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Summer 1973

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Recommended Citation

Alan L. Feld, *Another Word on Child Care*, in 28 *Tax Law Review* 546 (1973).

Available at: https://scholarship.law.bu.edu/faculty_scholarship/2436

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Another Word on Child Care

Professors Schaffer and Berman have written a stimulating brief in support of a deduction for child care expenses in computing federal taxable income. But, in addition, by the range of considerations which their article takes into account, it illustrates the difficulty in opting for deductibility or nondeductibility on the basis of a rational consideration of income tax policies. The difficulty derives primarily from the fact that child care expenditures partake of both a personal (consumption) element and a business (income earning) element.¹ To the extent it represents the latter, it does not represent personal income appropriately subject to tax; to the extent it represents the former, it does.²

This problem affects many expenditures, ranging from travel and entertainment to commuting expenses to the cost of professional school education. A variety of considerations have entered into the determination that a particular expenditure falls on one side of the line or on the other.³ But a pervasive theme has been the degree to which the expenditure generally is connected with business activity, as compared with its connection to personal gratification.⁴ In the traditional sense, the connection between child care expenditures and income producing activity simply is not sufficiently compelling to require deduction under the general "ordinary and necessary" trade or business expense rubric; accordingly, the case law barred deductibility.⁵ In making the legislative judgment to alter this pattern, there must be some further justification supporting deductibility.

Professors Schaffer and Berman believe they have found this justification in the need to achieve tax neutrality as between the housewife (whose imputed income from services is excluded from gross income)

¹ See Feld, *Deductibility of Expenses for Child Care and Household Services: New Section 214*, 27 TAX L. REV. 415, 425-429 (1972); Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925, 952-954 (1967).

² For a recent thoughtful discussion of the concept of personal income in an income tax see Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972).

³ See, e.g., Rev. Rul. 70-474, 1970-2 C.B. 34 (cost of acquiring and maintaining uniforms is deductible if required as a condition of employment and not of a type adapted to general use); Reg. § 1.162-2(e) (commuting expenses are not deductible); and Reg. § 1.162-5(b)(2) (expenditures to meet minimum educational requirements for qualification in employment are not deductible).

⁴ See, e.g., *Welch v. Helvering*, 290 U.S. 111 (1933); *United States v. Gilmore*, 372 U.S. 39 (1963); *Rudolph v. United States*, 370 U.S. 269 (1962); *Henry C. Smith*, 40 B.T.A. 1038 (1939), *aff'd without opinion*, 113 F.2d 114 (2d Cir. 1940); *Richard W. Drake*, 52 T.C. 842 (1969).

⁵ *Henry C. Smith*, 40 B.T.A. 1038 (1939), *aff'd without opinion*, 113 F.2d 114 (2d Cir. 1940); *Mildred A. O'Connor*, 6 T.C. 323 (1946); and cases cited in Feld, *Deductibility of Expenses for Child Care and Household Services: New Section 214*, 27 TAX L. REV. 415, ns.13, 14 (1972). See the discussion in Keane, *Federal Income Tax Treatment of Child Care Expenses*, 10 HARV. J. LEGIS. 1, 30-35 (1972).

and the working mother (whose cash income will be subjected to tax).⁶ This tax difference may be substantial enough to affect conduct, as I have suggested elsewhere, and therefore presents a serious problem. But the lack of tax neutrality derives from the decision to exclude imputed income from the tax base. The decision can be ascribed to the administrative difficulty and perceived unfairness in assessing tax on noncash imputed income. The difference between being paid for services and consuming them oneself is a reasonable way to distinguish taxable from nontaxable income, even though it necessarily will produce some inequity as between taxpayers enjoying the same economic income. Any remedy should look to inclusion in income of imputed services income of the housewife, not further exclusions from the tax base.⁷

Moreover, the attempt to achieve equity of this sort through an exclusion or deduction affecting a particular kind of income frequently creates new inequity. It is difficult to distinguish child care from the other kinds of imputed services income which escape tax and for which a taxpayer who uses his services to earn cash income may have to substitute the nondeductible purchase of the services of another. Professors Schaffer and Berman attempt to do so on the ground that when a taxpayer employs another to mow his lawn, the expense is personal and not even partly business related. It is submitted, however, that such services may bear the same "but for" relationship to earning income as child care expenditures: But for the need to work, the expenditure would not be made because the taxpayer would use his own services. The difference between the two expenditures depends upon our perceptions as to the connection between the expenditure and the process of producing income. Is child care different from the cost of cleaning house to a single wage earner?

By reason of the graduated income tax rates, deductions are more valuable for high income than for low income taxpayers. Thus, to the extent that Professors Schaffer and Berman are wrong in their judgment that child care expenditures are an income producing, rather than a personal, expenditure, they will have succeeded in redistributing income from the poor to the rich. If we continue to eliminate higher income taxpayers from the benefits of the deduction by an adjusted gross income ceiling as the current statute does, however, we perpetuate the tax disincentive to mothers to work outside the home at precisely those income levels where the disparity between cash income and imputed income is likely to affect behavior.

"The search for precise equity among taxpayers" produces inordinate

⁶ Schaffer & Berman, *Two Cheers for the Child Care Deduction*, 28 TAX L. REV. 535 (1973). Andrews, *Personal Deduction in an Ideal Income Tax*, 86 HARV. L. REV. 309, 382 (1972), suggests that a child care deduction should not be considered a tax subsidy, but it is justified by the mother's loss of time for household tasks as compared with the nonworking mother.

⁷ Cf. Reg. § 1.119-1(c)(2).

complexity in the law at best;⁸ more likely, it states an unattainable goal. Tax provisions dealing with great numbers of taxpayers which depend for their soundness on generalized assumptions concerning the subjective intentions and motivations of taxpayers are apt to produce either unduly Draconian or unduly generous results in a great many cases. Perhaps the dilemma in dealing with child care expenditures derives in part from their being treated on an all or nothing basis as fully deductible or not. Unlike courts, legislatures have the option to mitigate extreme results by doing approximate and rough justice in most cases through arbitrary rules and distinctions. Where the child care covers a time period during which both spouses are at work and the child cannot be left unattended, there is some element of business relatedness which may be thought stronger and more certain than the purchase of other personal services as a substitute for consuming one's own services. While this difference is one of degree, it is one which might provide an appropriate basis for granting tax recognition to the expenditure. This recognition need not be full deductibility. Congress could give effect to the dual nature of the child care expenditure in an arbitrary arithmetic fashion by allowing a part of the expenditure as a deduction and disallowing the balance as personal. Alternatively, Congress could give recognition to the added costs of two spouses working and partially mitigate the disincentive to a wife to work outside the home, without tying the tax benefit to a specific expenditure, by excluding from income some portion of the earned income of the second spouse where both spouses work. In doing either, Congress might be giving fuller effect to the notion of taxable income as "aggregate consumption plus accumulation of real goods and services or claims thereto"⁹ than by denying or granting the deduction in full and taxing the income in full.

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⁸ *Hearings before the House Committee on Ways and Means on the Subject of General Tax Reform*, 93d Cong., 1st Sess. 7008 (1973) (statement of Secretary Schultz).

⁹ Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 318 (1972).