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I. INTRODUCTION

Child care relates directly to the raising of children, the responsibilities of parents, and inevitably the respective roles of men and women in society, and thus involves some of our most basic values. Not surprisingly, there are fierce political disputes about the appropriate tax treatment of child care costs.[1] The fundamental issue is whether provisions that provide benefits to parents working outside the home unfairly discriminate against families in which a parent chooses to forgo paid employment and stay at home with the children.[2] Other issues

1. *Compare Reclaiming the Tax Code for American Families: Hearing Before the House Select Committee on Children, Youth, and Families*, 102d Cong. 73 (1991) (statement of Heidi Brennan, Co-Executive Director, Mothers at Home) (recommending that Congress "transform the current dependent care tax credit into a universal young child credit that does not discriminate between the choices made by families to care for their children") [hereinafter *Reclaiming*], *with id.* at 88 (statement of Nancy Duff Campbell, Managing Attorney, National Women's Law Center) (noting that "[c]hild and adult dependent care is a significant employment-related expense for working families, and . . . government should provide some help to families in meeting that expense").

2. *See* David E. Rosenbaum, *G.O.P. Begins Assembling Budget Framework of Its Own*, N.Y. TIMES (Nat'l Ed.), Feb. 4, 1998, at A18 ("Republicans took special issue with the President's proposals to help working families pay for child care. They said the money should be equally available to families in which the mother or the father stays home to take care of the children."); *see also infra* notes 17-19 and accompanying text. *Compare, e.g., White House Description of Clinton's Child Care Package*, TAX NOTES TODAY, Jan. 9, 1998, *available in* LEXIS, Doc. 98-1148 (recommending increase in child care credit) [hereinafter *Child Care Package*], *with* Sen. William V. Roth, Jr., *Roth's Statement on President's Child Care Proposal*, TAX NOTES TODAY, Jan. 8, 1998, *available in* LEXIS, Doc. 98-1290 (criticizing President Clinton's proposal for not helping children cared for by parents and other relatives), *and* S. 1577, 105th Cong. § 101(b) (1998) (proposing credit for "stay-at-home" parents of children under the age of four).

In 1990 Congress enacted a $22.5 billion package involving child care and assistance for working parents. *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, tit. V, 104 Stat. 1388, 1607; *Families Gain Help on Child Care*, 66 CONG. Q. ALMANAC 547, 547 (1990). Bills considered by Congress in both 1989 and 1990 had involved major changes in the dependent care tax credit, but the final bill made no changes in the credit. *See infra* notes 15 & 104. Consequently, Congress was able to sidestep the controversial issue of whether the child care credit is unfair to families where one parent stays home to care for the children. *Compare* 135 CONG. REC. S7057 (daily ed. June 21, 1989) (statement of Sen. Wilson) (arguing that limiting child care assistance to working parents discriminates against families where one parent involving taxation and the family are much less controversial, such as an increased personal exemption[3] or the recently enacted per-child credit.[4]

Equitable tax treatment of work-related child care expenses is critically important, but fairness is not the only important issue. The availability of tax benefits undoubtedly affects decisions about supervision of children and employment.[5] There are probably wide-ranging

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stays home), *with id.* at S7158-60 (daily ed. June 22, 1989) (statement of Sen. Cranston) (arguing that child care assistance should help parents find gainful employment).

3. In 1991, Patricia Schroeder, the liberal Congresswoman, and Gary Bauer, the conservative president of the Family Research Council, agreed that the personal exemption should be increased. *See Reclaiming, supra* note 1, at 3, 49. Representative Schroeder said that "both groups on the right end of the spectrum and the left end of the spectrum are now coming together" on this issue. *Id.* at 3. Bauer said the increased exemption could "unite Republicans and Democrats, liberals and conservatives, and feminists and traditionalists." *Id.* at 49.

4. *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 101, 111 Stat. 788, 796. Both the Democratic administration and Republican Congress have supported the per-child credit, although they have disagreed on some of the specifics. *See* H.R. 2014, 105th Cong. § 101 (1997); S. 949, 105th Cong. § 101 (1997); U.S. Dep't of Treasury, *Summary Documents for President's June 30 Tax Cut Proposal*, TAX NOTES TODAY, July 1, 1997, *available in* Lexis, Doc. 97-19277. *See generally* Andrew Taylor & Mary Agnes Carey, *Hopeful Negotiation Schedule Threatened by Tax Battles*, 55 CONG. Q. WKLY. 1609, 1610 (1997) (noting that the President proposed making the per-child credit partially refundable and Republicans rejected the proposal as "nothing more than increasing welfare benefits at the expense of providing the [per-child] credit to a broader range of middle-class families").

Professor McCaffery vehemently has objected to the per-child credit, but (aside from nonrefundability) the primary reason seems to be not the provision itself, but rather that enactment of the per-child credit represents a lost opportunity to reduce marginal rates, particularly for married women, and secondarily to revise the provisions for work-related child care expenses. *See* EDWARD J. MCCAFFERY, TAXING WOMEN 214-17 (1997).

> The child credit, as a matter of opportunity costs, *maintains* the high marginal tax rates that largely deter secondary-earning wives and makes their paid workforce roles difficult and unstable. . . . By "opportunity cost," I refer to the accounting or economic analysis that looks to alternative means of spending money. . . . An opportunity cost analysis would ask how else we could spend this money.

Id. at 215-16. The high marginal rates for married women encourage them to substitute untaxed work at home for paid employment. *See id.* at 216. As Professor McCaffery also notes, a per child credit indirectly may encourage mothers to work at home because, with increased resources, they may find the extra income from paid employment less attractive. *See id.*; *see also* Lawrence Zelenak, *Tax and the Married Woman*, 70 S. CAL. L. REV. 1021, 1024 (1997) (book review) (discussing Professor McCaffery's analysis of the per-child tax credit).

5. Although the tax benefits in §§ 21 and 129 are available for care of certain dependents and are not limited to care of children, it is clear that the benefits are overwhelmingly used for care of children. *See Reclaiming, supra* note 1, at 89 n.3 (statement of Nancy Duff Campbell, National Women's Law Center); *see also* HOUSE COMM. ON WAYS AND MEANS, 103D CONG., OVERVIEW OF ENTITLEMENT PROGRAMS: 1994 GREENBOOK 544 (Comm. Print 1994) (noting that

effects on both the economy and behavior of families. Furthermore, the cost to the government is substantial; the foregone revenue in 1998 from current tax benefits for dependent care is an estimated $3.7 billion.[6]

In this Article, I use the criteria of fairness and neutrality to determine the correct theoretical tax treatments of work-related child care expenses, and then explore the policy implications. Fairness is the subjective determination that the relative tax burden between families with child care expenses and other families without these expenses, but who are otherwise similar in pertinent ways, is appropriate. Neutrality, on the other hand, involves an objective determination and is achieved when the income tax has no direct effect on economic decisions.[7] The problem is that an income tax can never be neutral; it affects the return of working for monetary compensation compared to providing goods and services for oneself or enjoying leisure. Nevertheless, the goal that the income tax be neutral *with respect to child care expenses* is appropriate and reasonable. If attained, the effect of the income tax on the decision to work would be the same whether or not the person incurred expenses for child care. Although perfect neutrality (like perfect fairness) is impossible to achieve, an appropriate goal is that the income tax not unduly distort a parent's decision to work.

My basic conclusion is that child care expenses incurred so that the parent may work should be deductible, but only to the extent that the cost exceeds the parent's personal benefit. If a parent would purchase identical child care whether or not she works, the personal benefit is at least equal to the cost, and the child care expense should not be

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tax credits are "the largest Federal source of child care assistance") [hereinafter 1994 GREENBOOK]; 135 CONG. REC. S7142 (daily ed. June 22, 1989) (statement of Sen. Cohen) (noting that dependent care credit was "[t]he largest Federal program assisting families with children").

6. *See* JOINT COMM. ON TAXATION, 105TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 1998-2002, at 24 (Comm. Print 1997) (estimating a sum of $2.8 billion for the dependent care credit and $0.9 billion for exclusion of employer provided child care, including care purchased through flexible spending accounts). In making the estimate, the Joint Committee assumed that taxpayer behavior remained unchanged. *See id.* at 15.

In 1993, the foregone revenue from dependent care tax credits exceeded aggregate direct federal spending on child care services. *See* Mary L. Heen, *Welfare Reform, Child Care Costs, and Taxes: Delivering Increased Work-Related Child Care Benefits to Low-Income Families,* 13 YALE L. & POL'Y REV. 173, 179 n.32 & 179-80 (1995). Head Start was considered a childhood development program, rather than a child care program. *See* 1994 GREENBOOK, *supra* note 5, at 544. Its main purpose is education of poor preschool-age children, and is not designed to meet the needs of working parents. It primarily operates on a part-day basis and does not provide services in the summer. *See id.*; Heen, *supra*, at 181-82 nn.44-45.

7. For a discussion of the meaning of "direct effect," see *infra* note 128 and accompanying text.

deductible. It is, however, difficult to discern whether a working parent would utilize child care if she did not work outside the home. Furthermore, even if we can establish that the parent would not have purchased the child care, she still may receive some personal benefit. In this case, the benefit is less than the cost. Nevertheless, an examination of the patterns of child care allows us to identify those situations where it is likely that the personal benefit is small. It is then possible to compute an appropriate ceiling on the amount deductible.

There are currently two provisions in the Internal Revenue Code that provide tax benefits for work-related dependent care expenses: section 21,[8] which provides a nonrefundable partial credit, and section 129,[9] which allows an exclusion from income for those workers whose employers have qualifying plans. My recommended deduction would replace both sections, but unlike current law, the maximum amount of benefits would vary with the age of the child. The maximum annual deduction would be as follows: $4300 for each child two years old or younger, $2700 for each child between three and five years old, and $2400 for each child between six and twelve years old. On the other hand, I would not change the type of expenses that qualify for tax benefits. Under current law, expenses for household services, as well as dependent care, qualify for tax benefits if there is an eligible child or other dependent and the expenses are incurred to enable the taxpayer to be "gainfully employed."[10] Finally, I also explore the implications of my approach for both the earned income tax credit and employment taxes.

The choice of fairness and neutrality as the ultimate policy goals for tax treatment of child care expenses assumes that tax policy should accommodate the decisions that individuals make concerning child care and employment. This assumption is based on the belief that it is not the role of government to override parents' decisions about the care of their children and thus the income tax should not be used to encourage or discourage child care.[11] On the other hand, it is appropriate for the government to provide support for children and their families. Such support, however, should be furnished in a way that does not interfere with the families' judgments concerning allocation of their time and resources. If the goal is to provide assistance to families with children, policies like the earned income tax credit, a per-child income tax credit,

8. *See* I.R.C. § 21 (West Supp. 1997).

9. *See* I.R.C. § 129 (West Supp. 1997).

10. *See* I.R.C. §§ 21(b)(2)(A), 129(e)(1) (West Supp. 1997).

11. If particular programs such as Head Start are considered beneficial, then the government should directly provide them or give direct subsidies.

and an increased tax deduction for dependents are better than special treatment for child care expenses.[12] Consequently, I disagree with recent proposals regarding an increase in the child care credit for low and moderate income families from both President Clinton[13] and Republican Senators.[14] In my view, helping such families is appropriate, but an increase in the credit is not the appropriate way to achieve that goal.

Those who believe that tax benefits should subsidize child care and who often advocate refundable child care credits[15] do not take into

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12. Professor Forman has suggested a credit of a fixed amount per dependent when adult family members are employed or seeking employment. *See* Jonathan Barry Forman, *Beyond President Bush's Child Tax Credit Proposal: Towards a Comprehensive System of Tax Credits to Help Low-Income Families with Children*, 38 EMORY L.J. 661, 688 (1989); Jonathan Barry Forman, *Using Refundable Tax Credits to Help Low-Income Families*, 35 LOY. L. REV. 117, 132 (1989). The effect, in many respects, would be similar to the current earned income tax credit. Because benefits would not vary with the amount spent on child care, such a credit also would not distort parents' choices about child care.

13. *See General Explanations of the Administration's Revenue Proposals*, Feb. 2, 1998, *available in* LEXIS, Doc. 98-4800.

14. *See* S. 1577, 105th Cong. § 101(b) (1998).

15. *See A Prospectus of Working Women's Concerns: Hearings on H.R. 2577 Before the Subcomm. on Employment Opportunities of the House Comm. on Education and Labor*, 100th Cong. 131 (1987) (statement of Rep. Snowe); Anne L. Alstott, *Tax Policy and Feminism: Competing Goals and Institutional Choices*, 96 COLUM. L. REV. 2001, 2059 (1996); American Bar Association, Section of Taxation, *Report of the Child Care Credit Task Force*, 46 TAX NOTES 331, 334-35 (1990); Wendy Gerzog Shaller, *Limit Deductions for Mixed Personal/Business Expenses: Curb Current Abuses and Restore Some Progressivity into the Tax Code*, 41 CATH. U.L. REV. 581, 612 (1992) (advocating refundable credits that are phased out for high income individuals). For an interesting debate about refundable child care credits, see 122 CONG. REC. 23,114-17 (daily ed. July 21, 1976) (statements of Senators Kennedy, Allen, Long, Mansfield, and Hathaway).

Bills to make the credit for household and dependent care expenses refundable, in whole or in part, were approved by the Senate Finance Committee and passed the Senate in both 1989 and 1990. *See* S. 1185, 101st Cong. (1989) (Senate Finance Committee bill); 135 Cong. Rec. S6637 (daily ed. June 14, 1989); S. 5, 101st Cong. (1989) (Act for Better Child Care Services); 135 CONG. REC. S7479 (daily ed. June 23, 1989) (passage of S.5); STAFF OF JOINT COMM. ON TAXATION, 101ST CONG., BUDGET RECONCILIATION: REVENUE PROPOSALS AS APPROVED BY THE SENATE COMMITTEE ON FINANCE ON OCT. 13, 1990 (Comm. Print 1990) (Senate Finance Committee Bill) (making dependent care credit 90% refundable); S. 3209, 101st Cong. §7302 (1990) (making dependent care credit 90% refundable). Refundability of the credit was not controversial in 1989. *See* 135 CONG. REC. S7149-50 (daily ed. June 22. 1989) (comments by Sen. Thurmond); *id.* at. S7150-51 (comments by Sen. Wilson); *id.* at S7157-58 (comments by Sen. Roth); *id.* at S7158-59 (comments by Sen. Cranston); *id.* at S7170 (comments by Sen. Warner). In fact, an amendment proposed by Senator Dole, the Senate Republican Leader, also would have made the credit refundable. *See id.* at S7035-36 (daily ed. June 21, 1989); *see also* S. 601, 101st Cong. (1989), *reprinted in* 135 CONG. REC. S2571, S2721-24 (daily ed. Mar. 15, 1989) (containing President Bush's proposal, the Working Family Child Care Assistance Act of account that working parents make different types of child care arrangements for their children. For example, of the 9.9 million children who were less than five years old and whose mothers were employed in 1991, 36% were cared for in their own homes (mostly by relatives), 31% were cared for in another home (mostly by nonrelatives), 23% were cared for in organized child care facilities, and 9% were cared for by the mother at work.[16] The cost of these alternatives can vary greatly. Assistance for parents, including low-income working parents, should not penalize those who utilize relatives or other low cost child care alternatives.

In addition, my approach should make tax benefits for child care less susceptible from attack by those who view the current child care credit as "discriminatory" and "unfair" to families where a parent stays home with the children.[17] They maintain that the existing credit is "a tax subsidy program rather than a business expense"[18] program and that it "penalizes parents for spending time with their children."[19] In contrast, my conclusion is that child care expenses are valid business expenses and that a deduction is not only fair, but also necessary to prevent the income tax from inordinately distorting people's choices. Consequently, the recommended approach allows proponents of tax benefits to avoid

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1989, introduced by Senator Dole, offering choice between refundable dependent care credit or new child credit).

Finally, in both 1981 and 1976, amendments that would have made the credit refundable were approved by the Senate, although they had not been in the bill approved by the Senate Finance Committee. *See* 127 CONG. REC. S8445-51 (daily ed. July 24, 1981) (Proposed Amendment 297); 122 CONG. REC. 23,113-17 (1976) (Amendment No. 2014).

16. *See* Lynn Casper et al., *Who's Minding the Kids?*, CURRENT POPULATION REPORTS: HOUSEHOLD ECONOMIC STUDIES, 1994, at 27 (tbl. 1) (Survey of Income and Program Participation 1991); *see also* SANDRA L. HOFFERTH ET AL., NATIONAL CHILD CARE SURVEY, 1990, at 32 (1991) (noting that "[t]hirty percent of all preschool-age children with an employed mother are cared for primarily by a parent, . . . 26 percent are in center-based care. Nineteen percent are in family day-care, and 18 percent are cared for by other relatives. . . .").

17. *See Reclaiming*, *supra* note 1, at 102 (statements of Gary L. Bauer, president, Family Research Council); *see also* 135 CONG. REC. S2723 (daily ed. Mar. 15, 1989) (comments by Sen. Domenici); *id.* at S7151 (daily ed. June 22, 1989) (comments by Sen. Wilson); *id.* at S7150 (daily ed. June 22, 1989) (comments by Sen. Thurmond); *id.* at. S7038 (daily ed. June 21, 1989) (comments by Sen. Dole); *Child-Care Bill Caught in House Spat*, 45 CONG. Q. ALMANAC 203, 215 (1989) (Republicans complained that the dependent care tax credit "discriminated against families in which one parent stayed home to care for the children.").

18. *Reclaiming*, *supra* note 1, at 56 (statement of Gary L. Bauer, President, Family Research Council).

19. *Id.* at 54; *see* David Blankenhorn, *Shouldn't We Help Parents Be Parents?*, N.Y. TIMES (Late Ed.), Dec. 19, 1997, at A39; *see also* Rosenbaum, *supra* note 2, at A18 (reporting that Republicans object to increased child care credits because money should be "equally available" when a parent stays home).

disputes about the relative benefits of different lifestyles. Although my approach may result in less tax benefits for child care than some would prefer, it does justify significant benefits that often will be greater than current law allows.

The next two parts of the Article provide some background and demonstrate that tax treatment of child care expenses is a complicated problem. Part II concludes that child care cannot simply be classified as a business expense, and therefore a deduction cannot be justified without further analysis. Part III shows that a credit for child care expenses has unacceptable results. Part IV presents the history of tax benefits for child care expenses and demonstrates that current law is not satisfactory because Congress never has adopted a consistent rationale for these tax benefits. The approach I advocate is set forth in parts V and VI. Part V provides the theoretical underpinnings, and part VI gives the related policy recommendations. Conclusions are then summarized in part VII.

II. CLASSIFICATION AND DEDUCTIBILITY

A basic principle of our income tax is that expenses incurred in businesses or profit-seeking activities are deductible,[20] while personal expenses are not.[21] Net income—income after expenses of earning income—is deemed the best indication of ability to pay. Therefore, one approach for determining the correct tax treatment of child care expenses incurred while parents work is deciding upon the correct classification of child care expenses.[22] If child care expenses are classified as business expenses, they are deductible. If they are classified as personal expenses, they are not deductible. The problem, however, is that child care expenditures are not easily categorized.[23]

The need for child care is caused by the intersection of both business and personal factors. On the one hand, it can often be readily assumed that the expenditure would not be incurred but for the decision to work.

20. *See* I.R.C. §§ 162, 212 (West Supp. 1997).

21. *See* I.R.C. § 262 (West Supp. 1997).

22. *See* Heen, *supra* note 6, at 205-06 ("Debate about the tax treatment of child care costs generally centers on whether such expenses are personal or business expenses, that is, whether to treat such expenses as a cost of producing income or as a personal consumption expenditure.").

23. The problem of correct tax treatment of child care costs is the same whether there is an income or consumption tax. With a consumption tax, rather than an income tax, the issue would be whether the child care expense should be deductible in determining net consumption. The argument for excluding work-related child care costs from consumption is the same as for treating it as a business expense in an income tax; they are a "legitimate cost of earning income." Michael J. McIntyre & C. Eugene Steurle, *Federal Tax Reform: A Family Perspective*, TAX NOTES TODAY, July 11, 1996, at 40, *available in* LEXIS 96 TNT 135-22 (1996).

Consequently, the expenditure appears to be a deductible business expense. On the other hand, the expenditure also would not be incurred but for the presence of a child. Expenses for support of a child or dependent are typically considered as nondeductible personal expenses.[24] Since the need for the expenditure arises from both personal and business factors, the correct tax treatment is not immediately clear.[25]

Parents' responsibilities to their children and the role of women are controversial topics on which most people have strongly held views, and, therefore, it is not surprising that they see the issue of tax benefits for child care through an ideological lens. Thus, some commentators ignore the personal component of these expenses and argue that bias against women explains the failure to provide a full tax deduction for child care expenses.[26] Other commentators ignore the argument that child care expenses are defensible as business expenses and conclude that any tax benefits must be viewed as a subsidy.[27]

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24. *See* Smith v. Commissioner, 40 B.T.A. 1038, 1039 (1939), *aff'd*, 113 F.2d 114 (2d Cir. 1940).

25. Testimony at 1991 Congressional hearings illustrate the problem. Gary Bauer, President of the Family Research Council, who opposes tax benefits for child care expenses, compared child care to eating out, "housekeepers, butlers, gardeners, interior designers, and chauffers [sic]." *Reclaiming*, *supra* note 1, at 55. Nancy Duff Campbell, Managing Attorney, National Women's Law Center, who supports tax benefits for child care expenses, views child care as significant employment-related expense similar to an "oriental rug for an office." *Id.* at 85.

26. Professor Staudt, for example, argues that

> Congress has limited the childcare deduction provisions, unlike other business expense provisions found in the Code. . . . Given the reality that women provide unpaid childcare, the Code effectively requires working women, but not working men, to show they are economically constrained to obtain the tax benefit associated with the "business" expense. Although men are assumed to work to obtain the highest amount of wealth, section 21 [which provides for a dependent care credit] seems to indicate that women are understood to work only for economic survival.

Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571, 1602 (1996); *see also* Grace Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 BUFF. L. REV. 49, 66 (1971) (arguing that working women should be able to deduct childcare expenses).

27. *See* Douglas J. Besharov, *Fixing the Child Care Credit: Hidden Policies Lead to Regressive Policies*, 26 HARV. J. ON LEGIS. 505, 509 (1989) (calling dependent care tax credit "an unjustified tax break for upper-income families"); Roland L. Hjorth, *A Tax Subsidy for Child Care: Sec. 210 of the Revenue Act of 1971*, TAXES, Mar. 1972, at 133; Philip K. Robins, *Child Care Policy and Research: An Economist's Perspective*, *in* THE ECONOMICS OF CHILD CARE 11, 14-21 (David M. Blau ed., 1991); *see also* William D. Popkin, *Household Services and Child Care in the Income Tax and Social Security Laws*, 50 IND. L.J. 238, 245-46 (1975) (concluding that child care expenses should be viewed as a personal expense, but that they should nevertheless be deductible to enhance neutrality); Shaller, *supra* note 15, at 613 & n.171 (recognizes that child care expenses are mixed business and personal expenses, but then states that the tax benefits "subsidize" the child care of affluent persons).

The problems in determining the correct treatment for child care expenses are very similar to those presented by commuting.[28] Some perspective for the former can be obtained by examining the tax treatment of the latter. Like child care, commuting involves both business and personal factors. The need for commuting depends on the location of one's place of employment and the location of one's residence. The connection with place of employment indicates that commuting is a deductible business expense; the connection with a personal residence indicates that commuting is a nondeductible personal expense. Probably, the correct conceptual answer depends on a taxpayer's choices and preferences and varies for different persons.[29] Yet the rule that commuting is nondeductible is well established[30] and subject to very few exceptions.[31] The nondeductibility of commuting costs demonstrates that failure to allow full deductibility for work-related child care expenses cannot simply be condemned as irrational hostility to the modern family, but provides little additional guidance.[32] The location of one's residence, while important, is a much less sensitive topic than child care costs. An easily administered rule that at least arguably advances desirable social policy[33] is acceptable for commuting costs, but we need a more exacting rule concerning the tax consequences of child care expenses.

III. CREDIT NOT APPROPRIATE

The nonrefundable credit for dependent care expenses allowed under current law results in the taxpayer offsetting her tax liability by a percentage of a base amount, which is the amount expended on

28. *See* Popkin, *supra* note 27, at 245.

29. *See* William A. Klein, *Income Taxation and Commuting Expenses: Tax Policy and the Need for Nonsimplistic Analysis of "Simple" Problems*, 54 CORNELL L. REV. 871, 871-74 (1969).

30. *See* Commissioner v. Flowers, 326 U.S. 465, 469-70 (1946); Anderson v. Commissioner, 60 T.C. 834, 835 (1973); Treas. Reg. § 1.262-1(b)(5) (as amended 1972); Treas. Reg. § 1.162-2(e) (1960).

31. For an example of an exception, see Pollei v. Commissioner, 877 F.2d 838, 842 (10th Cir. 1989) (holding that police captains could deduct cost of driving from their residence to headquarters because they were required to perform services such as monitoring police calls while commuting).

32. *But see* Popkin, *supra* note 27, at 245 (concluding that commuting expenses are considered personal, so child care expenses also should be considered personal).

33. An argument for nondeductibility of commuting costs is that we do not want to encourage those who work in the downtown areas of cities to live in the suburbs. *See* Moss v. Commissioner, 758 F.2d 211, 212 (7th Cir. 1985) ("To allow a deduction for commuting would confer a windfall on people who live in the suburbs and commute to work in the cities. . . .").

dependent care subject to various conditions.[34] If the base amount is $2000, a 20% credit would reduce tax liability by $400. If, unlike current law, the credit were refundable, any excess of the $400 over the tax liability would be paid to the taxpayer. Because the benefit from a credit does not depend on the taxpayer's marginal rate, a credit is not consistent with the general principles of an income tax.

Consider, for example, two taxpayers, Rich and Poor, with taxable incomes of $50,000 and $10,000 respectively. Assume that Rich is subject to a 50% marginal tax rate and Poor is subject to a 10% marginal rate, but each spends $2000 for work-related child care in the taxable year. A fixed credit of 20% would result in an equivalent tax reduction of $400 for each, despite Rich's higher marginal rate. It is inconsistent with the different marginal rates that each receives the same tax benefit from the expenditure. If the $2000 for child care were considered to be a business expense in the same way that rent for an office normally would be, the $2000 expenditure should reduce Rich's tax liability by $1000 and Poor's by $200.[35] With the 20% credit, Rich receives less favorable treatment than if the child care expenses were considered a valid business expense, and Poor receives better treatment.

Many would argue that the result described above is not so bad. The credit benefits the poor more and the rich less than a deduction would—probably not a terrible outcome. The problem is that a child care credit is not an appropriate method of providing general assistance to low income persons. To see this, compare Poor to Very Poor who has an income of $8000 and who leaves her child with a grandparent and thus has no expenses for child care; recall that Poor has income of $10,000 and $2000 of child care expenses. Poor's income after child care expenses, but before taxes, is $8000, the same as Very Poor's, and thus Poor cannot be worse off economically than Very Poor. Poor pays for child care and, in the absence of the income tax, still has as much to spend on items other than child care as Very Poor, who pays nothing for child care. In fact, it is likely that Poor is better off economically than Very Poor. Very Poor might prefer purchased child care to leaving

34. *See* I.R.C. § 21 (West Supp. 1997). The percentage allowed varies with income. *See id.* § 21(a)(1)-(2). For taxpayers with adjusted gross income equal to or below $10,000, the credit is 30% of qualifying expenditures. *See id.* The percentage is reduced, but in no event less than 20%, by one percentage point for each $2000 (or fraction of $2000) that adjusted gross income exceeds $10,000. *See id.*

35. A business expense reduces ability to pay, and therefore a business expense should be deducted when determining the tax base. *See* I.R.C. § 162 (West Supp. 1997). With a $2000 business deduction, Rich's taxable income becomes $48,000 and Poor's becomes $8000. Given their respective tax brackets, Rich's reduction in taxable income reduces her tax liability by $1000 and Poor's by $200.

ıer child with the grandparent, but cannot afford the $2000 that it would ;ost. Very Poor would then view Poor as able to afford more desirable ;hild care and still able to spend as much on other items as Very Poor. A tax credit for child care is troublesome because Very Poor will, in most cases, have a higher tax liability than Poor. To see this, assume that both Poor and Very Poor are subject to a flat 10% tax and that there is still a 20% credit for child care expenses. Poor's tax liability is $600 and Very Poor's is $800.[36] That Poor pays less income tax cannot be justified by the basic tenet of an income tax, which is that those with greater ability to pay have higher tax liability.

The same problem is present if the child care credit is refundable. Assume that incomes below $10,000 are not subject to tax, but there is a 20% refundable tax credit for child care expenses. Poor is now entitled to a $400 payment, while Very Poor receives nothing. As discussed immediately above, the payment to Poor cannot be justified by the relative economic position of Poor and Very Poor.

Of course, tax credits for child care help achieve goals that are not directly related to income and ability to pay. Although full discussion of the various benefits and problems in subsidizing child care is beyond the scope of this Article, my belief is that the case for child care credits is more limited than most persons realize. For example, child care tax credits, particularly refundable credits, may be viewed as an appropriate policy for encouraging parents to work. However, the earned income credit, which provides benefits to low-income parents who work,[37] is a much better way of promoting this policy. The earned income credit provides greater benefits to those with two children than those with only one,[38] and could be expanded to take account of more than two children.[39] With the earned income credit, the choice between different types of child care assistance is not distorted. Those utilizing a

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36. Poor's tax liability before the credit is $1000 (10% of $10,000). The credit for child care expenses is $400 (20% of $2000), and Poor's net tax liability is $600 ($1000-$400). In contrast, Very Poor has tax liability of $800 (10% of $8000).

Very Poor will have a higher tax liability than Poor whenever the credit for child care expenses exceeds the extra tax liability that results from Poor's $2000 of additional income. This generally will occur when the percentage for the partial credit exceeds Poor's marginal tax bracket.

37. *See* I.R.C. § 32 (West Supp. 1997). The earned income credit does provide a limited benefit to persons over 25 who are not supporting any children. *See id.* The maximum benefit in 1997 is only $332, and this benefit offsets social security and Medicare taxes for low income persons. *See* Rev. Proc. 96-59, § 3.03, 1996-53 I.R.B. 17. In comparison, the maximum benefit is $2210 for a parent with one child, and $3656 for a parent with two children. *See id.*

38. *See supra* note 37.

39. *See* Lawrence Zelenak, *Children and the Income Tax*, 49 TAX L. REV. 349, 401-04 (1994).

grandparent for child care are not encouraged by a subsidy to use a paid provider. Any assistance is provided directly to the parent, who can decide how to utilize the additional resources for the family's benefit.

Furthermore, the argument that government should provide extra help to those who have no choice but to use more expensive child care does not justify a tax credit. The government should not encourage those who must pay for child care to work more than it encourages others, who may receive a lower wage or have other costs such as long commutes. The argument can be illustrated using Poor from the discussion above. Poor, with income of $10,000 and child care expenses of $2000, can be compared with two other persons, one with income of $10,000 and one with income of $8000. Assume that each of these newly introduced persons leaves her one child with a grandparent, and thus neither has child care expenses. It is certainly arguable that Poor should be able to deduct the $2000 child care expenses and have the same tax liability as the person earning $8000; both are receiving the same net return from working and are in similar economic circumstances.[40] It also may be argued that Poor should receive the same treatment as the person with income of $10,000 and no child care expenses. Both are receiving the same gross wage income and that may be the relevant determinant for governmental assistance. There is, however, no obvious reason that Poor should receive better tax treatment, or greater encouragement to work, than either of the other two persons. A refundable credit often would do exactly that.[41]

It is, of course, possible to construct policy goals that require child care tax credits, particularly for low income persons. One example is a mandate that everyone should work, with financial assistance (that is just high enough to make the mandate feasible) provided to those with extra expenses like child care.[42] Obviously, the adoption of such a program would only have an impact on those with incomes at or near the poverty level. A second example is a policy of encouraging parents

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40. The possibility of deducting child care expenses when computing the earned income credit is discussed in Part VI. *See infra* notes 195-96 and accompanying text.

41. Any refundable credit for child care would result in Poor receiving greater benefits than the person who earns $10,000 (as does Poor), but who has no child care expenses. Poor also will receive greater benefits than the person who earns $8000 provided any reduction in Poor's benefits from any tax liability arising from extra income is less than the amount of the credit.

42. A goal of the most recent welfare reform bill is that most people will work rather than receive welfare benefits. *See generally* Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. 104-193, 110 Stat. 649. However, there is no guarantee of child care for those who are trying to work. *See* JOEL F. HANKLER & YEHESKEL HASENFIELD, WE THE POOR PEOPLE 6-7, 207-08 (1997).

to spend more on child care than they otherwise would because their children will benefit. However, families might benefit more from unconditional benefits, such as the earned income credit or the recently enacted per-child credit, than from incentives to spend more on child care.[43] In fact, it is not even clear that increased expenditures by parents on child care will lead to better outcomes for their children.[44] Finally, use of tax or other incentives for child care probably would be limited to low income parents. A reasonable expectation is that middle and high income parents can adequately provide for their own children, although regulation may be appropriate to protect children's welfare.[45] My conclusion is that special subsidies or incentives for child care are needed in a few limited situations, but the goal of a theoretically appropriate treatment of child care costs based on neutrality and fairness should remain paramount for most taxpayers.

IV. LEGISLATIVE HISTORY

A. *Background Prior to 1954*

Until 1954 no provision in the Internal Revenue Code specifically allowed a tax benefit for child care expenses. In *Smith v. Commis-*

43. It can be argued that the best way to help low income families is to give them extra money and let them decide how to spend it. Presumably, they know better than the government what their greatest needs are. On the other hand, there is a public interest in the child's welfare. The intent may be to focus aid so that it results in higher quality child care whether or not the parents think that is their most pressing need. A recent study, however, has found that the quality of child care has only a small impact on both the child's cognitive development and the mother-child relationship. *See* NATIONAL INSTITUTE OF CHILD HEALTH AND HUMAN DEVELOPMENT, MOTHER-CHILD INTERACTION AND COGNITIVE OUTCOMES ASSOCIATED WITH EARLY CHILD CARE: RESULTS OF THE NICHD STUDY (1997). For discussion of the study, see Press Release from National Institutes of Health, *Results of the NICHD Study of Early Child Care Reported at Society for Research in Child Development Meeting* (Apr. 3, 1997); Sue Shellenbarger, *Child Care May Affect Bond to Mother*, WALL ST. J., Apr. 4, 1997, at A5.

44. Parents' satisfaction with current child care arrangements seems to depend more on convenience of hours and location than on factors like child-staff ratio and provider training. *See* David M. Blau, *The Quality of Child Care: An Economic Perspective*, *supra* note 27, at 145, 157, 167; *see also* Sandra L. Hofferth & Douglas A. Wissoker, *Price and Quality in Child Care Choice: A Revision*, 31 J. HUMAN RES. 703 (1996) (finding that child-staff ratio is relatively unimportant to parents); Sandra L. Hofferth & Douglas A. Wissoker, *Price, Quality, and Income in Child Care Choice*, 27 J. HUMAN RES. 70 (1992) (same). *But see* Ellen Kisker & Rebecca Maynard, *Quality, Cost, and Parental Choice of Child Care*, *supra* note 27, at 127, 141 (arguing for consumer education and incentives for high quality child care).

45. *See generally* SUSAN KONTOS ET AL., QUALITY IN FAMILY CHILD CARE AND RELATIVE CARE 85-92 (1995) (finding that regulated providers provide higher quality care). *But see* Blau, *supra* note 44, at 167 (noting the possible adverse effects of regulation).

sioner,[46] however, the taxpayers, a married couple, argued that a deduction for child care expenses should be allowed as a general business expense.[47] The facts, which were stipulated, presented the issue of whether parents could ever deduct such expenses. Both husband and wife worked, and they hired "nursemaids to care for [their] young child."[48] The government did not contest that the wife could not work without the nursemaid's services.[49]

In a short opinion, the Board of Tax Appeals disallowed the deduction.[50] It considered child care, "like similar aspects of family and household life,"[51] an inherently personal expense.[52] According to the Board, child care is one of those activities "which, though they may in some indirect and tenuous degree relate to the circumstances of a profitable occupation, are nevertheless personal in their nature, of a character applicable to human beings generally, and which exist on that plane regardless of the occupation . . . of the individuals concerned."[53]

The Board's opinion now seems quite unsophisticated.[54] For example, it compared child care with food, clothing, and shelter, and stated that such items "are the very essence of those 'personal' expenses the deductibility of which is expressly denied."[55] The Board ignored the fact that people must eat, clothe themselves, and have shelter whether or not they work, but that parents can avoid costs of child care by staying home. The Board, however, would have found this distinction irrelevant. It reasoned that child care expenses are a cost of raising children and that raising children is always personal.[56] The Second Circuit affirmed the decision without an opinion, and other cases readily followed its holding.[57]

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46. 40 B.T.A. 1038 (1939), *aff'd per curiam*, 113 F.2d 114 (2d Cir. 1940).

47. *See id.* at 1038-39.

48. *Id.* at 1038.

49. *See id.* at 1038-39. It was apparently assumed by both the Board and the taxpayers that, if not for the nursemaid, the wife would not work outside the home and would stay home with the child.

50. *See* 40 B.T.A. 1038 (1939).

51. *Id.* at 1039.

52. *See id.*

53. *Id.* at 1039-40.

54. For thorough analyses of the opinion, see Blumberg, *supra* note 26, at 63-66; Alan L. Feld, *Deductibility of Expenses for Child Care and Household Services: New Section 214*, 27 TAX L. REV. 415, 416-18 (1972); William A. Klein, *Tax Deductions for Family Care Expenses*, 14 B.C. INDUS. & COM. L. REV. 917, 917-19 (1973).

55. *Smith*, 40 B.T.A. at 1039.

56. *See id.*

57. *See* King v. Commissioner, 19 T.C.M. (CCH) 1519 (1960) (single parent); Lorenz v. Commissioner, 8 T.C.M. (CCH) 720, 722 (1949); Hauser v. Commissioner, 8 T.C.M. (CCH) 384, 384-85 (1949); O'Connor v. Commissioner, 6 T.C. 323, 324 (1946).

B. *Limited Deduction: 1954-1976*

In 1954 Congress enacted a limited deduction for dependent care expenses "but only if such care is for the purpose of enabling the taxpayer to be gainfully employed."[58] Under section 214 a working parent could deduct a maximum of $600[59] for care of a dependent child who had not attained the age of twelve or of another dependent who could not care for herself.[60] The deduction was only allowable to a "taxpayer who is a woman or a widower,"[61] but the Code defined a widower to include a man "legally separated from his spouse."[62] For married, working women whose husbands also could work, the Code reduced the $600 maximum dollar for dollar as adjusted gross income exceeded $4500,[63] and thus the deduction was completely phased out when family income reached $5100. Unmarried women and women whose husbands were unable to work because of disability, as well as qualifying men, were not subject to the income phase out.[64] On the other hand, married men, men who had never been married, and men whose wives were unable to work were not entitled to any deduction.[65]

The House Ways and Means Committee and the Senate Finance Committee viewed child care expenses as "comparable to an employee's business expenses,"[66] but only for those who were forced by economic or other circumstances to work. Thus, the House bill in 1954 had only allowed the deduction for "expenses paid by a working widow, widower, or divorced person, or a working mother whose husband is incapacitated."[67] The Senate Finance Committee, however, recognized that in many low income families, "the earnings of the mother are essential for the maintenance of minimum living standards,"[68] and thus

58. I.R.C. § 214(a) (1954).

59. *See id.* § 214(b)(1)(A).

60. *See id.* § 214(c)(1).

61. *Id.* § 214(a).

62. *See id.* § 214(c)(2).

63. *See id.* § 214(b)(2).

64. *See id.*

65. For discussion of the "illogical quirks" that resulted from the definitions and eligibility rules, see Klein, *supra* note 54, at 921-25; *see also* Holmes v. Commissioner, 30 T.C.M. (CCH) 1426, 1426-28 (1971) (holding that classification according to gender was constitutional); *The Child Care Deduction: Issues Raised by Michael and Elizabeth Nammack and the Pending Amendment to Section 214*, 13 B.C. INDUS. & COM. L. REV. 270, 279-80 (1971) (arguing that classification was constitutional). *But see* Moritz v. Commissioner, 469 F.2d 466, 470 (10th Cir. 1972) (holding that classification was unconstitutional), *rev'g* 55 T.C. 113 (1970).

66. H.R. REP. NO. 83-1337, at 30 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4025, 4055; S REP. NO. 83-1622, at 36 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4621, 4667.

67. H.R. REP. NO. 83-1337, at 30, *reprinted in* 1954 U.S.C.C.A.N. 4025, 4055.

68. S. REP. NO. 83-1622, at 36, *reprinted in* 1954 U.S.C.C.A.N. 4621, 4667.

the final bill allowed the deduction to low-income families where both spouses worked.[69] Apparently, Congress considered child care expenditures a personal expense if a parent could stay home with a child, but a business expense where it might be concluded that the parent was forced to work.

In one important aspect the design of this new deduction defied explanation. Congress made it an itemized deduction, and thus it only benefitted those who did not use the standard deduction. In 1954, 72.3% of individual returns used the standard deduction,[70] and those with lower incomes probably disproportionately used it.[71] Therefore, in many cases, the deduction for child care expenses did not benefit those for whom it was intended. Furthermore, classification as an itemized deduction also was inconsistent with the determination that child care expenses were a cost of working. If child care expenses were considered a cost of working,[72] they should have been deductible whether or not the taxpayer used the standard deduction.[73]

In 1963 and 1964 Congress somewhat liberalized eligibility for the child care deduction,[74] but retained the basic framework and continued to provide different rules for men and women.[75] In 1964, Congress also

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69. *See supra* note 63 and accompanying text.

70. *See* U.S. DEP'T OF TREASURY, STATISTICS OF INCOME BULLETIN, SELECTED HISTORICAL DATA 45, 54 (Summer 1989).

71. The standard deduction was 10% of adjusted gross income, up to a maximum of $1000. *See* Revenue Act of 1948, Pub. L. No. 80-471, § 302, 62 Stat. 110, 114-15. For a history of the standard deduction, see Allan J. Samansky, *Nonstandard Thoughts About the Standard Deduction,* 1991 UTAH L. REV. 531, 532-39. Since itemized deductions probably increase disproportionately as income increases, the standard deduction would be used disproportionately by lower income persons. In addition, the $1000 limitation would clearly make the standard deduction less useful to higher income persons. Subsequently, on three separate occasions the Senate approved amendments that would have made the deduction for child care and household expenses allowable whether or not the taxpayer used the standard deduction. *See* 121 CONG. REC. 7991-8017 (1975); 118 CONG. REC. 33,868-73 (1972); 117 CONG. REC. 40,933-35 (1971). This provision, however, was never in the bill reported out of the Conference Committee. *See* H.R. CONF. REP. NO. 94-120, at 59 (1975); H.R. CONF. REP. NO. 92-1605 (1972); H.R. CONF. REP. NO. 92-708, at 42-43 (1978).

72. *See* 118 CONG. REC. 33,869 (1972) (statement of Sen. Tunney) (stating that child care expenses are work-related expenses).

73. Costs of employment generally have been deductible in determining adjusted gross income, and thus can be deducted whether or not the standard deduction is utilized. *See* I.R.C. § 62(a)(1) (West Supp. 1997). An exception is made for most employee expenses, *see id.*, but the need for child care does not depend on whether the taxpayer is self-employed.

74. *See* Revenue Act of 1964, Pub. L. No. 88-272, § 212(a), 78 Stat. 19, 49 (1964) (allowing deduction to married men whose wives were incapacitated or institutionalized); Child Care Expenses Act, Pub. L. No. 88-4, 77 Stat. 4 (1963) (removing women who had been deserted by their husbands from income phase out).

75. *See* sources cited in *supra* note 74.

increased the maximum deduction to $900 if there were two or more dependents[76] and increased the level of income at which the phase out started to $6000.[77] In addition, Congress increased the age of a qualifying child by one year, so a child who had not reached the age of thirteen was eligible.[78]

In 1971, section 214 was substantially revised.[79] Congress eliminated the differences between men and women, as well as differences between married and unmarried persons, but did require that, for married taxpayers, both spouses had to be "gainfully employed on a substantially full-time basis"[80] unless one was "physically or mentally incapable of caring for himself."[81] Congress also raised the limits on the maximum deduction and on maximum income for the phase out. For child care in the taxpayer's home, the revisions allowed a deduction of up to $400 per month.[82] The income phase out began at $18,000 with the maximum amount deductible reduced by one half of the excess of adjusted gross income over $18,000.[83] Therefore, no deduction was allowed to those with incomes above $27,600. The age of a qualifying child was increased by two years, so children under the age of fifteen qualified.[84] Finally, expenses for household services, as well as expenses of caring for a qualifying person, were deductible if the taxpayer "maintain[ed] a household" that included a qualifying person as a member.[85] Nevertheless, Congress continued with the same underlying rationale for the deduction. Child care expenses were "to some extent like an employee's

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76. *See* Revenue Act of 1964, Pub. L. No. 88-272, § 212, 78 Stat. 19, 49 (amending § 214(b)(1)(B)).

77. *See id.* (amending § 214(b)(2)(B)).

78. *See id.* (amending § 214(d)(1)(A)).

79. *See* Revenue Act of 1971, Pub. L. No. 92-178, § 210, 85 Stat. 497, 518. For more comprehensive discussions of the statute after the Revenue Act of 1971, see Feld, *supra* note 54, at 421-46; John B. Keane, *Federal Income Tax Treatment of Child Care Expenses*, 10 HARV. J. ON LEGIS. 1, 7-26 (1972).

80. Revenue Act of 1971, § 210 (incorporated in § 214(e)(2)(A)).

81. *Id.* (incorporated in § 214(b)(1)(C), (e)(2)(B)).

82. *See id.* (incorporated in § 214(c)(1)). The maximum deduction was available for child care inside the home. *See id.* For child care outside the home up to $200 of the maximum could be used if there was one child or other qualifying individual, up to $300 if two children or other qualifying individuals, and up to $400 if three or more. *See id.* (incorporated in § 214(c)(2)).

83. *See id.* (incorporated in § 214(d)).

84. *See id.* (incorporated in § 214(b)(1)(A)).

85. *Id.* (incorporated in § 214(a)). An amendment to the Senate Bill, which passed by a 74 to 1 vote, would have made the deduction available to those who use the standard deduction. *See* 117 CONG. REC. 40,933-35 (1971). However, this provision did not survive in the Conference Committee. Discussion of the amendment stressed that too many families, particularly low income families, were not utilizing the credit because they did not itemize deductions. *See id.* at 40,933-34 (comments by Sen. Tunney); *id.* at 40,934 (comments by Sen. Long).

business expenses,"[86] but the deduction should only be available to families whose circumstances required them to work.

In the preliminary portion of its report accompanying the Revenue Act of 1971, entitled "Reasons for the Bill," the Senate Finance Committee added a novel justification for the deduction: "encourag[ing] the employment of individuals in child care and domestic service."[87] Expansion of the deduction for child care expenses was seen as a way of reducing the cost of welfare.

> [The bill] can be expected to give large numbers of individuals who are now receiving public assistance the opportunity to perform socially desirable services in jobs . . . which are vitally needed. At the same time, it will help to remove these individuals from the welfare rolls and reduce the cost of providing public assistance.[88]

It certainly is questionable whether allowing tax benefits to relatively affluent families is an efficient way of helping persons on welfare. In any event, Congress hopefully has abandoned this reason for tax benefits for child care expenditures.

In 1975, the Senate was willing to make radical changes in the deduction for child care expenses.[89] While the final bill did not adopt these provisions, it almost doubled, to $35,000, the adjusted gross income level at which the phase-out of the deduction began.[90] Therefore, taxpayers with incomes above $44,600 were not allowed any deduction.

C. *Credit for Child Care Expenses*

In the Tax Reform Act of 1976, Congress replaced the deduction for household and dependent care expenses with a partial nonrefundable credit.[91] New Internal Revenue Code section 44A allowed a 20%

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86. S. REP. No. 92-437 (1971), *reprinted in* 1971 U.S.C.C.A.N. 1918, 1966.

87. *Id.*, *reprinted in* 1971 U.S.C.C.A.N. 1918, 1929.

88. *Id.*

89. *See* 121 CONG. REC. 7991-8017 (1975) (amendment introduced by Sen. Tunney). The bill would have removed limits on deductible expenditures, as well as on income, and would have changed "the deduction from an itemized deduction . . . to a 'business deduction,'" which would be "deductible from gross income in determining" adjusted gross income. H.R. CONF. REP. No. 94-120 (1975), *reprinted in* 1975 U.S.C.C.A.N. 122, 124-25; 121 CONG. REC. 7991-92 (1975) (§ 4 of amendment introduced by Sen. Tunney). It also would have allowed an optional tax credit for 50% of allowable expenses, up to a maximum of $50 per month. *See* 121 CONG. REC. 7991-92 (1975) (§ 5 of amendment introduced by Sen. Tunney).

90. *See* Tax Reduction Act of 1975, Pub. L. No. 94-12, § 206, 89 Stat. 28, 32.

91. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 504, 90 Stat. 1520, 1563. In the bills that had been approved by both the House Ways and Means Committee and the Senate

nonrefundable credit for a maximum of $2000 in child care expenses for one child under the age of fifteen, and $4000 for two or more children.[92] Among other major changes, section 44A no longer limited benefits to parents with moderate incomes.[93] The requirement that parents work substantially full time also was replaced by a condition that qualifying expenses could not exceed the parent's earned income, if unmarried, or the lesser of either spouse's earned income, if married.[94]

The Congressional Reports give the following reasons for the change from a deduction to a credit.

> Treating child care expenses as itemized deductions denies any beneficial tax recognition of such expenses to taxpayers who elect the standard deduction. Your committee believes that such expenses should be viewed as a cost of earning income for which all working taxpayers may make a claim. . . . While deductions favor taxpayers in the higher marginal tax brackets, a tax credit provides more help for taxpayers in the lower brackets.[95]

Congress' reasoning for a credit certainly seems muddled. The denial of benefits under prior law to those who use the standard deduction could have been cured simply by allowing the deduction whether or not the standard deduction is used.[96] For example, nonemployee business expenses always have been deductible regardless of whether the standard

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Finance Committee, the credit was nonrefundable. *See* H.R. 10,612, 94th Cong. § 504 (1975) (reported by House Ways and Means Committee on Nov. 12, 1975); S. REP. NO. 94-938, at § 505 (1976) (reported by Senate Finance Committee on June 10, 1976). However, an amendment introduced on the Senate floor and approved by the Senate would have made the credit refundable. *See* 122 CONG. REC. 23,113-17 (1976) (Amendment No. 2014). The Conference agreement followed the House bill in this respect and in the final bill the credit was nonrefundable. *See* The Reform Act of 1996, Pub. L. No. 94-455, § 504, 90 Stat. 1520, 1563.

92. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, § 504, 90 Stat. 1520, 1563-64 (incorporated in § 44A(a), (d)).

93. *See id.*

94. *See id.* (incorporated in § 44A(e)(1)). There were exceptions to the earned income limitation if one spouse is a student or unable to care for herself. *See id.* (incorporated in § 44A(e)(2)).

95. H. REP. NO. 94-658, at 147 (1975), *reprinted in* 1976-3 C.B. 695, 839 (Vol. 2); S. REP. NO. 94-938 (1975), *reprinted in* 1976-3 C.B. 49, 170 (Vol. 3).

96. On three prior occasions the Senate had enacted bills that would have made the deduction for child care expenses deductible directly from adjusted gross income and thus would have allowed the deduction whether or not the taxpayer used the standard deduction. *See* 121 CONG. REC. 7991-8017 (1975); 118 CONG. REC. 33,868-73 (1972); 117 CONG. REC. 40,933-35 (1971).

deduction is used.[97] Furthermore, viewing child care as a "cost of earning income"[98] implies that a deduction is appropriate; the fact that a credit "provides more help for taxpayers in lower brackets"[99] is irrelevant if the item is a cost of earning income. No one suggests that a credit for office supplies is appropriate for this reason. What Congress did is consistent with providing a subsidy for child care rather than an attempt to tax income.

In 1981, Congress increased the credit percentage for taxpayers with adjusted gross income below $28,000.[100] The credit percentage was 30% for those with adjusted gross income below $10,000 and decreased by one percentage point for every $2000 increase in adjusted gross income until adjusted gross income reached $28,000.[101] For those with higher incomes, the credit percentage remained at 20%.[102] This change is certainly consistent with viewing section 44A as a subsidy for socially important expenditures, and inconsistent with viewing it as a cost of earning income. In 1981, Congress also raised the maximum annual expenses eligible for the credit from $2000 for one child and $4000 for two or more children, to $2400 and $4800 respectively.[103]

The changes in 1981 were significant, but not dramatic. Furthermore, since 1981 there have been no major changes in the child care credit, although in 1984 Congress moved the credit from section 44A to section 21.[104] In contrast, there have been major changes in other tax provi-

97. *See* I.R.C. § 62(a)(1) (West Supp. 1997).

98. H. REP. NO. 94-658, at 147 (1975), *reprinted in* 1976-3 C.B. 695, 839 (Vol. 2); S. REP. NO. 94-938 (1975), *reprinted in* 1976-3 C.B. 49, 170 (Vol. 3).

99. *Id.*

100. *See* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 124(a), 95 Stat. 172, 197-98 (incorporated in § 44A(a)). A relatively minor change had been made in 1978 to allow payments to grandparents to qualify for the credit. *See* Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, 2770 (incorporated in § 44 A(f)(6)).

101. *See* Economic Recovery Tax Act of 1981, § 124(a).

102. *See id.*

103. *See id.* § 124(b) (incorporated in § 44A(d)).

104. *See* Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 471(c), 98 Stat. 494, 826. The other bills amending § 44A and its successor, § 21, include the following: Family Support Act of 1988, Pub. L. No. 100-485, § 703(a)-(c), 102 Stat. 2343, 2426-27 (changing the age of qualifying children from 15 to 13, reducing the amount of the child care credit by the amount claimed under § 129, and requiring taxpayer identification numbers for child care providers); Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10101, 101 Stat. 1330-384 (disallowing credit for overnight camps); Tax Reform Act of 1986, Pub. L. No. 99-514, § 104(b)(1)(A), 100 Stat. 2085, 2104 (making a technical change); Social Security Amendments of 1983, Pub. L. No. 98-21, § 122(c), 97 Stat. 65, 85 (making a technical change); *see also* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11114, 104 Stat. 1388-1, 1388-414 (establishing a program to increase taxpayer awareness of dependent care credit and other provisions).

sions and the economy. For example, in 1976 marginal tax rates for individuals varied between 14% and to 70%.[105] The Economic Recovery Tax Act of 1981 lowered the maximum rate to 50%,[106] and then the Tax Reform Act of 1986 instituted just two rates, 15% and 28%.[107] After further tinkering, Congress introduced a maximum rate of 39.6% in 1993.[108] The impact of a 20% percent credit for child care expenses, incurred so that a parent may work, will vary greatly if the parent is subject to a marginal rate of 39.6% on earned income, rather than 28%.[109] Yet for most taxpayers the percentage of credit has remained at 20% since 1976.

There also have been major changes in the taxation of low income persons. In 1976, a married couple with two children filing jointly owed no income taxes if their taxable income was equal to or less than $5100.[110] However, in 1997, a similar married couple owed no income

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In 1989 and 1990 major changes to the dependent care tax credit were approved by both the Senate Finance Committee and the entire Senate. *See* S. 1185, 101st Cong. (1989), *reprinted in* 135 CONG REC. S6637 (daily ed. June 14, 1989) (Senate Finance Committee bill, the Child Care and Health Insurance Act); S. 5, 101st Cong. (1989), *reprinted in* 135 CONG. REC. S7479-99 (daily ed. June 23, 1989) (Act for Better Child Care Services); STAFF OF JOINT TAXATION COMMITTEE, 101ST CONG., BUDGET RECONCILIATION: REVENUE PROPOSALS AS APPROVED BY THE SENATE COMMITTEE ON FINANCE ON OCT. 13, 1990 (Comm. Print 1990) (Senate Finance Committee bill); S. 3209, 101st Cong. § 7302 (1990) (Revenue Reconciliation Act of 1990); *see also* S. 601, 101st Cong. (1989), *reprinted in* 135 CONG. REC. S2571, S2721-23 (daily ed. Mar. 15, 1989) (containing President Bush's proposal, introduced by Senator Dole, giving parents a choice between refundable dependent care credit or new child credit). For discussion of the proposed legislation in 1989, see American Bar Association, *supra* note 15.

105. *See* I.R.C. § 1 (1976).

106. *See* Pub. L. No. 97-34, § 101(a), 95 Stat. 172, 176 (1981).

107. *See* Pub. L. No. 99-514, § 101(a), 100 Stat. 2085, 2096 (1986). For high income taxpayers the effective marginal tax rate was increased by 5 percentage points to 33% because of the phase out of the 15% rate and the personal exemptions. *See id.* (incorporated in I.R.C. § 1(g) (1986)).

108. *See* Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, § 13202(a), 107 Stat. 312, 461.

109. Consider a person who decides to work for a salary of $10,000, but who will incur $10,000 in child care expenses. Assume a 40% tax rate (rounded up from 39.6%) and a 20% credit for the child care expenses. The person's tax liability increases by $2000 because of the employment ($4000 initial tax increase minus credit of $2000), although income net of child care costs has not increased at all. The income tax will have a significant effect on the person's decision of whether to work or not.

On the other hand, assume a 30% tax rate (rounded up from 28%) and a 20% credit for the child care expenses. The person's tax liability now increases by only $1000 because of the employment ($3000 initial tax increase minus credit of $2000). Thus, the tax liability has decreased by 50% (from $2000 to $1000) although the tax rate has declined by only 25% (from 40% to 30%). The reason is that the 20% credit neutralizes more of the income tax when the tax rate is 30% rather than 40%. When tax rates decline, the impact of the income tax on the decision to work is disproportionately reduced because of the child care credit.

110. *See* I.R.C. §§ 141(c), 151(b)-(c) (1976). The low income allowance (or minimum

taxes if their taxable income was equal to or less than $17,500.[111] Because those who do not owe any taxes receive no benefit from the child care credit, the number of low income persons who can utilize the child care credit has been reduced. Consequently, the increased percentage credit for those with adjusted gross incomes below $28,000 now benefits relatively few persons.

There also have been major changes in the economy since 1976. Perhaps the most dramatic change has been the effect of inflation. According to the consumer price index, prices were 182% higher in 1997 than in 1976.[112] The maximum amount of child care expenses eligible for the credit is particularly in need of revision. The 20% increase in 1981 is inadequate.[113]

D. *Exclusion from Income*

In 1981, Congress not only liberalized the credit for qualifying child care expenses,[114] but also enacted section 129,[115] which excludes from an employee's gross income amounts paid or incurred for dependent care assistance.[116] The employer must adopt a qualifying plan, which may directly provide dependent care benefits or, more likely, allow an employee to make voluntary contributions to reimbursement accounts (often called flexible spending accounts).[117] A reimbursement account refunds to the employee amounts spent for child care. The exclusion is generally more valuable than the credit to employees who are in a 28% or higher tax bracket.[118]

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standard deduction) was $2100 and the personal exemption was $750.

111. For 1997 the standard deduction for a couple filing jointly is $6900, and the personal exemption is $2650. *See* Rev. Proc. 96-59, 1996-2 C.B. 392, 395-96 (§§ 3.05, 3.09). Therefore, a married couple with two children could earn $17,600 before they would have any income tax liability. The earned income tax credit is not taken into account because the dependent care credit is offset against tax liability before adjustment for the earned income credit. *See* I.R.C. § 21(d)(1) (West Supp. 1997).

112. The Consumer Price index was 160.5 in 1997 and 56.9 in 1976. *See* Bureau of Labor Statistics, *Bureau of Labor Statistics Data: Most Requested Series* (visited Jan. 29, 1998) <http://stats.bls.gov/top20.html>; U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1997, at 487 (Table No. 752: Consumer Price Indexes (CPI-U), by Major Groups: 1939 to 1996) (1997).

113. *See supra* note 103 and accompanying text.

114. *See supra* notes 100-03 and accompanying text.

115. *See* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 124(e)(1), 95 Stat. 172, 198, 201.

116. *See* I.R.C. § 129(a) (West Supp. 1997).

117. *See id.* § 129(a), (d). Among other requirements, a qualifying plan cannot discriminate in favor of highly compensated employees. *See id.* § 129(d)(2).

118. For a middle or high income person, the dependent care credit results in a tax benefit

The amount excluded under section 129 cannot exceed the earned income of an unmarried taxpayer, or the lesser of either the taxpayer's or her spouse's earned income if she is married.[119] At first, the amount excluded was not subject to any maximum, but in the Tax Reform Act of 1986 Congress provided for a $5000 maximum without regard to the number of children.[120] Congress enacted the $5000 maximum because it believed that it was unfair to provide an unlimited exclusion to those whose employers provided qualifying programs while there was only a limited tax credit for those required to pay their own child care expenses.[121] Nevertheless, the maximum amount excluded under section 129 is substantially more generous than the amount eligible for the credit, which is $2400 for one child and $4800 for two children.[122]

The exclusion of the value of dependent care services from the employee's income is generally equivalent to the inclusion of the equivalent amount and an offsetting deduction. Therefore, section 129 is consistent with the view that qualifying child care services are valid business expenses and should be deductible in the same manner as rent for an office. However, the exclusion is only of value to taxpayers whose employers have a qualifying program.[123] In addition, section 129 originated as one of two amendments approved together on the Senate floor that, among other items, also would have made the child care credit refundable and would have provided a 50% credit to an employer who contracted with day care providers.[124] The supporters

of 20% of qualifying amounts spent on child care. The exclusion results in a tax benefit of 28% of qualifying amounts for a person in the 28% bracket. In addition, amounts qualifying under § 129 are excluded from social security taxes, as well as income taxes. *See* I.R.C. § 3121(a)(18) (West Supp. 1997).

119. *See* I.R.C. § 129(b)(1) (West Supp. 1997). Special rules apply if a spouse is a student or unable to care for herself. *See id.* § 129(b)(2).

120. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 1163(a), 100 Stat. 2085, 2510 (1986). The maximum is $2500 in the case of a married person filing separately. *See id.* The Family Support Act of 1988 required the amount excluded under § 129 to be reduced by an equivalent amount of the expenses eligible for the dependent care credit. *See* Family Support Act of 1988, Pub. L. No. 100-485, § 703(b), 102 Stat. 2343, 2427 (1988).

121. *See* STAFF OF THE JOINT COMM. ON TAXATION, 100TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986, at 816 (Comm. Print 1987); *accord* H.R. REP. NO. 99-426, at 97 (1985), *reprinted in* 1986-3 C.B. 1, 97 (Vol. 2).

122. *See* I.R.C. § 129(c) (West Supp. 1997).

123. In 1991 slightly over one third of full-time employees at medium and large firms were covered by qualifying plans. *See* 1994 GREENBOOK, *supra* note 5, at 708 (citing DEPARTMENT OF LABOR BUREAU OF LABOR STATISTICS, EMPLOYEES BENEFITS IN MEDIUM AND LARGE FIRMS, 1991 (1993)). Presumably a smaller proportion of employees at smaller firms were covered by qualifying plans.

124. *See* 127 CONG. REC. 17,388-94 (1981) (Proposed Amendment 297).

were clearly more concerned about helping parents in need than in establishing child care expenses as a valid business expense.[125]

E. *Conclusion*

Although Congress made some important changes in 1986 and 1988, there has been no real attempt to evaluate tax policy with respect to child care since 1981. One consequence has been that sections 21 and 129 are out of date and, at the very least, various limitations need to be increased to take account of inflation and changes in the tax laws. However, the problem is more serious than this, because former and current provisions involving tax benefits for child care expenses have not been consistent with any underlying principles. Members of Congress, and relevant committees, often have stated that child care should be considered a valid business expense for working parents, but they are not willing to accept the consequence of that view and allow a broad-based deduction. Congress' primary goal probably has been to help parents who are struggling with the demands of work and child care, but it has never enacted a statute that is clearly focused on that goal. Perhaps the realization that a tax provision for child care expenses, standing alone, cannot solve social problems and redistribute income is the underlying reason for its restraint. Certainly, it is time that Congress establish relevant principles for tax treatment of child care expenses, and reevaluate sections 21 and 129.

V. THEORETICAL APPROACH

A. *Introduction—Justifying the Deduction for Business Expenses*

As demonstrated in Section II, costs of child care incurred so that a parent may work are not easily classified as either a business or personal

125. The sponsors of the bill believed that:

> [The two amendments] are a great step forward in trying to insure that the single parents of this country will have an opportunity to work and can afford to do so. . . . [T]he greatest single cost for . . . single parents or even for those who are married and both husband and wife have to work to make ends meet, is day care. This bill will be a weighty factor in their determination to try to enter the work force rather than think to themselves, "It's cheaper to go on welfare because I cannot afford day care."

Id. at 17,388 (Sen. Packwood, cosponsor of both bills); *see also id.* at 17,393-94 (statements of Sen. Cranston, cosponsor of both bills).

expense. Consequently, we need to probe why business, but not personal expenses, are deductible and then determine whether these reasons apply to work-related child care expenses.

Deductibility of business expenses by individuals helps achieve two goals: neutrality and fairness. The goal of neutrality requires tax treatment that minimizes the effect of taxes on allocation of economic resources.[126] Although the analysis may be quite complex, the tax treatment with the least distorting effect involves objective analysis. The policy maker's preferences or prejudices should have no effect. On the other hand, fairness involves our subjective feelings about how taxpayers should share the burden. Objective analysis can take us only so far since notions of fairness are ultimately established by perceptions.[127]

1. Neutrality

A tax is neutral if it does not directly affect economic decisions.[128] Under certain conditions, any change a tax causes in the allocation of resources would result in a less efficient economy.[129] Although these conditions are clearly not satisfied in our economy,[130] the economic effect of a tax is still typically evaluated according to the goal of neutrality.[131] There are, of course, exceptions, such as a tax on polluters that is intended to make the polluter take into account the extra cost

126. Nonuniform taxes probably are required for minimizing the extent to which taxes affect the economy. *See* Eric M. Zolt, *The Uneasy Case for Uniform Taxation*, 16 VA. TAX REV. 39, 64-65 (1996).

127. *See id.* at 86 ("[N]o consensus exists as to precise meaning of concepts like equity.").

128. The critical requirement is that the tax not affect relative prices. Even a lump-sum tax, which must be paid regardless of the taxpayer's behavior, indirectly affects economic decisions because it reduces the wealth or income of those subject to the tax. The reduced income will cause a greater decline in consumption of luxuries than of necessities. However, because a lump-sum tax does not affect relative prices, it will not impose an "excess burden," which is a "loss of welfare above and beyond the tax revenues collected," on an efficient economy. HARVEY S. ROSEN, PUBLIC FINANCE 303, 307 (1995). In contrast, an income tax affects the price of labor (*i.e.*, wages) and, thus, the return from working relative to leisure. Consequently, an income tax does impose an excess burden on an economy that would otherwise be efficient.

129. In this context, the strict definition of efficiency, usually called Pareto Efficiency, is appropriate. According to this definition, one allocation of resources can be said to be more efficient than a second if, under the first allocation, at least one person is better off and no one is worse off. *See id.* at 41. *See generally* Zolt, *supra* note 126, at 61-62.

130. Among other requirements, every industry must be perfectly competitive. *See* Zolt, *supra* note 126, at 61-62.

131. *See* MICHAEL J. GRAETZ, THE DECLINE (AND FALL?) OF THE INCOME TAX 11 (1997) ("Economic efficiency demands that a tax interfere as little as possible with people's economic behavior.").

the pollution imposes on others. The purpose of this tax may be to increase efficiency by increasing the cost of the product causing the pollution. Absent such special circumstances, however, a tax should have as little impact on the allocation of resources as possible.[132] The distortions caused by the tax will, more than likely, impose additional costs (often called a deadweight loss) on the economy.[133] An ideal tax should have as little effect as possible on the incentives for deciding such issues as whether to work and what type of work to pursue.

The deduction for business expenses helps minimize the effect of an income tax on the decision to work for compensation. If the government is going to share in the revenue from an activity, it also should share in the cost of obtaining that revenue. Otherwise, an activity that is profitable before taking account of any income tax may become unprofitable. Furthermore, without a deduction for business expenses, the income tax would greatly alter the decision among different types of remunerative activities. For example, if there were no income tax, a business with gross revenues of $200,000 and expenses of $100,000 would (other things being equal), appear equally as desirable as an activity with gross revenues of $100,000 and no expenses. Deductibility of business expenses would maintain the relative position of these two activities. On the other hand, taxing the gross revenue without allowing a deduction for expenses would result in the second activity becoming much more desirable.

An income tax reduces the benefit of working for monetary compensation, but has no effect on either the benefit of leisure or the return from providing goods and services to oneself.[134] Therefore, an income tax may discourage working for monetary compensation when compared with providing goods and services to oneself.[135] For exam-

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132. *See id.*; Zolt, *supra* note 126, at 63.

133. *See* EDGAR K. BROWNING & JACQUELINE M. BROWNING, PUBLIC FINANCE AND THE PRICE SYSTEM 369 (4th ed. 1994) ("The broad-based income tax does not distort choices among different ways of spending income and is therefore more efficient."); RICHARD A. MUSGRAVE & PEGGY B. MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 293 (5th ed. 1989) ("[M]ore harm might be done by misguided differentiation than would be gained from arriving at efficiency by a differential pattern.").

134. With a comprehensive income tax that taxed all forms of imputed income (including leisure), as well as returns from market transactions, the income tax would have no effect on employment decisions. A comprehensive income tax is a useful theoretical construct for analysis, but is clearly not feasible since it would be impossible to administer.

135. There is some uncertainty about the final result because the income tax not only changes the relative returns between various endeavors, but also reduces total income. The "income effect" may cause an individual to increase employment for monetary compensation. For example, if the individual has the goal of earning a particular amount of money, the reduction in earnings from the tax may encourage her to work more. In contrast, the

ple, with an income tax an individual may be more likely to repair the roof on her house herself than to pay someone else to repair the roof. Her tax liability will not change if she repairs the roof herself, but will increase if she works overtime and uses the additional money to pay someone else to make the repair. It seems clear, however, that the deduction for business expenses is not the appropriate place to rectify the distorting effect of the income tax. Modification of the deduction would only affect those with business expenses, and the different effect on various types of employment would create new distortions.

2. Fairness

A tax is considered fair if individuals are taxed according to their ability to pay. Of course, what determines ability to pay is subject to dispute. Issues can range from includibility in income of benefits from leisure to deductibility of medical expenses.[136] Nevertheless, it is clear that a business expense that provides no personal benefit must be deductible if persons are to be taxed according to their ability to pay. We would all agree that, other things being equal, a person with revenue of $100,000 and $20,000 of expenses incurred to produce that income, but who receives no personal benefit from the expense, has the same ability to pay as another person with income of $80,000 and no expenses. Both persons have $80,000 available to spend on personal consumption.

B. *Neutrality and Child Care Expenses*

1. Effect on the Decision to Work

The cost of child care can (at least theoretically) affect the decision to have children, as well as parents' decisions about working outside the home. There is, however, a crucial difference between the two. The decision to have children becomes irrevocable, while the decision to work outside the home can change as circumstances or preferences change. Consequently, whatever the impact of tax benefits for child care

"substitution effect" reflects the fact that an income tax reduces the return from working for compensation relative to other endeavors and thus discourages employment. *See* ROSEN, *supra* note 128, at 401. The income effect could outweigh the substitution effect, and the net effect of the income tax would cause the individual to work more than she otherwise would. *See generally id.* at 311, 400-02.

136. *See generally* Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45 (1990).

costs on the decision to have children,[137] it is appropriate to evaluate their effect on decisions by parents to work outside the home.

As discussed above, it is generally desirable that taxes change economic choices as little as possible.[138] Although an income tax inevitably reduces the benefit of working for compensation when compared with providing goods and services for one's own benefit, we do not want the effect of the income tax to increase when the taxpayer incurs child care expenses. Therefore, a suitable objective is that the income tax have the same impact on the decision to work whether or not the individual has child care expenses. If this objective is achieved, the tax can be considered neutral with respect to child care expenses.[139] As discussed above, the income tax is generally neutral with respect to various types of employment, although they may involve different amounts of business expenses.[140] Similarly, the income tax should be neutral with respect to persons with and without child care expenses. In fact, as is argued at the end of this section, it is particularly important that the income tax not unduly distort the decision to work by those with child care responsibilities.

If child care expenses would not be incurred but for the parent's employment and if the parent receives no personal benefit from the child care,[141] then neutrality is enhanced by allowing a deduction for the child care expenses. Consider a parent, *P*, who can earn $50,000, but must incur

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137. The next Part discusses the impact of tax benefits for child care costs on the decision to have children.

138. *See supra* notes 128-31 and accompanying text.

139. Although not formally stated, Professor Klein seems to have adopted this definition. *See* Klein, *supra* note 54, at 934 ("If the deduction [for child care expenses with no personal benefit] were disallowed . . . the financial reward of working would be reduced to a net figure below that of other persons with similar net income but with no dependents needing care."). In contrast, Professor Popkin states that the desired neutrality is "between housework and wage work." Popkin, *supra* note 27, at 238. Apparently, the goal is that the income tax not affect the choice between housework and wage work, but that goal is unrealistic. For example, suppose a person is considering working for a salary of $30,000, but would then incur child care expenses of $20,000. Even if the $20,000 in child care expenses were deductible, as Professor Popkin recommends, the income tax distorts the choice of whether to accept the employment. Net income of $10,000 is subject to the income tax, and thus the tax reduces the net reward from working. Consequently, a person might have been willing to accept the employment if she lived in a world without tax, but that same person may decide not to accept the employment when the after-tax net income is only $8000 (assuming a flat 20% tax). Income tax inevitably affects the decision of whether to work for monetary compensation.

140. *See supra* text accompanying notes 133-34.

141. The parent receives no personal benefit if she would not be willing to pay anything for the child care in the absence of her employment. A parent who would rather take care of her child herself than have someone else do it, even for part of the day, would, accordingly, receive no personal benefit from the child care.

$10,000 of child care expenses in order to work. Assume that, absent an income tax, *P* would work because the $40,000 of income after child care expenses compensates her for her effort. She faces the same incentives as a person, *Q*, who can earn $40,000 and who has no child care expenses. Subjecting *P*'s $50,000 gross income to tax, but not allowing the $10,000 as a deduction, would change this result. With a 40% tax rate, *P*'s after-tax income net of child care expenses would equal only $20,000.[142] The income tax would affect *P* much more severely than *Q*, who has after-tax income of $24,000. On the other hand, with deductibility of the child care expenses, *P*'s before-tax net income of $40,000 is reduced to an after-tax net income of $24,000, the same as *Q*'s. Since both were in the identical position before tax, the desired result is that both occupy the same position after-tax. In this situation, the impact of the income tax on the decision to work is the same whether or not the individual must obtain child care in order to work.[143]

The opposite conclusion is appropriate if child-care expenses provide some personal benefit to the parent and would be incurred whether or not the parent works.[144] Neutrality is then enhanced by not allowing

142. The tax liability would equal $20,000 (40% of $50,000), and after-tax income, consequently, would equal $30,000 ($50,000-$20,000). After-tax income net of child-care expenses would then equal $20,000 ($30,000-$10,000).

143. The facts in the example assume that, except for the $10,000 cost, *P* is neutral about the child care. This assumption may not be true because *P* may prefer to take care of her child herself. For example, *P* might require $3000 (in addition to the $10,000 out-of-pocket cost) to reimburse her for the loss in welfare when someone else takes care of her child. Consequently, absent an income tax, *P* would face the same incentives to work as a person, *R*, with no children who has income of $37,000. However, *P* and *R* would not occupy the same position after-tax even if child care expenses were deductible. With a 40% tax rate, *P*'s after-tax income is $24,000, but with the $3000 loss of welfare from child care, she will work only if the loss of free time and other disadvantages of working are worth less than $21,000. On the other hand, *R* will work if the disadvantages of working are worth less than $22,200 (which is her after-tax income).

It may be argued that this comparison between *P* and *R* demonstrates that deductibility of child care expenses when there is no personal benefit results in neutrality only under very restrictive assumptions. More generally, the possibility of loss of welfare from child care may be seen as undermining my overall conclusions about deductibility of child care expenses and neutrality. My view, however, is that these nonpecuniary costs of child care are analogous to other nonpecuniary costs of working like poor working conditions or unpleasant colleagues. The income tax is necessarily not neutral between jobs that have differing nonpecuniary costs, and it is unrealistic to expect it to take account of the nonpecuniary costs of child care. Perhaps, the conclusion really should be that the objective that the income tax have the same impact on the decision to work whether or not the individual has child care expenses is very complex and can not be fully achieved.

144. If a parent does not work, child-care expenses result in additional leisure or time to pursue a hobby like golf. Thus, when not working, the parent may purchase child care so that she can golf. She may enjoy taking care of her child herself, but receives more satisfaction from

a deduction for child care expenses. As a simple illustration of this conclusion, consider a parent, *P**, who can earn $50,000, and will incur $10,000 of child care expenses whether or not she works. Absent an income tax, she would face the same incentives as a person, *Q**, who can earn $50,000 and will have no child care expenses. Each would work if the $50,000 sufficiently compensated her for her effort. Not allowing a deduction for child care expenses preserves the identical incentives to each after we take account of the income tax. With a 40% tax rate, each will work if the $30,000 after-tax income is sufficient incentive. If the $10,000 of child care expenses were deductible, *P**'s after-tax income would equal $34,000.[145] Her incentive to work would now substantially exceed that of *Q**.

The most complicated situation for determining appropriate tax treatment of child care expenses that will enhance neutrality occurs when the parent receives a personal benefit from the expenditure, but would not have incurred the expense if not for the decision to work. An example is a parent, *P***, who must pay $10,000 for full-time child care, but is willing to pay only $4000 if she does not work. Therefore, *P*** will not purchase child care unless she works. The correct rule in this situation is that a parent can deduct the excess of the child care cost over the personal benefit.[146] Accordingly, *P*** should be allowed to deduct $6000. For a simple illustration of this principle, assume that *P*** can earn $50,000 in full-time employment. Absent any tax, *P*** would work if $44,000 were sufficient compensation for the sacrifice of leisure and the other nonmonetary costs of working. She has $40,000 left after child care expenses, but also has received $4000 of personal benefit from the child care since she would have paid that much for it. Therefore, absent an income tax, she would face the same incentives as a person, *Q***, who can earn $44,000 and has no child care expenses. Allowing a deduction for $6000 of the child care expenses preserves the

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golfing than from supervising the child. Therefore, a parent willing to pay for child care when not working may not receive any benefit from the child-care services when she works. It is still true, however, that neutrality is enhanced by not allowing this parent a deduction for child-care expenses. Because the child-care expenses are incurred whether or not the parent works, they do not affect the incentives to work. Consequently, the example in the text is still valid. It is true that by working, the parent gives up the imputed income from golfing, but loss of imputed income from leisure or a hobby is usually sacrificed when a person accepts a paid position.

145. With taxable income of $40,000 ($50,000 minus the $10,000 of child care expenses), the tax liability of *P* would equal $16,000. Her net compensation for working would then equal $34,000 ($50,000 minus the $16,000 tax liability).

146. *Cf.* Daniel I. Halperin, *Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem*, 122 U. PA. L. REV. 859, 863 (1974) (contending that the deduction for business expenses should generally be limited to an amount in excess of personal benefit).

identical incentives to each. With a 40% tax rate, each will work if $26,400 is sufficient incentive.[147]

There are two possible objections to the above analysis. First, since an income tax inevitably affects employment decisions, neutrality with respect to child care costs is not necessarily desirable. A policy that is beneficial in an efficient economy may have adverse effects when there are existing distortions.[148] Tax treatment of child care costs, however, is not an appropriate tool for remedying the distortions concerning employment decisions introduced by the income tax. We do not try to manipulate deductibility of business expenses to compensate for these distortions. Child care costs that provide no personal benefit should receive the same treatment. The goal is that the income tax have the same impact on the decision to work whether or not the individual has child care expenses. The alternative of not allowing deduction of any child care expenses would be unacceptable. Those with child care responsibilities, primarily women, would be subject to a greater disincentive to work than those without child care responsibilities. The government would be discouraging women from engaging in market employment, with all the expected negative effects on careers and future prospects.[149] Although staying at home and taking care of one's children is an appropriate choice for many, parents should make it with as little government interference as possible.

The second possible objection is that no principled reason exists for applying the above analysis only to expenses for child care.[150] The same justification used for deducting child care costs could support a deduction for other expenses such as repairing the roof on the taxpayer's personal residence. The argument is straightforward. As suggested earlier, the income tax may encourage a person to repair her own roof rather than work overtime and use the extra compensation to pay someone else to repair it. However, the income tax would not have this effect if the person who pays someone to fix her roof could deduct the expense. No additional tax liability would be created whether the taxpayer repairs the roof herself or earns additional compensation that is used to pay someone else to make the repair. The income tax would

147. With taxable income of $44,000, tax liability would equal $17,600 (40% of $44,000). After-tax income would then equal $26,400 ($44,000-$17,600).

148. This principle is called the theory of the second best. *See* ROSEN, *supra* note 128, at 314-15, app. B at 325-27.

149. *See generally* Alstott, *supra* note 15, at 2057.

150. *See* Brian Wolfman, *Child Care, Work, and the Federal Income Tax*, 3 AM. J. TAX POL'Y 153, 178-81 (1984).

then be neutral with respect to roof repairs in the same way that, according to the argument above, it should be with respect to child care.[151]

There are, however, pertinent differences between child care and other personal activities. First, the choice between taking care of one's own children and working outside the home is much more important than routine decisions about accomplishing household tasks. Since the parent who does not work outside the home is typically the mother, the issue involves not only the raising of children, but also the role and status of women. Distortions introduced by the income tax should not affect such sensitive issues. Second, a parent of a young child may have no choice but to purchase child care if she is going to work because she typically cannot both work and provide her own child care during business hours. She must make a choice between working for compensation and taking care of her own children. Therefore, the income tax may change a parent's decision to work outside the home. In contrast, the person who wants to repair her own roof or do other chores can do them when time is available and need not adjust her hours of work. Since the person can both do her chores and work, it is less likely that the income tax will cause a major change in decisions about working.

2. Ignoring the Effect on Decisions Concerning the Number of Children

Tax benefits for child care costs are equivalent to a decrease in the cost of child care for qualifying parents. The parent's net cost is reduced by the amount of tax savings. Since a decrease in the cost of raising children should have a positive, although probably small, effect on individuals' decisions to have children, tax benefits for child care may encourage persons to have children.[152] Nevertheless, in evaluating the

151. Allowing deductions for personal expenses like repairs on a personal residence is not feasible. If all personal expenses were deductible, the income tax would be transformed into a tax on savings. If only selected personal expenses were deductible, the tax would favor some personal expenditures over others.

152. One study, using multivariate regression, has found that the child care credit "affects fertility positively." Leslie A. Whittington, *Taxes and the Family: The Impact of the Tax Exemption for Dependents on Marital Fertility*, 29 DEMOGRAPHY 215, 222 (1992) [hereinafter Whittington, *Taxes and the Family*]. This article and others also have found that tax savings from the personal exemption have a positive and significant effect on fertility. *See id.*; Yannis Georgellis & Howard J. Wall, *The Fertility Effect of Dependent Tax Exemptions: Estimates for the United States*, 24 APPLIED ECON. 1139, 1141 (1992); Leslie A. Whittington et al., *Fertility and the Personal Exemption: Implicit Pronatilist Policy in the United States*, 80 AM. ECON. REV. 545, 547 (1990) [hereinafter Whittington et al., *Fertility*]. For example, one study found that estimated elasticity of fertility with respect to the personal exemption ranged from .127 to .248, depending on the formulation of the model. *See* Whittington, *Fertility*, *supra*, at 550. An

goal of neutrality and tax benefits for child care, it is appropriate to ignore the effect on incentives for having children.

Any tax benefits for child care expenses can only represent a small fraction of the economic and noneconomic costs of raising children.[153] Furthermore, the effect of government on the costs and benefits of raising children is profound, ranging from free public education to the tax deduction allowed for dependent children. Consequently, it is not clear whether particular tax benefits for child-care costs will bring us closer to or further away from neutrality.

Finally, the justification for a neutral tax is based on the advantages of a competitive economy. The argument is that private decisions concerning working, spending, and saving result in an efficient economy and that the distortions introduced by an income tax have a deleterious effect. (Of course, there are offsetting benefits to an income tax, such as financing income redistribution and the production of public goods.) Decisions concerning number of children do not easily fit in this economic model, and the arguments about adverse impact of distortions introduced by the income tax are inapplicable.[154]

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elasticity of .2 means that doubling the tax savings from the personal exemption would cause a 20% increase in fertility.

153. Tax benefits for child care costs only are allowed to the extent the parent has made qualifying expenditures. *See* I.R.C. § 21(a)(1), (b) (West Supp. 1997). Therefore, whether either a deduction or, as in current law, a partial credit is allowed, the benefit only will cover a fraction of the child care expenses. Furthermore, there are many expenses associated with a child in addition to those for child care.

154. Economists have used utility functions to investigate demand for children. "Children are assumed to provide utility for their parents; the standard demand model for children is structured as a utility maximization problem subject to income constraints. The cost of a child will depend on the price of the inputs to the child." Whittington, *Taxes and the Family, supra* note 152, at 215 (citations omitted); *see also* Georgellis & Wall, *supra* note 152, at 1140-41 (applying economic analysis to fertility). But children are not conventional private goods. Society's interest in the presence and welfare of children is obviously different in degree than in the number of factories. At the same time, children impose significant costs, such as for schools, that are borne by the population at large. There is no reason to assume that individuals' unfettered decisions about the number of children will lead to optimal results. For example, in the absence of specific governmental policies, private choices may lead to a situation where there are too few children to maintain the population, and a long-term decline in the population may have severe, adverse consequences. Consequently, economists and demographers seem to accept that government policies affecting the number of children may be desirable. *See, e.g.*, Whittington et al., *Fertility, supra* note 152, at 545.

Professor Cigno uses standard economic analysis in analyzing the optimal number of children, and suggests that, in the absence of externalities, child benefits would encourage parents to "have more children than is socially desirable." Alessandro Cigno, *Fertility and the Tax-Benefit System: A Reconsideration of the Theory of Family Taxation*, 96 ECON. J. 1035, 1047 (1986). However, he recognizes the possibility that, because of externalities, "there may indeed be an argument for cash payments or benefits in kind like free education, health, etc." *Id.*

C. *Fairness and Child Care Expenses*

Fair or equitable tax treatment of work-related child care expenses is necessarily based on subjective evaluations and, at least conceptually, is a more complex topic than neutrality. Probably, the best way to approach the topic is the comparison of different families with and without child care expenses. The unavoidable problem, however, is that the conclusion about the appropriate tax treatment may depend on the subjects used for comparison. Nevertheless, the discussion below illustrates that, with fairness as the only criterion, a strong case exists for allowing a deduction for at least a portion of child-care expenses.

The case for deducting child care expenses is strongest if the accepted norm is for families to have children and for one parent to not work outside the home. The parent who works only in the home and takes care of the children has imputed income, which is not subject to tax. Now consider a family that departs from this norm. If both spouses work and they pay someone to take care of their children, part of their monetary income is being used to purchase the child care services that the first family provides for itself. Since the first family is not subject to tax on these services, neither should the second family. This result is achieved by allowing the second family to deduct the cost of child care. The earnings used to purchase child care are then tax-free.

A straightforward comparison of two families illustrates this argument. Assume that in the first family one spouse works outside the home and earns $80,000 per year. The other spouse works in the home and takes care of their children. In the second family both spouses work full-time outside the home, and each earns $50,000 per year. They pay $20,000 per year for child care since neither spouse can take care of the children during normal business hours. A comparison of the two families supports a conclusion that the second family should be able to deduct their child care expenses since, other things being equal, both families have equal ability to pay tax. Both families have $80,000 to spend and save for everything other than child care. The first family receives child care services tax-free since the imputed income of the spouse who stays home and takes care of the children is not subject to tax. For most of us, fairness would require that the second family also not be subject to tax on the child care services that it purchases. Allowing a deduction for the amount spent on child care achieves this result because it is equivalent to not taxing the portion of income that is used for purchasing child care services.[155]

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155. Professor Popkin has introduced a third family (Family 3) in which one spouse works outside the home and earns $100,000, and the other spouse is not employed, perhaps pursuing a hobby such as gardening. *See* Popkin, *supra* note 27, at 239-40. Like the two families considered in the text, Family 3 pays $20,000 per year for child care. Most probably would

An argument against taxing these two families identically is that we normally do not consider imputed income when determining tax liability. The person who can do her own home and automobile repairs is taxed the same as the person with the same money income who hires others to perform these tasks. Nevertheless, the first person may be economically better off since she can use more of her income for purchases other than repairs. The issue is why child care expenses are treated differently from expenses for repairing one's home and car.[156] Tax liability should take into account work-related child care expenses because they represent a basic lifestyle choice—the decision of a parent to work outside the home and purchase child care services rather than work at home. It is important that government tax parents fairly regardless of which choice they make. On the other hand, some unfairness between those who can do their own home repairs and those who cannot is tolerable. Simplicity of our tax laws is a higher priority.

In fact, the conclusion that fairness supports deduction of the child care services by the second family does not necessarily depend on lack of any personal satisfaction from the services. Assume that the second family would have purchased the child care even if one of the spouses did not work outside the home, although both spouses do, in fact,

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agree that this family should not be able to deduct the child care expenses because it is not necessary for paid employment. The assumption is that the expense for child care is incurred so that one of the spouses can pursue the personal activity of gardening. A comparison of this family with the second family (Family 2), however, reveals a potential problem. Each family has $100,000 income, and child care expenses of $20,000, but Family 2 will pay less tax. The conclusion that Family 2 has less ability to pay than Family 3 must rely on the fact that Family 3 has more leisure, but extra leisure does not normally result in additional taxes. For example, the person who does not work and has income from interest and dividends has, other things being equal, the same tax liability as the person with income from paid employment.

Professor Popkin concludes that the comparison of Families 2 and 3 illustrates that a deduction for child care expenses is unfair. *See id.* at 246. This conclusion can be questioned. It is easily concluded that Family 3, with only one spouse working for compensation, has greater ability to pay than Family 2. Or, stating the conclusion in a somewhat different way, Family 3 is obtaining imputed income that is not subject to tax. The fact that increased leisure or imputed income is generally not subject to tax does not mean that, in this case, it is unfair to impose a higher tax liability on Family 3 than Family 2. Rather, the problem is that in general, the person with less leisure or less imputed income is not taxed fairly. But this result reflects a basic shortcoming of the income tax and need not be automatically imposed when the issue is deductibility of child care expenses. Consequently, I conclude that it is appropriate and fair to require that the deduction for child care expenses be available only when the parents are working.

156. This same issue also was considered in the context of neutrality. *See supra* notes 150-51 and accompanying text.

work.[157] The two families still have equal ability to pay tax. Each has $80,000 to consume or save after having provided for child care. What is critical, however, is that the cost of services purchased by the second family not exceed the value of the services that the first family provides for itself. The basic assumption in the original comparison is that the child care services for the two families are comparable. For example, if the second family pays $20,000 for child care services, but the first family only has child care services worth $10,000, then the second family is consuming more and should have a greater tax liability. An appropriate rule would state that a family with work-related child care expenses should not be entitled to a deduction to the extent that the cost of their child care services exceeds the value that those who stay home with their children routinely provide for themselves.[158]

The argument for deducting child care expenses is not as compelling if we accept as the norm that every adult works outside the home, but not every family has children.[159] In this situation, child care expenses might be more readily considered a foreseeable cost of children than an expense of working. The cost of child care could then be classified as a personal expense, and thus not deductible. Again, a simple comparison of families is helpful. The first family has income of $100,000 and is childless; the second family has income of $100,000, and spends $20,000 on child care for its children.[160] In each family both husband and wife work outside the home. The issue of deductibility of child care expenses is then reduced to the question of whether the two families should have equal tax liability. It might be argued that the second family should be taxed like the first because the parents should have known that they would incur child care expenses when they made the decision to have children. Presumably they decided that the nonmonetary rewards of having children were greater than the monetary and nonmonetary costs. It appears that the costs of raising children, including child care, are properly classified as personal and thus should not be deductible.

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157. If one of the spouses does not work, the analysis changes because of the increased leisure. Theoretically, the increased leisure could justify a higher tax liability for the second family. *See supra* note 155.

158. *See* Popkin, *supra* note 27, at 247.

159. The implications of this comparison were noted by Professor Klein. *See* Klein, *supra* note 54, at 938-40.

160. Assume that for both families the $100,000 income is after deduction of personal exemptions. Therefore, the income for the second family has been adjusted to take account of the impact that the obligation to support children is deemed to have on general ability to pay. *See generally* Allan J. Samansky, *Tax Policy and the Obligation to Support Children*, 57 OHIO ST. L.J. 329, 362-74 (1996) (discussing ability to pay and obligation to support children).

As this example illustrates, if employment is considered an immutable fact and a child is considered discretionary, then it probably seems fair that child care is considered a cost of raising children and should not be deductible.[161] However, this state of affairs is not realistic. Persons may change their minds about working and can enter or leave the workplace as different factors arise, but they obviously cannot treat the decision to have children in the same way. For example, divorce may change parents' expectations about employment and the need for child care. It is unreasonable to suggest that they should have considered the possibility of divorce and the increased need for child care after divorce when deciding whether to have children. In most cases, economic necessity will force the parent with custody of the children (as well as the other parent) to work. Most of us probably would agree that, when thinking about child care expenses, the presence of a child should be accepted as an immutable fact and employment should be considered discretionary. If this supposition is correct, the earlier comparison involving families with children—one family with a parent that does not work outside the home and one family where both parents work—seems the more relevant, and fairness requires deduction of work-related child care expenses.

D. *Conclusion*

A strong case exists for allowing a deduction for some of the child care costs that most parents incur in order to work. Allowing the deduction furthers the goal of neutrality and fairness. On the other hand, it is not consistent with either fairness or neutrality for all childcare expenses to be automatically deducted, although each goal requires a somewhat different rule for determining the amount. According to the goal of neutrality, the amount deducible should equal the amount that is incurred because the parents work, but that does not provide any personal benefit. According to the goal of fairness, child care expenses that are necessary for work should be deductible, but only to the extent that the value of the purchased services does not exceed what parents who stay home with their children normally provide by their own efforts.

161. If decisions about employment are unaffected by children and child care expenses, then arguments about neutrality become largely irrelevant. By assumption, tax treatment of child-care expenses would have no effect on decisions to work. The only possible consequence might be on the decision to have children. If it is also assumed that tax treatment of child care expenses will have no effect on the decision to have children, then the tax treatment would have no direct effect on behavior. Absolute neutrality is being assumed.

The different amounts that neutrality and fairness would allow as a deduction are very close. One is based on the taxpayer's subjective valuation and the other on a comparison with other persons. If the amount of purchased child care that does not provide any personal benefit equals the value of the services provided by a typical parent who does not work outside the home, then the two goals would allow the same deduction. For example, assume a typical parent pays $4000 for work-related child care services, and receives a personal benefit valued at $1000. The goal of neutrality requires that she be able to deduct $3000. For the goal of fairness, we would compare the $4000 cost with the value of the child care services provided by a typical parent who stays home with her children. If this value is $3000, then a deduction of $3000 also would be consistent with fairness. Although the two amounts might not be exactly equal as in the example, they will probably not be very far apart. The personal benefit received from purchased child care often will result from the extra services available beyond those typically provided by parents who stay home and care for their children.

Of the two rules for deducting child care costs that are consistent with neutrality and fairness respectively, allowing a deduction for expenses that do not provide any personal benefit seems the more attainable goal. With available data, we can make educated guesses about what parents would spend on child care if they did not work. In the next Part, I try to make the necessary judgments and then fashion general rules that can be administered by the Internal Revenue Service.

VI. Policy Recommendations

A. *Maximum Amount Deductible*

I concluded in the prior section that child care expenses incurred so that one or both parents can work should be deductible, but only to the extent that the cost exceeds the parent's personal benefit. Determining the correct amount of child care expenses that a working parent should be able to deduct, however, often will prove very difficult. First, only expenses for "basic" care should be deductible because, by definition, only amounts spent for basic care are necessary for a parent to work.[162] If a child-care provider also provided educational instruction or training in a skill like gymnastics, the portion of the cost allocable to

162. Basic care might be defined as the services that are typically provided by a parent who cares for-her own child during the business day. According to the rule that is consistent with the goal of fairness, only the cost of basic care should then be deductible by the parent who purchases child care. *See supra* notes 157-58 and accompanying text.

the instruction or training would not be deductible.[163] But there is no fixed standard for what constitutes basic care, and any attempt to establish such a standard and allocate costs will inevitably cause controversy. Second, to determine the parent's personal benefit from the child care, we need to know how much the parent would pay for the care if she were not working.[164] The parent might not know herself how much the child care is really worth to her, and there will be an incentive to convince herself and others of a low valuation if that will reduce her income taxes.

Consequently, it is impossible to determine the amount that a particular taxpayer should be able to deduct for child care expenses. Placing a ceiling on the amount deductible, however, is a good alternative. The ceiling can take into account whether the taxpayer would have utilized child care even if she did not work and, therefore, whether some child care expenses should not be deductible.[165] Use of child care by persons who are similar to the taxpayer, but who are not working, can be studied to determine whether it is likely that the taxpayer would have utilized child care if she were not working. A ceiling also can help assure that an excessive amount of child care is not deducted when a child is receiving training that goes beyond what is normally furnished with child care. With one minor exception, there always has been a limit on the amount of child care expenses that qualify for tax benefits.[166]

However, I suggest a significant departure from current law. In calculating the maximum amount deductible by the taxpayer, we should take into account the age of the taxpayer's children. The need for child

163. *See* S. REP. NO. 92-437, at 59-62 (1971), *reprinted in* 1971 U.S.C.C.A.N. 1918, 1967 (stating that educational expenses for a child in the first grade or above are not deductible).

164. One reason child care may have personal value to a parent is the additional training or education offered, and therefore, the personal benefit from child care is not independent of whether services beyond that of basic care are being offered. Nevertheless, even "no-frills" child care may be valued by the parent because it has some educational value and because it gives the parent a respite from caring for the child.

165. If the parent were willing to pay full price for the child care, the personal benefit would at least equal the cost, and the child care expense should not be deductible. *See supra* notes 143-44 and accompanying text.

166. When Congress added § 129 to the Internal Revenue Code in 1981, it did not limit the amount that could be excluded from income for child care benefits. *See* Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 124(e)(1), 95 Stat. 172, 198. But it did cap the exclusion at the employee's earned income. *See id.* In 1986, Congress placed a $5000 annual limit on the amount that could be excluded. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 1163(a), 100 Stat. 2085, 2510. Expenditures qualifying for the dependent care tax credit of § 21 have always been subject to a ceiling, and Congress recognized that it was "inequitable" to allow an unlimited exclusion. *See* H.R. REP. No. 99-426, at 97 (1986), *reprinted in* 1986-3 C.B. 1, 97.

care and the possibility of personal benefit are much different when the child is an infant, rather than a twelve year old. Therefore, the recommended maximum deduction varies according to the age of the child. In contrast, under current law, the maximum deduction does not vary with the age of a child.

In one respect, however, the law has always taken into account the age of the child. For a child without significant handicaps, there has always been a maximum age above which amounts spent for care of that child are not eligible for tax benefits.[167] Tax benefits are now available for care of children under the age of thirteen. This limitation seems justifiable. Most children who are thirteen years old are capable of caring for themselves in the afternoon or evening. Although a thirteen year-old coming home to an empty house or apartment every afternoon may not present an ideal situation, supervisory-type care is probably not the solution.

Whether the maximum deduction should depend on the family's income presents a more difficult question. Certainly the fact that wealthy parents probably spend more on child care than the less affluent does not justify a higher maximum deduction for the affluent. The standard for basic care should remain the same regardless of wealth. On the other hand, higher income parents are probably more likely to use child care even if a parent is not working outside the home. Child care is more likely to provide personal benefit when there are working parents with relatively high income. Therefore, one might argue that, in at least some cases, the maximum deduction should be less for those with higher income. Trying to differentiate in this way between taxpayers at different income levels, however, is likely to pose difficult problems of administration. Additionally, not allowing higher income parents to deduct as much as lower income parents because the former receive more personal benefit from the child care will seem unfair to many of those affected.[168] Consequently, I recommend that the maximum

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167. When enacted in 1954, a deduction for child care was allowed for a child less than twelve years old. *See* I.R.C. § 214(c)(1)(A) (1954). In 1964, Congress increased the age of eligible children to those under thirteen, and in 1971, to those under fifteen. *See* Revenue Act of 1971, Pub. L. No. 92-178, § 210, 85 Stat. 497, 518 (incorporated in § 214(b)(1)(A)); Revenue Act of 1964, Pub. L. No. 88-272, § 212, 78 Stat. 19, 49 (amending § 214(d)(1)(A)). Finally, Congress decreased the eligible age by two years in 1988 to where it is now. *See* Family Support Act of 1988, Pub. L. No. 100-485, § 703, 102 Stat. 2343, 2426-27. This provision originated with the Conference Committee and was apparently introduced to generate revenue. *See* H.R. CONF. REP. NO. 100-998, at 199 (1988).

168. Until 1976 the deduction for dependent care expenses was limited to low and middle income parents. *See supra* notes 58-69 and accompanying text. The view was that the deduction was only justified where parents were forced to work by economic or other circumstances. The rationale for my proposal, on the other hand, is that child care expenses are often a valid

deduction not depend on the income of the parents.

Determination of the maximum deduction is, of course, somewhat arbitrary, and the following recommendations are intended more as an illustration of the appropriate method than a proposal about specific numbers. In estimating the deduction, I used $2.05 per hour as the cost of child care for children less than six years old. This is the amount, after an adjustment for inflation, that employed mothers with preschool-age children using center-based programs as their primary arrangement paid per hour.[169] Similarly, I used $3.09 per hour as the cost of child care for school-age children because this is the amount, adjusted for inflation, that employed mothers with school-age child who used center-based programs as their primary arrangement paid per hour.[170]

The maximum annual deduction for children two years of age or younger is obtained by assuming forty hours per week of child care for

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business expense and thus, in appropriate cases, should be available to persons at all income levels. Since 1976, the partial credit and, in later years, the exclusion from income for dependent care expenses have been available to persons at all income levels. *See supra* notes 91-125 and accompanying text.

169. *See* HOFFERTH ET AL., *supra* note 16, at 138-40. The reported cost per hour was $1.67, which was derived from a 1990 survey. I used the consumer price index to adjust for increase in prices between 1990 and 1997. *See* Bureau of Labor Statistics, *Bureau of Labor Statistics Data: Most Requested Series* (visited Jan. 29, 1998) <http://stats.bls.gov/top20.html>; U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1997, at 487 (Table No. 752: Consumer Price Indexes (CPI-U), by Major Groups: 1939 to 1996) (1997).

Employed mothers surveyed in 1990, who primarily relied on center-based care, used child care for an average of 38 hours per week. *See* HOFFERTH ET AL., *supra* note 16, at 138-40. "Center-based care" programs include child care centers, nursery schools, and (for school-age children) before- and after-school programs. *See id.* at 23-24. The study included five-year-old children and school-age children (but not preschool-age children) and thus the average of $1.67 per hour for child care did not apply to them. *See id.* at 124-30. However, because I assumed kindergarten is (like the typical preschool) only half a day, it was more convenient to assume that the average cost of child care was the same for five-year-old children as three and four-year-old children. With this assumption the maximum amount deductible for five-year-old children was the same as for three and four year-old children. In any event, it seems unlikely that the average cost of an hour of child care differs greatly for five-year olds than for three and four-year olds.

According to the survey, employed mothers may pay the least amount for children less than one year old and the most for children one to two years old, with those three and four years old in the middle, but the differences are small and not statistically significant. *See id.* at 135 (tbl. 3.1). For another estimate of the cost of child care, see Casper et al., *supra* note 16, at 25, 39 (tbl. 12).

170. *See* Casper et al., *supra* note 16, at 147. The reported cost per hour was $2.52. For discussion of the inflation adjustment, see *supra* note 169.

According to a survey, employed mothers pay less per hour for children between five and nine years old and more for children between ten and twelve years old, but the differences are small and not statistically significant. *See* HOFFERTH ET AL., *supra* note 16, at 149 (tbl. 3.2); *id.* at 152. For a description of "center-based programs," see *supra* note 169.

the entire year at a cost of $2.05 per hour. The maximum annual deduction is (with suitable rounding) $4300 per child. I used forty hours per week because there is usually relatively little personal benefit from care of very young children; those parents who do not work provide most of the care themselves.[171] Of course, some parents work, and thus must use child care, more than forty hours per week, and some have to pay more than $2.05 per hour. Consequently, it might be argued that a greater, and possibly even an unlimited, deduction should be allowed for care of children two years old and younger. On the other hand, some personal benefit may result from the child care because many parents enjoy the respite from child care responsibilities. Forty hours per week at a reasonable cost seems an appropriate compromise.

For children between three and five years old, the maximum annual deduction is obtained by assuming twenty-five hours per week for the entire year at $2.05 per hour, or approximately $2700 annually. I used twenty-five hours per week because many of these children are enrolled in a nursery school or kindergarten when mothers are not in the labor force.[172] Consequently, it is reasonable to conclude that most parents receive a personal benefit nearly equal to the cost for about fifteen hours per week. An alternative, which I reject, would allow a deduction only for child care in excess of fifteen hours per week. A parent might then only deduct annual expenses in excess of $1600, the estimated cost of fifteen hours per week. This result seems harsh, however, and would unduly discourage part-time employment. A substantial percentage of parents who do not work are not sending their three-year-old children to preschool or kindergarten, and thus many of those who do work and are purchasing child care are probably receiving little personal benefit from the child care.

Finally, the maximum deduction for children between six and twelve years old is based on $3.09 per hour for fifteen hours per week, or approximately $2400 per year. I used fifteen hours per week because only after-school care is generally needed for these children.[173]

In summary, my recommendations for the maximum annual deduction for child care expenses are the following: $4300 for each

171. Only 14% of mothers who are not employed pay for the primary arrangement of their youngest preschool-age children. *See* Casper et al., *supra* note 16, at 122. Presumably, a disproportionate number of those who do pay have older, preschool-age children.

172. Fifty-two percent of children between ages three and five whose mothers are not in the labor force are enrolled in a nursery school or kindergarten. *See* U.S. DEP'T OF COMMERCE, 1995 STATISTICAL ABSTRACT OF THE UNITED STATES 160 (tbl. 244).

173. Perhaps a more refined formulation would take into account that school does not meet during the summer months and consequently increase the maximum deduction. On the other hand, there is probably a substantial amount of personal benefit from child care in the summer.

child two years old or younger, $2700 for each child between three and five years old, and $2400 for each child between six and twelve years old.

B. *Some Parameters for Qualifying Expenditures*

Even with a ceiling for the deduction, some outer boundaries for qualifying child care expenses are required. In this section I discuss three issues concerning which expenses are eligible for the deduction. Although important, these issues do not have major theoretical significance, and, in my opinion, their resolution primarily raises questions of feasibility and line drawing. Because I do not have a strong conviction that current law requires change, my discussion will aim to be straightforward and concise, rather than comprehensive.[174]

The first issue is the availability of tax benefits for general household expenses. Originally, Congress limited the deduction for dependent care expenses to services directly related to care of an individual.[175] Therefore, if a housekeeper cared for the children and also cooked and cleaned the house, the cost of the salary would have to be prorated.[176] Congress liberalized this rule in 1971, allowing a full deduction for household services when the taxpayer maintained a household for a qualifying dependent and the other conditions were met.[177] As the Senate Report stated, taking care of the house was covered, but services of a chauffeur were not.[178] The reasons for the change were explained as follows:

> [The Senate Committee on Finance] believes that families with one working adult or families with two adults where the income level is such that both must obtain employment and there is a child (or incapacitated dependent) in the home, need help not only with respect to child

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174. Because a comprehensive discussion of the present statute is not one of the goals of this Article, some issues that current law raises are ignored. One example is whether there should be any restrictions on the person or entity providing the care. Current law provides a number of restrictions. Thus, the dependent care credit is not available if the taxpayer or her spouse is allowed a personal exemption for the caregiver. *See* I.R.C. § 21(e)(6)(A) (West Supp. 1997); *see also id.* § 21(e)(6)(B) (stating that the caregiver may not be a child of the taxpayer who is under 19 years old); *id.* § 21(e)(9) (requiring disclosure of name, address, and taxpayer identification number of provider on return claiming the credit); *id.* § 21(b)(2)(C) (imposing restrictions on certain facilities providing dependent care).

175. *See* I.R.C. § 214(a) (1954).

176. *See* S. REP. NO. 83-1622, at 221 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4621, 4857.

177. *See* Revenue Act of 1971, Pub. L. No. 92-178, § 210, 85 Stat. 497, 518 (incorporated in § 214(a)).

178. *See* S. REP. NO. 92-437, at 61 (1971), *reprinted in* 1971 U.S.C.C.A.N. 1918, 1967.

> (and incapacitated dependent) care expenses but also for household help that they must obtain in order to be gainfully employed. The domestic help is needed in these cases because the adult members of the family are employed full time and in this sense the domestic help expenses can to some extent be likened to an employee business expense.[179]

Current law continues to allow tax benefits for general household services.[180] There is obviously some unfairness to those without qualifying dependents or who otherwise do not meet the qualifications for the child care tax credit or exclusion. These individuals obtain no tax benefits if they pay for general household services. On the other hand, families with young children and with no adults who forgo paid employment to stay home with their children will need more cleaning and household work, and will have less time to do it, than most other families. Additionally, allocating time of a domestic worker between care of the children and various household chores such as cooking and cleaning will be difficult at best. Many families will accordingly exaggerate the child care responsibilities if that would lead to greater tax benefits. Finally, the ceiling for qualifying expenses under current law (and under the deduction proposed in this Article) will prevent an inordinate amount of general housework from qualifying for tax benefits. On balance, I believe that current law should remain unchanged.

The second issue is the required relationship between the expense and employment of the parent. Since 1954, when Congress first enacted a provision allowing tax benefits for child care expenses, the Internal Revenue Code has stated that qualifying child care expenses must be incurred to enable the taxpayer to be "gainfully employed."[181] A strict interpretation of this provision would require the taxpayer to show that she would not have purchased the child care but for the fact that she was working. This would impose an impossible burden in many cases, and accordingly, seems never to have been required by the Internal Revenue Service or the courts.

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179. *Id.* at 60, *reprinted in* 1971 U.S.C.C.A.N. at 1966. The Report also states that expanding the services that qualify for the deduction will help "provide employment opportunities for persons presently having difficulty in this respect." *Id.* Today, most persons probably would agree that increased tax benefits for child care is probably not a good way to help persons who might work as caregivers or domestics. If the goal is to help these persons, more direct assistance is appropriate.

180. *See* I.R.C. §§ 21(b)(2)(A), 129(e)(1) (West Supp. 1997).

181. I.R.C. § 214(a) (1954); *see* I.R.C. § 21(b)(2)(A) (West Supp. 1997) (using the same language).

Although parents have not had to demonstrate that they purchased child care because of their employment, they have had to work to receive the tax benefits.[182] In the Revenue Act of 1971, Congress also required that, if the taxpayer were married and her spouse not disabled, then the deduction was only available if both the taxpayer and her spouse worked "on a substantially full-time basis."[183] In 1976, Congress abandoned the requirement of working "substantially" full time, and added an income limitation,[184] which is still in the Internal Revenue Code.[185] Qualifying child care expenses generally cannot exceed the earned income of the taxpayer or, if married, the lower of the taxpayer's or her spouse's earned income.[186] Current law seems satisfactory; no greater connection between the earned income and expense for child care seems practical or appropriate.

The third and final issue is eligibility of the parent or taxpayer. When first enacted in 1954, Congress strictly limited the allowable deduction. For example, it was not available to male caretakers who were not widowers or legally separated from their wives.[187] Current law, of course, does not have similar restrictions. Tax benefits for child care expenses are now available to an individual "who maintains a household" for a qualifying dependent or spouse,[188] and this requirement seems appropriate.

C. *Implications for Earned Income Tax Credit and Employment Taxes*

This subsection explores some of the implications of my analysis for the earned income credit and employment taxes. Concrete proposals are

182. *See* H.R. REP. NO. 83-1337, at A60-61 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4025, 4197-98.

183. Revenue Act of 1971, Pub. L. No. 92-178, § 210, 85 Stat. 497, 518 (incorporated in I.R.C. § 214(e)(2)). Until 1971 men were generally not eligible for the dependent-care deduction; it was allowed if he was a widower, or after 1964, if his wife were incapacitated or institutionalized. *See* I.R.C. § 214(a) (1954); Revenue Act of 1964, Pub. L. No. 88-272, § 212, 78 Stat. 19, 49.

184. *See* I.R.C. § 21(d)(1); Tax Reform Act of 1976, Pub. L. No. 94-455, § 504, 90 Stat. 1520, 1563 (incorporated in I.R.C. § 44A(e)(1)).

185. *See* I.R.C. § 21(d)(1) (West Supp. 1997).

186. *See id.* 21(d)(1); *see also id.* § 21(d)(2) (containing an exception for a spouse who is a student or is incapable of caring for himself).

187. *See* I.R.C. § 214(a) (1954).

188. *See* I.R.C. §§ 21(a)(1), 129(e)(1) (West Supp. 1997). Congress added this requirement to the Code in 1971. *See* Revenue Act of 1971, § 210 (incorporated in I.R.C. § 44A(a)). Currently, there is a special rule for divorced parents. *See* I.R.C. § 21(e)(5) (West Supp. 1997).

probably not particularly helpful at this time, and consequently the primary purpose is merely to highlight some of the issues.

The earned income tax credit is a refundable tax credit for low income persons. Taxpayers receive a net payment from the government to the extent that the credit exceeds their regular tax liability.[189] The amount of the credit depends on both income of the individual and the number of children, with the maximum credit available for those with two or more children.[190] It is calculated by taking a percentage of earned income up to a stated maximum, and then phasing out the credit as the greater of earned income or adjusted gross income exceeds a threshold amount.[191] In 1997, for a qualifying taxpayer with two or more children, the credit percentage is 40% on a maximum earned income of $9140, and is phased out as earned income or adjusted gross income exceeds $11,930.[192] Consequently, the earned income credit is zero when earned income or adjusted gross income exceeds $29,290, and the maximum credit is $3656.

Under current law, the dependent care credit is taken into account before the earned income credit.[193] Consequently, a taxpayer whose total tax liability is offset by the dependent care credit also may receive the earned income credit.[194] For example, a taxpayer with tax liability before credits of $1000, an $1100 child care credit, and $1500 earned income credit, will offset her entire tax liability with the child care credit and receive a net payment of $1500 because of the earned income credit.

Because some child care expenses are appropriately viewed as a cost of earning income, my proposal would replace the current dependent

189. *See* I.R.C. § 32 (West Supp. 1997).

190. *See id.* § 32(b)(2).

191. *See id.* § 32(a)(2).

192. *See* Rev. Proc. 96-59, § 3.03, 1996-53 I.R.B. 17. The credit phaseout rate is 21.06%. *See id.*

For a qualifying taxpayer with one child, the credit percentage is 34% on a maximum earned income of $6500; and for a qualifying taxpayer with no children, the credit percentage is 7.65% on a maximum earned income of $4340. *See id.* The credit is phased out a rate of 15.98% starting at earned income or adjusted gross income of $11,930 for a taxpayer with one child, and at a rate of 7.65% starting at earned income or adjusted gross income of $5430 for a taxpayer with no children. *See id.*

193. *See* I.R.C. §§ 35, 6401(b)(1) (West 1988).

194. If the child care credit were taken into account after the earned income credit, the taxpayer would obtain no benefit from the child care credit when her tax liability was totally offset by the earned income credit. In the example in the text, the taxpayer would receive a net payment of $500, which is the amount that the earned income credit exceeds her tax liability before credits, and receive no benefit from the child care credit. The recently enacted per-child credits is ignored in this discussion because it would complicate, but not change, the analysis.

care credit with a deduction. If this analysis is accepted, it logically follows that a portion of child care expenses also should be deductible for purposes of the earned income credit, at least when computing the phase-out amount. The earned income credit is phased out as income increases because the need for assistance diminishes. Income after deduction of permissible child care expenses would better measure the need for special assistance rather than income without any deduction.[195] If this proposal were accepted, the computation of the phase-out amount might require adjustment.

On the other hand, it is not clear if the basic allowance for the earned income credit, which is determined by multiplying earned income to the extent not in excess of a stated maximum by the credit percentage, should take account of child care expenses. The purpose of the credit is to encourage low income persons to work, as well as to provide assistance. Perhaps the base amount for determining the amount of benefit should be total earned compensation, without any allowance for child care expenses.[196]

Similar considerations should, at least theoretically, apply to employment taxes like social security and Medicare. These taxes are levied on both employers and employees and are computed on the basis of gross wages without reduction by any expenses.[197] Self-employment taxes, which are levied in lieu of social security and Medicare on those who are self employed, are levied on net income.[198] In neither case is the base reduced by any personal deductions or by child care expenses. However, if child care expenses are recognized as an expense of earning income, then it might be argued that the base should be reduced by the appropriate expenses when computing the employee liability.[199] Such

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195. Some programs have allowed child care expenses to be deducted in determining eligibility of persons for governmental programs. *See* Public and Indian Housing Program, 42 U.S.C.A. § 1437a(a)(1)(A), (b)(3)(G)(5)(D) (Supp. 1997); Section VIII Housing Program, 12 U.S.C.A. § 1831q(e)(1), (p)(1) (Supp. 1997).

196. The issue is not the aggregate amount of the earned income credit since the percentage and maximum earned income can be adjusted to take account of the deductibility of child care expenses. Instead, the issue is whether *A*, who earns $15,000 and leaves her child with a grandparent at no cost, and *B*, who earns $17,000 and pays $2000 for child care, should receive the same amount of credit if they are equivalent in all other relevant ways. It can be argued that, because one of the purposes of the credit is to encourage employment, *B* should be entitled to the greater credit.

197. *See* I.R.C. §§ 3101(a), (b), 3121(a) (West 1988).

198. *See* I.R.C. §§ 1401, 1402 (West Supp. 1997).

199. There is no reason to allow a deduction for the employee's child care costs when computing the employer's liability for social security and Medicare taxes. The total amount paid to the employee remains a cost to the employer, regardless of the employee's child care expenses.

a change would, however, represent a major change in determining employment taxes and would require some other change, such as an increase in rates, to offset the impact on revenue.

VII. CONCLUSIONS

My primary goal in this Article was to determine the theoretically correct tax treatment of work-related child care expenses using the criteria of fairness and neutrality, and then explore the policy implications. In pursuing this goal, I assumed that tax policy should not influence parents' decisions about care of children, but rather should accommodate the decisions that individuals make concerning child care and employment. The choice between taking care of one's own children and working outside the home involves not only rearing children, but also the role and status of women. It is important that distortions introduced by the income tax not affect such sensitive issues.

I first concluded that sections 29 and 129 of the Internal Revenue Code, which provide tax benefits for work-related dependent care expenses, are not consistent with any underlying tax principles and need to be replaced. Although members of Congress and relevant committees have often stated that child care should be considered a valid expense for working parents, they have not been willing to accept the consequence of that view and allow a broad-based deduction. In fact, the primary goal of Congress has probably been to help working parents with children, but it has wisely never enacted a statute clearly focused on that goal. Tax benefits for child care are not an effective tool for subsidizing employment or redistributing income.

A deduction for some of the child care costs that parents incur in order to work is consistent with both neutrality and fairness. However, child care often has a personal component, and a rule allowing a deduction for all child care expenses is not appropriate. Although neutrality and fairness require somewhat different rules for determining the amount that should be deducted, the differences will usually be very small. I concluded that the rule consistent with neutrality—allowing a deduction for child care required by employment to the extent that it does not provide any personal benefit—seems the more attainable goal. Of course, it is still impossible to determine the actual amount that a particular taxpayer should be able to deduct for child care expenses. However, a ceiling on the amount deductible, which can take into account whether the taxpayer would probably have utilized some child care even if she did not work, and thus whether some child care might be providing a personal benefit, is a good alternative.

Using available data, I estimated what parents might spend on child care without receiving substantial personal benefit and utilized this amount for the maximum deduction. Because the need for child care and the possibility of personal benefit to parents are much different for infants than for twelve-year olds, I generated different estimates for children of different ages. My recommendations for the maximum annual deductions are as follows: $4300 for each child two years old or younger, $2700 for each child between three and five years old, and $2400 per year for each child between six and twelve years old. In contrast, section 21 currently allows a partial credit for a maximum of $2400 if there is one qualifying child and $4800 if there are two or more children.[200] Section 129 allows a maximum of $5000 to be excluded from income regardless of the number of children.[201] I did not, however, recommend any changes in the type of expenses that qualify for tax benefits. Finally, I explored some of the implications of my analysis for the earned income credit and employment taxes, and suggested that, at least for some purposes, deductibility of child care expenses might be appropriate for both.

200. *See* I.R.C. § 21(c) (West Supp. 1997).

201. *See* I.R.C. § 129(a)(2) (West Supp. 1997). Any exclusion reduces the maximum amount that can qualify for the partial credit of § 21. *See* I.R.C. § 21(c) (West Supp. 1997).