EXECUTIVE SESSION

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FRIDAY, SEPTEMBER 8, 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, Ribicoff, Byrd, Nelson, Gravel, Bentsen, Moynihan, Curtis, Hansen, Dole, Packwood, Roth and Danforth.

The Chairman. Let me call this meeting to order.

We have a number of Senators who will be here in just a moment.

Let me just make this suggestion, and it comes from a discussion that we had among those Democrats that are sitting here this morning. I have communicated this to our Republican members as well.

We anticipate that the number of things that members of this Committee would like to do, if the revenue, would greatly exceed anything that this bill can carry. That being the case, we believe that the best approach would be, first to go through the bill and finish discussing what the House has proposed, and then urge the Senators to bring up for discussion those items that they want considered that they think would be most significant, but to make no final decision on those matters until our staff has had a chance to compile what all of this would be, and then to try to make some suggestions to us as to how much of this we might be able to fit in. And I would think in the course of it that the staff would seek to find from Senators those items that they felt deserved the highest priority and consideration as among the things that these Senators would like to see added to the bill, or taken from it. Then hopefully we could move in terms of thinking of a package that would fit the budget. We do not know right now how much the budget is going to allow.

The Senate Resolution would allow a bigger tax cut than the House Resolution would allow, and we are hoping that we would have the figure in the Senate budget. To me, that is a minimal figure. We may not have that much.

First, we should see what items Senators would like to see considered and then try to pare them down and see how much can fit. We might be able to work out some guidelines on just how far we will try to go, and also at some point, we are going to have to leave behind some of those things that we would like to vote for if the budget could stand it.

It would probably spare us the embarrassment of having to retreat from a position we have already taken to do something that fiscally is not possible.

Mr. Shapiro, suppose you go ahead, then, and tell us the rest of what is in the bill and we will proceed from there.

Mr. Shapiro. Let me just make one comment on the budget, putting into perspective the difference between the House and Senate Budget Resolutions. It is $3.5 billion, so that is the difference that has to be resolved in conference as to the revenue figure that will determine what money you will have in the framework in the bill in the Finance Committee.

Very briefly summarizing the House bill, let me just give you an overview again of the fact that the House bill had four major areas: individual tax reductions, tax shelter provisions, business tax reductions and capital gains provisions. Yesterday, we had covered the individual tax reductions, the tax shelter provisions, and we had just started reviewing the business tax deductions.

We are working from the booklet headed, "Description of H.R. 13511 as Passed by the House." This booklet here, the summary in the front of it is what I was summarizing for you.

The Chairman. What page are you on now?

Mr. Shapiro. Right now, we are on page 6.

Let me just say briefly, at the bottom of page 5 I had covered yesterday the beginning of the part in the House bill, the business tax reductions. At the bottom of page 5, covered the corporate rate reductions, the graduated rate reductions. There was a 46 percent top corporate rate of income above $100,000 and graduated rates on the $25,000 increments below that.

At the bottom of the page is the investment tax credit which is made permanent at the 10 percent rate with several other modifications in that.

We left off the top of page 6, item C, which would be the investment credit for pollution control facilities. Under present law, the investment credit is available for pollution control facilities but for those taxpayers who elect the special five-year amortization, the five-year depreciation rather than the regular depreciation on pollution control facilities, present law allows them one-half the investment tax credit. The House bill allows them the full 10 percent investment tax credit for pollution control facilities except for those facilities which are financed with industrial development bonds.

Senator Curtis. If I may ask a question at that time, is that not contrary to what this Committee did a few years ago in order to encourage the construction of scrubbers or new machinery, whatever it was, we made the investment development bond more liberal for them than for ordinary facilities, did we not?

Mr. Shapiro. Senator, this does not cut back on present law. It just does not give the liberalization to those who use industrial development bonds.

Senator Curtis. Would they get any investment credit?

Mr. Shapiro. Yes. They will get a 50 percent investment credit, the same that they get in present law. What the House bill does is to say for those cases where they use industrial development bonds for financing, they will not get a full 10 percent credit. They will only get a 5 percent investment credit. They still, in addition to the 5 percent credit, they would still have the five-year depreciation write-off.

We will say there is some concern from the people who want the full 10 percent credit. They are not hurt by present law. They do not get what those taxpayers who do not use industrial development bond financing get. There is a disadvantage to use other financing, but they are not hurt by present law.

Senator Curtis. When we dealt with it before, what we did, we removed the limits.

Mr. Shapiro. Yes, that is correct.

Senator Curtis. For pollution control.

Mr. Shapiro. Pollution control facilities. This does not go against this at all. This just puts a limitation on the amount of the investment credit -- I am sorry, continues the limitation that present law has that you only get a 50 percent investment credit, if you use industrial development bond financing.

In any event, they still get the five-year write-off.

The next item, D in the House bill in the business area, is the targeted jobs credit.

Senator Curtis. One more question. Is any part of that retroactive?

Mr. Shapiro. No, it is all prospective. It applies after this year.

Senator Curtis. So if a company installs their pollution control and arranges their financing, they would continue, according to the tax situation that existed at the time that they took the action?

Mr. Shapiro. That is right, Senator. This would not affect anyone in an adverse way over what they have in present law.

Senator Curtis. It would not affect anything but future actions?

Mr. Shapiro. All this says is that when they construct facilities after the end of this year--

Senator Curtis. Future construction.

Mr. Shapiro. Future construction.

-- they can get an additional investment credit. It does not adversely affect anyone on what they are doing presently.

On item D, the House has a targeted jobs credit. As you know in the 1977 Revenue Act, you provided a general jobs tax credit for the increase in employees across the board, without any targeting. The House eliminated that provision at the end of this year. It was a two-year provision, and that would expire.

In lieu of that provision, the House substituted a targated jobs tax credit aimed at the structurally unemployed. The target has a two-year effect. It is a 50 percent credit of the first

$6,000 of wages in the first year and then a one-sixth credit the second year.

The effect of that for an individual who has more than $6,000 of wages, that employee can get a $3,000 credit for wages in the first year anda $1,000 credit in the second year. The targeted group is listed on page 6 in categories 1 through 7.

Essentially they are the welfare recipients, those who register under the WIN program and a series of categories of handicapped recipients of SSI payments.

The youth between 18 and 24 who are in households receiving food stamps; Vietnam veterans, these types of structurally unemployed individuals.

Also, the House bill requires the Secretary of Labor to submit a report to Congress by June 30, 1981, to point out the effect tiveness of the general jobs credit program when it was in effect and also the general effectiveness of the targeted jobs credit as provided in the House bill.

The next item in the House bill on page 6 is E, which increases the limit of small issue industrial development bonds. As you recall in 1968 the Congress eliminated the tax exemption for most industrial development bonds. There were certain exceptions. One of those exceptions allowed any small issue, issues under $5 million, to continue to be exempt, meaning that their issues would have tax exempt interest.

The House bill increases that small issue exemption to

$10 million. That means that issues of less than $10 million can still have their interest exempt from taxation.

Item F on page 6.

Senator Talmadge. If you would yield at that point, is there not some other provision relating to $1 million? What is that?

Mr. Shparo. The $1 million is across the board. It means you can get up to $1 million on any issue if you have certain requirements.

What the $5 million is, when your total issue is less than $5 million, that total issue can be exempt. The $1 million sets the criteria. You can have an issue of $20 million and up to $1 million, under certain circumstances, can be exempt, but no more than $1 million.

The $5 million means that your total issue has to be less than $5 million and certain tests have to be met. That is generally the distinction between the two.

Item F on page 6 deals with the small business provisions in the House bill. There are three categories.

The first category is providing certain technical modifications to Subchapter S, provisions that corporations would be treated essentially like a partnership. It expands availability of corporations, available to be treated as Subchapter S.

There is a shareholder limitation. You cannot elect Subchapter S if you have more than ten shareholders, except for the fact that you can go up to fifteen within a five-year period, and the House year provides a fifteen shareholder rule immediately that you can have up to fifteen without having a five-year waiting period.

Also, there are certain other modifications which are intended to make the Subchapter S provisions work better administratively. There is not a revenue cost, as such, associated with that provision.

Item number 2 deals with small business corporate stock. This is a provision which is intended to provide, to assist in certain risk investments in small businesses. Many investors who make investments, especially in small businesses, are as concerned about losses as they are about gains. If they have a gain, they get a capital gain. If they have a loss, they would very much like that to be treated as an ordinary loss, the effect of which is to allow him to offset that ordinary loss against the ordinary income.

If it is treated as a capital loss, then that has to first be offset against capital gains.

One of the incentives that is provided for small businesses is to say up to a certain amount of issue, $500,000 under present law, for an individual -- they could have up to $50,000 of that investment. If that business should lose money, that investor should treat that loss as an ordinary loss and, as we understand it, many investors find that as attractive an incentive to invest in small businesses as capital gains, because small businesses and new ventures tend to be very risky and provide loss situations. This alleviates some of that burden.

The House bill doubles that provision by providing that limitations up to $1 million and the loss up to $50,000 or $100,000 on a joint return.

The third item for small businesses, at the top of page 7, which provides a special depreciation rule for small businesses. Before going into that, let me give you the background as to how that came about.

As you know, the general jobs tax credit that is in present law for small businesses, whether they are corporate or not, sole proprietorships, partnerships and corporations, when you eliminate that provision, which is approximately a $2.5 billion advantage for small businesses and you shift over to a targeted jobs credit, but increase the benefits from a corporate rate reduction, those corporate rate reductions only go to corporations. They do not advantage individuals, operating businesses as sole proprietorships or partnerships or unincorporated businesses.

The only benefit they have from a business situation is the tax benefits they get as individuals by way of individual tax reductions.

In order to compensate small businesses from the standpoint of their business situation rather than their personal situation, the House bill provides an increased depreciation allowance in the first year, directed only at small businesses.

Under present law, it allows a special 20 percent depreciation deduction on the first $10,000 in the first year only. It means, in addition to what you otherwise would depreciate in any business, small or large, you have what is referred to as additional first-year depreciation of 20 percent of the first $10,000 so on single returns of $2,000 and those businesses that are unincorporated on a joint return, that can go as high as $4,000.

As you can appreciate, in some small businesses that $2,000 or $4,000 can be significant for some small businesses. For a large corporation, that additional $2,000 is not as meaningful.

The fact that the House bill has significant corporate reductions in the rates that applies to small businesses as well as large businesses, but only corporations. This was an incentive to small businesses, primarily the unincorporated -- although it is not limited to unincorporated, but it was directed to them by increasing the first year percentage from 20 percent to 25 percent and increasing the property that is eligible for depreciation from $10,000 to $20,000.

This has the effect of increasing the amount of first-year depreciation right off from $2,000 under present law to $5,000. In order to limit this to small businesses, there was a cap put on it by saying that this provision was only available to those businesses that had an adjusted basis and depreciable assets of less than $1 million.

As indicated, this was directed at small businesses as a way to compensate for the loss of tax benefits that they have from the general jobs credit.

The next item on page 7 is G, the accrual accounting. Essentially that is the chicken farmer amendments that you had on the Senate Floor that had additional exceptions from the one-family exception for the accrual accounting method, and these covered two-family situations that were the chicken farms, and that makes that position permanent.

As you recall, the week before you went out, the Senate added a one more year deferral of the application of this rule of the 1976 provision in anticipation of the House provision making it permanent. This is a provision that does make that rule permanent.

The other provision in the House bill deals with certain nurseries, florists and farmers -- taking care of a problem that had arisen.

Item H on page 7 has been what has been referred to as Section 167(k) which is a special five-year depreciation write-off for low-income rental housing. As you recall, that was enacted in 1969 from four or five years, and it has been extended for one or two years subsequent to 1974 when the five-year period ran out. The last extension would expire at the end of this year. The House bill would extend that for an additional three years until 1982.

At the bottom of page 7 is the fourth and final area under the House bill and that is the capital gains provisions.

The capital gains provision, as you see on page 7, the first one is the alternative capital gains tax rate. It may be helpful if I give you some background to show you what the discussion has developed around.

Prior to 1969, there was a maximum tax on capital gains of 25 percent. What you did, you would compute your regular tax with the 50 percent exclusion, the capital gains tax with a 50 percent exclusion. You can only include 50 percent of your income and the other 50 percent is excluded. There was no minimum tax.

The alternative to that, you could elect to take a 25 percent tax on all of your capital gains and the effect of that is individuals in tax brackets again above 50 percent would generally favor a 25 percent rate, because that would be more favorable for someone above the 50 percent rate, but all individuals below the 50 percent rate would find it more advantageous to take the general provision.

For example, some having the 40 percent rate would include one half the capital gains and one half would be in effect of the 20 percent tax, would be less than the 25 percent tax, which is the alternative rate.

In 1969, Congress made a number of revisions. The first one was it provided a $50,000 cap on the 25 percent rate. That meant the 25 percent rate was still available, but you could only use $50,000 of gains on it.

Second, Congress provided a minimum tax. They excluded a portion of the capital gains, a preference item. What was excluded from income was treated as a preference item and therefore subject to the minimum tax.

The third factor, which has been an important aspect, was Congress was provided a maximum tax on earned income. The theory behind that was one of the problems that caused a lot of individuals looking for shelters and preferences was the very high tax rates which went as high as 70 percent.

There was concern that the Federal government should not impose a tax any greater than 50 percent on individuals' earned income. This did not apply to investment income, only to individual's earnings.

One of the provisions that the Congress enacted there was to provide a penalty that, to the extent that an individual continued to go out and make investments which were in an area of preference, it was referred to as "poison." The preference items, in effect, poisoned, or offset, the earned income available for the maximum tax on earned income.

So if you had a lot of income from earnings but then you had capital gains, the capital gains would reduce the earnings which were eligible for the 50 percent maximum rate, and this has caused certain cases to get to a high rate which has been reported as a 49 percent rate on capital gains and essentially it is this provision. It does not apply to many individuals. As we understand, there are less than fifteen individuals that are at that 49 percent rate, but that is a provision that causes it.

The Chairman. The reason that there are less than fifteen individuals, no one is going to do that with his eyes wide open. It is only that many poor saps that walk into the trap. That is why you have that small number. Some poor fool walks into it, like an open manhold cover in the street.

If he were looking where he was going, he would have walked around it.

Mr. Shapiro. It was the '76 Act that caused the situation. Prior to 1976, the minimum tax allows you to offset 100 percent of your regular taxes against your preference items. You added up your preference income, you offset the exclusion and offset 100 percent of your regular taxes you paid, and then you had a 10 percent tax on your preference income, and there was a $30,000 exclusion at that time.

The 1976 Act and the minimum tax reduced the exclusion down from $30,000 to $10,000, but it made an alternative exclusion. You either took a $10,000 exclusion or 50 percent of the regular taxes -- not 100 percent, as you had in prior law, but 50 percent.

The effect of the increase in the minimum tax, plus this offset of capital gains against your maximum tax on earned income, was what resulted in the potentially high rate on some individuals.

The Chairman. Let me just say about the minimum tax, in my judgment, the House was very unwise about the minimum tax. It should have been an alternative tax from the beginning, so that if a person got by without paying anything of substance, we would compute his tax liability on a different basis, and that is what he would owe us.

Well, they did not do it that way, and our staff did not know enough to show us how they could do it. The Treasury could not give us enough help to draw up an adequate minimum tax, so after awhile, they got it to where the minimum tax was just an add-on tax.

We started out saying that you could subtract the tax you had already paid from the amount of preference income to which the minimum tax was going to be applied, but the House wanted to strike that out completely in subsequent years and we compromised to say that you could reduce the preference items to which the minimum tax would apply by one-half of the tax you already paid.

Now, we had a witness before this Committee who served some time with distinction in Treasury saying that people making over $200,000, if you looked at what they were really paying in terms of economic income, you would assume he is paying 30 percent, on the average, of their income in taxes. I do not know. People are complaining about that.

But this Treasury study shows that you have people, let's say, paying as little as 5 percent of their income in taxes in this same earnings bracket.

It is to this latter group that the minimum tax ought to apply. It ought to apply to those people with a vengeance. Instead, we are adding a minimum tax on top of some of these people who are already paying 30 percent of their economic income in taxes. That was not the idea at all.

I, for one, would like to see the minimum tax raised every bit as much, even more, than it is raising now. I would like to see it targeted so and apply to those people who are paying less than 10 percent of their income, or less than 15 percent of their income in taxes -- not the people who are paying 30 percent or more.

The add-on tax on top of those people who are already paying a nice slug of taxes, if you look at how much they did with their money, how much they gave to charity and so forth, we ought to work it so that the people who are getting by without paying a fair amount of taxes are going to pay substantially more.

And the way to do that is to draw up a tax which works in the alternative. You compute, one, what a person pays ordinarily. Then you assess a tax on the preferences with considerations for whatever should be considered and then, whichever is higher is what you would owe. So the people who are paying 5 percent or less, what they would really owe is a tax on their preferences.

For that purpose, the minimum tax rate should be a great deal higher because it is not an add-on tax at that point, it is an alternative tax.

So, for those who enjoy tax shelters, by the time they get through computing where their liability would fall, it is over on the other side of the ledger. Their liability would fall on their sheltered income, because they would have escaped fair liability on the front side. It would be on the back side of the sheet where they would find what they would pay.

That is how I would like to see it.

Senator Bentsen. Mr. Chairman, I very much agree with you on the alternative tax and in '76 this Committee went in exactly the wrong direction when it took away half the credit for taxes already paid before you put on the minimum tax. What you are trying to do is see that everyone in this country pays a fair amount of taxes. A fellow cannot live off cash flow and not pay any taxes.

But when they took away the credit for taxes already paid, it worked in just the reverse direction.

Senator Byrd. I do not think the Committee did that. I think that was done in conference.

Mr. Shapiro. The Committee had a 100 percent tax offset and the House had a zero offset.

Senator Bentsen. The Senator from Virginia is absolutely right.

Mr. Shapiro. It may be helpful -- let me give you a little more background as to what happened.

In 1969, the Administration proposed and the House bill had an alternative tax. They had two provisions. One was referred to as an LTP -- Limit on Tax Preference -- and the other was an allocation of deductions. That was essentially proposed by the Administration.

The alternative tax, the limit on tax preferences was, in effect, an alternative tax, but the allocation reductions, which is a companion of that allocated deduction between taxable income and tax-exempt income, and that had so many complexities and so many concerns with it that this Committee revised the approach that the House had and their alternative tax and allocation reduction because the two together caused problems. And the Finance Committee's objective at that time was to come up with something that was a hybrid.

You came up with a minimum tax which was an add-on tax where you had your preferences separately, but then you gave a $30,000 exemption so that it would not go after the low-income people. And then the ones who had preferences, then you had a 100 percent offset of regular taxes. That was an alternative to the extent who had paid a lot of taxes could reduce the preferences by the taxes they paid.

That was viewed as somewhat of a hybrid between an alternative tax and an add-on tax.

Once in 1976 when you eliminated part of the tax reduction, you eliminated that hybrid form of an alternative tax and add-on tax  the prior law had, and it is now viewed more closely, as an add-on tax.

The Chairman. Let me just say this on behalf of myself and, I think, on behalf of every Committee member with whom I have discussed this matter. I know that the President is very much concerned about the aspects of the House bill that might make it possible for someone to make a lot of money and pay no tax to this government by way of income tax.

As far as this Senator is concerned, I am on his side in that respect. Anybody who is making a lot of money and not paying us anything more than 1 or 5 or 10 percent of his income in taxes should just get ready -- he was going to pay a big tax bill he was not anticipating.

I think we now have this information and Treasury has studies available. Our staff knows a lot more than they did before. I think we know how to tax those people and I think we can sell it when we get to the House. That aspect of it, I believe, can be handled in a way that everybody in the country would feel very good.

We have managed to take care of the situation where a person pays no tax. If you look at the 22 cases in the Treasury study of people who paid no tax at all, I honestly think that a fair appraisal would say none of those 22 people owed us a tax.

Where the mischief is is those paying a small amount of tax, but by no means enough. That is an area that we should take a look at, and I would like Treasury to start pulling those returns and study them and prepare us some typical advantages that you think illustrate what we ought to be concerned about, and you might give us your suggestions as to how we might tax that income and we have our own ideas of how we might do it.

I, for one, would like to vote to ease the burden on capital gains and to be more realistic of the way we tax it, that you do not crucify somebody because of inflation. I want to see to it -- and I think most members of this Committee want to see to it -- that the kind of people, small in number though it may be, who are getting by without paying more than a modicum of taxes, even though they made a great deal of money, will pay a substantial amount of taxes.

I think it can be done and I would hope that this Committee would work together -- I believe it will. Every Senator that I have talked to has indicated while they would reserve many about the details they shared the objective. I think we can do something about it.

Mr. Shapiro. Now, having given the background to the prior law, the big controversy in the House was over the proposal advocated in the Ways and Means Committee by Congressman Steiger and introduced in the Senate, in an identical amendment, by Senator Hansen which would have gone back to the pre-1969 law with respect to capital gains. That means that you would the alternative rate of 25 percent without a limitation, eliminating the present $50,000 cap and taking capital gains out of the minimum tax as a preference item and also not having capital gains as an offset against the maximum tax in earned income.

The compromise that the House came up with in this package on capital gains is listed here on page 7 at the bottom: a) the first one, to eliminate the alternative tax, capital gains tax completely; not even allow the $50,000 tax cap. So there would no longer be, under the House bill, a 25 percent rate on any capital gains.

Second, b) is to remove capital gains from the list of tax preferences from the minimum tax which has the same effect of not treating it as an offset as the earned income, that 50 percent rate.

C) the alternative minimum tax on capital gains. The problem that developed in the Ways and Means Committee was that a number of cases came out taking capital gains out of preference item. A number of individuals with high capital gains, $1 million or more, would end up paying no minimum tax under the House bill, and therefore, the House added a small minimum tax to make sure that these individuals would at least pay some minimum tax.

It was viewed as an alternative tax.

The effect of it is to have a 10 percent rate on the one-half excluded capital gains, the 50 percent excluded from income. The House bill would have a $10,000 exemption, so it would not cover the smaller capital gains, but then impose a 10 percent rate on the excluded capital gains above that. And, if a taxpayer was able to pay less taxes on regular income than this 10 percent rate, the taxpayer would pay that.

The objective in the House bill is to make sure that all taxpayers at least pay some portion of capital gains, at least 10 percent on the excluded one-half, which has the effect of a 5 percent tax on the full capital gains.

The Chairman. The House made a complete circle. They started out in 1976 sending us a minimum tax bill that gave the taxpayer no credit at all for the taxes he had already paid, no consideration at all for what he paid. Then they came along a couple of years later and just repealed the tax, in effect, where most of the minimum taxes are going to apply on capital gains.

Having voted then one, to go to the extreme of not considering whether the taxpayer has already paid, then they send us something starting out to repeal and then they wind up with their micro-mini tax, which would be subject to very severe criticism.

It helps to illustrate the fact that the House serves on two-year terms. When you have a lot of new members over there --

Mr. Shapiro. The next item on capital gains is on page 8, the top of page 8, item D. That is the inflation adjustment for capital assets.

This provision would, in effect, index capital gains. That is to adjust the basis of the capital assets at the time they are sold for the rate of inflation from the period that they held the asset. This provision has a delayed effective date. It does not apply until after 1979.

From 1980 on, the indexing begins at that time. This means that any asset after 1979 would be indexed on the consumer price index increase between the time they bought it and the time they sold it.

For any assets that the taxpayer had before 1980, you would index it only for the period after 1979. There would be no indexing before that, but it would start from 1980 on.

This provision is limited to certain types of assets, for example, corporate stock, real estate, tangible personal property.

Item E in the House bill is the provision that provides a once in a lifetime exclusion for personal residences. This is a $100,000 exclusion that can be taken once.

As you know, present law has a rollover provision. That means if you have to go from one residence to another and you go from a residence with a smaller cost to a larger cost you can roll over your gains so you do not pay a gain upon that sale, but when you purchase that house, you just reduce the basis of that larger house by the gains that you had on that smaller house.

Senator Curtis. Does the present law have anything in it about sales of residences by anybody over 65?

Mr. Shapiro. Present law has an exclusion, this rollover or deferral across the board for all taxpayers as long as they keep upgrading the value of their home. Once an individual is over 65 and sells the home, then there is an exclusion.

Senator Curtis. A one-time exclusion?

Mr. Shapiro. That is also a once in a lifetime exclusion. You have to meet certain requirements -- for example, living in it five out of eight years and it has to be a principal residence. An exclusion of up to $35,000 -- that is $35,000 over the sale price.

The Chairman. Is that excluded? He does not pay any price on it if he is over 65?

Mr. Shapiro. Not a total exclusion. The way it works is there is a fraction and you take your total profit of your total sales price times your capital gains, so it is a fraction of it, not just that you exclude up to $35,000 of gain.

Let's assume that if your sale price is under $35,000 you exclude the entire gain. For example, your sales price is $70,000. Then one-half of your gain is excluded. It really works as a fraction, and the $35,000 is some of your base amount.

Senator Curtis. $35,000 is the sales price, not the gain?

Mr. Shapiro. Yes.

What the House provision does, it has no age limitation. It continues present law deferral. In essence, it is a once in a lifetime exclusion. An individual still can get the deferral of a gain by rolling it over to a larger house like present law. There is no change in that.

But in addition to that provision, there is a once in a lifetime exclusion of $100,000 on the gain.

Senator Packwood. They get both?

Mr. Shapiro. They cannot get both at one time. Either/or, but presumably they will take the roll over until they build up high enough, because that $100,000 is not cumulative in the House bill. Once they go to a smaller house or an apartment, then presumably they would elect this provision.

Senator Byrd. Is the $100,000 the sale price or the gain?

Mr. Shapiro. The gain. You can have a house selling for $1 million and have a $90,000 exclusion. It would be the entire amount.

It is a gain. Up to $100,000 it is a gain, regardless of age, regardless of price.

Senator Curtis. If this residence is on a farm, would it exclude the whole thing?

Mr. Shapiro. I think there is a question there as to what extent you are talking about the residence and to what extent you are talking about the business, and then it would probably have certain facts and circumstances -- some allocation for the total sales price of the residence and some for the business.

Senator Curtis. The same thing would apply to nonfarm people. Somebody may have a yard, or five or ten acre and somebody else have a fifty foot yard.

Mr. Shapiro. Presumably, with your example, they may have a residence on a ten or twenty acre tract and they intend to sell that tract for commercial development, a farm or some commercial use.

Senator Curtis. But a small farm is still a home, and there are situations where the land has had a terrific inflation boom, and the house they live in may be very modest.

Mr. Shapiro. Presumably, a certain portion of the property around the home would be attributable to the home. These are the typical types of concerns that raises the facts and circumstances test. There is no way you can provide guidelines in the statute that can cover each case unless you want to exempt the entire farm. That was not done in the House bill. You have to have some allocation brtween the residence and business.

Senator Curtis. The simplest thing would to be to make as much reduction in the capital gains tax generally; from the standpoint of drafting, it would be the simplest thing.

Mr. Shapiro. That would be one of the judgments that the Committee would have to make in looking at the total picture, that is correct.

Senator Curtis. How expensive is this $100,000?

Mr. Shapiro. Approximately $700 million. At least that much for the first number of years.

The Chairman. Gentlemen, there is a vote on the Senate Floor. It is not a controversial vote, I do not believe, but final passage of one of the agriculture bills. I suppose Senators will want to go over and vote on it. I suggest we go vote and come back.

(A brief recess was taken.)

The Chairman. All right, gentlemen.

Mr. Shapiro, I would like you to explain what you have here, if you can briefly, then we would like to make a suggestion or two.

Mr. Shapiro. Mr. Chairman, we have just two provisions left on the House bill on page 8. The first one is a minor provision dealing with the gain on certain residential sales. The problem came to the House members that the deferral period -- as you know, when you roll over one house to another house, a lower price to a higher price, you can defer the gain on that, but there are some rules that apply to it. One of the rules is that you have an eighteen-month period in which the rollover -- the way the rollover is drafted, you only have one.

It has come to the attention of some House members that there are some situations where a company moves its employees more than once within an eighteen-month period. Technically, the rule does not apply to them. There is no intention not to, it is just the way it was drafted, considering the fast mobility of some situations.

The House position here just allows more than one rollover within that eighteen-month period.

The next item, the last provision is a study in which the

House requires the Treasury Department to prepare and submit to Congress a study on the effectiveness of the reductions and the individual and corporate capital gains tax rates, stimulating investment, increasing economic growth including the effects on the growth of employment.

Those are the provisions in the House bill on capital gains, and that concludes the summary of the House bill.

The Chairman. Let me just make a suggestion now, under the rules that I suggested in the beginning, that I would like to see us consider moving that earned income credit up to where it would be 10 percent of $6,000 for a maximum of $600 earned income credit, and perhaps phasing that out whereby the time people earn $9,000, the earned income credit would be phased out. At that time, hopefully they would be paying some taxes rather than getting the benefit of the earned income credit.

I would like to see an estimate. It might be that if you consider relative factors, such as food stamps being phased out and things like that, that it might be too sharp a phase-out, but I think a lot of us, at least, feel that people should not be on these welfare rolls, or should not be receiving welfare type benefits, if they are making more than $9,000.

We should work up the best that you can provide for us to look at and give us your revenue estimates, what you think it would take.

The House has the earned income credit, but it does not move the figure up.

Mr. Shapiro. The House just makes it permanent, as far as that is concerned, but the House makes three structural type changes to make the provision work better administratively from the standpoint of having taxpayers know exactly how to make a computation by allowing them to use tax tables and also to provide that on the tax return.

There is information that the Internal Revenue Service can compute the earned income credit for those people who do not take it, that the Service can take it.

The Chairman. Does the House bill provide for negative withholding?

Mr. Shapiro. No withholding.

The Chairman. I would like to get an amendment up that would provide for negative withholding. If you do that, that is going to increase the cost, because a lot of people who are entitled to it are not getting it right now.

Mr. Shapiro. That is correct.

The Chairman. It should be accompanied by a provision for negative witholding, and I would like to see that. This is not a welfare benefit. This is for people who are not on welfare or, at a minimum, either this should be reduced by the welfare benefit or the welfare benefit should be reduced by this, because the purpose of this is to move people into the mainstream.

Now, what kind of ballpark figure are we talking about, if we agree to that?

Mr. Shapiro. Senator, with a phase-out, present law has a 10 percent earned income credit on the earned income with a maximum of $400, 10 percent of the first $4,000. Between $4,000 and $8,000 there is a phase-out.

For example, with the $400 maximum, if an individual has an income of $6,000, the $400 maximum is reduced in half, to $200. If the individual has more than $8,000 of income, they would get no earned income credit.

10 percent up to $4,000, a maximum of $400 with a phase-out between $4,000 and $8,000.

The proposal that you have suggested would keep the 10 percent but increase the maximum to $600 so it would be 10 percent up to the first $6,000 with the maximum earned income credit increased from $4,000 to $6,000. The question that remains, what kind of phasedown?

You could phase it down at the same basis that you have in present law. That would have a phase-out of $12,000, between $6,000 and $12,000. Alternatively, you can phase it down, for example, at $10,000 or $9,000.

The revenue effects would be, if you have a phasedown at the $12,000 level, it would be approximately $1.8 billion. If you had the phasedown between $6,000 and $10,000, the revenue would be approximately $1.3 billion.

If you had a phasedown between $6,000 and $9,000, the revenue is just about even.

The Chairman. While it is my understanding, while this may not be budgeted in the Administration's tax plan, but they have it budgeted it in the welfare plan. Is that correct, do you know?

Mr. Stern. I do not know what the effect of the earned income tax increase --

Mr. Sunley. It was not going to be effective until the welfare program became effective in 1981. It is not budgeted for '79 or '80.

The Chairman. My experience with that -- Senator Moynihan knows more detail about it than I do -- is that the Administration theory on welfare, when they are ready to do business, they want you to do it yesterday. For example, when I first came here, they wanted us to pass the whole bill by now and put 22 million more people on the rolls. Meanwhile, they have taken a second look because it did not move quite that fast. Now they might want to say, even though this is a desirable piece of what we might recommend, we would just as soon not have it for the time being.

But it seems to me if it is a good feature of the welfare plan that they are recommending, and they have this in their budget, that we ought to go forward with it. Here is something I think that we can buy and I have been through this before.

I recall when we first moved into the earned income credit area the Secretary of the Treasury said that should be in the welfare bill rather than the tax bill. It is a tax matter. It can just as easily be in this bill as in the welfare bill.

Senator Moynihan?

Senator Moynihan. Mr. Chairman, I would like to agree with you on this matter. I think it is clear that we had an experience in the House of Representatives this year with the President's welfare program and a major good faith effort was made. It came to nothing. Not one of the standing committees in the House even considered the final bill that was put together by the ad hoc committee.

The prospects that anything of that sort of global -- I do not want to describe it as anything more than a total program. I do not want to be pejorative, but the prospects of the program do not exist. It is not going to happen.

Here is a program that is in place. It is working. I think that it has a problem of now having it well enough known. But time takes care of many of those things. I think we should go ahead with your proposal.

I would like to say, the fact that the President's major program is not going to be adopted -- how many Presidents have to find that out before this Committee finally is impressed?

I would like to say that there is a question of marginal rates in taxation, if you go down a sharper curve, and I am sure we can hear more about that. I do not want to do anything more than suggest that you may find that going from $5,000 and scaling out at $10,000 might solve some of those problems for you, because they become real problems when the marginal rate of taxation reaches 40 percent.

The Chairman. I am not trying to perfect an amendment right now. I am just trying to get something out that we can talk about.

Senator Moynihan. I would like to support your amendment?

The Chairman. Why do you not, then take a look at the $5,000 and $10,000 aspect that Senator Moynihan had. That might reduce the cost.

The Senator is right, talking about the marginal tax rate. That is very important. How about working with whoever we need to work with to get us some comparative charts to look at to see what the ballpark figure is?

Now, if we put this in the bill, that will improve the balance of this bill. There has been criticism and a lot of attention has been drawn to the fact that there is not enough in here for the low-income earner. Basically, this proposal says if you are working and trying to support yourself and do not make enough money to pay income tax, we are going to give you back some of that Social Security tax money.

It can help a lot of working poor people. It is a tax cut for the working poor. It falls on the lower end of the scale.

In addition to that, I think you ought to try to prepare for us an amendment trying to see to it to see how the people who come just above that would come in for their appropriate share of a tax cut bill would be.

I am not interested in trying to decrease taxes of people earning $50,000 and over, $40,000 and over. Up to $25,000, I think we should see that they get a fair share of the tax cut.

Mr. Shapiro. You would probably have some additional rate cuts that would go to those brackets built on the earned income tax levels.

Senator Curtis. Mr. Chairman, since this program has been on the books, I have increased my opinion of it. I think that it serves a useful purpose in our tax program. If I were going to guess what the intention of the Chairman was when he originally offered this, my guess would be that it was to give a tax break to the individual who worked and somehow managed to get along on his earnings, even though it was very small, and was not a recipient of the welfare programs, whether it be direct welfare or food stamps or anything of that sort.

I think it should be held to that.

I believe if we make it available to any of those people who draw welfare that it will soon become just an added welfare provision instead of it being a tax break for people of very low income who lived on their earnings.

Senator Byrd. Does it not apply to those on welfare?

Mr. Shapiro. They could take advantage of it, Senator, but the way it works is they must maintain a household for a dependent and must provide more than 50 percent of the support of that dependent. If that individual -- the welfare is for the child. It is aimed at that child, so if you had more than 50 percent of the support from welfare,you are not eligible.

Let's make an example where you may have $4,000 of earnings and $2,000 for welfare. If you supply more than 50 percent support of that child, then you can have it. You are eligible for an income credit. It is a dependency test.

Senator Byrd. Then this would be in addition to the welfare program?

Mr. Stern. There is one particular feature. It says that the amount that you get in the earned income tax credit should be disregarded for welfare purposes, and that would be -- I would gather a part of this packet would be the repeal of that so-called disregard provision.

So that, in fact, the amount that you get in the earned income credit would offset the equivalent amount of welfare payments.

Senator Byrd. My second question is, yesterday you gave an estimate of $1.8 billion as the cost of going to the $600 and $400. Today you gave the same figure, $1.8 billion.

Did that take into consideration the negative withholding aspect?

Mr. Shapiro. Senator, that assumes that those who are eligible for it would come under the revenue estimates that we have looked at. It was the total population, and made assumptions that the great majority of those would take it.

Senator Long is aware that in the House bill those who filed tax returns are able to get the credit, even if they do not claim it, because the procedures are there for the Internal Revenue Service to make it available for them. The concern Senator Long has is those individuals below the filing requirements and do not file a return, the IRS cannot give it to them, and to make sure they do get it, Senator Long wants to make sure that the employer makes it available to them by the way of cash payments.

Senator Byrd. That is a new proposal. That would be over and above the $1.8 billion, I would assume.

Mr. Stern. The $1.8 billion assumes a phase-out from $6,000 to $12,000. It would be less -- for example, it would be only $1 billion if you phased out the $9,000.

Senator Byrd. If you went with the $12,000, which is the figure --

Mr. Stern. The estimates do assume a high rate of participation, so do assume withholding.

**Mr. Shapiro**. We have assumed all on the withholding part of the feature and those figures do take that into account. Those who are eligible for the earned income credit would get it, and the withholding would be a more effective way to make sure they get it.

Senator Byrd. I thought the $1.8 billion applied to the

House bill, adjusted.

Mr. Shapiro. The House bill made no change.

Senator Byrd. It was based on the House bill, adjusted by the change of $400 to $600.

Mr. Shapiro. It does. In other words, the House bill made the present provision permanent. The proposal you are referring to takes the $400 to $600. The $1.8 billion referred to that increase of $400 to $600 and that is assuming the availability to the population that would be covered. On the negative withholding, that is a way of doing it.

I understand your concern. If you do not have negative withholding, that would mean that some individuals who otherwise were eligible and do not file tax returns would not get it, and therefore, there would be a lower revenue loss, showing a difference in those revenue figures, making some assumptions on who would or would not get it.

Senator Byrd. My thought was that estimate is probably low if you are going to have a negative withholding.

Mr. Shapiro. I think what is happening is the estimate would be lower without the negative withholding. We have assumed that those would take it.

Let me show you both estimates and I will have it for you next time.

The Chairman. If we phase this out, as Senator Moynihan suggested, if we only go up to $500 and phase it out at $10,000 as Senator Moynihan has suggested or we go to $6,000 and phase it out at $9,000 as the alternative might be, in either event, that would greatly reduce the cost of it, would it not?

Mr. Shapiro. That is correct. The suggestion Senator Moynihan made of going to $5,000 and the $10,000 phase-out would cost $800 million.

The Chairman. That is a tremendous reduction. Even that would not cost all of that in the first year, in that fiscal year.

Mr. Shapiro. That is right. The fiscal year, it would cost only a fraction of that, less than half on a fiscal year basis.

The Chairman. Let me just explain for a moment why negative withholding is so important.

Let us assume that a poor person is working, trying to support his children, and that person is making, let's say, $400 a month. If you had negative withholding, every time that person gets $400 that employer is including $40 to make it $440 in their paycheck -- negative withholding, reverse withholding.

And he simply subtracts that $40 from the money he is withholding from himself and others on that withholding statement. Instead of adding $40, you subtract $40, in that case, and he pays that $40.

It means that this poor person working to support a family gets about 10 percent extra.

The alternative is to wait until the year is out. At that time the person gets, let us say, $480. The person for whose benefit and the family for whose benefit it is intended, they have been needing that $40 month by month to help meet expenses. Rather than have them wait a year and get a $480 lump sum, pay them $40 a month as he does his bookkeeping. That is negative withholding.

That, then, assures the people who ought to be getting it are getting it, and they are getting it as they need the money rather than getting it all in one lump sum where they have had to sacrifice.

Senator Byrd. If there is no individual employee under the existing tables who owes no withholding, then he gets his net check, right, minus the Social Security?

Mr. Shapiro. A cash payment made by the employer to the employee.

Senator Byrd. I mean in his monthly check, he would get his check without any deductions?

Mr. Shapiro. That is correct.

Senator Byrd. Under this he would get his check plus an amount, whatever that amount might be.

Mr. Shapiro. Yes.

Senator Byrd. When that is phased out, then the employee will assume that -- I mean, assuming that he is getting a lesser salary?

Mr. Shapiro. When you say if that is phased out, if that individual has income?

Senator Byrd. That makes him non-exempt.

Mr. Shapiro. The way it is proposed, you have withholding the amount of the cash payment made by the employer would be based on the withholding table, taking into account that employee's income, and if that employee's income is above that level, then he would get nothing. Or, let's assume that that $10,000 phase-out, that that individual is getting $9,500. His cash payment would be very small, so you would not have that situation. It would be done by tables of some sort.

He would not get the full $600 and then find at the end of the year he was only eligible for $50. The table would be based on his projected income for the year and would be adjusted by the amount of the cash payment made to him.

Senator Byrd. If he was earning $9,000 that would make him eligible for the difference between $9,000 and $1,000, I guess -- whatever that figure would be.

Mr. Shapiro. He would be eligible for a $50 earned income credit. That would allow him to get $1 a week. He would not get $50. He would be adjusted for that amount.

Senator Byrd. You get $1 extra.

Mr. Shapiro. $1 extra each week.

Senator Byrd. Then he gets a raise and he hits $10,000 and so he no longer would get that $1?

Mr. Shapiro. It depends when that raise would come. As soon as that raise would come and he would go over the limit, then he would lose that. That is correct.

Senator Byrd. I am not critical of it, I am just wondering how it would work from the psychological point of view between the employer and employee.

Mr. Shapiro. Senator, the purpose of Senator Long's suggestion of having withholding by getting it initially is a better work incentive because he gets it each pay period rather than at the end of the year. If you have it at the end of the year, it loses that work incentive.

Senator Byrd. I understand the theory of it. I agree with that theory. Would that cause any problems between the employer and the employee?

Mr. Shapiro. There will be times where you will have some situations where there would be some problem in that regard. I am sure there would be cases. First of all, the employee has to elect -- I am sure you have some employers that will not make the notice to the employees that he is eligible. Some employers would not know anything about it.

In other cases, where you have the adjustments made in salary and some may not think to adjust the withholding. All I am saying is that is the type of problems that occur in a number of other areas.

I cannot give you any assurance that you will not hear of certain problems in the future about this. We will make every effort we can, at our staff level, working with the Treasury Department and the Internal Revenue Service, to design a withholding schedule to alleviate the significant problems to the extent we can.

The Chairman. Up until now, Senator, this poor person is expected to come in and file an income tax return, not for the purpose of paying us the tax, but for the purpose of showing that he has something coming to him, and a lot of them are not doing it -- probably a majority of them who are entitled to the credit are not doing it for whatever reason. They are not familiar with the tax procedures, and all of that.

So that the employer can be expected to know a great deal about this -- whether the employee has it coming to him. The employer wlll have his instructions on how to do it. If a person has children to support, he simply makes an X or some mark on the application form that this person is entitled to the negative wihholding and so, instead of where for most people he is putting a figure down that he is adding to the tax he is withholding, in this case he puts down a minus.

If there is $40 involved, he puts down a minus $40. That is a negative withholding. He just pays that on through to the employee in his calculations.

So what you do is have the employer, who knows a lot more about what the laws and procedures are, or the accountant who is handling it, simply make that calculation and add that to the person's paycheck rather than do the opposite, which is to make the calculation and take it from the person's paycheck. And I believe that this will be a far better procedure to assure that those who are entitled to it will receive it and also that they will receive it as they earn their money bit by bit to help defer the cost of living, rather than receive it as one lump sum after the year is out.

I want to make this point. The cost in the first year, even if we settle for the lower figure of $800 million, the cost in the first year would be a great deal less than this figure because in the next fiscal year it would not go into effect in the beginning. It would take employers awhile to put this into effect. Is that right?

Mr. Shapiro. That is correct. On a fiscal year's basis, we antitipate that would be less than $200 million. That $800 million is a full year effect. It would be less than $200 million on a fiscal year effect.

The Chairman. In full operation, you think it would be perhaps $800 million plus anywhere from $800 million up to $1.8 billion?

Mr. Shapiro. The $800 million is based upon the $5,000, $10,000. The $1 billion is based on the $6,000/$9,000 phase-out.

Senator Curtis. What would be the situation for an employer with just one employee, so that he has no withholding to transmit, therefore nothing from which he could deduct this advance?

Mr. Shapiro. One of the suggestions available is that he can take against his Social Security payments that he has. He could deduct it either against the Federal tax withholding --

Senator Curtis. Anything gong to the government?

Mr. Shapiro. That is correct.

Senator Roth. Mr. Chairman, one question I have -- and I have a lot of sympathy for what you are proposing -- but how many people would this take off the taxpaying rolls? In the Roper poll recently taken, there is a feeling among the American people -- a majority of the American people -- that they think everybody should pay some taxes, including the very rich. I just wonder what the impact would be.

Mr. Shapiro. What has happened, you make an effort taking people off the tax rolls and when you have a tax increase, you keep taking the same people off the tax rolls.

When you say in effect -- this would have the effect of taking most of those off the tax rolls that have gone on since the last time that you put in the earned income credit, this has the effect of adjusting for those who were put back on the tax rolls because of the inflation since the last Act.

Senator Roth. Do we have any estimates of the numbers that are off now and what this would do?

Mr. Shapiro. The rough estimate we have now is approximately $1 million.

The Chairman. Let me just touch on one aspect of this, though, that everybody ought to understand. I was very proud of what I thought we had done when we passed that tax bill in 1964, the one that you referred to, the Kennedy bill. So I asked Larry Woodworth to get us a chart to show how this tax cut was distributed. I thought it would do a great job of showing there was a balanced distribution, and so forth, and the wealthy would pay more and the poor would pay less. I thought it would be great.

And he asked me how much of that corporate income tax do you want to attribute to the corporations and how much do you want to attribute to the consumers? That sort of shocked me.

Well, what he had in mind was he said, I think you ought to attribute only 50 percent of that to the consumer. If you talk about the ultimate incidence, you ought to contribute 50 percent of that to the consumers or you ought to attribute 75 percent of it to the consumers.

So I told him to use his best judgment and see how it worked out. It never occurred to me that a corporate income tax cut, that about 75 percent of that would be reflected in lower prices -- or even so far as we tightened up on corporations, most of this would be passed on to the consumer.

So in the last analysis, while we put on the chart that the corporation is paying this, more than half of that tax that the corporation is paying is being passed on to the consumer in the price of the product.

You think about it. They have no choice about it. Tf they cannot make a profit, then they are not a business. So they have to pass all of those costs, including taxes. Otherwise they go broke.

The consumers are absorbing that. You take the Social Security tax. Theoretically, the employee is paying only this 5 percent or 6 percent, but that part that the employer pays, he has to add that to the cost of his business. Otherwise, he is going to go out of business to.

When the employee buys the product, even though it would be the same product he helped manufacture in the plant, he is absorbing the other half of that Social Security tax as a consumer.

The same thing is true about the unemploymetn insurance tax. Sure, it is levied on the payroll, but is passed on through as a cost of doing business. So the working poor are absorbing a lot of taxes -- Social Security, even corporate income taxes -- in the price of the product which sometimes is overlooked.

So when we start out with the earned income credit and this Committee's taking the view that if some poor soul did not make enough money to pay you an income tax, you ought to consider giving back some of the money that he was paying in taxes. So we started out looking at the Social Security tax and from that we said, well, he is absorbing a lot of it as a consumer, even the part that the employer has paid.

So before we start trying to pay him a grant on welfare, we ought to give him back some of the taxes that he has absorbed, even if he is not absorbing it as a direct tax on this paycheck.

And we passed that incentive in the House, if I recall, twice -- Mr. Stern recalls it. We sent it to the House twice. It got turned down by them twice before the House passed through the proposal and gave a name for it. So that we appreciate the House finding a name for our idea, but at least when we saw it over here, we recognized it because we had thought about it over here and given it everything except its final name.

When they sent it back with some perfection, that is fine, but it is in the Administration's plan and we ought to go forward now and improve on it again.

I think we know how to do it. That is one aspect of what we could be doing in this bill. The initial cost would not create a budget problem. There is only about $200 million or something like that in the first year and this will help us to put the balance of what this bill is going to need, starting out at the bottom and working up.

Senator Byrd. That $200 million would apply if you take Senator Moynihan's suggestion of $5,000 and $10,000 rather than $6,000 and $12,000.

The Chairman. If you took the $6,000 and $12,000, it would not be much more than that. I was thinking about $6,000 and $9,000. You have to look at what Senator Moynihan called the marginal tax rate as you phase this thing out. It may be that when you put this phase-out, the phase-out works just like the tax. You are getting less because he earns more. When you put that phase-out into it and you look at the other things he is going to be using at the same time, the taxes he is going to start accruing, it may be that that phase-out-- if you did it as fast as I would think of doing it at $6,000 or $9,000 it may be that you would be giving a marginal tax rate of above 33 percent.

Mr. Shapiro. We will look into this and try to get cases to show you what the marginal effect is. That is a concern that we will try to provide material on for you.

The Chairman. If you will get that prepared for us and let us look at it and see what the cost is, I would like to have that considered.

Senator Danforth. Would the figures be with and without welfare recipients being eligible? Would you do it both ways?

Mr. Shapiro. Not eligible at all?

Senator Danforth. That is my understanding of the Chairman's proposal.

Mr. Shapiro. You would save some money. One of the concerns we have --

Senator Danforth. I am talking for the phase-out of the individuals, what the effect, if the theory of the earned income tax credit has to do with marginal taxes. It would seem to me that one of the things you would have to build into that analysis is the effect that a person -- do you follow me?

Mr. Shapiro. I understand what you are saying. We can do that.

The Chairman. You see, one thing that we hope to do with this, in so far that people are receiving very small welfare payments, they are receiving a payment but it is a very small payment, hopefully this would lift those people off the welfare rolls. I am happy to say that we have a million people less on the rolls than we did at the high point, not because we have been mean to people but because we have provided CETA jobs and different things that gave them a chance to find a job somewhere.

And by this little thing, those on the welfare rolls that are drawing only a pittance, hopefully this would lift them out of it. This would make their incomes adequate so they would not have to apply for welfare.

But whatever we say about putting somebody off welfare, I would like to find some way of putting that into our cost estimates.

Gentlemen, do you want to discuss some other ideas? I would suggest that we come back at 10:00 o'clock Monday.

(Thereupon, at 12:15 p.m., the Committee recessed to reconvene Monday, September 11, 1978 at 10:00 a.m.)

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