio, if they buy a smaller house that now costs $100,000 to roll it over and then take the advantage of the formula?

Mr. Shapiro. Under existing law, they cannot do that if they are under age 65. They can do that if they are over age 65.

What the Committee can do is provide just the same rule for the over-65 and keep present law in that regard.

Senator Packwood. In other words, if you kept present law, this formula, if they bought a house for $100,000, originally it was $50,000, sold it for $150,000 and bought a smaller one for $50,000, that bottom figure would drop to $100,000, not $150,000.

Do I understand the formula correctly?

Mr. Shapiro. The only question I have, I think what that would be, the gain would be reduced, not the fraction, which would still be one-third. $50,000 over $150,000. Instead of a $100,000 gain, you would only have a gain of $50,000 because the other $50,000 has been rolled over.

Senator Packwood. All right. What you are saying, you are going to base the fraction on the whole selling price no matter how much they roll over. What I am saying is base the fraction on the actual capital gain they have after the roll over.

Mr. Shapiro. The formula would only reduce the gain in the example that you gave.

Senator Packwood. I do not like it.

Senator Curtis. I think the Chairman has done a good job here. I am ready to buy it.

There is one point -- I will not insist that we thrash it out now, but I would hope that staff, in drafting, could see what they could do to produce equity between persons. It is conceivable that someone -- someone's residence might be five or ten acres, flowers and grass, all residence, and then when they apply the rule to someone whose life is on the farm, I would not like that restricted either.

So in drafting, if you can do something in that field, but at this time, I am ready to support the Chairman's suggestion.

Senator Packwood. Mr. Chairman, I am going to offer an amendment that those who are over 65 be allowed, as they are now, to rollover and deduct from the increase the difference between the selling price and what they paid for a new house.

The Chairman. I will tell you what that will do now.

Mr. Shapiro. I am sorry. Could you repeat your proposal?

Senator Packwood. In your example, if they sold their house for $150,000 and they had bought it 25 years ago for $50,000 and they now move into a smaller house and sell it for $100,000, which is a lesser house than they sold, then the only multiplier would be the difference between the selling price or their gain.

Let's see. You would subtract from the gain the increase that they had to pay for the new house, which would be $50,000 in that example. You would still have a $50,000 gain, but you would not have a $100,000 gain. The original house was $50,000. You sold it for $150,000. You have a $100,000 gain, but you can subtract from that what you have rolled over into a new house.

Senator Curtis. Are you saying this, that someone who rolls over into a less expensive house, they can get proportionately the proper share of the rollover and then still have this formula apply only to the balance?

Senator Packwood. More than a proportionate share. They get to deduct the whole rollover from the difference, and then they pay the capital gain above that.

Senator Roth. Mr. Chairman, when it comes to the voting, I would also like to have a vote on the House proposal limited to those of 60 years or older.

The Chairman. Let us first get an answer about Bob Packwood's suggestion.

Mr. Shapiro. Senator, I am sorry. I got your proposal up to the gain. What would you do to that formula up there?

Senator Packwood. Your $100,000 in the multiplier is the gain. In my example, that would change the $50,000.

Mr. Shapiro. That is what we are saying, too. It would have the effect of doing that under the way we are doing it. It would be reduced in that case, for those over 65. That is what would be in the basic proposal. I do not think we need your amendment to do that.

Senator Packwood. Fine. I still do not like this formula, but if that is what is in the formula, this is the first time I heard it was in there.

Mr. Shapiro. It would be in there for those over age 65 only.

The Chairman. Why do we not call the roll on this proposal. Then Senator Roth can offer a substitute and we can have a roll call on that, too.

Senator Matsunaga. Your proposal?

The Chairman. Yes.

Mr. Stern. Mr. Talmadge?

(No response)

Mr. Stern. Mr. Ribicoff?

(No response)

The Chairman. I think I have his proxy.

Mr. Stern. Mr. Byrd?

Senator Byrd. Aye.

Mr. Stern. Mr. Nelson?

Senator Nelson. Aye.

Senator Bentsen. What are we voting on?

Mr. Stern. The formula on the board, except in the case of people 65 and over, that would be the same rollover as permitted in present law. The gain would be reduced.

Senator Bentsen. Yes.

Mr. Stern. Mr. Gravel?
(No response)
Mr. Stern. Mr. Bentsen?
Senator Bentsen. Yes.
Mr. Stern. Mr. Hathaway?
(No response)
Mr. Stern. Mr. Haskell?
Senator Haskell. No.
Mr. Stern. Mr. Matsunaga?
Senator Matsunaga. Aye.
Mr. Stern. Mr. Moynihan?
Senator Moynihan. Aye.
Mr. Stern. Mr. Curtis?
Senator Curtis. Aye.
Mr. Stern. Mr. Hansen?
Senator Hansen. Aye.
Mr. Stern. Mr. Dole?
Senator Dole. Aye.
Mr. Stern. Mr. Packwood?
Senator Packwood. No.
Mr. Stern. Mr. Roth?
Senator Roth. No.
Mr. Stern. Mr. Laxalt?
(No response)
Mr. Stern. Mr. Danforth?

Senator Danforth. Aye.

Mr. Stern. Mr. Chairman?

The Chairman. Aye.

Senator Haskell. Mr. Chairman, I vote aye.

The Chairman. Thirteen ayes and two nays.

Now, let's vote on Mr. Roth's suggested substitute, that you just simply provide the $100,000 provision for those over 60.

Senator Roth. Plus the rollover.

Mr. Stern. Do you mean the formula there?

Senator Roth. We are talking about the House version, limited to those 60 years of age or older.

Senator Packwood. Plus including the rollover.

Senator Nelson. Are you substituting the House provision plus something else?

Senator Roth. I am just taking the House version of $100,000 and limiting it to those who are 60 years of age or older.

Mr. Shapiro. Someone who is aged 35 or 40, for example, would not get any exclusion until they were aged 65?

Senator Packwood. They would still have the present continued rollover as they buy more houses that are more expensive and would pay no gains at all until they sell it when they are elderly.

Mr. Shapiro. There is nothing in the House bill or what members have said today about changing the rollover.

Senator Packwood. This takes the present law, in essence, and raises it to $100,000 or close to that.

Mr. Shapiro. What Senator Roth is saying is you no longer have the formula for over 65. They could exclude up to $100,000 without any formula.

Senator Byrd. Let me ask this question, if I may. What We just voted on is more beneficial to the homeowner than what the present law is, is that correct?

Mr. Shapiro. That is correct.

Mr. Stern. Mr. Talmadge?

The Chairman. No.

Mr. Stern. Mr. Ribicoff?

The Chairman. No.

Mr. Stern. Mr. Byrd?

Senator Byrd. No.

Mr. Stern. Mr. Nelson?

Senator Nelson. No.

Mr. Stern. Mr. Gravel?

(No response)

Mr. Stern. Mr. Bentsen?

Senator Bentsen. No.

Mr. Stern. Mr. Hathaway?

(No response)

Mr. Stern. Mr. Haskell?

Senator Haskell. No.

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. No.

Mr. Stern. Mr. Moynihan?

Senator Moynihan. No.

Mr. Stern. Mr. Curtis?

Senator Curtis. No.

Mr. Stern. Mr. Hansen?

Senator Hansen. No.

Mr. Stern. Mr. Dole?

Senator Dole. No.

Mr. Stern. Mr. Packwood?

Senator Packwood. Aye.

Mr. Stern. Mr. Roth?

Senator Roth. Aye.

Mr. Stern. Mr. Laxalt?

Senator Roth. Aye, by proxy.

Mr. Stern. Mr. Danforth?

Senator Danforth. No.

Mr. Stern. Mr. Chairman?

The Chairman. No.

The nays appear to have it. I want staff to see what you can work out to see if you can take care of Senator Curtis's problem. He has a point there.

The vote was three yeas, thirteen nays. He has a point there. When people drive down the bayou and the bush in Louisiana from where those shrimp boats move, they say, look, do not judge these Frenchmen by the house they are in. Judge them by the automobile.

You would be surprised how many poor folks have made some money down there from shrimp, oil as the case may be. They live a different lifestyle than other people do.

People living on a farm do tend to make their land for more land. They settle for a more austere home.

If staff could find some way to work it out that we would be more liberal on the amount of land around the house that they can take into account, I think that it would be more equitable to all concerned.

I think the Senator is right. If a fellow lives on a farm if you count only the one acre that they live on, by Texas standards, that is being strict. Fven in Louisiana, if you only count one acre, that is tough.

Senator Curtis. We do not want it more liberal for agriculture. We would like to see what you could work out so that they would get an even break with the city slickers.

Senator Matsunaga. Mr. Chairman, may we have a vote on the exemption in the case of involuntary taking?

Mr. Shapiro. Let me give you a hypothetical. A family has lived in a home for 20 years and they move to another house and they had a rollover -- in other words, they sold their house for $80,000 and they bought a new one for $100,000. The $80,000 house they lived in for 20 years, they moved into a $100,000 house and for one or two years, it was involuntarily converted. It was destroyed, it was taken, and they did not meet the number of years, and this would say that they can add to the years they had for their old home to get this provision.

I do not think there is any problem in that particular situation. It is limited to involuntary conversions.

The Chairman. Involuntary conversion. They do not have to pay. We would have a rollover?

Mr. Shapiro. They get to have this provision. They could add to the years the years they hold the rollover.

Senator Matsunaga. Under present law, there is not such an example.

The Chairman. Without objection, it will be so modified.

Now we will hear from Senator Bentsen. He has something.

Senator Bentsen. Mr. Chairman, I have one which is a clarificaton of the funding of water projects as far as favorable tax treatment, and my amendment would allow tax-free bonds for facilities for the furnishing of water for any purpose, if operated by a governmental unit or a public agency thereof, which makes or will make available water to members of the general public, which includes electric utility, industrial, agricultural or commercial users.

The construction of water projects has traditionally been a governmental function, just like construction of public schools, parks, and state university dormitories. I do not think there is any reason to deny the tax-exempt financing for the water projects and allow the favorable tax treatment to other public functions, and I have been conferring with Treasury on this and I believe that they are supportive of it, and we have that coupled with the advanced refunding of the public bodies that are airports and ports and wharves.

But they are being public ones and an example of that would be Newark and Kennedy and Dallas, Fort Worth, Houston would be examples of those kinds of airports where you do have advanced refunding of bond issues that are outstanding.

Senator Moynihan. Mr. Chairman, I join with Senator Bentsen in this matter.

The Chairman. Does that present a problem to Treasury?

Mr. Lubick. Mr. Chairman, we have been working with both Senator Bentsen and Senator Moynihan on this problem and the language which Senator Bentsen has read is satisfactory to us and I might simply describe the language in a little more detail, in the second half, which he did not read.

Basically what we have here is the situation where Treasury was concerned about advanced refundings of industrial development bonds to put out reglations to prohibit in effect the multiple bonds being outstanding with respect to pollution control facilities and a number of industrial facilities.

Because the definition of industrial development bond includes a lot of quasi-governmental and public areas, it picked up that, too, and we have indicated that we tend to support some modifications and therefore we would allow advanced refunding of obligations of a governmental unit, again, with Senator Bentsen's language, including a public agency thereof, if substantially all the proceeds are used to provide public airports, docks, wharves, mass commuting facilities or parking, storage or training facilities directly related to any of the foregoing.

And that arrangement, we believe, would solve the problem.

Senator Moynihan. Would you accept trade or convention centers?

Mr. Lubick. If they are public trade or convention centers, that is satisfactory.

The Chairman. If there is no objection, then, we will agree to the amendment.

Senator Bentsen. The report would cite these examples that I cited.

Senator Moynihan. Cite the examples that Senator Bentsen cited.

The Chairman. Let me put down the order that I have Senators for amendments: Senator Dole, Senator Roth, Senator Haskell, Senator Hansen, Senator Nelson.

Senator Curtis. I would like my name on the list. I am willing to wait for this afternoon.

The Chairman. We are all going to have to wait for this afternoon, Senator Danforth, Senator Curtis.

Senator Bentsen. Will you recycle me, Mr. Chairman?

Senator Matsunaga. Mr. Chairman, will you put me down, too?

The Chairman. I would hope, gentlemen, that the Senators have already offered their best amendments because, at some point, I think at some point the curtain will close, the lid will fall, and there will be a motion to report the bill, so the best amendments ought to be offered first.

What I am planning to do is to go around and offer his suggestion and it will be considered and then we will go around again, but I think it is sort of unfair to any of us that if one man is able to state his whole shopping list and go through all his suggestions --

Senator Dole. It depends on the value of the total. You might have a billion dollar one, and I might get $10 million.

The Chairman. The trouble is, when I recognize a Senator, I do not know how much he has in mind.

Senator Curtis. Mr. Chairman, in that regard, I think all I have left are a few tag-end things that should be called up. Most of it will be decided by the staff and if you will stay here with me, I will be glad to go to the bottom of your list.

The Chairman. I would hope that we would all

I would like to suggest that Senator Haskell is going to have to leave and will not be able to be here this afternoon. He has an amendment we can dispose of fairly quickly. If there is a no objection, I would like to accommodate Senator Haskell and call him now.

Senator Haskell. Thank you very much, Mr. Chairman. Basically, this amendment deals with bonds and it has the support of the National Governors Association, the National Conference of State Legislators, and also the Municipal Finance Officers.

The regulations that were issued under 103(c) which was enacted about ten years ago are still in proposed form and basically there is no practical way to challenge the validity of proposed regulations or rulings. Therefore, my amendment would permit issuers to initiate legal proceedings for the purpose of obtaining declaratory judgments regarding the validity of Section 103, regulations and applicable rulings.

The amendment would further roll back proposed regulations so that the regulations in place before May would be generally applicable and the application of the new proposals would be authorized only where invested sinking funds are used and advanced refunding is used.

Only in those instances would Treasury be authorized to treat revenues invested in sinking funds as proceeds.

Basically, this amendment tries to straighten out the situation, but the basic problem is that there is no way of getting a ruling, if you want to issue municipal bonds, to know what bonds they are going to be. And part of the amendment, and the important part of the amendment, is the declaratory judgment right where you can find out in advance whether or not you have -- to find out which bonds that you have, one or is or is not tax free.

The balance of the amendment is complex, but I stress that the heart of the amendment is this right of declaratory judgments, the same right we gave people on C(3) organizations a couple of years ago.

Mr. Lubick. Senator Haskell, the most troublesome part of your amendment is, indeed, the part that you indicated is the most complex. We are concerned about the rollback of the regulations would permit that a substantial amount of bonds that are directly contrary to the provisions already adopted by the Congress. Our estimate is if 20 percent of those bonds are refunded, the revenue cost -- not refunded -- are changed so that new issues can come out using these funds, you may have $3 billion to $3.5 billion of additional revenue cost with respect to new issues in the long run.

The immediate effect, that it starts out slowly at $360 million in '79.

But on your basic points, on the importance of allowing taxpayer review, we are absolutely in accord with you. We think it would be much better to submit these matters for adjudication rather than having these controversies that have to be resolved.

We would suggest that you model the review on the existing provisions in the Code with respect to exempt organizations and pension funds that give the Tax Code authority to review either a ruling issued by the Service or a failure to rule. We would like to have a specific case in controversy, and I think you would recognize that.

So if we could model it on the existing procedure that is in the Code now with respect to those other areas, we would endorse that -- in fact, we would welcome the opportunity to have a forum to decide these questions.

Senator Haskell. Thank you. Actually, that is my real purpose, is to get a forum for decision on these matters. I would modify my amendment in accordance with that, and model it after the sections on C(3) organizations where we received declaratory judgments.

The Chairman. All in favor?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it.

I suggest that we come back in at 2:00 o'clock, and I hope that we can report this bill out this afternoon.

(Thereupon, at 12:30 p.m. the Committee recessed, to reconvene at 2:00 p.m. this same day.)

AFTERNOON SESSION

(2:40 p.m.)

The Chairman. Let me ask the staff to explain this table that the staff has that they prepared as to how we might handle the rate cuts.

Can you distribute that to every Senator at the table?

Mr. Shapiro. I think every Senator has it. You should have two packages in front of you. Both of them have table 1 in it, but in the righthand heading, one will say Alternative 1 and the other will say Alternative 2.

The Chairman. Okay.

Senator Hansen. Which alternative are you using?

Mr. Shapiro. Let me explain both, Alternative 1 and then Alternative 2.

Alternative 1 and 2 will be in the right hand column, the right hand side of the page at the top.

The Chairman. Yes, sir.

Mr. Shapiro. Okay, the Committee instructions to the staff was to prepare two alternatives. The first one was to take the existing rate schedule and to round off the House numbers and to add approximately $1.8 billion into above the House bill, and what you will see on page 2, table 2 of that Alternative 1, in the left hand column is the present law rates, and in the right hand column are the proposed tax rates, and as you can see, they are the same number of tax brackets, reduced to take into account the instructions to the staff to round off from the House bill and to add $1.8 billion into the rates.

Alternative 2 is the same thing from the standpoint of the $1.8 billion, but if you will look on table 2, you will see that instead of 25 brackets, it is down to 15 brackets for married couples, and 16 brackets for single returns. It is just reducing the number of brackets significantly to take into account the fact that the present 25 bracket structure has been in the law for many years when the difference of $1000 of income was significant enough that it threw you into a higher bracket. In today's situation, however, it seemed to be appropriate that the Committee could modernize the brackets by widening them and reducing the number of brackets from 25 down to the level of 15 or 16, and therefore, that alternative 2 is before you.

In general they do about the same thing. From your standpoint of comparing them, if you go back to table 1 in the front, the major item to look at is the column that is the fourth column from the left that says additional tax cut. That will show you the amount of money that is added in these rates above the House bill, and as you can see from the total at the bottom of the page, both of them are approximately $1.8 billion, and that is the additional tax cut that these rate schedules include above the House bill.

Now, if you go to the column next to that which is staff proposal, you will see that your total is $12.1 billion whereas the House bill was $10.3 billion. So it is approximately $1.8 billion more than the House bill on a calendar year basis, and you can see that the distribution of that is set forth in the column for staff proposal as to your total rate structure, and then in the next column, additional tax cut, the distribution of your additional tax cut above the House.

Just to further complete this packet for you, let me just say, Table 1 is this overall income distribution, Table 2 is the married couple tax rate, Table 3 is the single taxpayer tax rates, and Table 4 is the tax burdens for each of these proposals.

The Chairman. Well, it seems to me that it serves a purpose. Rather than have that long list of all these different numbers, if it works out to about the same amount, if the tax liabilities are approximately the same, you just don't have as many different rates.

Mr. Shapiro. That was the intent, Senator, was to have them approximately the same without so many brackets, to reduce those brackets by widening them.

The Chairman. And so that you still have a lot of brackets, you have still got -- how many brackets would you have?

Mr. Shapiro. You'd have 15 for married taxpayers and 16 for single taxpayers.

The Chairman. Compared to how many?

Mr. Shapiro. 25 under present law.

Senator Hansen. Are you talking about Alternative 2?

Mr. Shapiro. Alternative 2.

Senator Hansen. Well, if I count correctly -- and maybe I don't -- it looks like to me there are only 14 brackets there on the right side, on Table 2 of Alternative 2. Is that right?

Mr. Shapiro. I think there are 15, Senator.

One column, the left hand column has eight and the right hand has seven.

Senator Hansen. I see now. I beg your pardon.

The Chairman. Well, now, you are talking about roughly the same amount of money, are you not?

Mr. Shapiro. Yes, it would be.

The Chairman. Now, let's look at the Alternative 2. That one appeals to me more than the other one, and the taxpayers, that additional tax cut, that is what we are doing above what the House does, and then is the final column the total then of what we do?

Mr. Shapiro. No, the final thing which you do is to the left of the additional tax cut. That is the column that says staff proposal, the third column from your left it says staff proposal, is the total of what you do.

The Chairman. Oh, that is staff proposal, yes. That is how much tax cut.

Mr. Shapiro. That is the total that you do in your rate reductions.

The Chairman. So you have about $95 million of tax cut and that is because the people below $5000 don't pay much taxes.

That is what that is about, is it not?

Mr. Shapiro. That is correct.

The Chairman. And then you come to $5000 and $10,000, and for the same reason they don't pay much taxes, but that is a tax cut of $631 million, and then the $10,000 to $15,000 area, you have got -- those people pay a lot more and therefore they get more tax cut. That is about $1,150,000,000, and then you get in the $15,000 to $20,000 and that is about -- again, they pay a lot of taxes in that area and they pay at a high rate, so they get a bigger tax cut, $1,862,000,000 and the $20,000 to $30,0000 bracket, that is $3,781,000,000, and the $30,000 to $50,000, they get a tax cut of $2,869,000,000; $50,000 to $100,000, they get a tax cut of $1,267,000,000, and the $100,000 to $200,000 class they get a tax cut of $370 million, and $200,000 and over they get a tax cut of $126 million.

Now, most of the tax cut then is concentrated I guess in what you would call the middle income area, is that right?

Mr. Shapiro. Yes, sir.

Now, as you know, the Committee agreed to the earned income credit, which is not reflected in here. These are just the rate cuts. So the rate cuts are concentrated in the middle income brackets, but you have already agreed to an earned income credit expansion which goes at the lower levels.

The Chairman. Well, it seems to me as though you ought to get some kind of chart then to show what they get. If you add that in, how much would that add to these various, below $5,000 and the $5,000 to $10,000 and the $10,000 to $15,000? It would be all in the, practically all in the below $5000 and the $5,000 to $10,000, but I think that ought to be -- if I were reporting it, I would like to report how much those people get in the below $5000 category.

Senator Dole. About $1.8 billion.

Mr. Shapiro. It is approximately $1.8 billion. What you can do is, see where you have the column Additional Tax Cut, let me just give you the figures to add in. It is 12, under the rates you can add to that $283 million, which is the earned income credit, which gives you a total of $295 million.

The Chairman. So it would be $295 million tax cut then for the below $5,000.

All right, now, how much would it be for the $5000 to $10,000?

Mr. Shapiro. Okay, then, to the $181 million you add $1,441 million, and that gives you a total of $1,622 million.

The Chairman. $1,622,000,000.

Mr. Shapiro. Yes.

The Chairman. All right, well, that adds some balance then.

All right, now, then, what, are you adding anything in on the next bracket?

Mr. Shapiro. In the next bracket you add $53 million --

Senator Hansen. $.53 million?

Mr. Shapiro. No, just $53 million.

The Chairman. Just $53 million.

Mr. Shapiro. And that gives you $297 million.

The Chairman. $297 million.

All right, then.

Mr. Shapiro. And that is all.

The Chairman. That's all? The rest of them follow on through then.

Now you say that is the additional tax cut that this Committee does, is that what you mean?

Mr. Shapiro. Yes. This table here is just the rates alone. What I just gave you is the earned income credit, and then the new totals.

The Chairman. But that is an additional tax cut over the House bill, is that correct?

Mr. Shapiro. That is correct, over the House bill.

The Chairman. Then maybe you ought to give us those figures alongside staff proposals. That is what we are talking about doing here, isn't that right?

Mr. Shapiro. They go both places, Senator. You can add them in both places. We will give you totals there, too.

The Chairman. What would they be in staff proposal? That is what people get from the tax cut.

Mr. Shapiro. That would be $378 million, $2.450 billion for the next one, $2.450 billion.

The Chairman. Well, now, you say $378 million, does that add the $95 million to the other?

Mr. Shapiro. $95 million plus $283 million gives you $378 million.

The Chairman. All right, what is the total on the next column, the $5,000 to $10,000, where you have $631 million, what does that become?

Mr. Shapiro. Okay, the $631 million would become $2.072 billion. I gave you a wrong figure before. It is --

The Chairman. $2 billion?

Mr. Shapiro. $2,072,000,000, $2.072 billion.

The Chairman. All right. And what does it become in the next column, the $10,000 to $15,000?

Mr. Shapiro. Okay, it becomes $1.203 billion.

The Chairman. All right, now, when we --

Senator Byrd. Is this table the one you are speaking of now?

Mr. Shapiro. We are adding it to Table 1, Alternative 2, Senator, right below Table 1, and in that next line to the right, which should be Alternative 2, that is the table we are working with.

The Chairman. Is that on a full calendar year basis we are talking about now?

Mr. Shapiro. That is on a full calendar year basis in 1979.

Now, for the fiscal year on these additional rate cuts equals $1.3 billion.

The Chairman. Where would that appear on here?

Mr. Shapiro. You see where it says additional tax cut, it is $1.796 billion which is $1.8 billion, on the calendar year. However, it is $1.3 billion on the fiscal year.

Senator Dole. But you have to add to that the other $1.8 billion.

Mr. Shapiro. You have to add that, that is correct.

It would be $1.8 billion for the calendar year and $.2 billion for the fiscal year.

Senator Dole. And the additional tax cut would be what over the House, would be $3 billion following the calendar year?

Mr. Shapiro. It is almost $3.6 billion, $3.57 billion, and in the fiscal year it is $1.5 billion. It is the $1.3 billion for the rate and $.2 for the earned income credit.

The Chairman. Now, I am inclined to think that we ought to print up the letters that we have received from these various people who I think ought to know the most about what the treasury impact would be, and we ought to print that up as a committee document, and I think we ought to make that available to all Senators, and I personally would favor putting some language in this bill to say that it is the sense of the Congress that the cut in capital gains on a calendar year basis would be, would actually have a positive impact on the budget, and the reason

I say that is while the Treasury doesn't find that much -- keep in mind, I am not talking now about something that I think is subject to a point of order. I am just talking about I think the -- I would like to vote, say that I think that seven out of eight former Secretaries of Treasury who tell us that they think that this would have a positive impact on the budget and about the same proportion of people who have served as Under Secretaries of Treasury and that sort of thing, and also a majority of those who, so far as I know, have served on that Council of Economic Advisors seemed to agree with that, that this would have a positive impact on government receipts. To me, the overwhelming majority of those whose judgment I value in the matter think that the capital gains tax cut had an actual positive effect on government revenues, and I would like to vote on that, vote for it at some point because when I am voting for this capital gains cut, I honestly think that it is actually going to increase government revenues rather than reduce it.

Now, I would like to just present my evidence, and I would like to vote to say that. Now, maybe we could put that right in the language of the bill itself.

Did you check the budget part about that? I mean, I don't want to bog this bill down in the Budget Committee, but I would just like the chance to vote to say, I would like the chance to say by my vote what I have been saying verbally in this Committee for about a week now.

Mr. Shapiro. Senator, what we could do, we are not quite sure right now, if the Committee wanted to put that in the bill, I would like to ask you to do it on a contingent basis, that you agree to that with the contingency that if we check with the Parliamentarian and find out that that raises a parliamentary problem, that it can be deleted when the bill is reported.

The Chairman. Well, I would be glad to --

Mr. Stern. It seems that that is not the case, Mr. Chairman. The jurisdiction of the Budget Committee seems to relate more specifically to resolutions and things connected with the budget process. When the Committee -- when you raised a similar amendment in, the fiscal responsibility amendment in 1976, there wasn't any point of order raised that that would cause the bill to be referred to the Budget Committee or anything. In other words, just to have an estimate or language saying it is the sense of the Senate that receipts will be so and so much under this amendment we don't believe fits within the specific jurisdiction of the Budget Committee.

The Chairman. Well, I think I'll just offer the amendment on the floor if that is the case, if it is not subject to a point of order I will just offer it on the floor. But I just want to make it clear that I personally feel that -- and that to a large extent dictates my vote on this matter. I think that what we are doing is reducing a counterproductive tax down to where we think it will be productive.

Senator Hansen. Mr. Chairman, I share your view and I am encouraged to believe that it is right and tenable because of the overwhelming preponderance of the testimony that Senator Byrd's Subcommittee received. We have heard from all kinds of experts and while, as has been noted before, no two of them might agree precisely on the impact to the Treasury, there was almost consensus with exceptions of the Treasury representatives and perhaps one or two others, that it would yield greater revenue for the Treasury. So it is a view that I share.

The Chairman. Well, I have high admiration for the Secretary of Treasury. He is a great American. But my impression of these great men that serve in the President's cabinet is that many times when they are serving up there, they are not expressing necessarily their own opinion. They are speaking what somebody else thinks. When those men leave that responsibility and go on to wherever they want to serve thereafter, from that point forward they are privileged to speak their own views.

What did you want to say, Mr. Sunley?

Mr. Sunley. Mr. Chairman, we have tried to look very closely at this feedback effect, and I think it is important that the Committee realize that there are several different pieces that have to be considered. First there is the piece in terms of what effect -- what happens on the effective date. In other words, you have an effective date, January 1. People may delay realizations just to get on the other side of an effective date, and that would shift revenues out of fiscal '79 into fiscal '80 with possibly a significant effect on revenues.

Second, it is possible that when you have reduced the rate of tax on capital gains, because this tax rate, as you correctly point out, does involve a tax wedge, I mean, a price you have to pay when you turn over your portfolio, it is possible that as a result you will want to turn that portfolio over more often, that is to say, you will have increased transaction, and that the average holding period of your portfolio may be decreased. You said this morning, I believe, that the average holding period -- I believe it was Senator Hansen said that the average holding period on corporate stock was about eight years, and that is what we find and if you -- you know, if that average holding period should decrease from eight years to seven years, then you would be turning it over 12 percent faster. Also, since you haven't held each asset quite as long, the average amount of gain per transaction would be somewhat less, so that going from eight to seven years does not increase realized gains by 12 1/2 percent.

If I could just say one final thing. Then the third kind of effect is that what happens when you go from your eight years to your seven years, and since during that transition period you may have increased realization, and we have tried to allow for that.

But I think as you look over the testimonials that were given to your committee, a number of the people like Paul Volker, Henry Hauttakker, made a particular point that they thought that in the long run you are not going to get much more. You may get some short run effects, and that is of course the main feedback effect that the Treasury has taken into account, but it is really very hard to think that in the long run that you can double transactions unless there is just a tremendous increase in accruals of capital gains, and that really can only come --

The Chairman. Well, all you are counting, Mr. Sunley, is the primary effect. You are not counting one moment the secondary and tertiary effects that a man buys an office building for which he has a use, and when he buys the office building he is going to fix it up, and when he does he puts a lot of people to work. And then when he does that, that increases employment, it reduces welfare expenditures, it reduces unemployment insurance, it does a lot of things that help the economy.

Now, I have heard -- I mean, I am familiar with all that conversation. I have heard your argument before and I have explained mine, and I guess we just march to a different tune, but anyway, I would like to -- I just want to make it clear that it is my present attention to offer an amendment on the floor and present my evidence that here are people that have this type of responsibility, they think that it is going to have a positive impact because I think it does. I think that we have got some of these taxes so high that they are counterproductive. They are defeating their own purpose which should be not only to bring revenue to the government but to help, have a growing, expanding economy, and that to the extent that they are retarding economic growth, they are costing us revenues.

Senator Hansen. Mr. Chairman, if I could add one further word, Mr. Sunley began by saying, admitting, and I don't mean that it was an admission we had to squeeze out of him at all, but he did say that it isn't a static economy when he pointed out quite accurately that whether a person were to sell an asset now or wait until after the first of the year would depend upon his assessment of the impact of any tax law changes. I think that brings up and suggests for our consideration this additional point. It is certainly my contention and the contention of a lot of people who organize new companies and new corporations and new partnerships and individual enterprises, will be encouraged to go into the kind of an operation which may result in a probable capital gains down the road sometime, and I point out that it is a case now and a choice now of deciding whether to spend income for things to satisfy one's pleasure and enjoyment at the time or to invest in America so as to expand job opportunities, to expand our productive capacity and all that sort of thing.

For a long time, in the last, well, maybe seven or eight years, some of these new corporations and new partnerships and new individual efforts that have started up in this country have had to go abroad to find venture capital which I think reflects a fact that we have known for a long time. If you try to explain the oil business, Lloyd Bentsen can tell you that the reason a lot of people went out of the drilling business is there were better ways of making money.

And if we, by changing capital gains laws, encourage more money to be invested in this kind of activity which is productive, which will create jobs, I think it is reasonable to assume that there can be not simply a leveling off of the average of a static economy over seven years, but we can see an expansion in the productive capacity of America which will yield more.

Thank you.

Senator Bentsen. Mr. Chairman, we have a lot of other issues yet to be resolved this afternoon, and I wonder if we could get on with it.

The Chairman. Yes. Well, I would suggest that -- and I believe the staff is of the opinion that at this point we would still have some room to take care of these amendments that don't have a heavy revenue impact and that this could fit inside what we could talk about doing.

Is that correct?

Mr. Shapiro. Yes, Senator.

The Chairman. Then I would propose that we take the Alternative 2, because I think it is the simpler, more streamlined proposal.

Senator Gravel. So move.

Senator Roth. Mr. Chairman, are you talking about these ranges or brackets for the individual now?

The Chairman. I am talking about the Alternative 2, yes. This simply has a smaller number of brackets.

Senator Roth. Mr. Chairman, I am not sure that I entirely understand it, but I would like to raise some questions that at least give me some cause for concern, and I like the idea of fewer brackets and making it more simple, but if I understand what the Table No. 2 would do or the fewer brackets would do, is to raise the taxes for many people. As a matter of fact, as you go into a new bracket, you are going to pay higher taxes, is that correct?

Mr. Shapiro. Senator, what you are doing is you are --

Senator Roth. Is this the one we are talking about right now?

Mr. Shapiro. That is correct.

Senator Roth. Now, isn't it true that some people would face in these brackets lower marginal tax rates than they do now and others would face higher within each bracket?

Mr. Shapiro. Senator, relative to present law, as well as the House bill, these schedules are a tax cut almost across the board.

Senator Roth. For every individual. Well, not, almost.

Mr. Shapiro. Just looking at the rates alone. Now, the final bill you have got some other provisions, depending on what you do with things like the gas tax deduction, but just looking at this alone, for example, if you turn to Table 4 of our packet, you will see the burden tables and you will see that it reduces the tax for every single category.

Senator Roth. But I am talking -- let me make one point very clear. What I am concerned about is the impact on the individual, not what it does to all the people within a particular bracket.

Let me ask you this question. As you move up into a new tax bracket under this, let's take Table 4, Alternative 2, the tax rates for married couples, isn't it true that some people would face lower marginal rates and others would face higher marginal tax rates as a result of these new brackets?

Mr. Shapiro. From a standpoint of a marginal tax rate --

Senator Roth. I am talking about the individual now.

Mr. Shapiro. Okay, from a marginal tax rate, that may be the case, but on the overall tax cut, they all have tax cuts.

Senator Roth. Yet aren't we, as a result of this proposal, as you move from one tax bracket up to the next marginal tax rate, on the low end won't you be paying higher taxes than you are today?

Mr. Shapiro. Not at the low end. For example, what you are doing is you are just spreading those brackets out wider so that they get more income at a lower marginal rate. So it may be that in certain cases you will find a tax payer at a higher marginal rate, but he will have had the benefit of a lower marginal rate for more income at the lower levels.

Senator Roth. Yes, but his ultimate rate may be higher.

Mr. Shapiro. The effective rate would be lower. The effective --

Senator Roth. I mean, you are talking about the average of all the rates that he actually pays.

Mr. Shapiro. But the marginal rate --

Senator Roth. When you are moved up into a higher bracket, the ultimate marginal tax rate, won't you be moving into a higher tax in that bracket?

Mr. Shapiro. There are cases where that may occur, but overall, compared to the present law or the House Bill, as a result of the fact that the brackets are widened below that, that taxpayer has an overall tax cut. He will have --

Senator Roth. But if you are really talking about the effect of the marginal tax rate, and you want to promote savings and you want to promote people going back to work and working longer hours, it is not only the average, it is what the new tax rate he is being pushed into that has that impact.

Mr. Shapiro. There will be cases, Senator where -- I think overall from this schedule, the marginal rates are lower for most taxpayers, and there are some cases where the marginal rate may be higher for a few.

However, their net tax would be less, and their average effective tax rate would be less in all cases.

Senator Roth. But what I am talking about is the incentive side. I realize that it may average out lower all the way across because of the wider bracket, but what I am saying is that as you earn a couple additional dollars and you are pushed into a higher tax bracket, under these new rates, under those additional two dollars, you will be getting, retaining less of those than you would under the current practice.

The Chairman. You don't have a notch situation there, do you?

Mr. Shapiro. No. Let me give you another factor, too, Senator. It may be that that marginal rate, when he first earns that next dollar, the next bracket, it may be higher in some cases. However, the incentive that would exist there is that he would be in that bracke t for a longer, for more income, and therefore there is more incentive because instead of going to the next bracket, as in the present law or the House bill, within the next $2000 income, he may be in that bracket for $3000 or $4000. So overall, although that one dollar of income, it may appear that there would be a marginal rate higher than the House bill, and it may be the case, that one dollar, the --

Senator Roth. Or the existing tax rates.

Mr. Shapiro. Or the existing law, the incentive to earn more still exists because that bracket is much wider and he can earn more income within that bracket at that level before he goes up to the next bracket.

Senator Roth. Well, as you move further on up, that is true, but if I understand what you are saying, I haven't had -- you know, I have just seen this the last few minutes. I haven't had a chance to digest it, but as I understand it, if I am sitting here earning such income that a few dollars more will push me into the next tax bracket, that marginal tax rate on those extra dollars -- I'm not talking about the average, what happens to the low or the fact that later on I can still stay in that bracket -- it is giving me less incentive to go ahead and earn those extra dollars.

Mr. Shapiro. Okay, it depends on how you look at the incentive. From your point of view, if you are talking about earning just a little bit, that is correct, but to the extent the incentive is to earn more than just a little bit --

Senator Roth. No, I am thinking about, for example, a guy just a couple of weeks ago, one of the policemen downstairs said to me, why bother to work for overtime. I am not talking about big sums of money, but to me -- and I am sympathetic to trying to simplify the number of brackets, but it would seem to me, without having worked on the problem in detail, that somehow we could be lower that marginal tax rate so we would not be creating less incentive for that extra dollar.

The Chairman. Well, my -- well, maybe I am in error, but let me if I'm not, if this is not the case. Now, I'm just looking at Table 2, Alternative 2. All right, let's say you start out in a bracket, look on the second side over there. You start a bracket, $35,200 and then that goes up to $45,800. All right, now, as I understand it, if you go at the $35,200, that would be, your tax would be $8174, is that right? That's what I am reading right there.

Mr. Shapiro. That is correct, Senator.

The Chairman. All right, now, so you pay, you pay the $8100, so on the first $35,200, you pay $8174, and then you pay 43 percent of what you earned above that point up until you reach the $45,800, right?

Mr. Shapiro. That is correct, Senator.

The Chairman. All right. Well, now, at the time you reach that point, aren't you just about at what the next bracket figure would be which is at the $45,800, you pay $12,732? Aren't you just about up to that point?

Mr. Shapiro. That is correct.

The Chairman. All right, now, when you reach that point, on the next dollar you then move up into a higher bracket. You then move up -- at that point youwould be paying 49 percent. Now, when you cross over, then you get up to that next figure, but isn't that supposed to be what the multiplication of that percent by that number of dollars would make you?

Mr. Shapiro. That is correct.

The Chairman. All right. Then from that point on you are then paying at a higher rate, which is the 54 percent rate.

You move up to the 43 percent rate, and you cross that over the next bracket, you then pay at the 49 percent rate, and then when you cross the next one, you pay at the 54 percent rate. But wouldn't it be so that when you make that additional dollar or two, then you are paying at a higher tax rate, but you are still keeping that, a part, let's say, at the 49 percent rate, you are still keeping 51 cents on the dollar, and when you cross over the next bracket, you are still keeping 46 cents on the dollar, are you not?

Mr. Shapiro. That's right, Senator.

Senator Curtis. Now, are we repealing the maximum tax?

The Chairman. Not at this moment. All we are talking about is how many brackets we want, and the staff suggested, and it seemed to me that it makes good sense, not to have so many brackets. Talk about having 17 would be plenty enough. We have got, now, what number did you say?

Mr. Shapiro. There's 25 under the present law, and this would have 15 for married couples and 16 for single taxpayers.

Senator Hansen. And the other point that Mr. Shapiro made which I think is important is that there is greater incentive, it would seem to me, in this schedule here, as proposed on Table 2 of Alternative 2, in that a taxpayer has greater latitude to earn more income before he gets into the next higher bracket.

Mr. Shapiro. That is correct because that bracket is much wider, and he would have a lower rate and incentive to earn more in that bracket.

Senator Hansen. That is incentive. I think this is a good proposal, Mr. Chairman.

Senator Byrd. May I ask this question? What is the basic difference, Bob, what is the basic difference to the individual between alternate 1 and alternate 2?

Mr. Shapiro. It is not intended to have any difference from the standpoint of their tax liability. There is very small differences between the two. The intention was to try to have it so as nearly as possible it would be approximately the same. Now, there are slight differences but it is just the fact of the way the brackets are set forth.

Senator, you can see, if you compare the two burden tables, that would be Table 4 of Alternative 1 and Alternative 2, you can see the differences with taxpayers at various levels. That would be a good way to see comparisons, look at Table 4 on each of the alternatives, and then compare an individual case.

The Chairman. Let's vote on this one first.

All in favor say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

(No response.)

The Chairman. The ayes have it.

Now, why don't we go vote, gentlemen. We can come on back over here and go on the other amendments.

(A brief recess was taken.)

The Chairman. While we are getting organized here, why don't you cover a thing or two that has sort of got to be cleared with the Committee anyhow, while we are getting more Senators back in here.

Mr. Shapiro, tell us what you are going to do about those employee stock ownership amendments.

Mr. Shapiro. Okay, Senator, there are a series of technical-- when you made the employee stock ownership provisions permanent, when they were presently tentative, you indicated that you had asked the staff to work out a series of technical modifications to make the provisions work a little bit better since they came to the attention of the staffs and were brought to your attention since they were enacted.

There is a list of about 15 points. I should point out to the Committee that they are not all technical from the standpoint of just minor changes. Some of them have a substantive effect but are believed to be appropriate from the standpoint of the ESOP provisions.

Treasury has gone over the list. There is some disagreement on three of the 15 items. What I would like to suggest to the Committee, that since Treasury supports or does not object to 12 of the items, and only three, that it may be appropriate to agree to all 15 for purposes of taking them to Conference, let the staff and Treasury continue to work with these and to work out some additional modifications that are appropriate so they will be in conference. Otherwise they don't get to Conferenc, and since Treasury approves 12 of the 15 and just three others that they would like to work with.

The Chairman. Well, the most sensitive one so far as I know is the matter about the voting rights, and I am afraid that if some people, that if you are going to require voting rights in these closely held companies, it might keep people from setting these stock ownership plans up, and the Treasury had a real good point in saying that they want the stock or the shareholders to know, not that they want the shareholders to take control of the company, but they want the shareholders to know what is going on so that they can protect themselves, and generally speaking my thought is well, the kind of thing you are trying to protect the workers against would be some abuse by a corporation executive, and that in that area, I feel like that the Treasury ought to watch these things and the Treasury ought to monitor it, and if they think that something is not the way it ought to be, the Treasury ought to come down on top of them and deny the deduction.

But I would hope that we can work this out. So far we have been able to work most of these problems out, 90 percent of them in a very satisfactory manner, and I would hope that between now and the time that the matter is discussed on the floor, that we can resolve whatever difference remains in that area.

Mr. Shapiro. For purposes of the record, let me point out that Treasury still has a concern for Item No. 7 that you just referred to, Item No. 11, and Item No. 15. The other 12, as I understand, they either support or do not object, and I think it may be that if the Committee agrees to these, then between now and conference, the staff and Treasury continue to work, and to the extent that any modifications are appropriate, we can discuss them in conference, but at least these provisions can be taken to conference to discuss.

The Chairman. Well, I think Mr. Lubick is doing a good job for Treasury in looking this thing over. He is concerned. He has some good points, and also I think our staff has some good points, and I know with regard to most of the points of difference, I find that they both make good arguments, and I find some difficulty knowing where I ought to come down on it, so that if we can just agree to this, and then have more time to discuss it, I think we can resolve it.

Senator Curtis. I so move.

The Chairman. Please understand that if possible, I would like to satisfy the Treasury objection on all points, and I think that in fairness to Mr. Lubick, I think that he and his group have been fair. We have just got a few more points we need to resolve.

But without objection, then, we will accept that part.

Now --

Mr. Shapiro. Senator, there are a list of items that are in the House bill that the Committee has not discussed, and under the procedure you are working, it means that unless they are agreed to, they are not part of the substitute.

The Chairman. Well, why don't you bring up some of the less controversial ones first, and by the time we get to the most controversial ones, we ought to have more people here.

Senator Hansen. I just have a clarification, Mr. Chairman.

First, last week when the Committee approved the Treasury study of the ways the investment tax credit might apply to expenditures for OSHA related equipment, this concern occurred to me. OSHA applies to safety requirements for nonmining activities. I believe there is also good reason to study the expenditures for compliance with safety requirements for mining activities covered by the Mining Safety and Health Act, MSHA.

May we include expenditures for mining safety requirements in that Treasury study? That's all I'm asking.

Mr. Shapiro. It is for the study, it is a companion provision and it would probably be appropriate for the Committee to just ask for the study with regard to both of those.

The Chairman. No objection.

Mr. Lubick. We have no problem with that.

The Chairman. All right, no objection.

Senator Hansen. Now, the second point, in calculating his tax liability, under the new minimum tax system adopted by the Committee, it would seem fair to allow the tax payer to elect whether he adopts the intangible drilling cost approach or instead chooses to use the normal nonpreference, nonpreference tax -- may I start again -- or instead chooses to use the normal nonpreference cost depletion method. Once made, the taxpayer of course, would be bound by his election for the life of the well.

It is my information that staff finds no objection to this, and I would ask if we might have an expression from them.

Mr. Shapiro. No, Senator, in fact, that is the way the staff understood that the provision was to be drafted anyway. All it does is to allow a taxpayer to elect out of the preference, and they have their option. If they elect the preference, then the alternative tax would apply, but they can elect not to have the preference, in which case they are under the regular rules, and that appears to be appropriate, and we had planned to draft it that way.

Senator Hansen. Thank you very much, Mr. Chairman. That takes care of me.

The Chairman. Okay.

Why don't you tell about those items?

Mr. Shapiro. All right. Mike Stern has one here that has to be done, too.

Mr. Stern. Mr. Chairman, as I started to mention the first thing in the morning, the Budget Act requires that in order for the Senate to act on any spending bill, that each Committee has to file a Committee report showing how they would allocate the amounts allowed under the most recent budget resolution.

This bill already has in it two items that are spending items, the refundable portion of the earned income credit, and the social services grants. So we would -- I am not sure whether you have it in front of you --

The Chairman. I have it here, allocation of --

Mr. Stern. Allocation of amounts allowed in the fiscal year 1979 budget resolution.

The table that is on the back of that sheet shows the amounts that the Budget Committee assumed in these different categories for new legislation. Other income security, $700 million, social services, $300 million and Medicaid, $100 million. We would see no problems with that. As far as we can tell, all the legislation you are going to handle would fit within the amounts allowed.

The only exception is there is no allowance for --

The Chairman. Can we settle it right now?

Mr. Stern. The only thing I would mention to you, we would recommend that you accept these amounts and file a report on this basis except there there is nothing allowed for refundable credits for energy in the Budget Committee allocation allowance. I don't --

The Chairman. Bring that up, the energy thing, as soon as we get back, okay?

Mr. Stern. Okay.

The Chairman. Go ahead and explain what you had.

Mr. Stern. The Budget Committee has assumed that new legislation within the jurisdiction as it affects spending will total $1.1 billion. You have already agreed to the amount that they allowed for Social Services. They have several million dollars for income security and $100 million for Medicaid. These are in round numbers.

I want to point out to the committee that the second Budget Resolution under their assumptions does not have any amount for refundable credits for energy. I don't know whether you want them included or not, but in the bill pending in Conference the amounts are about $400 million in refundable energy credits which under which under the budget process are considered to be expenditures.

This includes the $304 million on the corporate side for alternate energy equipment, and so forth, $45 million for special energy equipment such as heat recovery equipment. The only other substantial item is $26 million on the individual side for insulation and energy use, and so on.

The question will be whether you want to make a decision now or whether you want to make an allowance in the Fiscal Year 1979 for refundable credits for energy, whatever might emerge from the legislation.

The Chairman. Let me ask you: do we have a couple of days to get this thing back in here?

Mr. Stern. The allocation report has to be filed before you can take up any legislation that affects spending, including this bill in which you have added two spending items.

can take up any legislation that affects spending, including this bill in which you have added two spending items.

The Chairman. What I have in mind is that you have a Conference Report on the energy bill. The Conference Committee is meeting on the energy bill scheduled for Friday. If we can wait until Friday or Friday evening to make a final decision, I think by Friday evening we would know what to do about energy. Can we take that long?

At that point our conferees, I would hope, would pick out the particular refundable item that they think has the highest priority and drop some of the others. So we would have a refundable item and I would hope that it would be where we think it is the most desirable, all things considered, which has the most argument for it.

Can we wait to decide that?

Mr. Stern. Yes, sir. I assume you will have another committee meeting at some point next week and you will decide it at that time.

The Chairman. Right.

Let's agree to everything except the refundable item on the energy bill. That one I think we can decide Friday and then we can do business.

Now on that Energy Conference, we have a quorum of the

Finance Committee, so do you think we can call the meeting the same day and meet after we do that and agree on this?

Mr. Stern. You can agree on a sort of contingent basis that you will allow for whatever the conferees agree to and I think you would have to reduce in the other income security category, that is the larger category. If you agree to $200 million worth then you would still be within this total.

Senator Byrd. How would the refundable work on the energy?

The Chairman. You have a refundable tax credit on insulation. That has to do with people, poor people, who insulate homes. Is that right?

Mr. Shapiro. There are a couple of items. You have refundable residential requests for insulation and solar. There are also some business properties. For example, alternative energy property. Certain boilers are provided for refundable credit. That means that if that corporation does not have sufficient income to offset additional investment tax credit on that they can get the refundable credit. The Government would give any amount of credit that they have available to them.

The Chairman. The point is that assuming that the crude oil equalization tax does not survive that Conference, then that means that you have to have a very major reduction in the tax reduction and tax credits that are in there, so we wouldn't have much of anything to talk about, assuming that it would pare everything down. You would not have much in the way of refundable credit by the time you get through. Maybe a couple hundred million dollars, or something like that.

Mr. Stern. The bill as a whole is a $5 million bill. So a quarter of a million dollars is less than 10 percent. By the time you scale the size of the credit down this $400 million might be substantially lower.

Mr. Shapiro. If you make the effective date January 1979, the fiscal year effect of any refundable credit for businesses would be very, very small. The calendar year effect may be different but the fiscal year effect for budget purposes would be small.

The Chairman. Then we will try to decide that and try to get a committee decision. I hope we can announce the committee meeting now to meet for this purpose just immediately after we resolve the Conference on the energy bill. The rest of it we will approve.

Mr. Shapiro. What you might want to do is to tentatively approve what he has here with the contingency if you have any refundable credit, then you would take it into account in reducing the other element he has. In this way you would not need another meeting. You would do that today.

The Chairman. All in favor say aye.

(Chorus of ayes)

The Chairman. Opposed, no.

(No response)

The Chairman. The ayes have it.

While we have the Senators here, Mr. Nelson has a matter pending a few days back.

Senator Nelson. I passed this out yesterday. This is what the estate tax lawyers call the Widow's Tax. If legal title to a farm or business is jointly owned by husband and wife, and the wife contributes substantially, works in the store every day or on the farm or in the enterprise, the entire value for the estate tax purposes is deemed to be the husband's property.

Incidentally, in a Federal District Court case in South Dakota in June of this year the Federal Dsitrict Court overruled IRS in a case in which the evidence was clear that the wife for 43 years had worked in the enterprise of farming with her husband. They ruled that that was a constructive partnership and half of that estate was hers.

This bill would simply permit a spouse, either husband or wife, permit a spouse to earn an estate tax credit on jointly-owned property at the rate of 2 percent a year up to a maximum of 50 percent if he or she can demonstrate the participation in the enterprise.

Now, the fact is that if they were wise enough to create a partnership when they got married, that settles the case; or if they lived in a community property tax State, of which there are I believe seven, then the woman is entitled to half the estate.

This would correct a situation that is very discriminatory.

I believe the Treasury agrees with the concept and would like some modifications.

Would you like to settle the question of the effective date and some other points which I think we can reach agreement on?

Mr. Lubick. It is correct that in principle it is an appropriate amendment to the estate tax law. A few of the technical points with which we are concerned which we will be able to work out are: first, that it ought not to apply to community property States. I think it is not necessary in that situation. There is the question of how you handle reporting the self-employment income, and the question involving indebtedness of property where part of the spouse's share of the earnings ought to be regarded as having paid off some of the indebtedness to which the property is subject.

If we could have some time between now and the Conference perhaps we could come up and work with you, Senator Nelson, with technical amendments that will clarify these problems.

Senator Nelson. I wonder if we can approve it, subject to reaching an agreement on the details, including the effective date, which I understand makes a significant difference.

Senator Curtis. Would the Senator yield for a question.

Senator Nelson. Yes.

Senator Curtis. Twenty-five years is a long time. Why are you wedded to two percent? The wife is certainly entitled to more than two percent.

Senator Nelson. I am not particularly wedded to it. How long should somebody make a contribution to a particular enterprise to achieve half ownership?

You understand the way it would work? If each puts in money they are equal on that aspect in any event. If she and her husband put $10,000 into an enterprise, let's say it is a grocery store, on a regular basis she worked in the grocery store 25 years, under this she would have 50 percent of whatever the value of the estate was, minus the past contribution made by the husband at the time. Of course if he wants he can make a gift or create a partnership and resolve that part too. We thought two percent per year would make a half interest.

Senator Curtis. I am not interested in more than 50 per cent. I think 25 years is too long.

Senator Nelson. Too long to be married?

Senator Curtis. No. Too long an apprenticeship to become a full partner. That is what it amounts to.

The Chairman. Let me tell you my concern. My concern is the last sentence, "Joint committee estimates net revenue loss approximately $200 million."

Can the Treasury go along with this the way it stands?

Mr. McConaghy. That revenue is on a calendar year. On a fiscal year basis depending on what effective date you use, if you use today's date the revenue may be somewhere in the neighborhood of $50 million. If you use the end of the year the revenue on a fiscal basis would be about $10 million.

Mr. Lubick. Wouldn't the revenue be less because decedents dying after a specific date would have a time to file a return?

Mr. McConaghy. Nine months. If you start January first it would be $10 million or less than $10 million. If you start today it may be $50 million, but it can't be $200 million.

The Chairman. I am trying to protect these middle income people. To do that we need to hold the figure down.

Senator Nelson. We could make it January first and anywhere from zero to $10 million.

Mr. McConaghy. Yes.

The Chairman . That helps a lot. Does Treasury go along?

Mr. Lubick. Yes, January first.

Senator Nelson. I would like to leave it that way but if after looking at it you wish to offer an amendment on the Floor to change that percentage or adjust it with Treasury --

Mr. Lubick. The two percent is appropriate because it is a situation that usually arises where one spouse has furnished the initial capital and then they leave the earnings of the operation in and it builds up incrementally based on the earnings. So we have the question of one spouse having made an original contribution.

It is the question of the two of them participating together and leaving an increment in the business as it builds up. We have explored the possibility of a more direct and accurate method that will appraise each spouse's annual contribution. It got so complex we came to the conclusion that Senator Nelson's approach was probably the only practical way to solve the problem .

Senator Curtis. I won't stand in the road. I am delighted for any relief in this area. Now this is aimed primarily at those couples who do no estate planning?

Mr. Lubick. That is correct. Any good lawyer would not leave property like this in joint names.

Senator Curtis. Some lawyers are very good.

Senator Nelson. I would like to point out on that very important point a check in our State indicates that only 50 per cent of the farmers even have a will. So if they had counsel and created a partnership when they got married, there would be a 50-50 split on the estate at the time of death anyway.

Senator Packwood. You have indicated a lot of concern about some of our potential tax losses in the out years. The Treasury has no objection to the $200 million calendar loss following next fiscal year.

Mr. Lubick. Basically, Senator Packwood, the principle of this amendment is appropriate because it gives for those decedents who did not have the benefit of proper estate planning that which is obtainable by securing the advice of competent counsel.

Senator Packwood. I understand that. The merits are good. Often the argument is used against other meritorious amendments there is a tremendous out year financial loss. There is a $200 million calendar year financial loss in this amendment.

Senator Nelson. If you are going to throw logic into this, we will never get through.

Mr. Lubick. This is a technical question of giving a person rights which exist for most persons. If you are talking about questions of corporate cuts that involve very large amounts in the out years, I don't think that is a question of assuring to some groups of taxpayers those rights which they already have under the law if they were smart enough to take advantage of it.

Senator Nelson. That sounds like "animal farm" reasoning. I know what you mean.

I so move.

Senator Gravel. I second the motion.

The Chairman. All in favor say aye.

(Chorus of ayes)

The Chairman. Opposed, no.

(No response)

The Chairman. The ayes have it.

Senator Dole. First I would like to address a question to Mike or to Bob. A couple of years ago we extended the exemption for moneys received from the Armed Forces Health Professions Scholarship Program, and Public Health Services, from taxation. My understanding is that the Joint Committee is going to make a report on the appropriate treatment of scholarship moneys and that has not been completed. It affects five thousand participants in the Armed Forces Haalth Scholarship Program, and five thousand in the Public Health Service, National Health Service Corps Scholarship Program.

It is my understanding that study has not been completed. There has been a suggestion that we extend the provision for one year. I don't know of any objection to it.

Mr. Shapiro. This would say students entering the training program during 1979 would have one additional year to complete their program. For example, before 1974 I think it is. We have had trouble keeping up with the legislation. We would like to have an additional year for the study. We fully intend to do what the Congress asked us to do.

Senator Dole. I don't want to submit an amendment. I want to raise the question. I think they wanted to extend it.

The Chairman. No objection from Treasury?

Mr. Lubick. Senator Long, this is an amendment I believe we already acquiesced in on the House side.

The Chairman. Without objection it is agreed to.

Senator Dole. The other one is a little amendment to add additional exemption for the totally disabled. I don't know if there is any objection to the concept, but you know when we had Mr. Roper in here in July telling us about the survey, there was one point that I took special note of and that was 84 percent of those polled felt that one group who needed additional consideration was the totally disabled, the handicapped.

You have had a chance to see some of those young people around in the wheelchairs in the past couple days.

I understand there is some revenue impact and maybe it could be modified or phased in or somehow reduced. It would apply to those under 65. I think the staff is aware of my interest in this amendment. I don't know that it is necessary to make a case for it. We have of course one for the blind and that started back in the 1940's, I think primarily because they were organized and they advocated that and about 200,000 blind are recipients of that extra exemption, plus we have additional exemption for those 65 and over.

As far as handicaps are concerned, I think it is fair to say, particularly those who are so defined in Section 123(c)(1) are seriously disabled who I just happen to believe have additional expenses.

We are talking about taxpayers, heads of households or spouses 65 years or younger. They have additional costs in transportation, additional cost in housing, additional cost in clothing. It just seems to me that it is an area that we should address.

I know we have talked about helping the poor, helping the middle income, helping the rich. Maybe we ought to help the handicapped who are trying to help themselves.

Mr. Shapiro. The proposal that Senator Dole brings up provides for additional personal exemption for an individual who happens to be permanently totally disabled. Under the present law he gets a thousand dollars. The House Committee agreed to a personal exemption for an individual and for a spouse and each dependent. In the case of the aged or the blind, there is an additional personal exemption. Senator Dole is providing an additional personal exemption in addition to what the present law provides for the aged and blind, also if they are permanently and totally disabled.

The revenue cost on that on a full year basis without any phase-in would be approximately $1.3 billion. If you limit it to those under age 65 it would be $790 million. If you were to phase it in it would have varying effects.

For example, if you phased in at $250 that would be $307 million. All the estimates I am giving you are on a full year.

The fiscal year would be somewhat less. These are verious revenue tax alternatives.

Mr. Lubick. Mr. Chairman, we do believe that governmental support of the disabled is an important function of the Government but we believe that doing it through income tax exemptions or income tax exclusions is not the appropriate way to do it. The expenses which are attributable to disability are generally deductible expenses. So the basic need which is not met, of those who are disasbled or handicapped, is not a failure to allow appropriate adjustments to the income they have but, rather, the fact that they have a lack of income.

Now, if lack of income is the problem, then the need is not well met by giving exemptions and exclusions because those benefits more, and for the most part, only those who have a substantial amount of income. For the permanently and totally disabled, as a matter of fact, by and large, wage income by definition is impossible because they are permanently and totally disabled.

So therefore the exclusion is of benefit only to those who have other sources of income. The exemption for a totally disabled person in the 50 percent bracket would be $500 under the $1000 exemption you are talking about.

In the 14 percent bracket it would be $140. The person who is most in need of assistance obviously is the person in the lowest bracket. Basically, therefore, this approach of solving a very real problem of assisting the disabled with their problem of income is not well met through this extra exemption. We think that other methods of assistancee would be more appropriate.

Senator Dole. You could have a wage earner but you could have a spouse that is totally disabled to which it would apply.

As I understand, your medical is only three percent of your adjusted gross. So they are not all covered. Plus the other extraordinary expenses that are incurred.

Mr. Lubick. That is correct, there is a threshold of ordinary medical expenses. If we are talking about extraordinary medical expenses, it is fairly easy to pass that threshold.

The Chairman. It seems to me that in this area now we have a very, very big problem. It is not the tax, it is on the other end of it. It is on the spending end.

I supported the SSI and putting this thing under the SSI. Regretfully we have large numbers of people and the rolls are growing rapidly. We are spending billions, not just a few billions. Mr. Lubick might not even have the figure because it is in the Department of HEW.

Mr. Lubick. The figures are currently of the estimated six million disabled persons, approximately three million are currently assisted through DI and SSI.

The Department of Health, Education and Wel are has announced that it has set up a work fund disability and it has promised it will submit a set of proposals on the subject to Congress next year dealing with various questions, changes in SSI, vocational rehabilitation programs, and definition of disabled.

It seems to us that is the appropriate way to go at this problem and it would not be desirable to introduce an additional revenue loss to the tax system which would not be well targeted which could amount, when fully allocated, to one billion dollars.

The Chairman. The people I saw in the wheelchairs were telling me that what they want is to be permitted to earn something without its reducing their SSI benefits or veterans' benefits.

Senator Dole. That is another problem.

Senator Moynihan. We had hearings last night --

The Chairman. That is a different problem. It is not a tax problem. It is saying when they earn something they don't want their disability benefits to be reduced by what they earn. Right now I think they are being reduced dollar for dollar.

Mr. Lubick. That is the same tax problem that Senator Moynihan referred to in connection with the phase-out.

The Chairman. In trying to help the disabled that is a big probme. It is going up in cost so much that it is creating a real spending problem.

It seems to me that this is not the way to help those people. The way to help them if you want to do it is to go ahead by way of either payments or by disregarding some of the earnings. I really think, Senator, the other thing is a better way to help them.

I know it is not cheap. It is not cheap no matter how you do it. If you go the tax route that tends to be discriminatory.

Senator Dole. It is discriminatory now. I don't know if Mr. Lubick wants to repeal the additional exemption for the blind. Is that what you are suggesting?

Mr. Lubick. We are not suggesting that, Senator Dole. I think we would be very pleased to study it if you would like us to make a recommendation.

Senator Dole. I don't want a repeal. It is discriminatory now. I am talking about others who have serious handicaps who may have spouses severely handicapped. All I am suggersting is that we are refunding taxes to those who make up to $12,000 on a phase-out and we are getting ready to offer another welfare amendment to the tax bill. I am just trying to do something for somebody who might have a handicap who has some earning capacity, is a taxpayer, or on the other hand, may have a totally disabled spouse. Maybe this is not the right way to proceed, but I don't know how you explain the conflict.

Mr. Lubick. Your point is well taken that perhaps the existing exemptions are not the efficient way to solve the problem, in which case we can go into those and see if we can devise a better way to handle those problems. We would be very pleased to do that.

Senator Dole. I don't want to suggest that you want to do away with that. It seems to me that there are others who are hampered as much. I assume somebody takes advantage of the additional exemption for the blind. That costs some money, does it not?

Mr. Lubick. It does.

Senator Dole. About 200,000 take advantage of that provision. I don't know what the total cost is.

Mr. Lubick. That was introduced into the law many, many years ago.

Senator Dole. Right. In the 1940's.

Mr. Lubick. The primary justification for its existence, I suppose, is by proscriptive rights, having been there in the statute. I think if it was an original question you would not try to solve that problem in that way. Obviously it is a much less serious problem. The revenue cost with respect to the extra exemption for the blind apparently is about $20 million.

Senator Dole. I don't want to break the bank. It seems to me that there ought to be some inspiration over there on how we might recognize --

Mr. Lubick. There will be some inspiration delivered next year from the Department of HEW.

Senator Dole. You just don't think this is the best way to proceed through the tax system, is that correct?

Mr. Lubick. That is correct.

Senator Dole. Why is it all right to make welfare expenditures through the tax system?

Mr. Lubick, The earned income credit is designed to target some relief to very low income people. It is a credit to persons who have paid substantial Social Security on their earnings. It is designed as an offset to that and it phases out very quickly. The extra exemption would operate to very little benefit; in fact, no benefit to those persons who had no income. It would give small benefits to those with little income and it would give rather substantial benefits to those with large amounts of income.

Senator Dole. What would be the cost if you had a hundred-dollar credit?

Mr. Lubick. About $600 million. That would be a refundable credit. Six million disabled. It is a question of how many of them have tax liabilities of a hundred dollars. The next one would be $6 million.

Senator Dole. That is the outside.

Mr. Lubick. That is the outside. To the extent that we are dealing with non-taxable it would be somewhat lower.

The Chairman. Didn 't you say that if you gave them an additional exemption that that would cost about $20 million?

Mr. Lubick. Additional exemption when fully operative would cost about $1 billion $300 million.

The Chairman. I thought you mentioned somehting that cost only $20 million. What was that?

Mr. Lubick. Senator Dole asked what the effect of the existing exemption for the blind is.

The Chairman. That is one problem that it gave me when I posed that amendment for the blind.

Mr. Lubick. Especially since the Department of HEW is preparing programs which will address the problem directly, and hopefully more efficiently from a revenue point of view.

Senator Curtis. May I ask a question about your definition of the totally disabled.

There are some people under some programs who are totally disabled if it is certified by competent authority that they cannot perform ordinary work. I think Senator Dole had in mind the most extreme cases of wheelchair patients, paraplegics, others who are so handicapped that it costs them additional funds to live, as well as to be in a position to earn. Would it make any difference if

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you narrowed your definition of who is handling it?

Mr. Lubick. We assume that the definition that Senator Dole has in mind is the one currently in section 105(g)(5), "An individual is permanently and totally disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or medical impairment which can be expected to result in death, or which has lasted or can be expected to last for a continuous period of not less than 12 months."

Senator Curtis. Yes, but we know there has been a rather liberal definition applied to totally and permanently disabled Civil Service employees, in the military. It takes in a great many people in that category. Maybe they are, I don't know.

I think there are others who are more severely handicapped. What I am trying to do is see if there is any avenue by which those severe cases could get a break on their taxes.

Senator Dole. We are doing it the same way that the present law would apply to a spouse that is totally disabled.

Senator Curtis. And thus lower the cost.

Mr. Lubick. It would be very difficult. This is fairly close to a Social Security definition. Multiple definitions of permanent and total disability would be very confusing.

I don't believe the Internal Revenue Service is in a position --

The Chairman. Here is the problem you are in. If a person is totally disabled under Social Security or SSI he is entitled to a substantial amount of money from this Government, he is entitled to enough money to support himself. Now, when he goes to work to do something, in a great number of these cases in doing so he prov^s that he is not totally disabled and then he loses the SSI check.

I just got through the embarrassing situation of trying to help a friend. He said he has arthritis. He is thinking of going back and having a try at it. He was on the SSI. He was getting a check until he went back to try to do a job. After about three days he was in such pain he said he couldn't do it, so he had to quit. Then they go and investigate him and take him off the roll because they say he is not totally disabled, he went back to work.

From his point of view he went back to work and tried but he couldn't do it. Now he is off. Now you have that conflict there. The disabled person is supposed to be totally disabled. The answer to that is going to have to come in how are we going to define totally disabled, people who can do nothing whatever or people who can do some type of work.

I know a person who died a whie back, a wheelchair person She was getting by on her wits. She would tell humorous stories and sell them to other people, a gag writer, you might say. She was totally disabled. She was using her brain to make a few dollars.

I don't think that anybody has the answer to that right now. I know Senator Dole is sympathetic to people and wants to help them. I don't think he has the answer to the problem.

Senator Dole. I am concerned with some man out there working, or wife, and the other spuse is totally disabled. All I am suggesting is that they ought to have an extra exemption.

Mr. Lubick. Basically you have a situation where you could have one spouse earning $100,000 a year and the other spouse being disabled and you would be including an extra exemption.

Senator Dole. You probably have that right now in the blind. I don't assume everybody who is blind is at the poverty level.

Mr. Lubick. You are quite right. You have the blind to a very modest extent. Doubtless that is not the most efficient way to provide assistance to the blind, those that have problems with insufficiency of income. This approach simply is the 1940's approach to a 1970's problem.

Senator Dole. I wonder if we could exclude anyone who might be receiving compensation from Veterans Administration or Social Security.

Senator Curtis. Ot Civil Service.

Mr. Lubick. Again I don't think that addresses the real problem. The basic problem is one of insufficiency of income. If the person has sufficient income there is no particular reason to give either that person or his spouse or parent or whoever it is --

Senator Curtis. Why don't you just make it a lifetime disability, they can never work. That ought to limit it.

Mr. Lubick. I do believe in your case the committee in 1976 liberalized the child labor credit which provides again extra credits for the care of dependents. So you have acted to move in that direction. The extra exemption, no matter how limited, is not appropriate if it is limited to the person who earns. That person is not eligible, it is limited to the dependents.

You are giving the greatest benefits to those who are the dependents of those who have the least need for it.

The Chairman. Why don't we vote on it.

Those in favor of the amendment say aye.

(Chorus of ayes)

The Chairman. Opposed, no.

(Chorus of noes)

The Chairman. The ayes appear to have it.

Is that $1.3 billion?

Mr. Lubick. $1.3 billion.

Mr. Shapiro. I think it is only those under age 65. Therefore, it is $790 million.

Senator Curtis. If I could have the attention of the Treasury for a second.

Mr. Shapiro. It would be approximately $300 million.

Senator Dole. If it would be effective January first/

Mr. Shapiro. $800 million. We are saying less than

50 percent.

Senator Packwood. Even though it does not go into effect until January first?

Mr. Lubick. Reductions are reflected in the withholding table immediately as extra exemptions.

Senator Curtis. Perhaps I did not make myself clear. I think that without complication of definition and so on you could cut the cost down and still take cae of the most needy cases. If it is a husband and wife and one of them is totally disabled, but they are getting Social Security disability benefits or they are getting Veterans disability benefits or they are getting Civil Service disability benefits, if you eliminated those, then it wouldn't be double-dipping and the remaining would get the benefit of the Dole amendment.

I just raise that to see how much that would reduce the cost. Perhaps it is not acceptable to Senator Dole, but I imagine a realistic view of this is that you can not maintain the item if it is going to cost a billion three.

Mr. Lubick. Senator Curtis, I think the group which you have left eligible would be the group that is the very group that is eligible for the child care credit by the definition.

Senator Curtis. That is if they have to have a caretaker, isn't it?

Mr. Lubick. Yes, there are expenses.

Senator Curtis. It relates to expenses if they have to have a caretaker.

Mr. Lubick. It could be a housekeeper.

Senator Curtis. But it relats to the expenses.

Mr. Lubick. Yes.

Senator Curtis. Not for their condition, per se.

Mr. Lubick. No. If it was for the condition, per se, the medical expenses would apply.

The Chairman. How much would that reduce it if you did that?

Senator Dole. Let's make it $500.

Mr. Lubick. It appears that for the most part 4he persons that Senator Curtis is excluding are the lower income persons. What you are being left with tend to be the higher income people.

The Chairman. But those people are getting a payment from somewhere else. If the Government is paying them money you are entitled to take that into account.

Mr. Lubick. Mr. Chairman, the point is that we indicated that about half of the six million are receiving some sort of benefits. That leaves three million that are not. Those three million tend to be those with the higher income. So while you are reducing the number of eligibles by half you are probably not reducing the revenue cost by half because it would be a reduction of somewhat less than half.

Roughly speaking, we would estimate that it would still cost more than half the original estimate, somewhat more than half.

The Chairman. That reduces the cost of it, though. Say it cuts the cost in half.

Mr. Lubick. About 40 percent.

The Chairman. Then I so move. At least that would help. All in favor say aye.

(Chorus of ayes)

The Chairman. Opposed, no.

(No response)

The Chairman. The ayes have it.

Now if you can move the date forward at least we are somewhere near the budget.

Mr. Lubick. Senator Dole talked about cutting that to $500.

Senator Dole. They took care of it for me. They cut it in half.

The Chairman. If you move the date forward and make it effective in July, at least that helps to squeeze it inside this fiscal year. The Senator would go along with that.

Without objection we will agree to that. That lets it down to where we are at least in a --

Mr. Lubick. I assume you are requiring the dependency measure for the entire year, you have to furnish more than half the support for the entire year in order to be eligible beginning July 1.

The Chairman. It seems to me it would be likely to have the benefit of a half year for the first tax year, but you put it just as though it goes into effect and ends up January 1. The first calendar year they get half of it. The second calendar year they get the full amount. That at least would cut down on the revenue cost of it. To me that is very important. If you move it to July, what does that do on the fiscal year?

Mr. Shapiro. Our estimate is in the neighborhood of $100 million on a fiscal year basis.

Mr. Lubick. Senator, I assume you are suggesting for the calendar year 1979 one is entitled to only half of the exemption. If it is effective July 1, exemptions are normally measured when you make out your return for that year.

The Chairman. I am not trying to make this a matter of tax simplification. This complicates the tax law by definition. So that the people who want to apply for it --

Senator Dole. Let's make it $500 the first year, $750 and $1,000. Does that help you any?

Mr. Stern. It would bring you up against the budget question again of having an increase in fiscal 1980.

Senator Dole. I don't want to do that.

Mr. Lubick. It probably would go to a quarter which would be comparable.

Senator Dole. If I did it that way, 250, 500, I would still have the budget problem?

Mr. Shapiro. Yes. Anything you do in the fiscal year. You would have to skip one year. You could go, for example, 500 for 1979, 500 for 1980, a thousand for 1981. You can't have an increas in 1980.

Senator Dole. Let's do it that way.

The Chairman. Without objection the amendment will be so modified.

Mr. Stern. Do I understand correctly this would not apply to a person who is receiving benefits either as a disabled veteran or under the Social Security Act, or under the Civil Service Retirement Program?

The Chairman. If he is receiving those benefits it does not apply.

Senator Moynihan.

Senator Moynihan. Mr. Chairman, I would like to raise a matter which is not new to the committee which the committee agreed to a year ago and included in H. R. 7200, which we are not going to have time to deal with this year.

I would like to put it on this bill. It is the second half of the fiscal relief we agreed to last year. Last year we agreed for fiscal year 1978 and 1979 that there be in each year $500 million in fiscal relief apportioned by formula, half made up of the revenue sharing formula, the other half the formula for AFDC funds, and each State would get a greater or lesser degree accordingly as it made progress in reducing its error rate.

There is a slight variation on that, not to penalize some States that have had lower rates all along. In any event, these are small changes. What has happened this year is that one-half of this year's allocation has been distributed. We agreed to that last year and the money has been passed out. The other half is on H.R. 7200, and it is not going to come out in fiscal 1979. This would mean the fiscal 1979 money would go forward as we agreed a year ago.

Senator Curtis. That has nothing to do with what we voted on the other day?

Senator Moynihan. No, sir. We would be taking the tax from this bill and put it in this one.

Senator Packwood. Mr. Chairman.

The Chairman. Mr. Packwood.

Senator Packwood. The distribution half is the basis the same as we defeated yesterday, half revenue sharing, half AFDC?

Senator Moynihan. That is right.

Senator Packwood. What you have added to it is the error rate formula.

Senator Moynihan. I have gone back to the original figure.

Senator Packwood. We are using the same basis as yesterday.

Senator Moynihan. Yes.

Senator Packwood. A slight change is made based on the error rate reduction?

Senator Moynihan. Yes.

Senator Packwood. Your sampling period for the payment will be October 1978 to October 1979?

Senator Moynihan. That is for October 1978 to March 1979.

Senator Packwood. Is the money going to be passed out periodically?

Senator Moynihan. I believe it is one lump sum at the end of the year is the way the HEW has been doing.

Senator Packwood. Is that right, one lump sum next September?

Senator Humphreys. It would be between March and September.

Senator Packwood. So it would be a one lump sum, the State within reason will know what it is going to get and it will be basically yesterday's formula with some slight variation for their error rate improvement between October and March, but apparently some fail-safe provision for States that are already down around the four percent level?

Senator Moynihan. That is right.

Senator Packwood. I have no other questions at the moment, Mr. Chairman.

Senator Danforth. Isnt this the same thing we voted on yesterday, except it is $100 million more?

Senator Moynihan. No, yesterday in the context of a larger proposition about welfare change I said could we put in a one-year provision. That was agreed to.

Now I say can we not put on this bill a matter we afreed to a year ago and which program has already been in effect for one year?

Seantor Danforth. It is exactly the ssme concept. It is the fiscal relief section of 7200.

Senator Moynihan. That is right.

Senator Danforth. All it is is fiscal relief. What we agreed to a year ago in 7200 was a bill which had within it certain elements of welfare reform having to do as I recall with adoption services and other things. Now in the name of something that is called welfare reform, this is not any welfare reform at all. It is simply a fiscal relief provision put in a tax bill.

Senator Moynihan. I think the other measures were social service measures, not welfare reform. They are very much alive as far as this Senate.

Seantor Danforth. I don't think it is accurate to say that we are taking 7200. We are not. We are taking nothing more than fiscal relief.

Senator Moynihan. Implied nothing more, Senator.

Senator Danforth. It is the same formula we had yesterday. So you have exactly the same formula.

Take Texas, for example. Texas got 7.5 percent, and the poor people got 3 percent of the benefits under this program. New York has 7 percent of the benefits and gets something like 13 or 14 percent. It is exactly the same problem.

Senator Moynihan. If you want to get into the statistics, the statistics on who has the poor people, for example, in California the AFDC payments raised people above the poverty level. Therefore they are not recorded as important. They began as poor.

Senator Danforth. We are talking about the quantity of poor people.

Senator Moynihan. No, we are talking about the quantity of welfare recipients.

Senator Danforth. No, we are not.

Senator Moynihan. We are talking a bout different things.

Senator Danforth. That is exactly the point. The point that we are just trying to funnel money into certain States which have certain kinds of welfare programs or do you want to get into the question of helping people who are in need? All this is is a sort of relief program with the benefits that are apportioned according to bailing States out, not according to helping poor people.

The Chairman. Let me say this: This is the same thing we did last year. Isn't that right?

Senator Moynihan. That is right. What we agreed last year to do for this coming year.

The Chairman. We also agreed to do this in Congress and put it out on the calendar.

Senator Moynihan. That is right.

The Chairman. We are talkingabout something that we agreed to. Now if we don't do this, then the States are going to be in a very, very tight fiscal squeeze by the time we come back here next year.

Now, the Senator from Missouri made the point that he thinks that is a great thing to put them in a squeeze, squeeze the States as much as we can.

From my point of view the status quo is that we have continued some matching for the States and we are taking care of the financial pressure on the States with this provision that we voted, it is more than a year ago now. That is the law and that is how they are doing business.

My thought is that we ought not to try to increase the pressure on the States to try to make them advocate something one way or the other. We ought to go ahead with the fiscal relief we have and in the event we want to change the program, okay, we change it. But I don't believe in trying to put the pressure on the States to try to advocate one thing or the other.

Senator Bentsen. What is Treasury's position?

Senator Curtis. May I say this to Senator Moynihan. This is related to the matter yesterday. I assume that it would be brought up again. I am prepared to offer a compromise that will be acceptable. I can tell you briefly what it is.

It would provide an additional $400 million per year for AFDC and $200 million for Title 20 for three years subject to these conditions. These to be done on an option block grant basis applicable to both revenues and to expenditures so the State can choose either the existing law or the block grant and to operate and design their own AFDC program.

I would further agree that both the base and the additional $400 million be updated by the cost of living index, population and unemployment in the second and third years for those States which elect the block grants. For those States which do not elect the block grants option the $400 million provided would be tied to the quality of growth standards as done in H.R. 7200.

I would be glad to vote for a 3-year period if we could get a block grant started both on the revenue and expenditure side. Now maybe you want to think that over.

Senator Moynihan. Senator, it is generous of you to think that way. I think that is too large a measure to consider at this hour in this Congress. That is exactly where we should start in January with these types of problems.

Senator Bentsen. Mr. Chairman, I would like to hear Treasury's position on this.

Mr. Lubick. The Treasury has no departmental position on this. The Administration is opposed. There are representatives from HEW here who can speak to it.

Senator Moynihan. This is news to me. Is that the case?

Mr. Segal. Yes.

Senator Moynihan. I would like to have a vote on it anyway. The Administration is opposed to it. That is charming, that is damn charming.

Senator Danforth. Mr. Chairman, we had the Secretary of the Treasury here today giving reasons why the President is not happy with the bill in its present form. Now we are talking about adding a $400 million item to this bill that is not related in any way to taxation on which I don't think there have been any hearings and which the Administration is opposed to.

Senator Moynihan. Just one second. We passed this bill out of committee.

Senator Danforth. We passed a bill out of this committee of which this was a portion in connection with other parts of the bill. It is like saying you have a cake when you remove the icing from it.

Senator Moynihan. There was one fundamental reform. The only thing we touched on AFDC is the error rate. We said the relief is conditioned on reducing the error rate. That is explicit.

Senator Danforth. You have the whole adoption question in 7200.

Senator Moynihan. Which are legitimate questions having to do with social services.

The Chairman. I would like to report this bill today, gentlemen. I would ask that you go ahead and vote and come back.

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5:30 pm.

The Chairman. I would suggest we call the roll on the Moynihan amendment and the absentees can vote later on.

Senator Matsunaga. Mr. Chairman, I have discussed this matter with Senator Moynihan, and he has agreed to modify with another provision of H.R. 7200, which was unanimously adopted by this Committee with reference to Puerto Rico. If you'll recall we have a compromise, the compensation for disabled, blind, and the aged.

The Chairman. Unanimously agreed to.

Senator Dole. Does that take care of Guam and the Virgin Islands?

Mr. Stern. Puerto Rico, Guam and the Virgin Islands are covered by the providion.

Senator Talmadge. Senator Moynihan, your amendment, I understand now, includes the quantity controls that we have put in H.R. 7200 by the Committee by unanimous consent, is that correct?

Senator Moynihan. That is correct.

Mr. Stern. This section also affects the Northern Marianas so that you are talking about this whole Section 603 of the Committee bill that related to the territories.

Senator Matsunaga. Right.

Senator Dole. Are you ready to vote?

Senator Danforth. Mr. Chairman?

The Chairman. Gentlemen, we can't hope to discuss these matters all day and hope to vote them out.

Senator Danforth. I don't want to discuss them all day. I just want to discuss them for about two minutes.

I don't see any reason at all why we have to put a fiscal relief provision in this bill. It has nothing to do with taxation, nothing to do with tax reform, nothing to do with welfare reform. It is simply throwing the money out. The facts are that the states are not in a squeeze. The facts are that last year there were about $30 billion worth of surplus in state and local government. We are facing, what, a $40 billion deficit in the federal government. I see no reason why we should be throwing this money out, and especially on this kind of disproportionate basis.

I point out to Senator Talmadge that Georgia has 4 percent of the poor families in the country and it would get 1.6 percent of this money. It is just a redistribution of cash, and the cash is going to New York.

The Chairman. Well, let's call the roll.

Senator Packwood. Is the administration still opposed to this?

The Chairman. Yes.

Call the roll.

The Clerk. Mr. Talmadge.

Senator Talmadge. Aye.

The Clerk. Mr. Ribicoff.

Senator Ribicoff. Aye.

The Clerk. Mr. Byrd.

Senator Byrd. No.

The Clerk. Mr. Nelson.

Senator Nelson. Aye.

The Clerk. Mr. Gravel.

Senator Gravel. Aye.

The Clerk. Mr. Bentsen.

Senator Bentsen. No.

The Clerk. Mr. Hathaway.

(No response.)

The Clerk. Mr. Haskell.

Senator Moynihan. Senator Hathaway is aye by proxy.

The Chairman. Yes, I have the proxy, aye by proxy.

The Clerk. Mr. Haskell.

(No response.)

The Clerk. Mr. Matsunaga.

Senator Matsunaga. Aye.

The Clerk. Mr. Moynihan.

Senator Moynihan. Aye.

The Clerk. Mr. Curtis.

Senator Curtis. Aye.

The Clerk. Mr. Hansen.

(No response.)

The Clerk. Mr. Dole.

Senator Dole. No.

The Clerk. Mr. Packwood.

Senator Packwood. No.

The Clerk. Mr. Roth.

Senator Roth. No.

The Clerk. Mr. Laxalt.

Senator Laxalt. No.

The Clerk. Mr. Danforth.

Senator Danforth. No.

The Clerk. Mr. Chairman.

The Chairman. Aye.

Nine yeas and seven nays. There are two Senators left to be recorded. That would be Senator Haskell and Senator Hansen.

Now, hold on just a minute. Let me just get this list here.

Senator Talmadge, yes, I have his name here. I have you further down the list, Senator Gravel.

Senator Hansen, I believe he had been heard from already.

Senator Dole. He clarified his.

The Chairman. Mr. Nelson is not here at the moment.

We will go to Mr. Danforth.

Senator Dole. That was the widow's tax Mr. Nelson had, which we took care of.

Senator Danforth. Mr. Chairman, on Monday I offered an amendment with respect to tax-exempt bonds which would give the bond holder the option of receiving a partial credit for interest received as well as the present option that he has of an exclusion. This has negligible revenue effects. I believe it is supported by the administration. It is a genuine tax reform proposal in that it makes municipal bonds attractive to people in the 40 percent or lower tax brackets where they are not attractive presently.

It should be helpful to local governments in that insofar as the demand for municipal bonds is increased, the interest rates could be somewhat lower.

My office has run this by a number of people who were in the business. We haven't seen any opposition to it yet. I tried it out on Monday openly in order to give anybody an additional chance to comment on it. I don't know if there has been any comment, but I would like to move it at this time.

The Chairman. Is there any further discussion?

Senator Dole. Is the Treasury for it?

Mr. Lubick. Yes, Senator Dole, we think this is an excellent amendment. It solves a knotty problem that we have faced in a very appropriate way. It preserves the situation as far as the states and local governments are concerned, and at the same time is helpful to the Treasury from the point of view of its treatment of tax exempt interest.

Senator Bentsen. Do I understand that is up to about 165 percent if you are about, say, in the 40 percent and below tax bracket, and what you are trying to do is encourage people in the lower income brackets to buy municipals and have the same benefits from them that high income brackets now receive, is that correct?

Senator Danforth. That is correct.

The Chairman. Well, I just believe that if not now, that at some point you are going to hear a tremendous protest from people like they had before, and that is why I personally can't vote it, but maybe the Committee wants to vote for it. Let's call the roll and see.

The Clerk. Mr. Talmadge.

Senator Talmadge. No.

The Clerk. Mr. Ribicoff.

(No response.)

The Clerk. Mr. Byrd.

(No response.)

The Clerk. Mr. Nelson.

Senator Nelson. I'll pass. I didn't hear the bill.

The Clerk. Mr. Gravel.

Senator Gravel. Aye.

The Clerk. Mr. Bentsen.

Senator Bentsen. Aye.

The Clerk. Mr. Hathaway.

(No response.)

The Clerk. Mr. Haskell.

(No response.)

The Clerk. Mr. Matsunaga.

Senator Matsunaga. Aye.

The Clerk. Mr. Moynihan.

Senator Moynihan. Aye.

The Clerk. Mr. Curtis.

Senator Curtis. No.

The Clerk. Mr. Hansen.

(No response.)

The Clerk. Mr. Dole.

Senator Dole. Aye.

The Clerk. Mr. Packwood.

Senator Packwood. Aye.

The Clerk. Mr. Roth.

(No response.)

The Clerk. Mr. Laxalt.

(No response.)

The Clerk. Mr. Danforth.

Senator Danforth. Aye.

The Clerk. Mr. Chairman.

The Chairman. No.

The way I have it, the nays are seven and the ayes are three.

Senator Gravel. Wait a minute, it is the other way around.

The Chairman. I said it backward. The ayes are seven and the nays are three.

As usual, we will let the absentees record themselves. There is one present. Up to the report on the bill they can record themselves.

All right, next we will hear from -- Senator Nelson, did you have an amendment you wanted to bring up? I had your name down here.

Has your amendment been brought up?

Senator Nelson. Well, I mentioned two yesterday, but if somebody else has not gotten there --

Senator Packwood. Is my name on the list, Mr. Chairman?

The Chairman. Yes, it is.

Mr. Curtis?

Senator Curtis. Mr. President, I want to just call up one matter. I think it can be disposed of very quickly. Section 447 of the Internal Revenue Code makes certain farm corporations use the accrual method of accounting including certain inventory requirements. Nurseries and tree farms are exempt from these requirements, but sod farms are not specifically exempt. In the classification issued by the Department of Commerce, Standard Industrial Classification, sod farms are included with nurseries. It takes, for the most part, considerable time to produce this sod. It is not an annual. So I am asking that sod farms get the same treatment as nurseries and tree farms, that is, they will not be subject to Section 447, and that is my case, Mr. Chairman.

The Chairman. Does Treasury go along with that? Does that give the Treasury any problem?

Mr. Lubick. It does give us a problem, Senator. I am trying to --

The Chairman. A big one or a little one.

Mr. Lubick. -- find out what the problem is.

(General laughter.)

Senator Curtis. The Treasury's problem is that the classifications are against them. The official classification of the Department of Commerce lists a sod farm as a nursery.

The Chairman. You mean a farm where you grow grass which you dig up and then put on somebody's lawn.

Senator Curtis. Yes. You can't do that -- some of it you can, but the most of it you can't do that in one year, and it is classified the same as tree farms and nurseries.

All I want is the same treatment they get, that they do not have to go on the accrual method.

Mr. Lubick. Basically, Mr. Chairman, the Congress indicated that these large farms ought to be on the accrual method when it enacted Section 447, and there are some exceptions for the small farms, and there are exceptions for the family farms, but there is no reason why a sod farm should be treated any differently from any other kind of farm.

Senator Curtis. Oh, yes there is. These other crops are produced annually, and so is livestock, and nurseries and tree

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farms are treated differently.

Mr. Lubick. Trees seem to take a rather extended period of time. Sod takes about two years. I think that is --

Senator Curtis. Well, I don't know how you can keep an inventory of grass, and it doesn't change anybody's taxes.

The Chairman. Call the White House.

Senator Curtis. I'm talking about real grass, not --

(General laughter.)

Senator Curtis. I understand the confusion on the Department of Treasury.

Mr. Lubick. Senator, we are talking about corporations here with annual incomes of over $1 million. They are all keeping inventories already for their financial --

Senator Curtis. I am not trying to change that. These large corporations, the law is now they have got to go on the accrual basis. It doesn't fit.

Mr. Lubick. The small ones are already out, Senator Curtis. If they are under $1 million, they are already out.

Senator Curtis. But the Government's own classification classifies sod farms as nurseries. This is the standard industrial classification issued by the Department of Commerce.

I ask for a roll call or a vote.

The Chairman. All in favor say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

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(No response.)

The Chairman. The ayes have it.

Senator Curtis. Thank you, Mr. Chairman. I will wait my turn again.

The Chairman. Mr. Bentsen.

Senator Bentsen. Mr. Chairman, I understand this amendment is supported by Treasury and it is to provide a clarification of the guidelines for the 100 percent tax on prohibited transactions in real estate investment trusts, and would extend the foreclosure grace period an additional two years to provide for the slow recovery from the recession of 1975, which provided a bunch of foreclosures.

Mr. Lubick. This was a proposal that we worked out with the affected industries and seems to be a very reasonable solution to the problem.

The Chairman. Well, all in favor say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

(No response.)

The Chairman. The ayes have it.

Mr. Packwood.

Senator Packwood. Mr. Chairman, I have a widow's tax amendment that I wish to offer that I hope the Treasury will view with the same compassion they viewed the former widow's tax amendment. This deals with heads of household. Heads of household are those who are single people, mostly women, sometimes widows, sometimes divorced, who have dependents, and this is the situation -- and they are the most discriminated against of all of the people who pay taxes.

If a man and a wife and two children are all living, the husband is making $16,000 a year, they have four personal exemptions and they have under the new bill a $3400 dependency deduction. If the husband dies, the widow immediately becomes a head of -- or not immediately, after a one year delay, a head of household. She is down to three personal exemptions, and with her standard deduction drops into the present bill to $2300, and worst of all, she is put into a higher tax bracket. Heads of household pay higher taxes than do a married couple.

The facts of the situation are that most heads of households make about 50 percent of what a married couple makes. There is hardly a group that on the average makes less wages and they have less of a standard deduction, and they have a higher tax rate, and probably the worst burden in terms of supporting dependents that exists because they are usually widowed or divorced with children.

So I am going to move to change the $2300 under the present bill to $3000, not to the $3400, but to $3000 for the standard deduction. I want it to go into effect on January 1st, 1979, and as at present, they will continue to be withheld as if they were single, and with that provision, I would like to know what the fiscal year loss would be.

Mr. Shapiro. This is just saying that the standard deduction which under the Committee bill is $2300 for single taxpayers, $3400 for married taxpayers filing joint return, Senator Packwood would provide that for heads of household it would be $3000. Now, head of a household is a single person who maintains as a home a household which is the principal place of abode for a member of that household of a son, stepson, daughter and so forth, if the taxpayer is entitled to dependency exemption for that person.

The revenue effect on a fiscal year is between about $275 million.

Senator Packwood. I am curious, Bob, how do you come to that starting January 1st, if they are withheld at the single rate, as they are now --

Mr. Shapiro. Oh, I'm sorry, you are not going to reflect it in withhold.

Senator Packwood. I am going to have -- they are withheld at the single rate now and I would continue that.

So I would assume that the fiscal year impact has to be those heads of household who are self-employed who withhold, which I would take a guess, has got to be $5 million or $6 million.

Mr. Shapiro. Okay, there is a small effect to the extent of taxpayers who file estimated returns. There are very few of those, so the estimate -- somewhere a little above $50 million --

Senator Packwood. $15 million?

Mr. Shapiro. $50 million, for those who file estimated returns. They may not have withholding, and that is because you would keep them at the single rate. The full year effect is $447 million. So it is $447 million on the calendar year effect.

Senator Packwood. I would say that these people are certainly as entitled to the same compassion as those widows whose husbands died, who are having an estate tax levied against them because they were given no assumption of joint working with their husbands, these people, again mostly women -- they are 96 percent women -- either, in most cases widowed or divorced, making an average salary of about $8500 a year and supporting children.

Mr. Sunley. Chairman Long, we would like to express our opposition, but I would like to make these brief comments, because there's two conflicting pressures here.

I think you can make a case, as Senator Packwood has, that on equity grounds, that sort of the expenses of a head of household are about the same as the expenses of a married couple, and that maybe they ought to have the same standard deduction as the married couple, and that is one of the roles of the standard deduction is to sort of be an average for certain kinds of expenses that otherwise can be itemized.

On the other hand, there has been concern expressed before when this issue has been debated in your committee, of what impact does liberalizing the standard deduction for heads of households have on the so-called married penalty, that you end up in a situation today where a married couple has a standard deduction of $3400 under your bill, and a single individual has a standard deduction of $2300. So if a couple splits up, their standard deduction would be increased from the $3400 they would get married to $4600 if they are each filing as single or if one is filing as a head of household.

Now, under this proposal, this approach, you would find that a couple splits up and assuming one files as a single individual -- he doesn't have the children, let's say -- he would get a standard deduction of $2300. The other spouse who has the children would get a standard deduction of, as I understand it, $3000, and so they end up with a standard deduction, once they have split, of $5300, whereas if they stayed together they had a standard deduction of only $3400.

And you have to weigh that, it seems to me, against this sort of basic equity argument that the expenses of a head of household may be similar to the expenses of a married couple. And it does seem as though you can adjust this withholding by now allowing the heads of household to reflect this in withholding and only giving it to them in a final payment so that it has very small fiscal year effect, it will have a very significant calendar year effect that would significantly increase the cost of this bill.

So we are unfortunately opposed to this amendment.

Senator Packwood. I am using the same argument that was used with Gaylord Nelson's widow's tax amendment, has a very small fiscal year impact, but when you are trying to say that people are going to make fundamental life decisions, they are going to get divorced -- I have heard this argument made with people who are single and have no children, and are not therefore, although I think it is unfair, I am not here trying to change the tax law as far as single individuals without dependents, but to say that for a few hundred tax dollars people are going to get divorced and they are going to split the children and one of them is going to take the children, for the sake of getting a $2500 increase in the standard deduction is just folly. People don't get divorced for that reason. They certainly don't become widow's for that reason.

Mr. Sunley. I am clearly not suggesting, you know, that this is a major factor in, you know, couples getting separated, but it has been a continuing issue in the debate over the tax system of whether we have a marriage penalty or single penalty or what have you.

Now, I haven't seen today whether the rates that this committee has agreed on have increased the marriage penalty or decreased it. I know that in our discussions with the Joint Committee staff, we were trying very hard to design a rate schedule for joint and singles that did not increase the marriage penalty, that held it down, because that has been a major concern of this Committee.

And it seems that we ought to be very careful in adding in situations where we have increased the parent-marriage penalty.

Senator Packwood. Well, I am prepared to vote.

Mr. Sunley, if you are going to make the argument on heads of household that it is a marriage penalty and that they really get divorced for that reason, that is an incredible argument.

Mr. Sunley. Senator Packwood, I may sound incredible, but just before I came down here I was consulted by a client whose potential spouse had significant earned income, and the decision on marriage or not was indeed a matter of calculation and evaluation of the tax consequences.

It does happen.

Senator Packwood. I would be willing to leave it to the common experience of most of us who know people who have gotten divorced, as if that was a factor, to know if that was a factor in their thinking when they got divorced.

I have no other comments.

The Chairman. Ordinarily, when people get married, tax has nothing to do with it, but after they have been married for a while, they start thinking about all those things.

(General laughter.)

Senator Curtis. Is there a tax on marriage ceremonies?

The Chairman. Not to my knowledge, but let me just ask you this, now. If we did this, you say that you have got at present $2300 for a head of household, which is sort of between single person and a couple, is that it?

Senator Packwood. It is the same as a single person.

Mr. Sunley. Same as a single.

The Chairman. The same as a single person.

But doesn't a head of household get what amounts to about -- something more than a single person gets?

Mr. Sunley. With respect to the rate schedule, with respect to the tax rate schedule.

Senator Packwood. They are taxed less than a single person. They are taxed more than a married couple.

The Chairman. I see. But now, assume you had a couple with two children. Now, let's assume that the couple living together, how much standard deduction do they get? What is their deduction? Have they got --

Mr. Sunley. Under your bill, $3400.

The Chairman. $3400.

All right, now, iif the couple separated, under this amendment and each took one child, what would they get, $6000?

Mr. Sunley. Then they would each get $3400, $6800, if each gets one child.

The Chairman. Under this amendment? I thought he said $3000 each.

Mr. Sunley. Each would get $3000, $6000.

The Chairman. They'd each get $3000. So if the two were separated, each with one child, they would get a total of $6000 deduction rather than the $3400 that they would be entitled to if they were together.

Senator Packwood. If you presume that they will get divorced for that reason.

The Chairman. Well, but we are talking about a marriage penalty now. All right, now, that is a premium on family breakup.

Mr. Sunley. You could also put it another way. Two couples, each of whom have a dependent child, two individuals, each of whom have a dependent child, they might consider getting married and find that the expenses are quite high. It may not have affected their previous decision to get a divorce. They may have just slammed the door and walked out.

The Chairman. Then assuming that two people, each with one child, considered marrying and making one family where you have two today, then they would move from a $6000 deduction to a $3400 deduction. They would lose $2600 deduction.

All I'm saying is that all of that just moved us away from tax justice, equity and uniformity, and it costs a lot of money.

Is there a lot of cost to it or not?

Mr. Sunley. $450 million.

The Chairman. $450 million to move away from tax uniformity, away from encouraging people to form families rather than -- and giving a cash incentive to break them up?

Even if they didn't respond to the incentive, why would you want to do it? It doesn't make sense. But that is the kind of thing, then, that leads to the other taxpayers coming in and saying they are being discriminated against, and then --

Senator Packwood. Well, Mr. Chairman, you are flying in the face of your argument that you have been giving us for years on the earned income credit. It phases out at $11,000 now, and if a couple is making $11,000, they don't get it. If they want to get divorced and each take one of the children, and each make $5500, they are entitled to the maximum earned income credit. Your earned income credit is a marriage penalty.

The Chairman. But they are each supporting a child. You have got to give them credit for that.

Senator Packwood. Well, what's this poor woman doing?

The Chairman. And those are low income people. You hope you are going to keep them off the welfare by doing that.

Well, let us vote on it.

Call the roll.

The Clerk. Mr. Talmadge.

Senator Talmadge. No.

The Clerk. Mr. Ribicoff.

The Chairman. No.

The Clerk. Mr. Byrd.

Senator Byrd. No.

The Clerk. Mr. Nelson.

Senator Nelson. Aye.

The Clerk. Mr. Gravel.

Senator Gravel. Aye.

The Clerk. Mr. Bentsen.

Senator Bentsen. No.

The Clerk. Mr. Hathaway.

(No response.)

The Clerk. Mr. Haskell.

(No response.)

The Clerk. Mr. Matsunaga.

Senator Matsunaga. Aye.

The Clerk. Mr. Moynihan.

Senator Moynihan. No.

The Clerk. Mr. Curtis.

Senator Curtis. No.

The Clerk. Mr. Hansen.

(No response.)

The Clerk. Mr. Dole.

Senator Dole. Aye.

The Clerk. Mr. Packwood.

Senator Packwood. Aye.

The Clerk. Mr. Roth.

(No response.)

The Clerk. Mr. Laxalt.

(No response.)

The Clerk. Mr. Danforth.

Senator Danforth. Aye.

Senator Packwood. Mr. Hathaway votes aye by proxy.

The Clerk. Mr. Chairman.

Senator Packwood. Mr. Chairman, I am curious. Senator Ribicoff has co-sponsored this, and I was under the impression that he was going to support this. Did he give a proxy specifically?

The Chairman. He gave me the right to vote the proxy.

Senator Packwood. Did he give it specifically on this issue?

The Chairman. Not on this specific amendment.

Senator Packwood. Then I challenge the proxy.

The Chairman. I withdraw the proxy. The man told me this morning to vote his proxy. I have got a few witnesses here that he told me that.

Senator Gravel. He said on everything.

The Chairman. But if he is a cosponsor on the amendment, I will not vote it.

Senator Packwood. Well, as I recall, the rules of the Committee didn't require that proxies had to be on specific issues.

The Chairman. Senator, I can't recall it, but no, that is not how we do business. We haven't been requiring that a proxy be on a specific issue.

Senator Packwood. He had led me to believe that he continued to be in favor of this is the reason I asked, but I haven't got his proxy on it.

The Chairman. Well, I will withdraw -- well, Senator, now, the man told me in the presence of a lot of witnesses here to vote his proxy, but if you say he is a cosponsor of the amendment, I will withdraw the vote, and we will find out how he wants to vote when he has a chance to look at it himself.

Senator Nelson. What he did say, on all votes except two, and I have forgotten the two that were.

Senator Byrd. Everything except tuition grants and welfare.

Senator Moynihan. Well, I don't think the Chairman needs any witnesses when he says somebody said something.

The Chairman. Well, if he is a sponsor of the amendment, I wouldn't want to vote his proxy.

I just withdraw his proxy, and I will find out specifically.

Senator Ribicoff, by the way, is at another conference. He has been managing a conference for another committee. I know I had the proxy, but I might be in error in voting it that way, so just withdraw it.

The Clerk. Mr. Chairman.

The Chairman. No.

Senator Hansen. I will vote no.

The Chairman. That makes it seven-seven. We will have to hear from the others.

We haven't heard from Mr. Roth, Mr. Laxalt is not recorded, Mr. Haskell is not recorded.

Next we will call on Mr. Matsunaga.

Senator Matsunaga. Mr. Chairman, I have two very minor measures which the Treasury, I understand, will agree to, to correct drafting errors in previous tax laws. One is with relation to the Foreign Investors Tax Act of 1966. They inadvertently, I believe, omitted savings and loan institution deposits where they should have included it along with deposits in banks, that is, to qualify interest on deposits as possession source investment income. I am not Senator Corrada, but it seems I am representing Puerto Rico so frequently here that I may begin to look like Congressman Corrada.

(General chuckles.)

Mr. Lubick. We have no objection to that amendment, Mr. Chairman.

The Chairman. What is the estimated cost of it?

Mr. Shapiro. It is less than $5 million we understand.

Senator Matsunaga. And the second is also something, just to remove an inequity which I think the Treasury never intended, that is to treat horses, breeding horses, like cattle.

The Chairman. Well, let's vote on the first one.

All in favor of the first thing say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

Senator Dole. That's for the investment tax credit, the other one?

Senator Matsunaga. The investment tax credit for breeding horses, not race horses, just breeding horses. There is a limitation of $100,000 a year because they are considered used property.

(General laughter.)

Senator Matsunaga. And I brought this for Senator Dee Huddleston.

Senator Dole. And I am a cosponsor.

The Chairman. What's the Treasury position on that?

Mr. Lubick. Senator, I tried to check and we are unable to find out why the existing investment credit differentiates between breeding cattle and horses, so we can't give you any rational basis for a distinction. Perhaps you will recall why the Committee made that distinction, but we do not.

Senator Matsunaga. Mr. Chairman --

The Chairman. It violates the Equal Rights Amendment.

Senator Matsunaga. I think the reason the distinction was made is that there was some objection to race horses, but the amendment I am offering for Senator Huddleston excludes race horses. This is just for breeding horses.

Senator Byrd. I second Senator Matsunaga's motion.

The Chairman. All in favor say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

(No response.)

The Chairman. The ayes have it.

Senator Byrd.

Senator Byrd. Mr. Chairman, the House bill permits florists, nurserymen and farmers to use the accrual method of accounting and not take into account as inventory growing crops. Now, this is the procedure which these groups had followed prior to 1976. In 1976 the IRS issued a revenue ruling which required -- I'm sorry, this has already been approved.

Senator Curtis. On sod, yes.

Senator Dole. You took care of it the other day.

Senator Byrd. This would deal with florists. Accrual accounting by florists, farmers and nurserymen. It is in the House bill.

Mr. Shapiro. We have a list of items in the House bill, and at the appropriate time the Committee can bring them up and the Committee can make a decision.

Senator Byrd. Well, I withdraw my proposal.

Mr. Chairman, I have just one other brief thing. I think this has been handled, but I am not certain. My understanding also is that Treasury supports it, but Mr. Lubick can't say. Under the Subchapter S corporations, if one of the members has a trustee or if there is a trustee as a member of the Subchapter S corporation, then it can no longer be a Subchapter S corporation, and I think this has been handled before, but in the event that it hasn't, I would like to suggest that the staff indicate whether that is appropriate, whether it would be appropriate to change the law to permit a trustee to be a member of a Subchapter

S corporation, provided all of the funds are distributed and are handled the same way as any other Subchapter S corporation is handled.

Mr. Lubick?

Mr. Lubick. Senator Byrd, we suggested originally in our proposals in January -- and I think this is the proposal you are talking about, is that a simple testamentary trust, one which distributes all the income currently, as Senator Byrd has said, and a grantor trust for a period of time following the death of the grantor should be permitted to be shareholders of a Subchapter S corporation. Under the 1976 act, the grantor trust was permitted to be a shareholder up to the grantor's death, but that is an estate planning device that is usually used as a substitute for a will, so it is expected that that trust will continue, and it would be unfortunate if the Subchapter S election automatically terminated simply because the grantor died.

Senator Byrd. Well, let me give an example.

Suppose a Subchapter S corporation has five individuals involved, A, B, C, D, and E is a trustee for F. Now, under the present law, as I understand it, you couldn't have a Subchapter S corporation on that basis.

Mr. Lubick. That is correct, Senator Byrd, and we made the -- we recommended the change which I believe you are suggesting. We would count the beneficiaries of the trust who are the recipients of the income as individuals for this purpose.

Senator Byrd. And provided the number of individuals did not exceed the number that the --

Mr. Lubick. The 15, that's correct.

Senator Byrd. Yes, whatever the number is.

Well, I would like to make that as a motion then, if the Treasury does not object to that change.

Mr. Lubick. We favor the proposal.

Senator Byrd. I have a letter here from John M. Samuels, Deputy Tax Legislative Counsel who ends up by saying on behalf of the Treasury I would like to express appreciation for your suggestion. I believe it is a positive contribution.

Mr. Lubick. Mr. Samuels has since been promoted, so he is Tax Legislative Counsel, in recognition of that fine letter.

(General laughter.)

Senator Byrd. Good.

The Chairman. Treasury can go along with this, can you?

Mr. Lubick. Yes, sir.

The Chairman. All right, all in favor say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

(No response.)

The Chairman. The ayes have it.

Mr. Gravel.

Senator Gravel. Mr. Chairman, the IRS in Section 212 of the Revenue Act of '78, as approved by the House, would extend the statute of limitations for challenges by the IRS for partnerships from three to four years. I, under what has been done to date, I don't think that that is necessary, and I would like to see us not do that.

Mr. Shapiro. Senator, as of now, that is not in the bill, and in other words, you don't have to do anything to keep it out. What I had intended to do was at the appropriate time, to go over a list of items that are in the House bill, and if no member brings it up, it is just excluded from your bill. But as of now, it is only in your bill if the Committee puts it in your substitute.

Senator Gravel. Great.

Mr. Chairman, the next item, very briefly, is we are going to have a number of tax treaties coming up. We have had the British treaty. It was very controversial.

I think it would be very important to assert the jurisdiction of this Committee and be consulted or have membership consulted on this Committee for these negotiation procedures, and so I would like something placed in the record, whatever is appropriate. I think the staff has looked at this.

The Chairman. Well, now, I don't want to challenge the jurisdiction of the Foreign Relations Committee on a tax treaty, but I do think that perhaps our staff and maybe the Joint Tax Staff can help us to keep ourselves aware, abreast of what is being proposed in tax treaties.

Can you do that?

Mr. Shapiro. That can be done, Senator. There are times, I will say that every tax treaty that Treasury negotiates ahead of time in preparation of the treaty. Then the treaty is submitted to the Senate and of course goes to the Senate Foreign Relations Committee.

The Joint Committee Staff has traditionally been the Tax Staff for the Senate Foreign Relations Committee and that when a tax treaty comes up, our staff participates as the staff for that particular treaty.

A concern has been expressed, however, that the Senate Foreign Relations Committee is not a tax committee and therefore does not give the same attention to tax treaty matters that a tax writing committee would, and the concern has been that maybe there should be some consultation between the Treasury Department and the tax writing committees prior to the treaty being negotiated. The only question, apparently you have worked this particular procedure out in the case of trade matters, where a treaty would go go the Foreign Relations Committee, but there is some consultation ahead of time.

Senator Gravel. And this would be no different than what we currently do.

Mr. Shapiro. As I understand, that would be the case,and the only question I would raise is whether or not the Foreign Relations Committee would believe that this presents any encroachment on their jurisdiction. I don't think it is intended to.

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And the Committee just wants to get its tax expertise involved with regard to the tax matters that are referred to Committee.

Whether or not the Foreign Relations Committee would feel that this is any infringement in their jurisdiction, I am not personally aware of right now.

The Chairman. Mr. Lubick.

Mr. Lubick. Mr. Chairman, we are very anxious to have the cooperation of the staff of the Joint Committee in working in advance on these treaties to smooth the whole negotiating process and the ratification process, and Mr. Shapiro and I have talked about meeting on this regardless of what you do to discuss the procedures. So we welcome the opportunity for consultation and cooperation, and we would very much like to see treaties put on a fast track so that they don't languish in committee for a very long time. It would help us if we could get them ratified very quickly.

I have some concern, and I don't know if this, what you are suggesting, Senator Gravel, calls for implementing legislation to be required as a prerequisite to a treaty. I would hope that we would not do that immediately. We would like to think about that. That seems to involve some fundamental constitutional changes.

The Chairman. Well, now, I would just think that the best way to handle that would be that the Joint Committee would try to inform -- the Joint Committee would be in touch with Treasury and seek to inform Senators. You could send a memo to Senators about what is being considered in the negotiation of these treaties, so if someone wanted to complain about it or express a doubt that he had about it, that he could do it. But the last thing on earth I want to do here is to encroach on the jurisdiction of the Foreign Relations Committee on its jurisdiction of ratifying a tax treaty. They have that jurisdiction and I don't want to claim it, but I do think we ought to-- that we might be able to make a useful suggestion or two, and if so, that we ought to know about it. And obviously when the treaty comes to the floor, every Senator on this Committee, and many of them are good experts on taxation, has a right to express himself and get involved. And that being the case, I think we have a right and perhaps a duty to stay abreast of it and know what is going on.

I think you can work that out without putting something in this bill.

Mr. Lubick. We would certainly move ahead to implement that without any language in the bill. We were planning on it in any event.

The Chairman. So far the Foreign Relations Committee has been very good about not usurping our jurisdiction, and I don't want to open ourselves to the charge that we are trying to encroach on them.

Senator Gravel. Well, if you feel this can be handled, I don't want to press it.

Mr. Shapiro. What the staff will do is we will work with the Treasury to see to what extent we can learn ahead of time some of the negotiations they have, and work with the staff of the Ways and Means Committee and the Finance Committee and try to present that material to the Senators on the Finance Committee and the Representatives on the Ways and Means Committee in advance.

Senator Gravel. The next item I have, Mr. Chairman -- I hope this can get in the bill. Presently --

The Chairman. Well, Senator, what I am trying to do is for every Senator to offer an amendment and then take his turn and come back to him.

Senator Gravel. None of these were germane, but that's all right. I'll wait for another turn.

The Chairman. I'll put you down at the end and come back to you.

Senator Talmadge?

Senator Talmadge. Mr. Chairman, this Committee adopted a series of amendments to H.R. 7200 relating to welfare, every one of them designed to save money. I would hope that we could adopt them en bloc. Section 520 relating to the WIN program; Section 510 relating to the method of payment for child support collection services; Section 512 relating to payment to states for compensation of court personnel in child support cases; Section 501 of H.R. 7200 relating to the quality control program; Section

507 of H.R. 7200 providing for additional federal funding on the AFDC programs for certain mechanized claims processing and information retrieval systems, and Section 521 relating to incentives to report income by AFDC recipients.

Every one of these would save the government money. Every one of them has been approved by this Committee, and inserted in H.R. 7200.

Senator Byrd. May I ask one question, Herman?

Senator Talmadge. Sure.

Senator Byrd. On the incentives to report income --

Senator Talmadge. Bill Galvin, will you respond?

Mr. Galvin. The way the law and the HEW regulations are, the earned income disregard provision in Title IVA provides no reason for anyone to report income when income has been ascertained, that a person is working at an earned income. What the regulations permit and what the states do is they go back and recompute the grant as though they had known all the time that the income existed, and if there is any overpayment then, and there may not be any, that is the only amount of the overpayment.

What this provision does is says if without good cause they do not report income, then all of the income will be counted as an overpayment.

Senator Byrd. Thank you.

Senator Nelson. Mr. Chairman?

The Chairman. Senator Nelson.

Senator Nelson. We handled that bill so many months ago that I have forgotten what is in it. I recall that there were provisions in it that I disagreed with that were adopted and some that I did agree with, but I raise this point. This is basically welfare and not taxes. I am just wondering what we are going to the floor with, if we are taking welfare reform measures on the tax bill.

Senator Danforth. That doesn't make any difference.

Senator Talmadge. We have some of both in here as the Senator knows. This seems to be about the last train leaving the station, and I think it is very important that these provisions be incorporated in here.

Senator Nelson. But it is going to end up with so many flat wheels that we can't run if we keep --

Senator Danforth. Mr. Chairman, could we get HEW's position on this if their representatives are still in the room?

The Chairman. Are you for it or against it.

Senator Moynihan. I'll bet you they are against it.

HEW Representative. Senator, on the provisions as you read them off, I am not sure exactly which ones they are. In general, we would prefer not to see them attached to the tax bill.

Senator Talmadge. I beg your pardon.

HEW Representative. In general we would prefer not to see these provisions in the tax bill.

Senator Talmadge. In general, you would prefer not to see any welfare reform that reduces the welfare rolls, isn't that correct?

HEW Representative. No, Senator, I think Mr. Califano has been very clear about that. He is very eager to see reforms in the welfare system.

The Chairman. Well, just ask them specifically about that.

Senator Talmadge. All right. Section 520, relating to the WIN Program, H.R. 7200.

HEW Representative. Senator, I don't recall, is that the increase in the WIN program?

Senator Talmadge. Can you explain that, Mr. Galvin?

Mr. Galvin. Yes, that makes the WIN Program somewhat simpler. It provides for intensive employment training, employment search. It provides for a sanction in the program that would have to be issued under regulations of HEW and Labor.

HEW Representative. Senator, I believe that we had indicated earlier that with proper protections for the recipients, we were willing to support the extended --

Senator Talmadge. You do support it.

HEW Representative. I believe we do.

Senator Talmadge. All right.

The next is 510, relating to the method of payment for child support collection services.

Mr. Galvin. That provision provides that if within nine months after the -- six months after the quarter has ended, the child support agency has not reported the collections and expenditures and the other requirements, that they will not receive an advance fund for the quarter thereafter. It does not affect anything except advanced funding.

Senator Talmadge. That tries to make them chase down fugitive fathers, is that it?

Mr. Galvin. That program is designed therefor, and what this provision does is get reports from the states in time, and it gives them approximately nine months to get that in.

Senator Talmadge. Do you support that?

HEW Representative. Senator, I am sorry, I don't recall. I would have to find out.

Senator Talmadge. All right, Section 512 relating to payments to states for compensation of court personnel in child support payments.

Mr. Galvin. I think that everyone is aware of this position. I know of no --

The Chairman. I recall the Secretary said the Treasury was supporting that one.

HEW Representative. Yes, Senator, he did. Not for the payment of the judges, but for additional court personnel.

Senator Talmadge. Beg your pardon?

HEW Representative. Not for the payment of judges' salaries, but for additional court personnel.

Mr. Galvin. Judges' salaries are included in this.

The Chairman. Judges' salaries are included in it?

All right, go ahead with the next one.

Senator Talmadge. Section 501 of H.R. 7200 relating to quality control programs.

Mr. Galvin. Section 501 on the quality control program establishes that basically the quality control program will be operated in accordance with what the law is, that there could be no exceptions. The reason quality control is going up now is that we have been keeping a close watch on it. They have been making exemptions over the years for not issuing Social Security numbers, not counting WIN registration, and other items of that particular thing, no assignment of child support, when a case came on AFDC, they had not been counted in quality control errors.

They are now, and the quality control is going up. What this would do is would make it a permanent feature of law rather than by regulation. It grants many items in there would be subject to regulation by HEW.

Senator Talmadge. Do you support that?

HEW Representative. Senator, if I understand correctly, if this is the provision that also would have put into statute the level on which the quality control samples would be taken and so forth, we oppose that. We felt that it was not necessary and administratively burdensome.

Senator Talmadge. Section 507 of H.R. 7200 providing for additional federal funding under AFDC programs for certain mechanized claim processing and information retrieval systems.

HEW Representative. Senator, I believe we supported that. I would have to check that.

Senator Talmadge. You do support that.

HEW Representative. I believe so, but I would like to double check that.

Senator Talmadge. Section 521, pertaining to incentives to report income by AFDC recipients.

Mr. Galvin. We have already explained that one.

HEW Representative. Yes, and I believe we also supported that, but again, I would want to double check.

Senator Talmadge. Then, Mr. Chairman, I move that we incorporate the provisions that HEW does support.

The Chairman. All in favor say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

Senator Danforth. Could we have a roll call?

The Chairman. Let's call the roll.

Senator Danforth. I haven't heard any reports of what HEW does in fact support on this.

I have heard that we believe, to her recollection, on something that happened a number of months ago that maybe HEW supported this, but in no sense does HEW support including it in the tax bill, is that correct?

HEW Representative. That is correct, Senator.

Senator Danforth. And you really don't recollect for the rest of it whether you support it or not.

HEW Representative. On some of those provisions I am not entirely clear. It has been a few months.

Senator Danforth. I would just wonder, Mr. Chairman, at this point, whether very many members of the Finance Committee are clear about this provision.

Senator Nelson. I am assuming, Mr. Chairman, that the motion was made by the Senator to approve the provisions that HEW agreed upon.

Senator Talmadge. That have already been approved by the Finance Committee and already incorporated in H.R. 7200.

Senator Nelson. But I am assuming that there would be a chance before the report to check and see.

Senator Talmadge. Exactly, now, as I checked what she agreed to, it was 1, 2, 3, 4, 5 different provisions, I understand.

HEW Representative. Excuse me, but Senator, I did say I would like to double check some of those because I would like to be clear on it myself.

The Chairman. You are only offering the ones that she said --

Senator Talmadge. Well, I am offering the ones that she said she has agreed with.

Senator Matsunaga. Mr. Chairman, that was the understanding, that you were offering your amendment only on those provisions that HEW definitely agreed with.

Senator Nelson. Well, I am assuming that before we report that there would be a chance for HEW to double check.

Senator Talmadge. Yes, check with HEW, that's right.

Senator Nelson. And be sure that we are voting on those that HEW agreed to.

Mr. Stern. Mr. Chariman, could you just repeat the section numbers you checked off?

Senator Talmadge. Section 520, Section 512, Section 501, Section 507, and Section 521. I understood the lady to say that she agreed to --

HEW Representative. Excuse me, Senator, I don't believe that Section 501. If that is the quality control amendment that I believe it is, we did not agree with that provision.

Senator Talmadge. Well, if you are opposed to that, I will amend it, but I think it is really the most important provision here because Secretary Califano has been making loud noises which I applaud, and he says waste, graft and corruption amounts to $2 billion or $3 billion, and that is what I am trying to stop by these quality controls, by penalizing inefficiency through high error rates and rewarding efficient states with low error rates.

Now, are you against that?

HEW Representative. No, Senator. I think Secretary Califano would agree with your objective. The difficulty is that --

Senator Talmadge. If he agrees with the objective, he ought to agree with the result.

HEW Representative. Well, the difficulty with the particular provision as drafted is that the quality control process is one on which we work cooperatively with the states, and we feel that writing this into statute in the degree of detail that is in 7200, I believe in this provision, would unnecessarily hamper --

Senator Talmadge. All right, if you will check with the staff, we will just write in this act what you agree with. We hope you will agree with a lot of it.

HEW Representative. But I think on Section 501 that is not one we agree with.

Senator Talmadge. Mr. Galvin.

Mr. Galvin. I personally have tried for over a year to get a letter from HEW, Dick Warden, the Legislative, Assistant Secretary for Legislation has been approached personally by me. He has promised to have a letter, he started promising six months ago, he has got a letter on his desk. It has been there for at least two months. He promised a month ago that he would have it down immediately. All he had to do was check with OMB. We have done our best to find out HEW's position, and it is extremely difficult to get anything out of HEW.

The Chairman. Well, let's vote on the amendment, as modified.

All in favor say aye.

(A chorus of ayes.)

The Chairman. Well, let's call the roll, let's call the roll.

The Clerk. Mr. Talmadge.

Senator Talmadge. Aye.

The Clerk. Mr. Ribicoff.

(No response.)

The Clerk. Mr. Byrd.

(No response.)

The Clerk. Mr. Nelson.

Senator Nelson. Aye.

The Clerk. Mr. Gravel.

Senator Gravel. Aye.

The Clerk. Mr. Bentsen.

Senator Bentsen. Aye.

The Clerk. Mr. Hathaway.

(No response.)

The Clerk. Mr. Haskell.

(No response.)

The Clerk. Mr. Matsunaga.

Senator Matsunaga. Aye.

The Clerk. Mr. Moynihan.

Senator Moynihan. Aye.

The Clerk. Mr. Curtis.

Senator Curtis. Aye.

The Clerk. Mr. Hansen.

Senator Hansen. Aye.

The Clerk. Mr. Dole.

(No response.)

The Clerk. Mr. Packwood.

Senator Packwood. No.

The Clerk. Mr. Roth.

(No response.)

The Clerk. Mr. Laxalt.

Senator Laxalt. Present.

The Clerk. Mr. Danforth.

Senator Danforth. No.

The Clerk. Mr. Chairman.

The Chairman. Aye.

Nine ayes and two nays and one present, the amendment carries. That makes ten ayes. The amendment carries.

Next we will hear from Mr. Danforth.

Senator Danforth. Mr. Chairman, this has to do with arbitrage, and it is a matter that pertains to Jackson County, Missouri, I believe Milwaukee, I believe Wichita, Kansas, and some half a dozen or so other communities around the country.

In 1969, arbitrage was prohibited, and subsequent to that date, as I understand it, what happened was that a number of communities who wanted to issue advance refunding bonds would issue the advance refunding bonds and then with the proceeds, purchase from either citizens or the Treasury or charitable organizations U.S. Treasury Bonds, and they would get around the arbitrage prohibition with respect to the issuer of the bonds by purchasing the Treasury bonds from individuals or from charities or from the Tresury, bonds at an inflated price.

This, in effect, shifted the windfall which previously had been realized by arbitrage from the municipality to some third party. And this practice was followed fairly widely, especially with respect to charitable organizations, and in the case of Kansas City, Missouri, it happened to be the Boy Scouts, where the municipality would issue an advance refunding bond and in the process confer an advantage on in this case the boy Scouts.

In September of 1976 the Internal Revenue Service changed the rules with respect to arbitrage to prohibit this transfer of benefits to third parties except for Treasury itself. The problem was that some municipalities and third party organizations were caught in a time problem in that the municipality would have issued its own bonds, entered into a purchase arrangement with the third party, and what Treasury did as of I think September 26th, 1976, was to hold that its new provision would apply to not the issuance of municipal bonds subsequent to September 26th, 1976, but instead, to the acquisition of Treasury bonds from the third party after September 26th, 1976.

So this amendment is the same as a bill which has been introduced by Senator Eagleton, and I don't think that it is aggressively opposed by Treasury. I don't think that very much money is involved, but it would simply take care of this problem with dates that we have, and provide that the date of the change of the rule would be for municipal bonds issued after September 26th, 1976 as opposed to the acquisition of Treasury bonds.

The Chairman. What is the Treasury position on this?

Mr. Lubick. Nonaggressive opposition.

(General laughter)

Mr. Lubick. As I understand it, Senator, this applies only to the amounts currently in escrow that will be delivered to public charities.

Senator Danforth. That is correct, yes.

The Chairman. What do you estimate the cost of it to be?

Mr. Lubick. This is a negligible cost. It has got to be probably under $1 million.

The Chairman. Well, Treasury is not for the amendment, do I take it, but they oppose it very mildly. It is minimal opposition.

Mr. Lubick. Senator Curtis would label it paper thin, I think.

The Chairman. Well, all in favor of the amendment say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

The ayes have it.

Senator Curtis. I take it you are building up a reserve of strength to oppose something vigorously.

The Chairman. Mr. Bentsen?

Senator Bentsen. Mr. Chairman, I understand this is one that is supported by Treasury and it deals with the mutual fund administration of teacher annuities, and the manner in which the withdrawals are made, and I believe it puts it on some guidelines that are probably similar to withdrawals from profit sharing plans.

Mr. Lubick. I think, Senator Bentsen, this is such a good amendment that it ought to be extended both to the insured 403(b) annuities as well as the noninsured. Basically, it is trying to assure that these funds that are set aside will be used for retirement, and therefore they cannot be withdrawn prior to retirement without some penalty. The mutual funds have indicated willingness to accept such a penalty, and we think that is a salutary principle which should be extended across the board.

Senator Bentsen. Well, I would not be prepared to offer that without further consideration of it and understanding of it. So I am just proposing it in the form in which I have stated it.

Mr. Lubick. We would accept it.

Senator Bentsen. Thank you very much.

The Chairman. Well, all in favor say aye.

(A chorus of ayes.)

The Chairman. Opposed, no.

(No response.)

The Chairman. The ayes have it.

Senator Packwood. Would you put my name onf the list again at the bottom there.

I have got another one.

Senator Danforth. Can I be at the bottom also, Mr. Chairman.

The Chairman. Mr. Dole.

Senator Dole. I think first is the provision on payments to offset the loss in tax revenues on Guam and the Virgin Islands, is that in the House bill?

Mr. Shapiro. No, it is not, Senator.

There is a question in the House as to the jurisdiction of that matter. I think it may have been dealt with separately. Initially it was under the jurisdiction of the Interior Committee. I think someone has told me that they have referred that to the Ways and Means Committee.

Senator Dole. Well, I have been --

Mr. Shapiro. Okay, Senator, as I understand, that was referred to the Ways and Means Committee. They have marked it up and they have ordered it reported. So they have agreed to it this week. It is not in the big tax bill before this Committee though.

Senator Dole. Well, I wonder if there is any objection. I know Treasury doesn't like it, but --

Mr. Lubick. We think that it is inappropriate, Senator Dole. We think that if there is to be a -- if there is a cut in taxes and we have a mirror system, the territories are free to pay their own taxes; simply because we cut our taxes doesn't mean that without going through the regular appropriations process that we should reimburse them for that. I think in the interests of their own self-government, if they want to recompense themselves for whatever revenue they may lose through a cut in tax, they are entitled to levy that tax through their own legislatures, and they should do it that way.

Senator Dole. Well, let me for the time being withdraw that amendment and ask the Treasury if -- I had hoped to have prepared a productivity tax credit. It would be a minor amendment that probably wouldn't cost a great deal, but it would apply to employees and employers, and we have got tax credits for machinery, and what we are trying to deal with is inflation. We decided last week we weren't going to index for inflation. We have been discussing tax credits and a number of tax incentives for the past week, but I propose that we initiate a productivity tax credit, and then provide, say, a ten percent tax credit to the worker based on his wages up to a certain point if employed by a company that has not raised its prices over a modest level from the preceding year.

Now, what I would really like to do is -- I am certain it is premature for the Committee to act on it today, but request that the Treasury Department be instructed by the Committee to do a study, and you may be already in the process of doing that and maybe have something available in the next six months, the possibilities of using the tax system to control inflation, and I could give you some more details on that provision.

But all I am suggesting is perhaps we ought to take a look at it and see if it has any merit, and then let us know.

Mr. Lubick. We would be very pleased to do that.

Senator Dole. Is that all right, Mr. Chairman.

The Chairman. Sure.

I would like at this point just to get on some of these less controversial items that are in the House bill that we are going to have to do something about one way or the other, I would prefer that those that are more controversial, that you just wait until we have more people here, but --and we may have to go till tomorrow morning to report this bill, but on the less -- what are some of the less controversial things in that House bill that you think we ought to give you an answer on whether we want it in or not in?

Senator Gravel. Well, are we going to take up the balance of what we have?

The Chairman. Well, I am going to do that, but I would like to get just some of those less controversial things disposed of.

Mr. Shapiro. I think a few of these I can run through very quickly.

The first one is --

The Chairman. It is decisions that have to be made, but the less controversial ones, I think maybe we could decide some of those right now.

Senator Nelson. May I ask a question first? I need to go over to the floor.

Are we going to meet to finish the bill in the morning?

The Chairman. We may have to, but I would like to finish tonight, but I just don't know.

Senator Nelson. Well, I would like to just make one point before I leave.

I had thought we were going to be looking finally at a package that comes within the $21 billion or something, but on the -- on my friend President Dole's proposal this afternoon of a billion dollars that we had a voice vote on --

Senator Dole. Well, we reduced that to about $200 million.

Senator Nelson. Can't we get it down to about $10 or so?

Senator Dole. Well, somebody has to represent the handicapped on the committee.

Senator Nelson. I didn't see the -- I didn't know you got that. What did you do, get your billion and then negotiate it?

Senator Dole. No, we never -- we negotiated -- it is much like the widow's tax. We negotiated it a lot that you had, and --

The Chairman. What is your estimate of the full cost of it now?

Mr. Shapiro. Senator, we are estimating now that you are about $2.3 billion above the House bill.

The Chairman. For this particular amendment, what is the estimated cost in full operation?

Senator Hansen. Are you talking about the handicapped amendment?

Senator Dole. We took off anybody that had a government payment, then we cut it down to $500.

Mr. Shapiro. It is approximately $200 million in full year operation, we understand.

Senator Nelson. Well, I didn't know you got it back down, and I have no quarrel at all with Senator Dole's objective. I was interested in the comments of Treasury about the targeting of it, and I am concerned about the amount, and I thought at some stage we were going to have to deal with the question of squeezing this, some items down here so that we got it down to the budget resolution.

I have got a couple -- I have got a good capital gains tax proposal here that would probably save us about a billion. I don't think I got many votes for it, but it would help the budget balancing.

Senator Dole. Well, we did cut this down 80 percent or more.

Senator Nelson. Well, you will be meeting tomorrow morning?

Mr. Shapiro. Senator, there is a conference on the tuition tax credit scheduled for 10:00 o'clock tomorrow.

Senator Curtis. That is a small conference. I will abide by the Chairman's decision, but I doubt if we can finish tonight. We are still working on the floor and have to get some calls over there.

Senator Dole. We could go through some of the House provisions

The Chairman. Well, I would like to get as far as we can. If we can't report tonight, my thought is if we can't report tonight, I would like to come back in here at 8:00 o'clock tomorrow morning. That would give us a couple hours before the conference starts.

I'm told there is a Republican conference at 8:00 o'clock. We'll come in here at 9:00 o'clock and then maybe it could be worked in such a fashion that someone over there in that conference could communicate with those Senators and call in here and tell us how they wanted to vote on these matters so that we could -- well, we have this problem that our staff can't be at both places.

Mr. Shapiro. Senator, it may be that you can start the conference in the morning and then have this Committee pick up in the afternoon, earlier in the afternoon, and you probably will only need, I don't know how many amendments the Senators have, but based on the House list, maybe an hour, hour and ahalf, and two hours, and then if the tuition tax credit conference reconvenes tomorrow afternoon, maybe let that reconvene at 3:30 or 4:00 o'clock, in other words, just go into tuition tax credit in the morning, pick this up between 1:30 and 2:00 and then reconvene the tuition tax credit conference at 3:30 or 4:00.

The Chairman. Well, we have a vote right now. We really ought to try to get more of this done tonight if we can.

Senator Gravel. Let's come back.

Senator Packwood. Well, let's go vote and come back.

Senator Gravel. There is another hour of legislative work, so we can come back.

The Chairman. Are the Senators willing to stick around for another? All right, let's go vote and come back.

(A brief recess was taken.)

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The Chairman. The other Senators will be along shortly. Have we taken care of your amendment, Senator Dole?

Senator Dole. I did not have an amendment. I have one I called to the attention of Mr. Shapiro, the provision of ERISA which limits benefits under the defined benefit plan to a percent of participants, high three years of compensation.

Apparently, that has some impact on about 75 participants in the Major League Baseball Players Benefit Plan who are in the salary range of $10,000 to $20,000.

I gave a copy -- are you familiar with it?

Mr. McConaghy. Yes.

Senator Dole. I do not know if there is any impact at all, but I think we suggested an amendment there on page 4.

Mr. McConaghy. The revenue -- yes.

Senator Dole. I do not know whether there is an objection to the amendment.

The Chairman. What is the Treasury position?

Mr. Lubick. This is an acceptable amendment.

The Chairman. All in favor, say aye?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it. Mr. Moynihan?

Senator Moynihan. Mr. Chairman, I have three measures. I believe I am allowed one at a time.

The Chairman. I have a note here what you had in mind, one that you thought Senator Hathaway wanted a vote on his amendment and wanted a roll call vote on it. He is entitled to it.

Two, you were interested in the inclusion of the unemployment taxes in the House bill of 50 percent of income, and that is something you are going to cover, Mr. Shapiro, when you go through these House amendments, right?

Mr. Shapiro. That is correct.

The Chairman. The other thing that you had here was a syndicated partnership audit that the Treasury was interested in.

I would think that the top item, the one about AMEX, we will vote on that when we have everybody here, or as many as we could get, and the staff is going to cover item two. Why do you not bring up item three?

Senator Moynihan. Thank you, Mr. Chairman.

Mr. Chairman, the proliferation of long-syndicated investment partnerships which are largely engaged in tax shelter activities, have caused serious administrative problems for the IRS and its efforts to enforce the very complex tax laws which are applicable to ventures, ventures which might have 5,000 partners.

Under existing law, the Service can now finally determine partnership issues in a single administrative or judicial proceeding. Rather, it must identify and control the return of each investor whose tax liability is affected by such a partnership issue and either resolves that issue in the audit of the individual's return, get the individual's consent to an extention of the statute of limitations but hold the returns open pending resolution of the partnership issues in a test case, or issue an assessment to the investor and allow him to pursue separate administrative and judicial appeals.

I understand the Service has over 70,000 returns which are in suspense, awaiting resolution of these issues, and these procedures are burdensome to the Service. They pose serious difficulties in mounting effective administrative reviews of syndicated partnership ventures.

I am told that they frequently take questionable positions on the partnership return in the belief that those conditions may go unchallenged due to the difficulties imposed on them by the existing procedures.

The Administration's proposal is a complex one which I know that Mr. Lubick can identify, but it seems reasonable to me -- I have gone over it with them. Sir?

Senator Dole. It seems to me that it would be very complex. Do you think it is something that we ought to address at this time? Have we had any hearings on it, or are hearings necessary?

Mr. Lubick. There were hearings in the House and it is partially in the House bill. The House adopted a limited form pending further study. The House limited the application of the provision in two ways: one, it limited the partnerships to which the provisions would be applicable to those that are required to register with the Securities and Exchange Commission.

Senator Gravel has already indicated that that, perhaps, is an undesirable restriction because it might make it more difficult to market those type of partnership arrangements. We have suggested that the provision ought to be applicable with respect to their syndicated partnerships that are defined in the legislation that you enacted in 1976 in Section 464(c) which basically includes those that register under the blue sky laws of individual states, the intrastate ones.

The second aspect that the House acted on was to limit the provision to give the Service additional time to audit by extending the statute of limitations. We suggested that we should e able to go beyond this, that the issue of partnership by ability ought to be determinable by treating the partnership as an entity for audit purposes and for litigation purposes in court.

At the time that the matter was proposed in the House, a question was raised with respect to the protection of the dissenting partners who might differ from the managing partners in the handling of the case.

Since that time, we have done some work. We have talked with both the American Bar Association and the CPA Association, the American Institute of CPAs, and as with the tax section, in the case of the Bar Association, no formal action has been taken but the leaders of the section have indicated that they support it in principle. I believe the CPAs do support this in principle.

We suggest that if we adopt this entity approach we have developed language which will protect the dissenting partners and that seems to obviate the only real obstacle that existed in connection with the entire proposal.

So we would suggest that you ought to do two things. One is to extend the coverage to the syndicated investment partnerships as you have already defined them in 464 and, at the same time, apply that proposal not only to the extention of the statute of limitations but to the entire audit and litigation procedure. In that way, the Service will be able to handle the massive volume of tax shelter partnerships. These partnerships are formed with partners, only a partnership interest in tiers.

We have found with as many as 7500 different returns, and to adjudicate those, where the returns are all over the country, to keep all of the partners open, is almost an impossible task.

Therefore, we think that we can get a handle on this sort of activity by auditing at the partnership level, treating the partnership as an entity, just as the corporation is today.

The Chairman. After this amendment was called up I was handed this note which said that this proposal is opposed by the Louisiana Federally Registered Partnerships.

Mr. Lubick. I would suspect that their objection is the same one that Senator Gravel was raising, namely if one singles out the Federally-registered partnerships, you encourage investments in the intrastate partnerships that do not have to register Federally.

The principle is perfectly sound, but if you are only going to apply a sound principle to one class --

The Chairman. Let me say this now. We hope to report this bill tonight and this is the first I have heard of it. I had no knowledge of it, and it may very well be that I could go along with the amendment, but I would at least like to have an opportunity to discuss the matter and also let these people explain what their argument is so that we would have that account available to us.

I may thoroughly agree with you, but we have not held a hearing over here. Have you had a hearing, Senator Byrd?

Senator Byrd. No. I was wondering on that, why something like this should not be submitted to a hearing.

The Chairman. That is the point I had in mind.

It seems to me that Senator Byrd and Senator Haskell have made themselves available on matters like this, one on the technical parts, the procedural parts of the law, and Senator Byrd has been holding hearings on many of these complicated tax laws.

Mr. Lubick. This was a part of the hearings on the tax bill. The Secretary had included it in their recommendations. He spoke to it in the general hearings you held on the tax bill.

Senator Byrd. Not in detail. No hearing was held on this specifically.

Mr. Lubick. This in gross?

The Chairman. I do not think it is asking too much to let this matter be considered as a Floor amendment. It may be that I am with you on the thing, but I would certainly like to have an opportunity for some of my constituents -- I look down here to see people I hope will support me for office, and I would at least hope that at least that they wold have a chance to explain the reasons they are against this rather than you say they are against it for such and such a reason. That may not be the reason at all.

I think, in fairness, that the other side is entitled to be heard. It may be that you are entirely right about the thing. I do not want to find ourselves in a situation like we did where Harry Byrd thought -- he had a strong difference of opinion. He said it ought to be suspended, the carry forward basis. I have been trying to get Harry Byrd to go along with something in the spirit of compromise. His reaction is that he does not want to be caught in a fast shuffle again like he felt he was last time.

Senator Byrd. Mr. Chairman, my guess is that I will support what Mr. Lubick wants. My guess is I will support him, but I really believe that, at ten minutes to 8:00 on the last night when we are marking up this tax bill, to have a new, complicated procedure thrown at us, it seems to me, as a matter of policy, we ought to determine whether we are going to go into all of this.

The Chairman. It may be that I can go along with you on it. I just do not want to agree tonight. I would hate to agree tonight and then find out when the bill is out that I have to ask somebody to strike something out of the bill we agreed to.

I would hope that we can go along with you, but even though it may have been in the Secretary's statement, I was here when the Secretary testified. I must say that I did not remember it.

All I know is that I am going to have a couple of unhappy constituents if I do this tonight. I think they are entitled to communicate and explain their reasoning.

Mr. Lubick. Is there some procedure we can take to work on this between now and the Floor?

The Chairman. This bill is not going to pass the first day, Mr. Lubick. I would be delighted it it were passed the first day. Call it up and pass the bill. Boom, call the roll.

It is not going to happen that way. We will have time to work on this. I hope I can accommodate you on this. It sounds great, but at the same time --Senator Moynihan is nodding, he sees my problem. If he had an expression of concern from his constituents, he would feel the same way about it. He would want to know a little bit more about it before he votes.

Senator Byrd. My point is, Mr. Chairman, even if we do not have an expression of concern on the part of constituents, we ought to know what we are voting on, and I do not think anybody on this Committee understands this proposal.

Mr. Lubick. May we undertake to educate you during the period between now and the Floor debate?

Senator Dole. We will do the same.

The Chairman. Mr. Gravel?

Senator Gravel. Mr. Chairman, I have two small ones, and I will be done with my agenda. Under present law, we have a five-year rapid amortization for ocean equipment, for clean air and clean water. For some reason this is not applied to the Safe Drinking Water Act of 1974, so all I would be asking is that we have the same rapid amortization for government-mandated pollution control facilities for water companies that we have under the Clean Air and Water Act.

The regulations would have to come forward from EPA, and they would have to abide by those regulations. That would be the criteria.

That is all I am asking for. Are you familiar with it?

Mr. Shapiro. The problem we have right now, Senator, is that there are no regulations under it. We do not know the extent to which that Act applies, so there is no way that we can clearly interpret it or give you a revenue estimate until they come out with regulations interpeting how it applies.

Senator Gravel. From a policy point of view, would we be making any different judgment than we have presently made on environmental legislation to date on the Clean Air Act and the Clean Water Act?

Would we be making any different -- that is a policy question. Either we are consistent in our policy approach or we are not.

Mr. Shapiro. The direction of the amendment is consistent with what has been taken.

Senator Gravel. Could you take it that far, then?

Mr. Lubick. Senator Travel, we did agree with Senator Bentsen that we would study a related problem in connection with the ocean-mandated equipment. I wonder if we could include this.

Senator Gravel. Do we presently give a rapid amortization for OSHA equipment?

Mr. Lubick. No, we do not.

Senator Gravel. We presently give a rapid amortization, five years, for anybody who has mandated devices that they have to put on to clean air and water. This does not take a study. I could sit here in two minutes time and understand the policy ramifications. Either I am for it, or I am not. If I am for giving some pollution devices and not others, fine, but if I believe that if the government is going to mandate pollution devices, the private sector has to pay to put it in for clean air and clean water, we are prepared to do it, for drinking water, we are not, fine.

I can see that division. I see it inconsistent, but I do not think we need a major study to arrive at a decision in this regard. It is either sound and consistent government policy, or it is not.

Mr. Lubick. You are speaking now only of retrofitting.

Senator Gravel. This is no different from what they are getting from clean air and clean water, not a hair different. You people write the regulations. I am not going to write them. All I want to do is be consistent, that some industries are getting a rapid write-off because they are helping the environment and others do not.

I do not see consistent government policy in that all I am asking is that we be consistent down the line. I do not think that is too much to ask.

The Chairman. What is the cost of this?

Senator Gravel. Nobody knows, because we do not have any of the regulations.

Mr. Lubick. A study would have to be done on that.

Senator Gravel. Does anybody know what it costs for clean air? Does anybody know what it costs for the Clean Water Act? If we are going to live in blissful ignorance, let's live in blissful ignorance. At least we are consistent with the policy.

The Chairman. You might as well explain the Treasury position.

Mr. Lubick. We are opposed, Senator Long. We do not believe that the rapid amortization is an appropriate way to address this problem. It does create distortions economically in favor of retrofitting as opposed to purchasing new equipment which accomplishes the same purpose.

I do not know what the revenue is. I just learned of this amendment within the last hour or so. As Mr. Shapiro has indicated, we are not really exactly sure what equipment we are talking about.

I would very much prefer it if we could include it in our study and we will get back to you within the next few months.

Senator Gravel. I would like to strike any rapid amortization we have for clean air and clean water and also study that so we can all be consistent in Federal policy. I do not see any logic.

The Chairman. I would urge you to consider withholding it now. We can give it further thought, and offer it on the Floor if it looks like we can come to terms on it. We have a lot of amendments here.

Senator Gravel. Fine. I will offer it on the Floor and put Treasury on notice, and staff on notice, that if they have some legitimate reasons why it should not happen, I will withdraw it. But I just do not see inconsistency. There is nothing that has been said by staff or Treasury that leads me to any validity to inconsistency, but I will hold it to the Floor and have another shot at it and I will give you a chance to do your homework.

Fair enough?

The Chairman. Senator Gravel, one more?

Senator Gravel. We discussed this earlier. This was earlier in Committee, and that was on the at-risk provisions of equipment leasing. I talked a little bit with Treasury on it.

Senator Dole. That was in the House bill, is it not?

Senator Gravel. There is one element in the House bill but the House bill only compounds the injustice, not solve the injustive. We could strike out that, but in addition to striking out the House bill, the Treasury may be prepared to do something that, I confess, I do not understand.

Mr. Lubick. The problem that has been raised by all of the persons who have met with us can be solved by a rule that adds aggregation of leases for determining the amount at risk. If we have a number of leases and we pool them together and give the total investment for purposes of depreciation, that will give a larger amount at risk, particularly as older leases of equipment are involved, the indebtedness against the equipment is reduced producing a larger amount at risk. And, for this purpose, we would suggest that if you permit aggregation on a retroactive basis for aggregating and determining what is at risk, leases from before the '76 Act, going all the way back, all leases involved in trade or business could be aggregated.

That has solved the problem with respect to all of the trade or business leases that we have seen, leaving the provision applicable to the person to have a single odd lease or two odd leases that are being used to shelter unrelated income.

Senator Gravel. I am not concerned about those.

Mr. Lubick. With that adjustment, we feel that we have taken care of the problem of every taxpayer who has been in to see us.

Senator Dole. That is not what we are told by some of the small business lessors. They say that promises to be almost unfair, unworkable, devastating, as the unbalanced tilted tax situation which has prevailed since 1976.

Mr. Lubick. They have said that to us, too, but when we look at their factual situation they are not affected adversely. They have sufficient basis to maintain their depreciation.

Senator Dole. You are talking about corporations or individuals?

Mr. Lubick. We are talking about both. We have talked to both corporate and individual lessors in business.

Senator Gravel. I would be prepared to strike the House section and then accept this, and then if there is reaction to it, we can take it to the Floor, or in conference.

Senator Dole. I do not think we need to strike it. Just do not put it in our bill, and then we can go to conference.

Senator Gravel. That is what I mean. Do not put it in our bill.

Mr. Lubick. Do you have a problem with aggregation? I think you should get the aggregation in to establish that principle. That is not in the House bill.

Mr. Shapiro. That could be done in conference, if you wanted tol

Senator Gravel. What would be staff's comment on aggregation?

Senator Dole. We are concerned about the closely-held corporations. I am not certain I understand what impact aggregation would have. What little that I do know --

Mr. Shapiro. There is really legitimate concern in the Administration's proposal as to legitimate small businesses that compete with larger businesses where larger businesses are not covered by these provisions and the smaller businesses are.

The problem is that making a distinction as to which of these small businesses and closely-held corporations are legitimate corporations and which of them are simply a tax-sheltered operation. The tax-sheltered operations were the ones that the Treasury were directing their attention to, which the Ways and Means Committee wanted to cover.

The concern over legitimate small businesses is not focused on significantly until after the Ways and Means Committee acted.

The groups that have talked to staff in regard to corporations have indicated that the aggregation rule pretty much covers their cases.

Let me be very fair and say that that does not mean that every one -- that may be only the ones who talked to us. There may be some other businesses who have not talked to us who feel that it is not covered and apparently you have letters that so indicate. Or maybe they do not understand the way the aggregation rule works.

But I would say that the closely-held corporations who have discussed this issue with staff believe that the modifications that have been suggested would cover them.

The Chairman. Why do we not put the aggregation rule in our bill -- that is not in the House bill, is that right, Mr. Lubick?

Mr. Lubick. That is right, Mr. Chairman.

The Chairman. Put the aggregation rule in our bill, and the House has the at-risk provision in their bill.

Mr. Lubick. The aggregation is a part of the at-risk. It is a way of computing what is at risk.

The Chairman. Put the aggregation language in, right in there.

Mr. Shapiro. If there is to be the at-risk provision applied to corporations, you would like to have it aggregated.

Senator Dole. Small, closely-held, five shareholders or less.

Mr. Shapiro. Senator Long is not suggesting we agree with the House provision?

The Chairman. I am saying, why do we not put the language in so we have the verbage in there which would mean if you wanted to go to conference and agree to the House language with the aggregation rule, if that is in conference; and, on the other hand, if you want to -- it may be the judgment of the conferees, if you debate the matter for awhile, you may decide you do not want any of it.

You can have all of it, none of it, or have the House language with the aggregation rule. You have your options open.

I am sure the House people would make a small argument parallel to the Treasury position. They voted that way and sent it to us, and I am sure that would be their case.

Mr. Shapiro. The problem is this. If you go to conference without anything and the House insists on their amendment and you have to accede to it and this provision is put in, we do not have the benefit of hearing what the corporations affected really think of it. By doing what Senator Long is suggesting, you are not binding yourself, you are not agreeing to a provision. What you are saying, if it is accepted, you will do this, and therefore I think that we can get the comments of those we have not heard from and they can see how it is drafted, what the

Committee report will be written about it, and get the comments on that.

Senator Dole. On the basis we are going to reject the extention of at-risk in the House bill, that would be all right.

Mr. Shapiro. That is what Senator Long is suggesting.

The Chairman. That way, in conference, the whole thing will be open. You can do it the way Treasury wants to do it, or not do anything.

Mr. Lubick. I assume what we are talking about here is with respect to the equipment leasing. That seems to be the only problem.

As far as the rest of the at-risk, the phonograph records, those parts of the House bill are perfectly satisfactory.

The Chairman. Equipment leasing. All in favor, say aye?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it.

Senator Gravel. One last thing, Mr. Chairman. When we altered the capital gains tax, this was legislation I had secured some time ago, and that was an investment tax credit advantage for virgin materials, pulp. And now, when we alter the capital gains tax what we will do is place -- again, we will alter the inbalance that we established, that was that virgin material would receive the same tax advantage as recycled material.

I think, from a policy point of view, we would like to keep that same balance that we had. The only way we can do that is increasing the investment tax credit for recycled material on pulp.

As you recall at that time, I fought long and hard for a whole cross-section of recycleables and all I got was pulp, and that was carried on the Floor quite overwhelmingly.

I am trying to establish that inbalance that is created by giving the virgin pulpwood producers, lumber companies, an extra tax advantage not shared by the recycling people.

Mr. Shapiro. Senator, one of the times you were not here, Senator Matsunaga brought that up and the Committee decided that since it is in the energy bill and there is an energy conference on Friday, that the Committee defer consideration on that in this bill and wait until after the energy conference meets, and then it could be handled at some other time.

Senator Gravel. Thank you.

I apologize for taking your time. I did not realize that that was so.

The Chairman. Senator Packwood? He is not here at the moment.

Senator Danforth?

Senator Danforth. Mr. Chairman, this will be a controversial item and I would like a roll call on it. I think I can predict the outcome, but I think that it is fair to say that the consistent theme of Republicans on the Finance Committee has been that we would like some multi-year concept to protect people from the effect of inflation's putting them into higher and higher brackets. This was the part of the Roth-Kemp proposal that Senator Roth offered; it was a part of the indexing proposal that Senator Dole offered.

In the spirit of compromise and reason, I would like to now offer the most stripped-down possible version of that proposition, which is for one year, namely calendar year 1980, and it could be worked out, I have the language, if you wanted to get around ghet Budget Resolution -- for one year, to increase by 6 percent the brackets, the standard deduction, the personal exemption and the earned income tax credit.

We have debated this over and over again, and I think all of the arguments have been put forward pretty clearly, but basically it is that we just cannot pass tax bills around here fast enough to keep up with inflation and that has been proven in this bill.

When the President appeared before the Congress last January and said he was going to hold people harmless from inflation and Social Security, he could not do it. The reason he could not do it, he said that in January of this year, and we cannot get a tax bill passed fast enough to cover more than one year out of every two.

So that this is just to hold people harmless. It is not a tax reduction. It just says that for the effect of inflation, government will not benefit at the expense of the individual taxpayer.

Senator Curtis. Does it include rates?

Senator Dole. All it does is widen the brackets by 6 percent, increase the standard deduction, increase the personal exemption, increase the earned income tax credit. It does not do anything to rates.

The Chairman. Call the roll.

Mr. Stern. Mr. Talmadge?

(No response)

Mr. Stern. Mr. Ribicoff?

The Chairman. No.

Mr. Stern. Mr. Byrd?

Senator Byrd. No.

Mr. Stern. Mr. Nelson?

(No response)

Mr. Stern. Mr. Gravel?

Senator Gravel. No.

Mr. Stern. Mr. Bentsen?

(No response)

Mr. Stern. Mr. Hathaway?

(No response)

Mr. Stern. Mr. Haskell?

(No response)

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. No.

Mr. Stern. Mr. Moynihan?

(No response)

Mr. Stern. Mr. Curtis?

Senator Curtis. No.

Mr. Stern. Mr. Hansen?

Senator Hansen. Mr. Chairman, before I vote no, let me say that I am very sympathetic to the proposal offered by Senator Danforth. I am concerned about the overall cost of this bill and I am also concerned about the feeling that, when President Carter made the statement he did earlier to which Senator Danforth has alluded, the fact is that he could not keep the promise, and he knew it at the time. If he did not know it, he should have known it.

There is no way you can protect the people in this country from inflation unless you get a handle on inflation. If you take this step, it would seem to me to encourage some people to believe that inflation really is not a problem.

Despite my strong sympathy for Senator Danforth, I vote no.

Mr. Stern. Mr. Dole.

Senator Dole. Without a statement, I vote yes.

Mr. Stern. Mr. Packwood?

Senator Danforth. Mr. Packwood votes aye.

Mr. Stern. Mr. Roth?

Senator Roth. Aye.

Mr. Stern. Mr. Laxalt?

Senator Danforth. Aye.

Mr. Stern. Mr. Danforth?

Senator Danforth. Aye.

Mr. Stern. Mr. Chairman?

The Chairman. No.

Five yeas, nine nays. Senator Haskell votes no.

Mr. Packwood, he is not here.

Mr. Curtis?

Senator Curtis. Mr. Chairman, I have a few items. I will be as brief as I can.

I would like the attention of the Treasury on the question of the investment credit, that those industries really need to upgrade their equipment, and they do not have the money to do it. A very profitable company gets full benefit of the investment credit while the one without income does not.

It has been suggested that we make it refundable; that costs a lot of money. In a previous Congress, we extended the unused portion of the carry forward. What was the position of the Treasury on that?

Mr. Lubick. Basically, Senator Curtis, we believe that the appropriate period for carry over of the investment credit -- you should decide, as a matter of policy, of how long you wanted to go, and decide it on a uniform basis for all industries. As long as all industries are treated the same, then we think that is appropriate.

We would be opposed to singling out particular industries to say well, when they get up to expiration period, then we will run it on for this industry here, and that one there. As long as there is a uniform rule applicable to everyone, we think that the number of years it is appropriate is for your judgment.

Senator Curtis. I move for the unused investment credit that expires in any taxable year -- that is, 1978 -- be extended to '79.

Mr. Lubick. Senator Curtis, could you, instead, make this more of a permanent change so that everybody has an extra year? The problem of just extending those that are expiring --

Senator Curtis. All right. That will take care of the group I was talking about also. I do not want to have a gap in there every year. This is for everybody.

Mr. Lubick. You would be faced with the same thing next year. Some others would come in and say, you did it for some last year. It should be done on a uniform basis.

Senator Curtis. Just extend it one year.

The Chairman. How does Treasury feel about that? Do you oppose it, not too strongly?

Senator Curtis. They are in favor of it.

Mr. Lubick. It is really a question of revenue. It is a $20 million item the first fiscal year. In the long run, it will cost $50 million. It is simply a question of how long you want to have the investment credit carryovers go.

The Chairman. All in favor say aye?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

Senator Curtis. Thank you.

I would like to ask the staff about this, the bill that affects the different classification of property other than the investment tax credit, and there have already been problems in classifying property under present law. For instance, the IRS has publicly ruled that wall to wall carpeting is eligible for the investment tax credit as tangible personal property, but when privately held, it may not be used as a credit.

My question is this. Has the staff worked up any guidelines that would help both the government and the taxpayer solve this problem that might be incorporated in the Committee Report?

Mr. Shapiro. We have worked on some language. There are some problems that require certain line-drawing, and the investment credit, as you know, is only available to tangible personal property. It is not available to structures.

When you have a building -- there are some types of items. It is a question of whether or not it is personal property or whether it is the building. That raises certain problems. The regulations go into detail on this point. In some respects they are in conflict in certain areas. Questions come about. We are aware of certain problems that have come up and what we can do to make an attempt to outline in the Committee Report some better guidelines that deals with the situation.

We cannot list every item, but we will make an effort to provide some guidance in the report in this area.

Senator Curtis. This would go in the report only?

Mr. Shapiro. Yes.

Senator Curtis. I so move.

The Chairman. Without objection, agreed.

Senator Curtis. I would like to call up a matter for Senator Percy. This, I will rely upon what the staff and Treasury have to say. It is a technical one. It has to do with the charitable leave trust.

In the Tax Reform Act of '76, Congress extended the minimum tax on preference income to so-called excess itemized deductions effective January 1, 1976. A special rule was also included so that the charitable trust would not be caught by the minimum tax.

However, because of a technical error, this special rule did not work. Because of this error, the charitable trusts could not deduct the charitable contributions in computing their excess itemized deductions and thus they were being caught by the minimum tax.

The Technical Corrections Act passed by the House cures the problem in pooled income funds, but left out charitable leave trusts. This is a trust that leaves an annuity to charity for a period of time, after which the trust remainder passes to a beneficiary that is not charitable.

What is your recommendation about this problem?

Mr. Lubick. Senator Curtis, I had not heard about this problem since we considered it in connection with the House bill, so my recollection may be a little shaky.

My recollection has now been refreshed. If we could let it apply for one more year, I am given to understand that is about where we would come out.

Senator Curtis. Is that staff's recommendation?

Mr. McConaghy. There was quite a bit of confusion about how that particular provision did apply. The date that was chosen was January 1, 1977. The trusts created prior to that date -- in '76; I am sorry -- and the amendment would apply the minimum tax to those charitable leave trusts prior to January 1, '77.

Senator Curtis. One year.

Mr. McConaghy. Yes.

Senator Curtis. I so move.

The Chairman. All in favor, say aye?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

Senator Curtis. There is another date involved. The problen the Committee should solve is caused by H.R. 9251. It passed the House and the Senate, but final passage has been delayed. Section 6 changes Section 382 of the Code by the Tax Reform Act of '76. The Reform Act changes are effective for the taxable years beginning after June 30th, 1978. However, H.R. 9251, which would make them applicable after June 30, 1980.

This modification was made without taking into consideration those taxpayers who entered into transactions with reliance upon the Tax Reform Act. Unless we somewhat modify the effective date, H.R. 9251 can have unintended, adverse consequences for some taxpayers because it would be retroactive.

What is your recommendation on that?

Mr. Lubick. We support the provision. We think it is important to give us the time to work out the technical provisions of Section 382.

I would like to point out that the matter will be involved in Section 911 in Conference. We have no objection to putting the same provision in.

(Pause)

Mr. Shapiro. H.R. 9251 is the bill that includes the Section 911 provision as well as some other extensions. This provision was enacted in the 1976 Tax Reform Act as a way to deal with net operating loss carryovers, and Congress provided new rules in the 1976 Act.

H.R. 9251 extended the application of the rules so they would not apply for a couple of more years, in order to give the Treasury an opportunity to write regulations and the taxpayers time to deal with it.

It gave taxpayers one year, and then a couple of more years.

Senator Curtis' amendment would say that there are some taxpayers that looked at the new rules and would like to come under the new rules because they would presently apply, and they would like an exception to the deferral. If the rules applied to them, they would like to be able to come under those new rules, since they thought those rules would be the applicable law, and without the deferral, if 9251 is, for any reason, not signed, if these rules are not deferred, that would be the present law.

Your amendment would say that the taxpayer could rely on those provisions in 382 as if they were the law.

Senator Curtis. What is your recommendation?

Mr. Shapiro. I think it is similar to the situation you had in the carryover basis where a taxpayer could use carryover basis, even though it is deferred, because they relied on it as a similar type situation.

Senator Matsunaga. If the Senator would yield, as I understand it, relative to Section 911, the Americans employed in foreign countries, they must file their income tax return by October 15th of this year. Is that correct?

Mr. Shapiro. What they do, they are required to file their returns by April 15th. They have the normal 60-day delay until June 15th that is granted to them.

The Internal Revenue Service has made an extention until September 15th in order to give the Congress an opportunity to review it and provide legislation for that past period. The Commission extended that an additional period from September 15th until October 15th, but has indicated that that will be the last extention.

You have passed a rule dealing with Section 911, in effect providing the prior law to last year. In addition, you put in the bill Senator Ribicoff's amendment that would provide a permanent rule. The House has just passed yesterday their provision on Section 911 and added the 9251 and sent it to Conference, so H.R. 9251 has both the Ribicoff amendment plus the House provision on 911.

Senator Matsunaga. Right.

In view of the fact that the matter will be in conference, most likely it will pass October 15th, unless the Treasury is willing to extend that period. We may need to extend it by legislation.

Mr. Lubick. Senator Matsunaga, I talked to the Commissioner about this problem at noon today and he has been talking to the House people. He went back to talk to them this afternoon.

The Commissioner is not anxious to have returns filed and, a month later, have everybody else come in and file amended returns. That is not only bad for the taxpayers, it is equally bad for the Service.

So he is going to extend it to the extent that he legally can.

There are some questions about some taxpayers who are back in the United States as to whether he can extend it, but for all of those he can extend, he is going to do so.

Senator Matsunaga. We will not need any legislation.

Mr. Lubick. I do not believe so.

Senator Curtis. Back to 282.

Mr. Lubick. Back to your problem, Senator Curtis. There are two conflicting considerations here. One is that Section 282 is a very complex subject with many gaps and many problems and many difficulties of interpretation. It was for that reason that we urged upon you to defer its applicability so that we could come up with a new recommendation for amendment and change it within that two-year period.

Senator Curtis. We deferred it in a subsequent act.

Mr. Lubick. You deferred it in the extender act. Originally, the Ways and Means Committee had proposed to defer it for one year, and we thought it would take at least two years of study, and we recommended a two-year deferral which the House and you both agreed to.

It is fair, as I think that you indicated, that a taxpayer ought to be able to rely upon the statute as enacted rather than speculating about what Congress is going to do in a bill that has been tied up now for over a year. Taxpayers should be able to rely on the law as passed, as taking effect. I think that is a very strong argument in favor of legislation which you are proposing.

Senator Curtis. This would give an election.

Mr. Lubick. Which would give an election. The countervailing consideration is that the statute presents many difficulties. If the taxpayer thinks he knows what the section means as it is enacted, in many respects he is better informed than we are because we have some great difficulty in understanding it.

So what you are going to require of a taxpayer who does elect to apply that statute, there will be some many difficult questions that will arise and we would hope that we would not have to write regulations under the statute, because we hope, within another year, that you will change it and get something that we can interpret.

Senator Curtis. It might clear up, but I think that we should provide that if taxpayers rely on what the statute says that they should be protected against a retroactive change and I move adoption.

The Chairman. Treasury has no objection?

Mr. Lubick. I cannot argue with that argument, but there will be difficulties.

Senator Curtis. I think there will be difficulties in any event.

The Chairman. All in favor, say aye.

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

Mr. Shapiro. One thing I would like to say on this provision to make sure it works right, we would like to make it apply to purchases and reorganizations equally.

The Chairman. Without objection, agreed.

Senator Curtis. Now, Mr. Chairman, this relates to the method that has been carried on for 75 years by railroads of accounting for depreciation of railroad tracks.

For instance, if a 120-pound rail is worn out and replaced by a new 120-pound rail, the rail is retired at the cost of new replacement. If the 120-pound rail is replaced by a 130-pound rail, it is replaced.

They call this the retirement replacement betterment method for property used by common carrier by railroads, including switching companies or signal companies subject to the Interstate Commerce Act.

This has been the rule for 75 years. It has never been put into the statute.

Mr. Shapiro. The situation here is that the Internal Revenue Service generally follows the rule that the Interstate Commerce Commission provides and this so-called RRB -- retirement, replacement, betterment method of accounting for depreciation. This is what the railroads have been following for the last couple of years.

There is concerned that the Interstate Commerce Commission may change this rule for purposes of their regulatory purposes which would possibly have the effect of changing the tax treatment when the IRS has filed the Interstate Commerce Commission.

I understand that this has been a method by the railroad industry and they would like to see it put into the statute to be sure that they can continue to take this depreciation for tax purposes.

Senator Curtis. You think it is all right?

The Chairman. Treasury?

Mr. Lubick. We have some serious problems with this one, Mr. Chairman. We do not see any need for this legislation right now. The Internal Revenue Service does recognize for all the railroads to use this method of accounting. The Interstate Commerce Commission is reviewing the situation and they, at some future time -- and they do not move too awfully rapidly. They changed the method of accounting that will be permitted for railroads.

The Chairman. I would hope the Senator would hold up on this one. You might want to offer it on the Floor.

Senator Curtis. It does not cost anything.

The Chairman. In view of the fact that Treasury indicates that they have serious problems with it.

Mr. Lubick. There is no animosity to the problem. We are not proposing to take them off right now. We have been meeting with them and working with them and they have been trying to give us information.

The basic question is what the Interstate Commerce Commission is going to do with this whole accounting problem. Until the Interstate Commerce Commission makes a recommendation as to what is the appropriate method of accounting for railroads, there is not going to be any problem as far as the Revenue Service is concerned.

At that time, we would expect we would want to decide what is the best method of accounting, whether we do want a different method of accounting for tax purposes and for regulatory purposes. One would hope that, as far as possible, one could provide a consistent method of accounting for all purposes. That would be a great simplification.

Senator Curtis. This has gone on for 75 years.

Mr. Lubick. As long as it continues as a method of accounting which the ICC recognizes, the Internal Revenue Service --

Senator Curtis. The ICC makes these decisions on the basis of regulatory change and other things, and we need some certainty on the tax law, and that is why I feel that we should write into the statute what has been the law, by usage, for over 75 years.

Mr. Lubick. The basic question is what clearly reflects income. All of the accounting agencies are looking into that. I would hope that you would not move hastily on this. I do not see any need.

Senator Curtis. Seventy-five years is not haste.

Mr. Lubick. I understand this and the IRS is recognizing this. That is what they use for their books an d for their regulatory purposes. I would hope that we would try to freeze into the statute a method of accounting that may, at some future time, be changed. We ought to see what the ICC comes up with.

Senator Curtis. Mr. Shapiro, what is the situation with stock options as items for preference?

The Chairman. Before we go on with this, I would like to get some of these House amendments before us, and I will come back.

Senator Curtis. This is my last one. I just want to ask a question about it.

Is stock option still a tax preference for the minimum tax?

Mr. Shapiro. There is a provision in the House bill in regard to the minimum tax that we provided for the alternative minimum tax that would treat the qualified option as a non-qualified option, in which case it gives them the effect of having an election, whether or not to treat this as a preference.

Senator Curtis. The taxpayer has an election?

Mr. Shapiro. In effect, give them an election to treat it as a preference, as a qualified or nonqualified option.

Senator Curtis. I do not follow.

Mr. Shapiro. We have talked about this issue with a number of people involved who indicate that they think this is a satisfactory solution. Their concern is a qualified stock option is a tax preference under present law, and one of the concerns is it is forced to be under the minimum tax.

One of the changes that is being proposed is to give them an election to be treated as a nonqualified option.

Senator Curtis. What is staff's reaction?

Mr. Shapiro. When they treat it as a nonqualified option, treating it as ordinary income, as a result of that, it is no longer a preference item. There are situations where, because of the circumstances of the market when the options were issued that that is an appropriate treatment, and they wanted to be able to make that election. In present law, they can make that election and sometimes they have not been getting any benefit from the stock option but, nevertheless, are required to treat it as a preference item.

Under this, they would have an election to treat it as a qualified stock option where they would simply be getting a benefit. To that extent, it would be part of the minimum tax.

If they choose to elect to treat it as a nonqualified option, they may not get the benefit of the qualified option and therefore it would not be treated as a preference item.

Senator Curtis. What is your recommendation?

Mr. Shapiro. We intend to draft in the bill the same provision we talked about earlier today, to give those who have qualified stock options, they have the election to have it treated as a nonqualified option.

Senator Curtis. Will that take care of the problem?

Mr. Shapiro. As we understand it.

Senator Curtis. You have in mind doing that?

Mr. Shapiro. Yes, sir.

The Chairman. Treasury?

Mr. Lubick. We support this provision. We supported it on the House side. We think it is a good way out of the problem.

The Chairman. All in favor, say aye?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it.

Senator Curtis. Thank you, Mr. Chairman.

The Chairman. Let us hear from the staff about these procisions in the House bill that they think we might want to put in our bill.

Mr. Shapiro. I am going to only those I am certain have been dealt with.

Senator Packwood. I still have an amendment.

Mr. Shapiro. The first item is a medical expense deduction. I indicated when we discussed the bill in general that that was a compromise that was put together in the House as not raising revenue. As a matter of fact, there is a question as to whether or not it causes a complexity in dealing with it.

We would like to suggest, at this point, that you not take that provision. It will be in conference and you can make a determination there as to what extent you want to deal with that provision.

The Chairman. What is that?

Mr. Shapiro. The medical expense deduction. The House bill made certain modifications that raises a significant question as to whether it simplifies or further complicates that provision. It does not raise any revenue. It was a part of the compromise intentionally not to raise revenue. So you do not foreclose the cnange if you were to agree to it and it would not be in conference.

What we would life to suggest is that you not agree to it and leave the issue open for conference.

The Chairman. If there is no motion to put it in it does not go in.

Senator Byrd. What page are you on?

Mr. Shapiro. I am just kind of going over a list.

The Chairman. He is going through some provisions in the House bill that are not in our substitute but we might want to put them in and, if we wanted to put them in, we can.

Mr. Shapiro. You can take the booklet of the description of the House-passed bill and I am almost going down the table of contents, and you can go to the appropriate page -- the summary or the page.

The next one is the gas tax deduction, that is, the state and local gas tax deduction, and that is important from the standpoint of the revenue. As I indicated, the medical expense did not have a revenue effect. In this one, you are working with the House bill. If you did not agree to that change, it would make your bill cost $471 million more.

The Chairman. We need that in the bill in order to meet the budget, do we not?

Mr. Shapiro. You need the revenue. This is the provision that does it.

The Chairman. Just because, frankly, we need it for budget purposes and in this conference-- in the other conference, anyhow. That being the case, I would urge that we include it in our bill. Let the Senators speak their own convictions on the Floor. It may very well get knocked out, but if we go along with the House on this, at least it helps us to cover the cost of some of our own amendments.

Senator Dole. I am not going to move -- I am not going to do anything. I want to raise the concern of Senator Helms who called me several times on this particular amendment and he will be available as soon as the tax bill is considered, I assume, as he has in the past. He will try to delete it on the Senate Floor. I wanted to make that objection so that it is a part of the record.

The Chairman. I understand that. I hope the Senators would go along with the House bill on that item as long as to get it to the Floor so we can see where we stand. Otherwise, we have a budget problem.

Senator Gravel. I so move.

The Chairman. Without objection we will include that one in. All right.

Mr. Shapiro. The next item is the unemployment compensation. Under present law, there is an exclusion for taxable income for unemployment compensation paid pursuant to governmental programs. The House bill phases that exclusion out at higher levels of income that taxpayers have.

The way the House bill works, the excluded portion would be reduced by one-half of the excess gross income which includes the unemployment compensation over $20,000 for single taxpayers and $25,000 for married taxpayers.

Senator Dole. What if we do not put that in? Keep it out?

Senator Moynihan. Mr. Chairman, I do not think we should include this. It is a new idea altogether. It is a provision that would strike most of the people that we are most interested in helping in this bill, what we did this afternoon in the rate schedule.

The Chairman. How much money is involved in thatamendment?

Mr. Shapiro. Senator, this does not have a fiscal year impact. On the calendar year basis, it has a $251 million, but it does not have a fiscal year effect. It does not affect your fiscal year budget, but it has a $251 million annual effect.

The Chairman. There has been a motion to include it, so we will just include it.

Mr. Shapiro. That is all the provisions in the income tax. The next one is the tax shelters. I think you have already made a tentative agreement on that to extend it to the new activities as the House bill did, to extend it to the closely-held corporations, aggregating it -- if you extend it to the closely-held corporations, you aggregate it in the case of small businesses.

The House bill also has a recapture rule. There are situations where, under the '76 Act, a taxpayer gets a deduction because they are at-risk, then they take their at-risk out of the business. What the House bill does, it says in that case the taxpayer has to pay back the tax benefit he got because he took his money out.

Senator Dole. Why do we not leave that out, except what we agreed to put in?

The Chairman. How much money is involved?

Mr. Shapiro. Very little.

The Chairman. With no motion, we will just leave it out. We are voting -- my guess is we should be able to report this vote in a half hour.

Mr. Shapiro. I think so.

The Chairman. If you want to vote, let's go vote and try to bring everybody back. We want a quorum to report the bill.

(A brief recess was taken.)

The Chairman. Let us get back to business here. We covered the rest of those House amendments.

Senator Packwood. There will be another vote pretty quick.

Mr. Shapiro. I understand that Senator Dole may want to reserve on what the Committee had agreed to on at-risk. When he comes in, he may want to raise that, on the partnership audit.

The House bill has a provision for penalty on late filing of returns. Under present law, there is no such penalty, and therefore there is no incentive for a taxpayer to file a partnership return on time. The House imposed a late penalty, a penalty for filing late.

The Chairman. If there is no objection, why do we not include that one in?

Mr. Shapiro. The second one on partnerships was the statute of limitations extension. The concern that the Administration has for the statute of limitations, in the case of certain tax partnerships, they extend it from three years to four years for certain partnerships where they are required to report to the FCC. I am aware that there is concern -- I believe the letter that you had from the Louisiana constituents covered this as well as the other provision, where it was limited to SEC.

What they are saying is that it should cover all types, be consistent. Either cover all partnerships or do not cover any. But there is a question of whether or not it should be limited to these groups and what they are really saying is they prefer not to have it here.

The problem is, the tax shelter partnerships that are syndicated are nationwide. The Revenue Service does not have time to find all of them in a three-year statute. In this case, the statute open one year just for that partnership item on that tax shelter return. It does not keep the return open other than items of partnership, essentially with tax shelter items of a partnership where they must register and report to the SEC.

The Chairman. I am in doubt about that. What do you think about it? Should we have it in the bill or have it in conference? Give me your view.

Mr. Shapiro. It is a provision you could not have because it is in conference. I think that, as I understand it, they have said it is not consistent. It is not because they want to apply it across the board; they want it not to apply at all. I will say that the House was concerned about this provision and cut this one down to the situation where it is right now.

The Chairman. That is one more thing we can talk about in conference. If there is no motion to put it in, then we will leave it out. There is no real revenue involved.

Mr. Lubick. There is real revenue in the sense that we would be able to collect what people owe us already. That is very important. I think we talked about the possibility of a Floor amendment. I do not think an appropriate remedy would be a conference, unless you do something on the Floor, because the important thing here is to extend it to cover the intrastate as well as the interstate partnerships.

Let us talk with you between now and the Floor and see if we cannot persuade you that it would be desirable to expand this provision and take it to the Floor as an amendment.

The Chairman. All right.

Mr. Shapiro. Next, the business areas. We have finished the tax shelter items and the Committee has not had an agreement yet to make the investment tax credit permanent at 10 percent. We have assumed that you wanted to.

The Chairman. I would assume we would want that in. Without objection, that will be in.

Mr. Shapiro. That will include the ESOP, which is already agreed to.

Next is that the House bill increases the amount of the investment tax credit that can be offset against tax liability from 50 percent to 90 percent, phased in at ten percentage points per year. We assume that you wanted that in the bill as well.

Senator Dole. Why do we not make it 100 percent?

The Chairman. I think we should take what they have got.

Senator Curtis. Did the Treasury not originally recommend that we go to 90 right off?

Mr. Lubick. Yes, we did, Senator Curtis. For revenue reasons, the House elected to phase it in over a four-year period.

The Chairman. It increases the cost of the bill?

Mr. Shapiro. It adds revenue.

Senator Dole. Why do they stop at 90?

Mr. Shapiro. That was the Administration proposal.

Mr. Lubick. The idea was that everybody should pay some tax. I believe there was a lot of publicity attendant to President Carter's escaping tax completely through the investment credit.

Senator Dole. I think I mentioned that in '76.

Senator Curtis. This is to close the Carter loophole.

Mr. Lubick. It was our proposal that it be a straight 90 percent across the board. President Carter would still have a problem.

Senator Dole. He has a lot of problems.

Mr. Lubick. Because of the 100 percent of $25,000, if you want to go across the board at 90 percent.

Senator Dole. I just wondered. It seems they should be set against tax liability.

Mr. Shapiro. The next one, I assume you adopted the 90 percent phase-in. The next one increases the limitation from 50 to 100. It is in present law. It would make it permanent.

The Chairman. What?

Mr. Lubick. Under present law, for up to 1980 you can take the investment tax credit on $100,000 for used property. The House made that permanent.

The Chairman. Leave that in. Put it in. Without objection, we will put it in.

Mr. Shapiro. The next item is that the House provided the investment tax credit at 10 percent levels for pollution control facilities. Under present law, it is 50 percent.

The House, however, did not allow the full 10 percent if they financed the pollution control facilities with tax-exempt bonds.

Senator Matsunaga. Mr. Chairman, why was that done? Does the Treasury oppose that?

Mr. Lubick. It was our proposal that the financing of pollution control facilities with industrial development bonds ought to be eliminated, and instead all in the stores for pollution control facilities have the full credit plus the five-year amortization -- a much more efficient way of providing a subsidy to them than the use of the industrial development bonds.

We would prefer to make it nonelective and give them the full investment credit and the five-year amortization but eliminate the financing.

The Chairman. Why do we not leave that out? We will talk about it in conference.

Senator Nelson. Do you get the five years?

Mr. Shapiro. Do you want to leave that portion out, giving the 10 percent credit for pollution control even if they use industrial development bonds financing?

Senator Matsunaga. My thought was to even extend it to those financed by the bonds.

Mr. Shapiro. That is what I said.

Mr. Lubick. That will give you some additional revenue in the bill. If you do that, it will cost you some money.

The Chairman. Is there a lot of money involved in that?

Senator Curtis. These communities and industries were urged to take care of these pollution matters and if they worked them out in these ways --

Mr. Lubick. The pollution control bonds are the biggest source. They constitute close to 80 percent of industrial development bonds that are out.

So, if you extend this provision, it is going to be costly.

Senator Matsunaga. In 1979, $4 million. In 1980, $16 million.

Mr. Lubick. That is because --

Senator Matsunaga. Extending the full 10 percent rather than 5 percent for those financed by industrial development bonds.

Mr. Lubick. The estimate has to be considerably more than that. I do not have the figure. I thought you were going to propose eliminating the financing altogether.

The Chairman. It will be in conference anyway. Those in favor of just leaving out the provison that would say they would not get it -- if you want to leave it out, say aye.

(A chorus of ayes.)

Senator Nelson. It is in the House bill?

The Chairman. In the House bill.

We will just leave it out. We will leave out the part that they do not get it.

The next point?

Mr. Shapiro. The next area of the provisions deal with small business, Subchapter S provisions. There are three in the bill, noncontroversial.

The next one is Section --

The Chairman. If they are noncontroversial, we will leave them in.

Mr. Shapiro. I think so.

Increasing the amount for small business corporation stock that might be available for an ordinary loss treatment. That has been advocated for small business.

The Chairman. With no objection, we will put it in.

Mr. Shapiro. Also, the House bill provided a change in Section 179 which would have a first-year depreciation write-off at an increased amount for small business.

The Chairman. Is there objection?

Mr. Lubick. What we suggested the other day, we suggested a liberalized ADR depreciation on a simplified basis for small business. We think it is more effective and it does not cost much in the beginning, and will have much more revenue consequence to us as it is used as a more efficient way to give a benefit to small business.

Senator Dole. We could leave it out and go to conference.

The Chairman. Why do we not just leave the whole thing out.

Mr. Shapiro. You can leave it out and discuss it in conference.

The next one is the accrual accounting for farm corporations, the chicken farm amendment, that provides the two-family rule. It exempts them from the accrual accounting rule.

Senator Hansen. Arkansas?

Mr. Shapiro. Arkansas and Maine.

The Chairman. I admit that is a limited thing, but the House has it in their bill, is that right?

Mr. Shapiro. That is correct.

The Chairman. Then let's leave it in there. If we do not keep it in -- that has been debated up one side and down the other. I think we should show mercy to chicken farmers, not that they show much mercy on the chickens.

Mr. Shapiro. The next one is, there is a part of accrual accounting, a special rule for certain farmers, florists and nurseries that takes into account the problem of the revenue ruling, and the House provided it in its bill to provide for that special situation. Senator Byrd brought it up earlier.

The Chairman. Leave it in.

Mr. Lubick. On florists, we solved their problem by a revenue ruling. It is my understanding they are supposed to drop the florists from the bill. We have allowed them, by revenue ruling, to stay on their hybrid accrual method of accounting. There would seem to be no particular reason to allow them to elect the cash method.

I think you could drop the florists and the nurserymen, because we have solved their problem through a revenue ruling.

Mr. Shapiro. What I would like to do there, I cannot recall which provision Senator Byrd was referring to. I do not know if it is one of these two. I am aware of the situation that Mr. Lubick is referring to. I indicated with Senator Byrd we would be bringing it up now. If we could check and be sure that that problem has been taken care of, we can take it out, and if it has not, we can put it in.

The Chairman. Next?

Mr. Shapiro. One proposal for small business that Treasury has been advocating to add to the bill, to ignore salvage value for ADR. It would be an additional provision.

The Chairman. Without objection.

Mr. Shapiro. Section 157(k) in the House bill extends, for three years. I would think you would want to do the same thing.

The Chairman. Yes.

Mr. Shapiro. On the bankruptcy rule, the ConRail provision is taken off. We indicated we would put it in this bill. It was passed by the Committee and on the Floor and, for jurisdictional problems, it was taken out.

The Chairman. Put it back in, that is right. Without objection.

Mr. Shapiro. Next, in tax -- you have knocked out with the capital gains preference item. You want to take that out of the preferences; capital gains is still a preference item and offsets maximum tax on earned income.

The Chairman. We do not want to penalize a person under the maximum tax because he has a capital gain.

Mr. Shapiro. That is right. Capital gains would be taken out if it as a preference item.

The Chairman. The House did it. We should do it also. Without objection.

Let's vote and come back in.

(A brief recess was taken.)

The Chairman. Let us hear -- what other House amendments are there to consider?

Mr. Shapiro. We left off with the maximum tax on preference and we agreed to take it off capital gains. The only thing we need guidance on is the effective date. Your 70 percent exclusion begins November 1.

You may want to say all capital gains after October 31st would be excluded from the maximum taxable income.

The Chairman. I think that is good. Without objection, agreed.

Mr. Shapiro. The next one, it is a small technical rule where the House had a provision that deals with the roll over on personal residences and there is an eighteen-month rule that had an adverse effect in the case of two moves within an eighteen-month period. This should be included. It does not have any significant revenue impact.

The Chairman. Without objection, it will be includedd.

Mr. Shapiro. The next provision deals with the corporate minimum tax. This was discussed earlier today, but it was not dealt with, and the question is -- the Committee has to affirmatively take action to eliminate capital gains as a preference item from the corporate minimum tax. The House has done that, and the Finance Committee has not acted.

Senator Dole. What is that?

Mr. Shapiro. The corporate minimum tax. The House took capital gains out as a preference item for both the individual and corporate minimum taxes.

You have already provided the alternative minimum tax. However, in the case of corporations, you have not acted.

Senator Dole. Senator Curtis had something on that.

Mr. Shapiro. Senator Curtis brought it up earlier today, but we did not resolve the issue. The difference here in the House, as I indicated, they took the capital gains out of both the individual and corporate minimum taxes. However, the Finance Committee has kept capital gains in the alternative minimum tax.

In the case of corporations, you do not have an alternative minimum tax. It does not have any significance, because we are talking about a flat corporate capital gains tax.

The question here is, you have already reduced the capital gains corporations and the Committee has to decide whether to leave or to take out capital gains as a preference item.

The Chairman. The House does not have a minimum tax on corporations, is that right?

Mr. Shapiro. The House, the present law has a minimum tax on corporations. The House took capital gains out of it.

The Chairman. I would suggest that we not take it out. It will be in conference between the two Houses.

Mr. Shapiro. The House did not reduce the corporate capital gains.

The Chairman. We will have both things in conference. Meanwhile, we will have a chance to give further thought to what the significance and meaning of it is. I get a little bit concerned if do not approve it and then somebody says it only applies to individuals. You ought to take it out of individuals. Put it in confeŕence where we can work it out, just by leaving it on corporations. That way we will have it in conference, our lower rate, and also have the fact that they do not have a minimum tax.

Senator Moynihan. Mr. Chairman, at the start of this session, you discussed with Secretary Lubick the appropriateness of earnings of all partnerships including those were income is the income-producing factor. I believe this was agreed to; I want to be sure it is included in the bill.

The Chairman. It is in there.

Mr. Shapiro. It has not been yet. The Committee did not take action at the time. There has been a problem of the maximum tax on earned income because there is a rule that there is an arbitrary 30 percent rule.

As I understand it, what Treasury has agreed to do is say that rule be eliminated and facts and circumstances be substituted. The Committee has not acted yet.

Mr. Lubick. A reasonable allowance for services would be treated as earned income.

The Chairman. Is that all right with you?

Mr. Lubick. Yes.

Senator Moynihan. That is my understanding.

The Chairman. Without objection, agreed.

All right.

Mr. Shapiro. The last provision in the House bill is the indexing of capital gains.

Senator Dole. I move that we put that in.

Senator Nelson. I move that we leave that out.

Senator Dole. Call the roll.

The Chairman. Call the roll.

Senator Nelson. It is in the House bill in conference?

The Chairman. The motion is that it be included in the bill.

Senator Dole. We can settle it now and save a lot of time in conference.

Senator Nelson. Is that what you want to do.

The Chairman. Let's vote on it. Those who want to have an index on capital gains that the Secretary of the Treasury testified on as opposed to it.

Mr. Lubick. Treasury very strongly opposes it.

Senator Nelson. Let me say in advance, Mr. Chairman, that this is a very important matter to those who are for it and against it. I think that everybody should be entitled to be reported on this so that, it seems to me, what would be fair about it would to leave the roll call open until tomorrow afternoon on that issue.

The Chairman. I would suggest that we vote on it with this understanding, that we will have the opportunity to contact all absentees, anyone who is not here, and he can record himself and we will hve to abide by what the vote is when all absentees have been heard from.

Obviously we have some absentees. I would anticipate that this would be a very close vote.

All right, call the roll. The vote is shall this Committee vote to index capital gains?

Mr. Stern. Mr. Talmadge?

Senator Talmadge. No.

Mr. Stern. Mr. Ribicoff?

The Chairman. No.

Mr. Stern. Mr. Byrd?

Senator Byrd. No.

Mr. Stern. Mr. Nelson?

Senator Nelson. No.

Mr. Stern. Mr. Gravel?

Senator Gravel. No.

Mr. Stern. Mr. Bentsen?

(No response)

Mr. Stern. Mr. Hathaway?

(No response)

Mr. Stern. Mr. Haskell?

(No response)

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. No.

Mr. Stern. Mr. Moynihan?

Senator Moynihan. No.

Mr. Stern. Mr. Curtis?

Senator Curtis. Aye.

Mr. Stern. Mr. Hansen?

Senator Hansen. Aye.

Mr. Stern. Mr. Dole?

Senator Dole. Aye.

Mr. Stern. Mr. Packwood?

Senator Packwood. No.

Mr. Stern. Mr. Roth?

Senator Roth. No.

Mr. Stern. Mr. Laxalt?

Senator Laxalt. Aye.

Mr. Stern. Mr. Danforth?

Senator Danforth. No.

Senator Hansen. Mr. Chairman, I vote no.

The Chairman. Two ayes, thirteen nays.

Let's finish these amendments. What we have to decide is what to do about the House language.

Are you through with that yet?

Mr. Shapiro. That completes it.

Senator Byrd. Mr. Chairman, may I ask this? There was a proposal that the florists are interested in and, Mr. Shapiro, when I brought it up earlier you indicated that it would be taken up at this point.

Mr. Shapiro. We took it up while you were away and the Committee agreed with the contingency that, as the House had it, with the rule applying to florists as well as to nurseries and others, that Treasury had indicated that the matter had been taken care of by a revenue ruling and suggested that florists be deleted.

I indicated that you had expressed an interest in that and the Committee had said that it was based on your concern, because you were out of the room when it came up.

Senator Byrd. I have no interest in it other than the florists have contacted me and they are very much concerned that the Treasury is forcing them to go back on a cash basis instead of an accrual basis. Otherwise, they would have to include inventory.

Is that correct?

Mr. Shapiro. What I would like to suggest right now is for the Committee to continue with the tentative agreement that they made to keep the provision as is and let the florists be in the provision and let the Treasury work with the florists, and if the florists agree that the revenue ruling covers them, that the ruling covers them, and we can delete it from this bill and that can be done on the Senate Floor.

Senator Byrd. I am not sure about what you say. The florists want to leave it as the House had it.

Mr. Shapiro. Leave it like the House. I am suggesting you do that for the bill you report.

Mr. Lubick. Then it is not in conference.

Mr. Shapiro. Before the bill finishes on the Senate Floor, the Treasury can meet with the florists and if it is agreed that the Treasury has worked out a rule that the florists can agree with, then you can come on the Floor and amend it for the Senate to delete that, if you want.

Senator Matsunaga. The House has has it on an accrual basis, accrual accounting.

Mr. Shapiro. The House exempts them from that provision.

Mr. Lubick. We allowed them to go on a cash basis by ruling.

The Chairman. Here is the way it stands. The way the bill is now, the way the House voted, the way that we thought, as far as the florists are concerned, the way everybody felt that the florists wanted, the last time they heard from the florists.

Senator Byrd. Leave it like it is.

The Chairman. Or like the House had it. We will have it the way Senator Byrd would like to have it and then when the bill is on the Floor it may be that you may hear from the florists again and they might come together with Treasury, get together. If so, you can offer it as a Floor amendment.

Mr. Lubick. What they want, Mr. Chairman, is to be on an accrual basis without inventory, which is not an accrual basis, or to have the option of going to cash. We indicated -- and I think the people in the House seem to agree -- that this was reasonable, to go on a cash method, or the accrual method, but not the hybrid method.

The Chairman. It seems to me that we have it the way that Senator Byrd wants it and we will leave it that way for the time being and it may be that, before the bill passes, between the Treasury and the florists and Senator Byrd they can agree on something else.

If they do not, just leave it the way it is.

Senator Byrd. I just want to clear up one thing. You say the House felt that it should be different. The House bill is the way the florists wanted it, right?

Mr. Lubick. What happened was that the House adopted the provision and, in the course of it, we came up with a ruling to try to solve the problem.

Senator Byrd. The House had it the way the florists wanted it. All right.

The Chairman. Senator Packwood?

Senator Packwood. I have a very simple amendment. That is one which would allow those who do not itemize, those who take the standard deduction, who do not itemize, to, in addition, deduct their charitable contributions, putting it below the line where eight or ten other deductions are allowed even for those people who take the standard deductions.

I know the Treasury has misgivings about the cost of it and I think Senator Moynihan and I would be willing to agree to a a floor or a limit of $100 to $200 which would dramatically cut down the cost, so you would only deduct those charitable contributions above the floor limit.

Mr. Lubick. Mr. Chairman, our misgivings go beyond the cost of it. Indeed, we have serious misgivings about the cost without the floor.

Senator Packwood. I will not argue with you about the floor, because I realize the figures -- as I recall, $100 for the next fiscal year, this fiscal year, is almost insignificant. Starting on January 1st, with the $100 floor, $1.3 billion for a calendar year. In the fiscal year, to start on January 1st, it has got to be relatively slight, I would assume.

Mr. Lubick. Our estimate is, with a $100 floor, it is $1.9 billion.

Senator Packwood. We have $1.3.

Mr. Shapiro. That includes the feedback. This is a reverse case. The $1.3 is a static estimate. The assumption is they would reduce additional giving.

Senator Packwood. I thought the Treasury did not use those kinds of estimates.

Mr. Lubick. We did not, but if we are going to accept the estimate, the rolling cost would be out of proportion and swollen.

One of the chief problems is that the $1.9 billion we estimate, or the $1.3 billion that Senator Packwood estimates, in any event is a pure windfall element. The tax reduction that goes to the people with respect to the gifts they have already made and are making and do not need a tax inducement for, if, indeed, there is tax inducement.

The reason we have used a dynamic estimate is that we do not believe that there will be a major tax inducement. The revenue estimate would increase.

The reason we do not believe there is a major tax inducement is that you are basically talking about persons who are in low brackets who provide for their charitable contributions either to the United Way or to their church through periodic giving through withholding, and the tax motivation with respect to that sort of giving is not compelling.

The tax benefit is relatively inconsequential, but the consequences that -- without the floor, you are introducing another 66 million returns which the Internal Revenue Service would have available for audit as to their charitable contribution deduction.

Mr. Shapiro. You are not going to audit those any more than you now audit. You allow below the line deductions now. I would assume that one more below the line -- that charitable deduction occupies a status as significant as the ten or twelve you have there.

Mr. Lubick. What you are doing, Senator Packwood, in addition to complicating the short form and getting those persons who are on the standard deduction get simplification, is adding anywhere from 45 to 66 million returns where the Service either has to audit to get verification or let them go without audit.

The whole idea of the standard deduction was to avoid putting taxpayers in the problem of recordkeeping, putting the Service in the problem of audit, and this is a major step backward from the purpose of the standard deduction.

The Chairman. Let me direct myself to this, if I may. What the Senator would like to do --

Senator Moynihan. May I say "Senators"?

The Chairman. Senator Moynihan is a co-sponsor.

What these two Senators would like to do, the objective is something I would like to do also. I have been trying to figure out a way that you could do this where you would not have to claim it on these individual returns but where we would work out a way of letting everybody make his donation and the fine print on the form would say just waive the deduction for the benefit of the charity and let them come in and show you how many donations they had, and do it as you would with an audit, where you run some sample studies and look at what they have available and say you will settle for a certain amount of this as an add on to what you have, because these tax deductions were waived for your benefit.

It seems to me, if you can follow that approach, you can avoid the complexity and get the charity that help all at the same time. That is something we cannot do now. Not at this late date. It requires some more study and it has a cost effect.

I would hope, starting on the next big tax bill, if the Treasury would look at this amendment, also at my suggestion, and try to help us put a major forward stride for charity and for the United Way and people like that into effect.

I do not think we can do it in this bill.

The Secretary of Treasury came here this morning to explain the way the bill stood as of this morning. He would have to recommend that the President veto the bill. We have a lot of squeezing out to do that. The President will sign just at this moment.

Senator Packwood. What is the fiscal impact?

The Chairman. The bill has increased since that time. I hope, Senator, that you would be willing to withhold this, and let's join with you to try to do something about charity in the next bill, when we have had a chance to try to fit inside the budgetary considerations.

Senator Packwood. Let me ask what the loss is in the fiscal year?

Mr. Shapiro. Approximately $700 million.

Senator Packwood. If you start it January 1st?

Mr. Shapiro. There are many of those who would be covered who would have estimated payments, and we are taking this into account. In addition, there are many taxpayers --

Senator Packwood. You are assuming that many are making estimated payments, when these are people that are taking the standard deduction?

Mr. Shapiro. Senator Packwood, there are many taxpayers that are taking additional exemptions and they do that for excess itemized deductions. There are other factors to take into account -- the withholding. This is the reason that Congress enacted several years back that it was becoming more of a factor for withholding.

The Chairman. I hope, Senators, you will withhold this and offer it --

Senator Packwood. Mr. Chairman, so long as we share the same view -- and we certainly get our dollars' worth out of these kinds of contributions in terms of what we would otherwise be spending to do what these charities do, I will withdraw it in the hopes that, early next year, we have had hearings on this already, but we will find a way to work it into the tax code where we can encourage this kind of giving by low- and middle-income people.

The Chairman. You have a good point and I would like to help with it.

Senator Moynihan. Mr. Chairman, you have said you will, and we take that to be one of the best things that has happened today. I appreciate it.

Senator Packwood. I will withdraw the amendment.

The Chairman. Senator Dole?

Senator Dole. We want to reconsider this action on 202. I discussed this with Senator Gravel -- we would like to leave it all out and go to conference.

Mr. Shapiro. The at-risk provision, the Committee has made a tentative decision that to adopt the House bill on the at-risk for all closely-held corporations except in the case of leasing activities, equipment leasing, in that case, the Committee decided not to accept the House provision, but to have a provision that if the equipment leasing were to be covered, that it would be aggregated.

That would mean that, if we went to conference, you would agree to the House provision and you would aggregate it.

Senator Gravel. If we leave it all together, we would go to conference and discuss it there.

Mr. Shapiro. What Senator Dole and Senator Gravel are saying is that they would like to reconsider that decision and have the Committee delete the House provision entirely and do not have it. Their understanding is the aggregation could be a modification in conference.

The Chairman. The aggregation -- could the aggregation be added in conference?

Mr. Shapiro. Yes, it could. It is a more liberal provision than what the House bill had. It is between that and present law.

Senator Curtis. Mr. Chairman, I have one matter --

The Chairman. Let's vote on it.

All in favor, say aye.

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. The ayes have it.

All right.

Senator Roth had his hand up first.

Senator Roth. Mr. Chairman, Senator Packwood and Senator Moynihan and myself had intended to add the college tax credit to this legislation that was recently adopted by the Senate.

In deference to the Chairman, we are not going to offer it at this time, although we intend to do it on the Senate Floor with the help of the Chairman.

We are hopeful that, tomorrow, real progress will be made and this legislation will be adopted by the Congress and acted on by the House and Senate and will go to the White House, so that it will not be necessary to take action on this legislation.

Otherwise, we intend to do so.

The Chairman. I hope that, in the conference, we will send a bill down there that the President will sign. If worse comes to worse and he will not sign it, I hope we have a right of veto. But it seems to me that we have come near knowing what can be done when we sent them, when we resolve this conference tomorrow and send a bill down there, and I believe that we are going to have a successful conference.

The big problem is, I think the Senator will be compelled on primary and secondary at least to insist on it in order to send something down. I hope we can put a bill together that the President would sign.

I heard some indications from people who seem to have pretty good vibrations with what is going on that it may be possible to put together a bill that the President will sign. If so, we would have solved it. Otherwise, we will take a reading and see where we stand on the Floor.

So I thank the Senator.

Senator Curtis?

Senator Curtis. Just one question first. A bit ago we agreed on the carry forward of unused investment credit for one year for all industry. I wanted to make sure that that was geared to credits that would expire in 1977, not in '78.

Mr. Shapiro. I am not sure if that date was discussed. I think that is what you had.

Senator Curtis. That is what I had in mind. I wanted to make sure.

One other thing, very briefly --

Mr. Shapiro. Before you do that, will you let me clarify for the record -- a question has been raised. We have assumed for the residence provision that you had agreed to earlier that capital gains on the sale of a personal residence, that the effective date was to be the same date that the House had -- sale after July 26, 1978.

The Chairman. That is right.

Senator Curtis. One other matter. This has been passed once before by the Senate. In the field of insurance, they sell what they call an investment annuity. The investment annuity, the purchaser of the insurance, something like a veritable annuity which is invested in risk stocks usually, and the insured has something to say about where that is farmed out in the nature of investment.

The Internal Revenue proposed, by regulation, to say that annually the gain on that investment was taxed to the policyholder, still paying premiums before you do anything else.

The Chairman of this Committee, Senator Long, Senator Ribicoff and I believe, and Senator Talmadge, Senator Hansen and myself wrote a letter to Assistant Secretary of the Treasury, Larry Woodworth asking that that proposed regulation not go into effect.

It did go into effect, and last year we put a provision into the law that nullified that regulation. And my motion is that we do the same thing this Congress.

Mr. Lubick. This matter has been before you before a number of times. We are very deeply concerned with the continuation of this device. Basically it is a device to take an investment portfolio and to wrap it in the form of an annuity contract and thereby enable the investor to avoid current taxation on his interest and dividends.

I can take a quotation from the sales literature for this sort of thing. "How do you want your interest, with or without current taxes? You no longer need to pay current taxes on interest and dividend income when you have utilized the benefits of the tax-deferred investment annuities. Unlike other annuities, the investment annuity allows the owner to direct the investment of the funds within his personal custodial account. He may choose from a broad list of accepted assets," and so on.

Basically, the man is in exactly the same position as if he were running his own investment portfolio, but by cloaking it in the form of an investment annuity, he is affording current taxation on his dividends and interest.

If this provision is permitted to prevail, there is going to be an incentive to everyone to put his investment portfolios, his bank accounts and his savings account in the form of an annuity. It will lead to a fantastic erosion of the tax base.

Everyone who has income from savings and investments will basically be able to avoid current taxation on them with the device of wrapping it up in an annuity.

We feel rather strongly about this.

Senator Curtis. Mr. Shapiro, have I stated the facts correctly? Will you refresh our memories about the letter, who signed it?

Mr. Shapiro. The letter was sent to the Assistant Secretary of Treasury for Tax Policy, was sent on April 6, 1977, was signed by the Chairman, Senators Ribicoff, Curtis and Hansen.

The Chairman. I think Senator Curtis is right about the matter, but this is a narrow amendment. It only involves about one taxpayer, I believe, or a few.

There are heads nodding; there are more than one, but it is a relatively narrow amendment and involves a relatively small amount of employers and, while I voted on this item, this matter, and while the Congress voted on this, and it sounded to me like they won their case in court, not withstanding this, we were not able to prevail or help these people.

Senator Curtis. The Treasury regulation put one company out of business.

The Chairman. My impression is, why we try to help the people, it is kind of a dead issue. The last thing I heard of, it was sending people out of business.

Mr. Lubick. They did sell out to a larger company. The matter is still in litigation. I believe it is before the Court of Appeals.

Senator Curtis. I do not think it is a dead issue.

The Chairman. I would hope that we would not put it in here. We did the best we could to help these people. I do not know what more we can do than pass a law for their benefit, and I would hope that we just leave it where it is. Let them go ahead and litigate some more, if they want to. We have done all we can do to help them.

I hope, Senator, that you would not press the matter any further. I think from my point of view, I have done all I should be asked to do. I hope, in view of the fact of the limited amendment that you would not insist on it.

Please understand. The Senator has every right to offer it on the Floor, but I feel that this might be very close to what we were talking about, that we were not going to consider narrowly-drawn amendments. Every Senator has the right to offer the amendment on the Floor.

Senator Dole?

Senator Dole. Mr. Chairman, just to get some indication, I know the amendment is going to be offered on the Floor and that would be to defer the Social Security tax increases for one year. That was recommended by the Chairman of the Federal Reserve Board. If there was no objection, we could do it now.

Senator Curtis. I will object.

Senator Nelson. Are you prepared to include everything he had in there, all the reforms of the Social Security Act at the same time?

The Chairman. If we were going to do that, then we would have to take out a great deal of the tax cut that we have in this bill. We would have to go through this bill and take out $3 billion worth of tax cuts.

Mr. Shapiro. Approximately $4 billion.

Senator Dole. I want to raise it. I think it is going to be raised on the Floor. The minimum wage, ADR --

Senator Nelson. The tax on Social Security income, if we put all of that in there, I will not vote for it.

The Chairman. The point is, of course it will be raised on the Floor. I understand that.

Senator Haskell asked me that we vote on this AMEX amendment, the AMEX amendment. He asked for a roll call vote.

Senator Moynihan. This bill is to provide a 10 percent credit to an individual who invests in the newly-issued stock of a corporation with a net worth of under $25 million. The maximum amount of the credit is $750 a year on a single return and $1500 on a joint return.

The Chairman. What is the cost?

Mr. Shapiro. $70 million, assuming there will not be any increase in these issues, because in the last several years there have not been too many issues at the secondary issue.

The Chairman. I do not think that is a safe assumption.

Call the roll.

Senator Danforth. Mr. Chairman, if I could, because it sounds so good and so popular, to speak for thirty seconds. There is a social problem with this particular proposal, in my opinion, and that is that it tends to suck relatively small investors into small, high-risk companies, and I wonder if that is the kind of thing that we want to do.

The Chairman. We should put a label on them, like a package of cigarettes, this warning: "You could lose every nickel you put into this thing."

Call the roll.

Mr. Stern. Mr. Talmadge?

Senator Talmadge. No.

Mr. Stern. Mr. Ribicoff?

(No response)

Mr. Stern. Mr. Byrd?

Senator Byrd. No.

The Chairman. I have Mr. Ribicoff's proxy. I will withhold it.

Mr. Stern. Mr. Byrd?

Senator Byrd. No.

Mr. Stern. Mr. Nelson?

Senator Nelson. Aye.

Mr. Stern. Mr. Gravel?

Senator Gravel. Aye.

Mr. Stern. Mr. Bentsen?

(No response)

Mr. Stern. Mr. Hathaway?

(No response)

The Chairman. He will vote aye.

Mr. Stern. Mr. Haskell?

(No response)

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. No.

Mr. Stern. Mr. Moynihan?

Senator Moynihan. Aye.

Mr. Stern. Mr. Curtis?

Senator Curtis. No.

Mr. Stern. Mr. Hansen?

Senator Hansen. No.

Mr. Stern. Mr. Dole?

Senator Dole. No.

Mr. Stern. Mr. Packwood?

(No response)

Mr. Stern. Mr. Roth?

Senator Roth. No.

Mr. Stern. Mr. Laxalt?

Senator Laxalt. No.

Mr. Stern. Mr. Danforth?

Senator Danforth. No.

Mr. Stern. Mr. Chairman?

The Chairman. No.

Four yeas, ten nays.

Just for fear at some point in these deliberations --

Senator Nelson?

Senator Nelson. A very quick one. I mentioned it the other day and I have been waiting to get to it. It will not take two minutes and I will not get many votes, but I wanted to raise this question on the Floor. The capital gains tax, the amendment would be what I hoped it would be about, what the President would be willing to accept, which would be a 60 percent exclusion.

The minimum tax, designed by the Chairman, that would put you in the 28 percent bracket versus the 21 percent that is in the one we voted here and one more point, the small investor, or any investor, would have a $500 exclusion of capital gains in any one year and a couple a $1,000 exclusion in any single year.

So the small investors, those who make a small capital gains, would get an exclusion of $500, a couple $1,000; a 60 percent exclusion; minimum tax. That puts you at the 28 percent rate. I would like to have a roll call on it. I will be putting it on the Floor. I think we should have something a lot closer to what the President has been talking about.

Mr. Stern. Mr. Talmadge?

Senator Talmadge. No.

Mr. Stern. Mr. Ribicoff?

Senator Ribicoff. No.

Mr. Stern. Mr. Byrd?

Senator Byrd. Aye.

Mr. Stern. Mr. Nelson?

Senator Nelson. Aye.

Mr. Stern. Mr. Gravel?

Senator Gravel. No.

Mr. Stern. Mr. Bentsen?

(No response)

Mr. Stern. Mr. Hathaway?

(No response)

Mr. Stern. Mr. Haskell?

(No response)

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. No.

Mr. Stern. Mr. Moynihan?

Senator Moynihan. No.

Mr. Stern. Mr. Curtis?

Senator Curtis. No.

Mr. Stern. Mr. Hansen?

Senator Hansen. No.

Mr. Stern. Mr. Dole?

Senator Dole. No.

Mr. Stern. Mr. Packwood?

(No response)

Mr. Stern. Mr. Roth?

Senator Roth. Aye.

Mr. Stern. Mr. Laxalt?

Senator Laxalt. No.

Mr. Stern. Mr. Danforth?

Senator Danforth. No.

Mr. Stern. Mr. Chairman?

The Chairman. No.

Eleven nays and three ayes.

For fear that we might not have a quorum present at some point in our proceedings, I am going to seek to make sure that there is no technical difficulty with the bill by moving, first, that we reconsider it and agree to all decisions we have made, and then I would like to offer all decisions we have made as a substitute en bloc for the bill.

We are then voting on the whole substitute.

All in favor, say aye?

(A chorus of ayes.)

The Chairman. Opposed, no?

(No response)

The Chairman. All right, the ayes have it.

Now, let's call the roll and report the bill.

Senator Roth. The hour is late and I have a statement, so late that I do not even want to hear myself read it.

The Chairman. Why do you not give it to the Press?

Senator Roth. I have already done that, Mr. Chairman. I just wanted to make the point that I think that what we have done here is, in effect, creating a new class of what I would call the middle-class poor and I intend to vote against reporting the bill.

Senator Nelson. Mr. Chairman, I just want to make one point. -- There are a number of things I do not agree with in this bill, including the capital gains, and I am going to vote no. I will vote for some of the provisions on the Floor, but I cannot buy the whole package.

Senator Dole. Mr. Chairman?

The Chairman. Yes, sir.

Senator Dole. Mr. Chairman, as we prepare to vote on this I would like to note to the colleagues on my right, this will be their last action on a mark-up of a tax bill and I certainly know that the Chairman and others want to thank them for all their assistance. Senator Hansen and Senator Curtis are voluntarily leaving the Senate.

The Chairman. They have been two wonderful members of this Committee, stalwarts in the best tradition of the United States Senate. I think we ought to give them a hand and a standing ovation.

(Standing ovation)

The Chairman. Call the roll to the report the bill.

Mr. Stern. Mr. Talmadge?

Senator Talmadge. Aye.

Mr. Stern. Mr. Ribicoff?

The Chairman. Aye.

Mr. Stern. Mr. Byrd?

Senator Byrd. Aye.

Mr. Stern. Mr. Nelson?

Senator Nelson. No.

Mr. Stern. Mr. Gravel?

Senator Gravel. Aye.

Mr. Stern. Mr. Bentsen?

Senator Byrd. Aye, by proxy.

Mr. Stern. Mr. Hathaway?

(No response)

Mr. Stern. Mr. Haskell?

(No response)

Mr. Stern. Mr. Matsunaga?

Senator Matsunaga. Aye.

Mr. Stern. Mr. Moynihan?

Senator Moynihan. Aye.

Mr. Stern. Mr. Curtis?

Senator Curtis. Aye.

Mr. Stern. Mr. Hansen?

Senator Hansen. Aye.

Mr. Stern. Mr. Dole?

Senator Dole. Aye.

Mr. Stern. Mr. Packwood?

(No response)

Mr. Stern. Mr. Roth?

Senator Roth. No.

Mr. Stern. Mr. Laxalt?

Senator Laxalt. Aye.

Mr. Stern. Mr. Danforth?

Senator Danforth. Aye.

Mr. Stern. Mr. Chairman?

The Chairman. Aye.

Mr. Hathaway votes for the bill.

Senator Curtis. Senator Packwood votes aye.

The Chairman. I think you should contact Senator Bentsen.

Senator Byrd. I voted by proxy.

Mr. Stern. Only Senator Haskell is unreported.

The Chairman. Fifteen yeas and two nays.

Senator Matsunaga. Mr. Chairman, I think after listening to the applause how we are going to miss those two members. I would suggest that we leave those two seats empty.

The Chairman. The Committee is adjourned.

(Thereupon, at 10:15 p.m., the Committee adjourned.)

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