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Child Care, Work, and the Federal Income Tax

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CHILD CARE, WORK, AND THE FEDERAL INCOME TAX

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I. INTRODUCTION

This Article explores the federal income tax treatment of employment-related child care expenses. It takes both a theoretical and historical approach, examining the various ways in which the Code has dealt with child care in relation to conventional tax notions and values at play in the community at large.

Part II outlines the history of the Code's various child care provisions. It is a critical analysis whose purpose is to decide whether any of the provisions which have existed can be explained by a particular tax theory.

Part III asks whether employment-related child care expenses can be characterized as "business" or "personal" expenses. This question is asked in the hope that it can reveal what the proper tax treatment of employment-related child care expenses should be. Would the exclusion of such costs be a refinement of the taxpayer's income or just another loophole?

The issue of the imputed income of home production is taken up in part IV. Should a deduction for child care and household services be allowed so as to provide tax neutrality between wage work and housework?

Part V takes a second run through the history developed in part II. This time, however, the emphasis is sociological. I explore whether our reasons for preferring one child care provision over another, or over none at all, are more a product of underlying values regarding work and family than adherence to tax theory.

Finally, in part VI, I discuss what type of child care provision I think the Code should have in light of what I have presented in

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the paper.

II. A Critical History of the Tax Treatment of Child Care Expenses for Individuals Engaged in Gainful Employment

A. SMITH V. COMMISSIONER

Neither the Internal Revenue Code of 1939 nor the numerous revenue acts preceding it specifically allowed any deduction for child care expenses. Moreover, the tax law has contained since its inception a provision disallowing deductions "for personal, living or family expenses."[1] Indeed, if such expenses were deductible, an individual taxpayer could effectively eliminate his or her tax base through a total consumption of earnings.

Can personal, living or family expenses which the Internal Revenue Code generally considers nondeductible, be treated otherwise when such expenses are incurred in an extraordinary context? This was the question presented in *Smith v. Commissioner*.[2] In Smith, a woman whose husband was already working entered the marketplace. Prior to this, Lillie Smith provided household services in her home and cared for her infant son. As a result of the wife's decision to work outside the home, Lillie and her husband, Henry, hired nursemaids to take care of the child.

The taxpayers sought to deduct the cost of the nursemaids. They argued that since the expenses would not have been incurred "but for" the wife's employment, the nursemaids' wages were "ordinary and necessary business expenses" within the meaning of section 162(a).[3] The Board of Tax Appeals rejected this argument:

> Petitioners would have us apply the "but for" test . . . . This thought evokes an array of interesting possibilities. The fee to the doctor, but for whose healing services the earner of the family income could not leave his sickbed, the cost of the laborer's raiment . . ., and the very home which gives us shelter and rest and the food which provides energy might all by an extension of the same proposition be construed as necessary to the operation of business and to the creation of income. Yet these are the very essence of those

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1. Today the relevant section is I.R.C. § 262. Hereafter, unless otherwise indicated, only the section of the 1954 Code as amended will be cited. If other historical information is necessary it will be added in the text or notes.

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

3. Actually, the taxpayers sought the deduction under a predecessor provision identical to § 162(a), Revenue Act of 1936, § 23(a), 49 Stat. 1649, 1658.

"personal" expenses the deductibility of which is expressly denied.[4]

The Board's analysis was overbroad. "But for" causation is a necessary step in transforming an ordinarily personal expense into a business expense, but it certainly is not the only one. After establishing that "but for" a worker's food and shelter expenditures he or she would not have been fit to work, we should ask another question: "Would the expenditure have been incurred absent gainful employment?"[5] The answer to this question would generally be, "yes." Although in some instances unemployed individuals would not be able to obtain food and shelter, expenses for these items would generally be made absent employment.[6] The Smiths would have continued to eat even if Lillie Smith had remained at home providing household services and taking care of her child.[7]

As to the Smith's child care expenses, however, the answer to the above question is definitely, "no." The child care expenses were *only* incurred because of Lillie Smith's decision to join the workforce. This distinguishes the child care expenditures of working parents from, say, food expenditures which are related to work, if at all, in a more attenuated way.

This distinction is not necessarily dispositive of the issue presented in *Smith*. It does show, however, that the Board addressed the wrong issue—whether child care expenses in general should be treated like other personal expenses.[8] If it had focused more narrowly on the peculiar nature of child care expenses when incurred to enable an individual to work, it would have perceived, at least, a difference between the case before it and the near-complete evaporation of the tax base it conjured up in its decision.

Nevertheless, while the reasoning of *Smith* was not particu-

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

5. Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 BUFF. L. REV. 49, 64 (1971).

6. Without employment, however, the amount expended on necessities such as food, shelter and clothing would generally be less.

7. If Lillie Smith had not gone into the marketplace, the value of the foregone wages with which the Smiths could have purchased food is less than one might imagine. When she left the home, she and her husband lost the value of the untaxed imputed income from her home production. *See infra* part IV.

8. The Board, on several occasions, spoke generally of child care expenses and conclusorily determined that the expenses were personal, *e.g.*, "We are not prepared to say that the care of children, like similar aspects of family and household life, is other than a personal concern." Smith v. Comm'r, 40 B.T.A. at 1039. The expenses "are nevertheless personal in their nature of a character applicable to human beings generally, . . . and exist on that plane regardless of the occupation . . . of the individuals concerned." *Id.* at 1039-40.

larly persuasive, its holding made clear that no deduction for child care expenses would be allowed unless specific statutory authority for such a deduction were enacted.[9]

B. SECTION 214—LIMITED DEDUCTION FOR CHILD CARE EXPENSES

In 1954, Congress partially overruled *Smith* by enacting section 214 providing limited deductibility for child care expenditures. Specifically, it allowed up to a $600 itemized deduction for child care expenses, if the expenses were made to enable the parent to be gainfully employed. In 1964, Congress increased the maximum deduction to $900 if there were two or more dependents.[10] Dependent was defined as a child under the age of 13 or any other dependent of the taxpayer who was unable to take care of himself or herself.[11] In two-parent households, the expenses incurred could only be deducted if they enabled a second spouse to enter the workforce.[12]

In addition, the old section 214 employed an income phase-out and ceiling for married couples. Beginning at $4,500 in 1954 and $6000 after 1964, the deductible amount was reduced dollar for dollar for each dollar of combined adjusted gross income.[13] Interestingly, single mothers[14] were not subject to the income phase-out and ceiling provisions. They could take advantage of the full deduction regardless of their income. Finally, section 214 disallowed any deduction for a single male caretaker unless he was a widower.[15]

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9. Although *Smith*'s holding was indeed clear, that did not stop taxpayers from bringing other lawsuits raising the same issue in the context of substantially identical fact situations. *See, e.g.*, Lorenz v. Comm'r, 8 T.C.M. 720 (1949); O'Connor v. Comm'r, 6 T.C. 323 (1946).

10. Pub. L. No. 88-272, § 212(a), 78 Stat. 19, 49 (codified as I.R.C. § 214(b)(1)(B)) (repealed in 1971).

11. This was intended to cover disabled, mentally retarded and chronically ill individuals.

12. I.R.C. § 214(a),(b)(2) (1964). A working woman who incurred child care expenses while her husband was "incapable of self-support" because "mentally or physically defective" could still claim the deduction. *Id.*

13. I.R.C. §§ 214(b)(2) (1954); 214(b)(2) (1964). Since the income phase-out worked on a dollar-for-dollar basis, the 1964 ceiling was hit at $6,600 when the family had one qualifying "individual" and $6,900 when the family had two or more "dependents."

14. Widowers also were not subject to the income phase-out and ceiling. *Id.*

15. I.R.C. § 214(a)(1964). This section was held to be an unconstitutional denial of the equal protection guarantee implicit in the fifth amendment due process clause. Moritz v. Comm'r, 469 F.2d 466 (10th Cir. 1972), *rev'g* 55 T.C. 113 (1970). By the time the 10th Cir-

At first glance, the old section 214 might be viewed as an acceptance of the taxpayer's position in *Smith*. Since the provision is structured as a deduction, it is reasonable to assume that qualifying child care expenditures were considered to be true costs of going to work. That being the case, the deduction would properly offset taxes at the taxpayer's marginal tax rate. However, the fact that the statute included phase-out and ceiling amounts indicates that the business deduction concept was abandoned for higher income taxpayers. If the deduction was seen as a cost of doing the business of being employed, it is difficult to see why taxpayers with incomes above $6,900 should be denied such a deduction. They, too, must incur child care expenses when they enter the labor market. Moreover, the business deduction explanation breaks down on the lower end of the income spectrum as well. By making section 214 an itemized deduction, Congress denied a deduction for employment-related child care to a very large proportion of low and middle income taxpayers. Finally, even if we assume that in 1954 $600 was a proper estimate of the annual cost of care for one child, nine hundred dollars could not have covered the cost of care for two, let alone three or more, children.[16]

Since the old section 214 was not structured as a business expense, it was probably seen by Congress as a tax subsidy or hardship provision. This is indicated by the presence of the income phase-out and ceiling. However, if it was meant as a hardship provision it certainly failed. First, it ignored those taxpayers most in need by only allowing the deduction to itemizers. Second, by virtue of the graduated tax rates the deduction, as opposed to a tax credit or a direct subsidy targeted to low- and middle-income parents, gave a relatively greater benefit to those whose incomes came closest to the phase-out amount.

In effect, then, the old section 214 combined certain aspects of a tax subsidy and a business expense deduction in an incoherent manner. The result was an expensing of child care costs for a small proportion of middle-income taxpayers. In addition, Congress' decision to disallow the deduction for single fathers, and to disregard the income limitations for single mothers, was, when read in con-

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cuit decided *Moritz*, the statute had already been changed to cure the constitutional defect. Pub. L. No. 92-178, § 210, 85 Stat. 497, 518. *See also* Note, *Sex and the Single Man: Discrimination in the Dependent Care Deduction*, 5 VAL. U.L. REV. 415 (1971).

16. By the time the old § 214 was overhauled in 1971, $600 per year was well below the average cost of child care in this country. S. REP. No. 437, 92nd Cong., 1st Sess. 60, *reprinted in* 1971 U.S. CODE CONG. & AD. NEWS 1918, 1967.

junction with the entire section, inconsistent with either a notion of business deduction or subsidy. Those provisions can only be explained as expressions of social ideals regarding child rearing and family life.[17]

C. THE NEW SECTION 214—EXPANDED DEDUCTION FOR CHILD CARE EXPENSES

In 1971, Congress rewrote section 214, providing for the first time a large deduction to a fairly wide range of taxpayers.[18] The amounts allowed as deductible expenses increased dramatically. If child care was provided in the home, a family was allowed to deduct up to $400 per month regardless of the number of children in the household.[19] For child care outside of the home, most likely purchased from a day care center, a deduction for one qualifying individual of up to $200 per month was allowed; for two and three qualifying individuals the maximum amounts allowed were $300 and $400 per month, respectively. Thus, an otherwise eligible taxpayer could deduct up to $4800 per year. The section retained an income phase-out and ceiling, but they were greatly in excess of those allowed by old section 214. The phase-out began at $18,000 and was reduced by one-half the excess of adjusted gross income over $18,000, resulting in a ceiling of $27,600. Moreover, the phase-out and ceiling amounts were increased in 1975 to $35,000 and $44,600, respectively.[20]

Qualifying individual in the new section 214 was defined somewhat differently than it had been in the past. Disabled adult dependents were still included, as were dependent children, but the maximum age of a child for whom expenses were deductible was raised to 15. In addition, married couples could take deductions if only one spouse worked, provided that the other spouse was disabled or otherwise unable to take care of the children.[21]

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17. *See generally infra* part V.

18. Sec. 210(a) of the Revenue Act of 1971, Pub. L. No. 92-178, 85 Stat. 497, 518 (repealed in 1976).

19. I.R.C. § 214(c)(1) (1971). Section 214 allowed the deduction of employment-related expenses including not only child care costs, but ancillary household services as well. I.R.C. § 214(b)(2)(1971) (repealed in 1976).

20. Section 206 of the Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26, 32 (repealed 1976).

21. Old § 214 had been amended in 1964 to allow deductions "in the case of a [working] woman who is married [for such child care] expenses incurred while her husband is incapable of self-support." Pub. L. No. 88-272, § 212(a), 78 Stat. 18, 49.

Finally, the new provision made all taxpayers, married and unmarried,[22] subject to the income phase-out and ceiling, and gave single fathers parity with single mothers by allowing them to take full advantage of deductibility.[23]

In spite of its major changes, section 214 still did not evoke a uniform rationale for its adoption. It failed to choose between business deduction and subsidy, between refinement of income and hardship provision. The legislative history suggests that Congress saw the new child care provision as a departure from the income tax base which was specifically enacted to encourage economic growth. As the Senate Finance Committee put it:

> [T]he bill provide[s] a new job development deduction which is designed to encourage the employment of individuals in child care and domestic service and to relieve hardship in certain cases where substantial extra expenses are incurred for such purposes . . . . [I]t provides a substantial incentive for the employment of qualified individuals in household service. Accordingly, it can be expected to give large numbers of individuals who are now receiving public assistance the opportunity to perform socially desirable services 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.[24]

Section 214 hardly seems to be the proper mechanism to achieve the Committee's objectives. First, the new provision, like its predecessor, could only be used by itemizers. If "hardship in certain cases" was Congress' primary concern, the scheme enacted would bypass those most in need by excluding nonitemizers.[25] Second, the measure could not have fulfilled its goal of being a hardship provision because it was structured as a deduction which provides relatively greater benefit as the marginal tax rate increases. Finally, if one of section 214's aims was to increase employment of domestics, lower income nonitemizers should have been targeted for the deduction in addition to the moderate income itemizers, because the latter were more likely to have been employing domestics already.

The legislative history also reveals the continuing belief that

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22. *See supra* text accompanying notes 14 and 17.

23. *Compare supra* note 15 and accompanying text.

24. S. REP. No. 437, 92nd Cong., 1st Sess. 13, *reprinted in* 1971 U.S. CODE CONG. & AD. NEWS 1918, 1929.

25. Of course, those most in need are those who owe no federal taxes by virtue of their poverty. *See infra* text accompanying notes 35-36 (regarding refundable child care credit).

child care expenses (when incurred to enable a parent to enter the workforce) are business expenses, and should be deductible on the ground that their exclusion from the tax base is a better indication of the individual's net income or ability to consume.[26] The arbitrary income limitations imposed by the new section 214, however, made it a poor business deduction model. It also failed as a business expense at the other end of the income spectrum by not including nonitemizers. This result could not reasonably be explained on the grounds that the greatly increased amount of child care expenses allowed by new section 214 was already subsumed within the standard deduction.

The new section 214 made the same mistakes as did its predecessor; it failed to decide what type of provision it wanted to be. If the Congress wanted to enact a hardship provision, it certainly failed by leaving out those most in need and skewing the assistance which it did provide to taxpayers with relatively higher incomes. On the other hand, if Congress wanted to extract child care expenses from the tax base as a refinement of income for working parents, it did so in a remarkably underinclusive manner by focusing on a relatively small group of middle-income taxpayers.

Nevertheless, by increasing the maximum allowable deduction from $900 per year to $4800 per year, Congress took a significant step in expanding the child care provision and making it possible for second earners and single heads of households to obtain gainful employment outside the home.

D. SECTION 44A—THE CHILD CARE CREDIT

As part of the Tax Reform Act of 1976, section 214 was repealed and replaced by section 44A, a credit for household and dependent care services.[27] With section 44A, Congress, for the first time, fully embraced the notion of a subsidy or hardship provision. As the Senate Finance Committee stated:

> The committee believes that the availability of the child and dependent care deduction under present law (sec. 214) is unduly restricted by its classification as an itemized deduction . . . .

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26. S. REP. No. 437, 92nd Cong., 1st Sess. 59, *reprinted in* 1971 U.S. CODE CONG. & AD. NEWS 1918, 1966 ("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").

27. Sec. 504(a) (1) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, 1562.

> Treating child care expenses as itemized deductions denies any beneficial tax recognition of such expenses to taxpayers who elect the standard deduction. The committee believes that such expenses should be viewed as a cost of earning income for which all working taxpayers may make a claim. One method for extending the allowance of child care expenses to all taxpayers, and not just itemizers, would be to replace the itemized deduction with a credit against income tax liability for a percentage of qualified expenses. While deductions favor taxpayers in the higher marginal tax brackets, a tax credit provides more help for taxpayers in lower brackets.[28]

As implied in the above quote, section 44A enacted a credit available to all qualifying parents, nonitemizers as well as itemizers. It eliminated the income ceiling and the previously recognized distinction between child care provided in the home and child care provided in a day care center.[29] It also permitted certain married students to qualify as employed persons for the purposes of the credit.[30]

Originally, section 44A allowed a 20 percent credit for up to $2,000 in child care expenses per year for one qualifying individual[31] and $4,000 per year for two or more qualifying individuals. In 1981, Congress raised these amounts to $2,400 and $4,800, respectively, because of substantial increases in employment related expenses.[32] In addition, in 1981, the section 44A flat credit of 20 percent was changed to a reverse graduated credit beginning at 30 percent for taxpayers with adjusted gross incomes of $10,000 or less and bottoming out at 20 percent for taxpayers with adjusted gross incomes of over $28,000.[33] With this alteration, Congress more explicitly moved toward a subsidy of low income parents. The chart below, correlating the maximum credit benefit with income level, is illustrative:[34]

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28. S. REP. No. 938, 94th Cong., 2d Sess. 132, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3439, 3565.

29. *Compare supra* text accompanying notes 19-20 *with* I.R.C. § 44A(d). The 1981 amendments to § 44A require that payments made to a day care center can be credited only if "such center complies with all applicable laws and regulations of a state or unit of local government . . . ." Sec. 124(d) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, 198 (codified as I.R.C. § 44A(c)(2)(C).

30. *See* I.R.C. §§ 44A(c)(2)(A), 44A(e)(2).

31. The term "qualifying individual" was defined as it was in the old § 214. *See supra* text accompanying note 21.

32. H. R. REP. No. 201, 97th Cong., 1st Sess. 56 (1981).

33. Sec. 124(a) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, 198 (codified as I.R.C. § 44A(a)(2)).

34. The chart is reproduced from STAND. FED. TAX. REP. (CCH) ¶523J.05 (1983).

Adjusted Gross Income	Applicable Percentage	Maximum Credits: One Qualifying Individual	Maximum Credits: Two or More Qualifying Individuals
Up to 10,000	30%	$720	$1,440
$10,001-12,000	29%	696	1,392
12,001-14,000	28%	672	1,344
14,001-16,000	27%	648	1,296
16,001-18,000	26%	624	1,248
18,001-20,000	25%	600	1,200
20,001-22,000	24%	576	1,152
22,001-24,000	23%	552	1,104
24,001-26,000	22%	528	1,056
26,001-28,000	21%	504	1,008
28,001 and over	20%	480	960

Under present law, the child care credit still does not benefit society's poorest parents because it can only be used to offset taxes otherwise owed; in other words, it is not refundable. Senator Kennedy proposed a refundable credit when the enactment of section 44A was originally considered. His proposal was passed by a large margin in the Senate (71-21), but it was rejected by the Conference Committee.[35] A refundability proposal met the same fate in 1981.[36] Without refundability, however, section 44A cannot carry out fully the purpose implicit in the reverse graduated credit—to extend the bulk of the benefits to those most in need.

Nevertheless, section 44A represents the first time Congress has enacted a child care provision which is seemingly consistent with its stated purpose. The 1976 enactment envisioned a certain amount of child care as socially desirable and fashioned a credit to subsidize all qualifying taxpayers for a part of that amount. In 1981, Congress extended the subsidy even further to low-income taxpayers by granting them a tax credit for a greater percentage of their child care expenditures.

E. SECTION 129—DEPENDENT CARE ASSISTANCE PROGRAMS

In 1981, as part of ERTA, Congress enacted section 129 which provides for dependent care assistance programs.[37] A dependent

35. 122 CONG. REC. 23117 (1976); H.R. CONF. REP. 1515, 94th Cong. 2d Sess. 432, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 4118, 4141.

36. H.R. REP. No. 215, 97th Cong., 1st Sess. 200-01, *reprinted in* U.S.CODE CONG. & AD. NEWS 105, 290-91.

37. Sections 124(e) and (f) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-

care assistance program must be embodied in a "written plan of an employer for the exclusive benefit of his employees to provide such employees with dependent care assistance."[38]

If the dependent care assistance program satisfies the requirements of section 129, an eligible employee may exclude from gross income the amount of dependent care assistance purchased by the employer on the employee's behalf.[39] Dependent care assistance is defined as "services which if paid for by the employee would be considered employment-related expenses under section 44A(c)(2)."[40] Therefore, dependent care expenses incurred to enable the taxpayer to be gainfully employed are excludable. The dependent care can be provided in the home or in a day care center.[41] Unlike section 44A, there are no absolute limits on the amount of dependent care expenditures which can be taken into account,[42] but the excluded amount cannot exceed the earned income of the taxpayer or in the case of a married couple, the earned income of the lower earning spouse.[43]

An employer must make the plan available to its employees on a nondiscriminatory basis by not favoring "employees who are officers, owners or highly compensated."[44] In addition, "[r]easonable notification of the availability and terms of the program shall be provided to eligible employees."[45] Finally, a self-employed person can be considered his or her own employer, and a partnership can

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34, 95 Stat. 172, 199.

38. I.R.C. § 129(d)(1) (1983).

39. I.R.C. § 129(a)(1983).

40. I.R.C. § 129(e)(1) (1983).

41. I.R.C. § 44A(c)(2) (1983).

42. *Compare* I.R.C. § 44A *with* I.R.C. § 129.

43. I.R.C. § 129(b)(1). Earned income, as defined in I.R.C. § 43(c)(2), does not include for the purposes of § 129 amounts incurred by an employer in providing dependent care assistance to an employee. Section 44A also has an earned income limitation in addition to the absolute limitations on the amounts to which the credit may be applied. *See* I.R.C. § 44A(e).

44. I.R.C. § 129(d)(2). The nondiscrimination clause was modified by Pub. L. No. 97-448, § 101(e)(1)(A), 96 Stat. 2365, 2367. However, discrimination will not result from excluding "employees not included in a program who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that dependent care benefits were the subject of good faith bargaining between such employee representatives and such employer or employers." I.R.C. § 129(d)(3)(1983). *See also* I.R.C. § 129(d)(4) (Amounts paid to employees who are large corporate stockholders or owners cannot exceed 25% of the total amounts paid or incurred by the employer in any year).

45. I.R.C. § 129(d)(6).

be considered as the employer of working partners.[46]

Section 129 seems to do what section 44A does not—it allows the taxpayer to treat dependent care expenses as a business deduction. For example, a two-earner family earning $20,200 per year with $4,400 in child care expenses excluded pursuant to a section 129 plan receives the same tax benefit as it would earning $24,600 in otherwise taxable income with a deduction for $4,400 of child care costs.[47] Very significantly though, an exclusion benefits all nonitemizers and itemizers in full because it operates without regard to the zero bracket amount. By allowing all eligible parents to effectively expense their child care outlays, section 129 embodies the ideal of business deduction to a much greater degree than did the section 214 deduction with its income ceiling and bar against nonitemizers.[48]

However, section 129 poses two problems. First, by allowing a deduction limited only by the earning power of the taxpayer-parent,[49] the government has created the potential for deductions which are purely personal in character. For example, a working couple has a combined income of $40,000 per year, split roughly equally between husband and wife. Their two preschoolers need child care and, therefore, the couple investigates the local day care center which they discover costs $4800 per year for two children. The day care center complies with all state and local health and safety regulations. It provides continuous supervision and organized group activities in safe and pleasant, but not extravagant, surroundings. The children eat a lunch at the center which they bring with them each morning. The center does provide a small midmorning snack every day.

The couple considers the day care center, but decides that it simply is not good enough for their children. Instead, they hire a

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46. I.R.C. § 129(e)(3) and (4).

47. The tax rate for married individuals filing joint returns for taxable incomes over $20,200, but not exceeding $24,600, is 23%. I.R.C. § 1(a)(2). Therefore, the tax savings for the family in my hypothetical would be $1,012 ($4,400 x .23). I have simplified the hypothetical by making the couple's gross income equal to their tax table income. In reality, the couple would have taken at least four exemptions and probably other deductions and credits.

48. Of course, any deduction or exclusion benefits the taxpayer only to the extent to which it is used against or exempts otherwise taxable income. If a single taxpayer earned $2,000 in a year all of which was excludable as a fellowship under I.R.C. § 117, the taxpayer would not receive any tax benefit because $2,000 in income is effectively taxed at zero percent.

49. *See supra* text accompanying notes 42-43.

nursemaid to come to their home every weekday for eight to ten hours. The nursemaid dresses the children each morning, cooks and feeds them lunch, and otherwise keeps them occupied by taking them to visit neighborhood children and to the local park. The nursemaid demands a $11,000 salary.

The mother is a partner in an accounting firm. The partnership reduces her $20,000 salary to $9,000, and pays the $11,000 salary directly to the nursemaid on a periodic basis pursuant to its section 129 dependent care assistance program.[50]

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50. Indeed, there is no need for the partnership to pay the nursemaid. The partnership can simply create a "reimbursement account." The partner can pay the nursemaid, submit evidence of such payment to the partnership (cancelled check or the like), and be reimbursed by the partnership for the proper amount. The reimbursed amounts will be excluded from the partner's income. Large companies follow the same procedures for their employees. Waldholz, *'Cafeteria' Benefits Plants Let Employees Fill Their Plates, Then Pay With Tax-Free Dollars*, Wall. St. J., May 9, 1983, at 58, col. 1 ("During the year he will submit bills from his housekeeper and be paid out of the company's child care reimbursement account."). Although the child care expenses will not appear on the taxpayer's W-2 form, the employer is required by January 31 to submit a statement to the employee showing the amounts incurred for child care expenses for the prior year. I.R.C. § 129(d)(7). The Service has the right to demand a copy of the statement from the employer. STAFF OF THE JT. COMM. ON TAX'N, 97TH CONG., 1ST SESS., GENERAL EXPLANATION OF THE ECONOMIC RECOVERY TAX ACT OF 1981 at 55, *reprinted in* INTERNAL REVENUE ACTS 1980-81 (West) 1369, 1430.

Recently, the Service has attacked the use of reimbursement plans under § 129 and, more generally, under § 125 (cafeteria plans) which had been interpreted to allow exclusion for a host of benefits, *e.g.*, health care, prepaid legal services, in addition to child care. *See generally*, Waldholz, *supra*.

On February 10, 1984, the Service issued an announcement retroactively invalidating most reimbursement plans, *i.e.*, those which allowed periodic reimbursement for benefits as expended and a gross determination of tax exludability at year's end. IR 84-22 (Feb. 10, 1984), 1984 FED. TAXES(P-H) ¶ 54,902.

The only plans which the Service found legal were those "in which the employee can make a one-time election before the beginning of the year between cash and eligibility for reimbursement of certain expenses . . . up to a stated amount." *Id.* Thus, if an employee overestimates his or her child care expenditures, he or she would simply lose the excess allocated to child care which might otherwise be paid out as salary. If an employee underestimates the cost of child care, the excess necessary to provide such child care must be paid out of after-tax dollars. Thus, the Service interpretation invoked the notion that only those dollars at risk (based upon a prior estimate of expenses) should be excludable. It is difficult to see how the Service derived such an interpretation from either § 129 or § 125. Moreover, the at risk concept simply does not inform a policy judgment of how much child care (or other) costs should go untaxed, but rather forces the employee into a pre-expenditure guessing game regarding the cost of certain services. For instance, if the cost of child care were to unexpectedly double in a particular year, the affected employee would have guessed wrong, and would thus lose tax benefits clearly provided for in § 129.

In any event, the Service announcement, which promised regulations in the near future, raised "questions about the validity of all but the most conservatively drawn flexible compensation arrangements." DAILY TAX REP. (BNA) No. 30, at G-2 (Feb. 14, 1984). Reaction was swift and negative from the lawyers of large corporations making use of such plans and

Assuming that the $4,800 day care center provides services which would have enabled the taxpayer to be gainfully employed,[51] then the additional $6,200 spent by the couple can only be viewed as consumption. Of course, whether such expenditures would be excludable depends on the quality and quantity of dependent care services which are seen as necessary to enable the taxpayer to be gainfully employed. The Tax Court and the Service have interpreted this standard quite liberally.[52] Moreover, section 44A(c)(2), which creates the standard to which section 129 must look, specifically permits the taxpayer to include household services as an expense when such services are performed in conjunction with child care. Therefore, it is extremely likely that the couple in the above hypothetical would be allowed the full $11,000 exclusion even though less than half of that amount can be viewed as a business expense.

Second, section 129 excludes taxpayers whose employers do not adopt a plan from partaking of its benefits. For employers, amounts incurred under section 129 are considered employee com-

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of wealthy individuals benefiting from such plans, especially with regard to the Service's decision to apply its interpretation retroactively to the original effective date of § 125, January 1, 1979. *See* Lublin, *IRS Provokes Uproar by Attacking Corporation 'Reimbursement' Plans*, Wall St. J., March 20, 1984, at 35, col. 4; Klott, *'Cafeteria' Plans Face I.R.S. Curb*, N.Y. Times, May 4, 1984, at D-1, col. 1.

Shortly thereafter, Representative Barber Conable (R-NY) proposed a legislative change, basically adopting the Service's stance, but eliminating retroactivity. All reimbursement plans existing on or before January 1, 1984, would be valid. In addition, the Conable proposal would establish exclusion limits under section 129 of $2400 applied to one child and $4800 applied to two or more children. Thus, the maximum amounts excludable would track the limits under the § 44A credit. *See* DAILY TAX REP. (BNA) No. 83, at G-3, J-1 (April 30, 1984).

On May 7, 1984, the Service issued proposed regulations which basically confirm its February 10, 1984 announcement, though there is some narrow relief from retroactivity. 49 Fed. Reg. 19,321-28 (May 7, 1984). For an excellent description and analysis of the proposed regulations *see* 23 TAX NOTES 743, (May 14, 1984).

Regardless of whether or not the Service's interpretation is justified, the outcry after its announcement makes clear the economic interest that individuals and corporate employers have in continuing the tax-exempt status of the significant employee expenditures covered by § 129 and related provisions.

As this Article goes to press, the Tax Reform Act of 1984 has been signed by President Reagan. A generous transition rule in the Act eliminates retroactivity, § 531(b), Pub. L. No. 98-369.

51. *See* I.R.C. § 44A(c)(2). This is the standard set out in the § 44A child care provision. However, § 129 specifically invokes the § 44A standard. I.R.C. § 129(e)(1).

52. Brown v. Comm'r, 73 T.C. 156 (1979) (food and lodging components of boarding school expense deductible where parent said she could not be employed if her son did not attend the school); Rev. Rul. 76-288, 1976-2 C.B. 83 (out-of-pocket expenditures for housekeeper's meals and lodging qualify as child and dependent care expenses).

pensation deductible under section 162.[53] Therefore, when incurred in the form of a salary reduction, the cost to employers of dependent care assistance programs will consist solely of the administrative overhead of devising and maintaining a plan. Plans likely will be adopted by large companies which can afford to absorb such costs[54] and want to use the plans to attract employees.[55] Self-employed taxpayers can adopt their own plans and thereby deduct, as employers, and exclude, as employees, expenses incurred for dependent care.[56] Section 129, by requiring employer plans as a conduit for child care deductions, will tend to exclude taxpayers who work for small and middle-sized firms which do not find it financially feasible to adopt such plans.

Therefore, while section 129 appears on the surface to achieve perfect excludability for employment-related child care expenses and thus give such expenses business deduction status, it is in fact both overinclusive and underinclusive. By failing to put a limit on the amount excludable, it permits personal expenses for the children of the well-to-do to go untaxed; by not extending the exclusion to all working parents who incur child care costs, it discriminates arbitrarily in favor of those whose employers adopt a dependent care assistance plan.

III. Child Care Expenses: Business or Personal

In part II, I discussed the various child care provisions of the Code in light of the fundamental assumption that business expenses should be excluded from the tax base. This assumption, embodied in section 162, is based on the notion that the taxpaying unit should be taxed on *net* income, *i.e.*, its ability to consume.[57]

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53. Staff of the Jt. Comm. on Tax'n, 97th Cong. 1st Sess., General Explanation of the Economic Recovery Tax Act of 1981, at 55, *reprinted in* Internal Revenue Acts 1980-81 (West) 1369, 1430.

54. *See* Waldholz, *supra* note 50 (for large companies the start-up costs for benefits plans can be very high); *but see* Brudney, *Local Groups Make Strides Toward Better Child Care*, Boston Globe, Jan. 30, 1983, at 73, col. 1 (Child Care Law Center has prepared a pamphlet explaining an easy-to-adopt model plan pursuant to § 129).

55. *See* Waldholz *supra* note 50 ("The idea [according to the vice president of a Pittsburgh bank] is to keep the bank competitive with other employers.").

56. I.R.C. § 129(e)(3) and (4). But the requirement that no more than 25% of the payments be made to owners or 5% shareholders will often limit the benefits available to self-employed individuals. I.R.C. § 129(d)(4).

57. *See* I.R.C. § 162(a)(deduction for "all the ordinary and necessary business expenses paid or incurred during the taxable year in carrying on any trade or business . . ."); *see also* I.R.C. § 212 (individuals "allowed . . . a deduction [for] all ordinary and necessary business expenses paid or incurred during the taxable year for the production of income . .

I have argued that the Congressional enactments regarding employment-related child care have failed to embrace fully the concept of business deduction or tax subsidy, although the legislative histories have given lip service to both.[58] Indeed, if such expenses were viewed as completely consistent with the business expense concept, the Congress would have enacted a child care deduction available to all working taxpayers. The deduction would be allowed up to the taxpayer's actual expenses, but not to exceed an amount reasonably calculated to enable the taxpayer to be gainfully employed.[59]

This part will discuss whether child care expenses can properly be classified as business expenses which should be deductible or as personal expenses, deductible, if at all, only under a hardship theory.

Politicians and commentators have argued that child care expenses should be treated in the same manner as other business deductions. Senator Tunney introduced a bill in 1975[60] which called for such treatment. He supported the measure by drawing the following analogy:

> [I]f John D. Rockefeller needed to hire a new secretary in order to be able to utilize his time more effectively in his work, he would be able to obtain a business expense under present Federal tax laws. If, on the other hand, a mother wants to go out and earn some money . . . and she wants to hire somebody to help care for her home and help look after her children, she is not able to claim such a salary cost as a business expense. It really is not fair to grant relief to the business man to hire a secretary and at the same time not grant the same relief to the mother who wants to work.[61]

One commentator has specifically decried the Code's prior in-

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58. Even the legislative history of the § 44A credit speaks in "business expense" language: "The committee believes that such expenses should be viewed as a cost of earning income for which all working taxpayers may make a claim." S. REP. No. 938, 94th Cong., 2d Sess. 132, *reprinted in* 1976 U.S. CODE CONG. & AD. NEWS 3439, 3565; *see supra* text accompanying note 28.

59. I.R.C. § 44A(c)(2)(A).

60. S. 1171, 94th Cong., 1st Sess. (1975). Senator Tunney had introduced two similar bills which had passed the Senate in 1971 (74-1) and 1972 (71-8), but had died in the Conference Committee. H. CONF. REP. No. 708, 92nd Cong., 1st Sess. 42, *reprinted in* 1971 U.S. CODE CONG. & AD. NEWS 2053, 2062. *See* Comment — *Section 504 of the Tax Reform Act of 1976: The New Credit for Child Care Expenses*, 30 TAX LAW. 456, 465 n. 55.

61. 117 Cong. Rec. 41252 (Nov. 15, 1971) (Statement by Senator Tunney in support of his 1971 bill); *see supra* note 60.

sistence on income limitations, and the continuing presence of an expense cap in the child care provision.[62]

> If, however, child care expenses are viewed as a cost of earning income, a deduction of simply the total expenses from gross income is the more equitable approach
> . . . Only a Section 162 deduction from gross income makes it at all feasible, as an economic matter, for a mother in the upper tax brackets to work outside her home.[63]

Another writer has defended a child care deduction on business expense grounds and included an attack on the notion of the child care deduction as subsidy:

> The Code does not require that a businessman show that he is economically constrained to pursue his business as a prerequisite for deduction of business expenses. Our society does not encourage individuals or families to view mere subsistence as an economic goal. . . . While . . . consideration for the poor is commendable it is beside . . . . the point. . . . A proper analysis of child care deductions should not focus on hardship; it should not even refer to it.[64]

On the other hand, other commentators have argued that a child care deduction erodes the tax base in providing for an essentially personal tax benefit.[65] The Office of Management and Budget has seemingly accepted this line of argument, as it has classified the child care credit as a tax expenditure.[66] Still other commentators have rejected the tax expenditure analyses as applied to child care.[67]

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62. This commentator would probably be quite pleased with the disregard of an expense limitation in § 129. *See supra* text accompanying notes 49-53.

63. Comment, *supra* note 60, at 466, 467, 468.

64. Blumberg, *supra* note 5, at 71, 77. In fairness to Blumberg, she does believe that poor working mothers should be helped also. "Direct subsidy is necessary. At the very minimum [the poor] should receive a 'refund' to the extent that they are unable to benefit from the deduction." *Id.* at 76. She would also insist on making a deduction available to nonitemizers. *Id.* at 77.

65. *See, e.g.*, Shreiber and Yoran, *Child Care Expenses: A Proposal for a More Equitable and Efficient Tax Treatment*, 54 TAXES 345 (1976); Hjorth, *A Tax Subsidy for Child Care: Sec. 210 of the Revenue Act of 1971*, 50 TAXES 133 (1972); Keane, *Federal Income Tax Treatment of Child Care Expenses*, 10 HARV. J. ON LEGIS. 1 (1972).

66. EXECUTIVE OFFICE OF THE PRESIDENT, OFFICE OF MANAGEMENT AND BUDGET, SPECIAL ANALYSES—BUDGET OF THE UNITED STATES GOVERNMENT FISCAL YEAR 1984 at G-27 (child care credit: $1.83 billion in fiscal year 1982).

67.For a criticism of tax expenditure analysis in certain instances *see* Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309 (1972). Andrews briefly rejects tax expenditure analysis with respect to child care expenses of working parents. *Id.* at 382. *Cf. generally* Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Re-*

It is my view that employment-related child care expenses cannot be forced into either a business or personal category. It is easy enough to reject a pure tax expenditure contention. A single parent, for example, must by law provide care for his or her young child if he or she wants to maintain employment outside the home. It is an expenditure resulting from the decision to enter the workforce which did not exist before that decision. Therefore, a deduction would arguably provide a refinement of the single parent's income. The prototypical tax expenditure, say, the municipal bond interest exclusion, never refines income, it hides income.

Should child care on the other hand, be seen as a pure business expense? First, it must be distinguished from the section 162 ordinary and necessary business expense. Although proponents of the business expense argument like to compare working parents' child care costs with those of business people, the latter are more businesslike because they are of a type which generally *never* arise in a personal context.[68] Typical section 162 expenses such as wages, rental of business premises and the like should usually be deductible no matter how imprudently incurred because those who incur them are not consuming thereby.

On the other hand, while child care expenses can be seen as employment-related when they provide the child with safe and proper care, it is difficult to justify deductibility for extravagant child pampering as necessary (in the section 162 sense) to the parent's employment.[69] Thus, the claim that "cost should not be an issue at all"[70] with regard to child care is without merit.

Second, even assuming that the child care deduction provision contains an expense ceiling, it can be argued that employment-related child care expenses are not entirely a cost of doing business. In the case where a two-parent family has been purchasing child

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form, 80 HARV. L. REV. 925 (1967) (tax expenditure analysis insufficient device to achieve comprehensive tax base; reform must be achieved on a provision-by-provision analysis).

68. The major exceptions are travel and entertainment expenses and business lunches which have large personal components. Examples of other borderline business purchases would be the building of an executive lunchroom, the purchase of plush carpeting for the law firm, etc. While these items may ostensibly be purchased to impress clients, they also provide comfort for those who work in the business environment. Although, the Code has drawn a line between the workplace as business and the home as personal for reasons of administrative convenience, it is easy to see that certain items are mixed in nature. In spite of the administrative convenience argument, it is clear that certain class biases play a role when one takes account of the types of items which fall on the business side of the business/personal borderline.

69. *See supra* text accompanying notes 49-53.

70. *See supra* text accompanying note 64.

care services even though one spouse does not work outside the home, it is clear when that spouse decides to enter the marketplace that the continuing child care expenses were not incurred to enable him or her to engage in gainful employment. On the other hand, it is still true that the couple must purchase child care so long as they work even if they would no longer purchase child care if not required by their employment. The fact that the child care expenses were not originally incurred to enable the second spouse to work is insufficient reason to classify such expenses as forever non-earnings-related. It is simply impossible in this situation to ascertain whether the expenses are business or personal.

Moreover, how would the Service effectively deny deductions to working parents who purchased child care services without regard to their market employment? The regulations under section 44A state: "An expense is not considered to be employment-related merely because it is incurred while the taxpayer is gainfully employed. The *purpose* of the expense must be to enable the taxpayer to be gainfully employed."[71] Despite this regulation there is no indication that the Service has tried to enforce such a policy.[72] Trying to delve into the purpose of taxpayers' child care expenses would be costly and fruitless. No objective test could be devised to divine people's reasons for purchasing care for their children. Therefore, if child care expenses are incurred, they must qualify for beneficial tax treatment even if they may not always *enable* the taxpayer to obtain gainful employment. However, Feld has argued that:

> [E]ven where the expense would not be incurred but for the opportunity to enter into gainful employment, the working wife is likely to receive personal gratification from the child care. Accordingly, at least in some degree, the expenditure does not represent a disincentive to work but a means of obtaining personal gratification. In view of the inherent difficulty in determining what part of the expenditure should be regarded as business related rather than personal, the tax base should not be further eroded by permitting a deduction.[73]

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71. Treas. Reg. § 1.44A-1(c)(1)(i) (1983) (emphasis added).

72. There are no cases denying child care deductions or credits to families because they could have afforded, or did in fact purchase, child care services prior to gainful employment. *See* STAND. FED. TAX REP. (CCH) ¶523J.2835 (1983). *But cf.* Semel v. Comm'r, 24 T.C.M. 1176, 1189 (1965) (employed father sent $40 per week to ex-wife pursuant to a court order; *held*, father did not prove expenses enabled him to be gainfully employed and, in any event, he did not stipulate what part of the $40 was for child care within the meaning of § 214).

73. Feld, *Deductibility of Expenses for Child Care and Household Services*, 27 TAX L.

Feld's personal gratification argument seems faulty. In what sense does child care serve as a means of obtaining personal gratification? When, for instance, a second spouse leaves the home to take marketplace employment, it is often true that he or she has given up homemaking and child-rearing because those tasks are no longer, or never were, personally satisfying. However, even Feld suggests, the anxiety of leaving one's children in the care of strangers might sometimes result in a net dissatisfaction for the parent.[74]

On the other hand, a business person may be very gratified when handing the first paycheck to an employee who he or she fought very hard to attract to the firm. Should we deny a deduction for all or part of the wages paid? A tax system cannot base itself on subjective assessments of satisfaction lest it be willing to award deductions for psychic depression and make positive assessments of units of happiness. Such a task would be impossible. The Code seeks, instead, to distinguish personal or consumptive behavior[75] from behavior whose purpose is to produce income with which to consume.[76] This distinction is not a clear one,[77] and is often deliberately strayed from, but is ultimately one which must be sought if we want to tax ability to consume, not merely gross receipts.[78] A

REV. 415, 429 (1972).

74. *Id.* at 426 ("Of course, the extent of the enjoyment derived from this service will vary among working mothers; indeed, for some the anxiety of being concerned about the welfare of the children . . . will outweigh any satisfaction.").

75. *See* I.R.C. § 262. The term "consumption" itself is very difficult to define. *See generally* Andrews, *supra* note 66 and especially at 355-56 where he rejects the concept of consumption as gratification with respect to the charitable deduction. *But see* Kelman, *Personal Deductions Revisited: Why They Fit Poorly in an 'Ideal' Income Tax and Why They Fit Worse in a Far from Ideal World*, 31 STAN. L. REV. 831, 835-58 (1979).

76. *See* I.R.C. §§ 162, 212. "Productive behavior" is an elusive term. How do we determine when the taxpayer is really trying to be productive? *See, e.g.*, I.R.C. §§ 183 (Hobby Losses) and 280A (Business use of Residences). *See also* Dreicer v. Comm'r, 665 F.2d 1292 (D.C. Cir. 1982), holding that the *objective* to make a profit even without the expectation of making a profit will justify a deduction under § 183.

77. Far from being clear, the distinction between business and personal life, like other public/private distinctions, is informed by our sense of the social universe which is constantly changing and often murky and indeterminate. *See generally*, Kennedy, *The Stages of the Decline of the Public/Private Distinction*, 130 U. PA. L. REV. 1349 (1982). My example involving the fast food entrepreneur, *see infra* text accompanying note 86, illustrates the difficulty of determining whether something is in fact business or personal, in spite of a superficial legal determination that it is clearly one way or the other.

My point here, nevertheless, is that even if such determinations are difficult to make, they must be made if an income tax, rather than a gross receipts tax, is the objective. *See infra* note 78 and accompanying text.

78. A gross receipts tax does not attempt to achieve vertical or horizontal equity as

discussion of a taxpayer gratification simply does not illuminate the problem.

Blumberg poses a more interesting problem adverted to earlier in this paper.[79] She claims that child care expenses are pure business deductions because they would not be incurred absent gainful employment.[80] On one level her point is absolutely correct; if a parent chooses to work in the home, no child care expenses need be incurred. When the parent leaves the home to take gainful employment, he or she must provide care or possibly face charges of criminal neglect. Except in the instances in which friends and neighbors take care of the child gratis, child care will be purchased.

Blumberg claims that the origin of the expense is the parent's decision to obtain gainful employment, and therefore, business deduction treatment is appropriate. The so-called origin test emanates from the case of *United States v. Gilmore*[81] in which the Supreme Court denied the taxpayer a deduction for legal fees incurred in a divorce proceeding. Even though the taxpayer's lawyer was employed in order to protect the husband's business interests from the wife, the Court denied the deduction on the ground that the expense had its origin in a family, *i.e.* personal, relationship. The *Gilmore* rule is problematic. For example, a restauranteur, on the verge of divorce, finds out that her husband is publicizing false and derogatory information about the quality of food at her restaurant out of sheer hostility. Business drops markedly, and the restauranteur brings a libel action. Is the origin of her resulting legal fees in her marital relationship or in the desire to protect her business?[82] The courts have had trouble answering questions like these, and have come to results, even in marital property cases, which seem to contradict *Gilmore*.[83]

Nevertheless, commentators have praised *Gilmore* for "present[ing] a satisfactory test for marking the borderline between 'costs of living' and 'costs of earning a living.' "[84] With this in

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those concepts are currently conceived. *Cf.* Andrews, *supra* note 66, at 335, where he states that personal consumption is a part of the tax base because it usually "provides an index of relative material well-being on the basis of which to distribute tax burdens." A gross receipts tax could not achieve this goal.

79. *See supra* note 5 and accompanying text.

80. Blumberg, *supra* note 5, at 65-66.

81. 372 U.S. 39 (1963).

82. Other intractable hypotheticals are posed in W. ANDREWS, BASIC FEDERAL INCOME TAXATION 329-30 (1979).

83. *See, e.g.*, Wild v. Comm'r, 42 T.C. 706 (1964), *acq.* 1967-2 C.B. 4.

84. Keane, *supra* note 65, at 32; *see also* Comment, *The Child Care Deduction: Issues*

mind, we turn back to Blumberg's contention that the decision to maintain employment is the origin of a parent's child care expenses. That is not necessarily so. One could say, and some have strongly implied,[85] that child care outlays originate in the decision to have a child. While not all decisions to have a child result in child care expenses, the argument goes, some do, as a result of the intervening decision of the parent (or both parents in the case of an intact marriage) to seek gainful employment. The origin, nonetheless, is familial. A similar argument can be advanced regarding a typical business expense. Does the decision today to expand a chain of fast-food restaurants from fifty to one hundred stores originate in a business context or in the purely personal, egotistic desire formed many years ago to dominate the market and become the next Colonel Sanders?[86] Of course, that may seem silly to us, but how much sillier is it than telling a low-income single parent with a six year-old child that he or she cannot have a child care deduction on the ground that it is not employment-related, but rather it arose out of a decision to bear the child nearly seven years ago?

Questions like these are not susceptible to rigorous logical analyses. How far back we wish to travel on the causal chain,[87] as with the doctrine of proximate causation in the law of torts, reflects our attitudes as to which events should be considered socially or economically significant. Where we find the origin of an employed parent's child care expenses is likely to reveal prevailing attitudes toward distinctions between work and family, earning and consuming, business and pleasure, in addition to society's conceptions of the roles of women as workers, wives, mothers and

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Raised by Michael and Elizabeth Nammack and the Pending Amendment to Section 214, 13 B.C. IND. & COMM. L. REV. 270, 275-76 (1971). Keane claims that the origins test is most useful in determining whether the taxpayer's motivation was directed toward carrying on a business within § 162; since "the origin of the child care expense is [a] taxpayer's personal need or desire for employment, it is not a cost of doing business, but a preparatory cost." Keane, *supra* note 65, at 34. How helpful is such classificatory language in determining the proper treatment of employment-related child care costs? *See infra* text accompanying notes 87-88. It may suggest that deductibility should not be allowed under § 162, *see* Keane, *supra* at 35, but it does not seem to tell us how we should otherwise treat child care expenses. *Cf.* I.R.C. § 195 ("Start-up Expenditures"); I.R.C. § 183 ("Hobby Losses").

85. *See, e.g.*, Hjorth, *supra* note 65, at 139; Comment, *supra* note 84, at 275-76.

86. *Cf. supra* text accompanying notes 73-78.

87. Of course, going back to the decision to bear a child does not exhaust the possibilities implicit in the "origins test," *e.g.*, the decision not to have an abortion, the decision to have sex.

homemakers.[88]

IV. Child Care and the Imputed Income of Home Production

It has been argued that deciding whether employment related child care expenses are business or personal is not important, indeed, not even relevant, because a deduction is required by "the paramount objective" of "neutrality between housework and wage work . . . ."[89]

The idea here is that when a person engages in home production he or she earns imputed income which goes untaxed under our tax system as currently structured. Because wages earned in the marketplace are taxed, the worker, all other things being equal, will be encouraged to take the paying job only if it pays the value of the previous home production plus enough to pay the taxes[90] as well.[91]

Chart One
(assuming 50% tax rate)

Person at Home		*Person Goes to Work*	
Imputed Income From Home Production	20	Wages	20
Tax	0	Tax	10
Net Income	20	Net Income	10

Thus, the argument goes, if a marketplace worker replaces his or her home services with purchased services, he or she should be given a deduction for such purchases. If no deduction is given the tax system provides a disincentive for work outside the home.

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88. *See generally infra* part V which deals in more detail with the interaction between social values and the child care deduction.

89. Popkin, *Household Services and Child Care in the Income Tax and Social Security Laws*, 50 Ind. L.J. 238, 238 (1975); *see also* Schaffer and Berman, *Two Cheers for the Child Care Deduction*, 28 Tax L. Rev. 535, 537 (1973) (will promote the efficient allocation of labor).

90. Of course, the wage earner may have to pay state, local and social security taxes as well as federal taxes. The imputed income analysis applies equally to those taxes. Popkin considers the social security tax in his analysis. Popkin, *supra* note 89.

91. I realize that this comparison is a little abstract: where does the person at home get his or her money on which to survive? A bequest perhaps? I use this example merely to illustrate that the imputed income theory is not tied either to the person's purchasing replacement services upon entrance into the workforce or to child care expenses *per se*. Rather, it rests on the fact that services performed in the home have a productive value (often measurable in market terms) but go untaxed. Indeed, this is why, standing alone, the imputed income argument is rather weak. *See infra* text accompanying notes 98-104.

Interestingly, in *Smith*[92] the Board of Tax Appeals alluded to the discrepancy between treating Lillie Smith's marketplace wages as taxable income, and failing to tax her previous home production:

> The wife's services as custodian of the home and protector of its children are ordinarily rendered without monetary compensation. There results no taxable income from the performance of this service, and the correlative expenditure is personal and not susceptible of deduction [citation omitted]. Here the wife has chosen to employ others to discharge her domestic function and the services she performs are rendered outside the home. They are a source of actual income and taxable as such. But that does not deprive the same work performed by others of its personal character nor furnish a reason why its cost should be treated as an offset in the guise of a deductible item.[93]

The Board reached the conclusion that the deduction should be disallowed, even though it is precisely the opposite conclusion reached by many commentators who have since engaged in an imputed income analysis.[94]

On the chart below, I have sketched the tax treatment of three two-parent families in which spouse 1 is already working in the marketplace. In families II and III the parents have hired household and dependent care services because spouse 2, who had been providing such services, has now obtained gainful employment.[95]

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92. 40 B.T.A. 1038 (1939).

93. *Id.* at 1039.

94. One commentator has called "[t]he Board's injection of the imputed income argument . . . regrettable." Blumberg, *supra* note 5, at 65.

95. I have adapted this chart from Popkin, *supra* note 89, at 239. I have changed it somewhat and added one permutation (Family III). (All the other charts in part IV are entirely of my own doing).

Chart Two
(assuming 50% tax rate)

	Family I	Family II (with deduction)	Family III (without deduction)
Cash wages, Spouse 1	100	100	100
Cash wages, Spouse 2	0	30	30
Household and child care deduction	0	20	0
Taxable income	100	110	130
Tax	50	55	65
Child care (after-tax)	0	0	20
After-tax and child care income	50	55	45

The above chart is a forceful explanation of the economic impact of our failure to tax the imputed income of home production. If spouse 2 of Family II had been able to find a job paying 20 only, he or she would have been indifferent between the wage-paying job and working in the home. As it turned out, spouse 2 found a job paying 30, the family paid a housekeeper 20 for household and dependent care services and was better off nevertheless.[96]

Family III's situation, on the other hand, illustrates the importance of the deduction (which Family II received) in providing neutrality between home production and market labor. Family III earns 130, but since it cannot deduct 20 for child care, it will have less disposable income after child care expenses than will Family I. All other things being equal, spouse 2 of Family III will not enter the work force in spite of the fact that the market values the work force labor (30) more than the home production (20).[97]

Thus, the imputed income analysis provides a lesson in horizontal equity. If spouse 2 of Family III had earned 20, the family would have had only 40 in disposable income while Family I would have had 50. And, yet, both families would be in the same economic circumstance measured in market terms. Both families would have two working spouses producing 120 in value, but the family with untaxed home production would fare better after

96. Family II, which gets the deduction, is better off than Family I because it can deduct the household and dependent care costs and, thus, offset the untaxed imputed income enjoyed by Family I.

97. In reality, Family III's disposable income would probably be less than 45. If we assume that Family I's average tax rate is 50%, then Family III's marginal tax rate would be somewhat higher because it has 30 more in taxable income.

taxes. If Family III, on the other hand, were allowed a deduction for the 20 purchase of household and dependent care services, both families would be left with 50 after taxes with which to consume. The principle of horizontal equity—treating taxpayers in similar economic circumstances similarly—would thus be achieved.

It has been argued that the imputed income analysis stands on its own as an argument for deductibility. One proponent claims that such an analysis is "better . . . than engag[ing] in an endless quarrel as to whether child care expenses are 'personal' or 'business.' "[98] I believe, however, that the imputed income argument is simply a way of *illustrating* how some commentators feel about child care expenses. It is not an independent mode of analysis; rather, it solves the "endless quarrel" over the nature of child care expenses by simply assuming that they are like business deductions and *then* applying an imputed income analysis to justify it.

If we believe an imputed income theory justifies a child care deduction, it is not because the tax system fails to tax the receipts of productive behavior in the home. On such a theory, why should not I get a deduction for paying someone to wax my car? That is: I normally work and earn 20 dollars per week, and also wax my car. Waxing my car produces five dollars in value. Because I love my work, I decide to earn another five dollars per week. I lose the hour in which I previously waxed my car to my work and, therefore, I pay someone else five dollars to wax my car. However, in reality, I will be less likely to trade my car waxing time for more work unless I can deduct the professional car waxing expense. This is because the value I produce by waxing my own car will always go untaxed.

98. Schaffer and Berman, *supra* note 89, at 543; *see also* Popkin, *supra* note 89, at 246-47.

Chart Three
(assuming 50% tax rate)

	Wax car myself	Pay someone else and work extra hour	
		Without deduction	With deduction
Gross "income"	25	25	25
Work	20 (wages)	25 (wages)	25 (wages)
Car Waxing	5 (imputed)	0	(5)(car wax deducted)
Taxable Income	20	25	20
Less Tax	10	12.5	10
Less Cost of Car Waxing	0	5	0 (already deducted)
Net Income After Car Waxing	10	7.5	10

Thus, if "we assume [that] labor should . . . be allocated by market forces,"[99] all expenditures for personal services should be deductible.

Of course, we could not allow deductions for market expenditures we make on car waxing, haircuts, gardening or any other of the myriad personal services we either perform for ourselves or have others do for us without a massive contraction of the tax base. In fact, we justify the inclusion of such expenditures in the tax base on the ground that they are purely personal.[100] Once this justification is put forth, we must ask why household and dependent care expenses are different. The answer must be that somehow they are not purely personal, that they are employment-related. The imputed income argument does not serve as an independent reason for deductibility.

Popkin has used an imputed income analysis to illustrate the present tax system's nonneutral treatment of housework and wage work as a justification for deductibility of household and dependent care services incurred by working people.[101] He fails to define housework, however. Is housework simply making the beds and cleaning the floors, *i.e.*, traditional housekeeping chores, or does it

99. Schaffer and Berman, *supra* note 89, at 537.

100. *Id.* at 544.

101. Popkin, *supra* note 89 at 247; *see also* Schaffer and Berman, *supra* note 89 at 538.

extend to house repairs? To some people, of course, mowing the lawn is a much more important household chore than washing floors or ironing shirts. And, yet, all are services which one can do in the home or pay others to do instead; all are potential sources of imputed income.

If we want to neutralize the tax treatment of wage work and housework we must define the latter. Ultimately, we will include in the definition household tasks which we deem important, tasks which we feel the worker should be able to replace without a tax burden if he or she enters the workforce. This has little to do with a concept of imputed income, and much to do with the types of housework we believe must get done to enable someone to hold gainful employment. Not surprisingly, the prevailing opinion has been that housework for the purposes of the household and dependent care deduction should be defined with the traditional conception of "women's work" in mind.[102] This is understandable if the household and dependent care deduction is tailored to help allow women to escape from traditional roles, but the notion of imputed income does not inform such a judgment; indeed, it is beside the point.

Finally, it has been argued that work in the home and work in the marketplace need to be treated neutrally by the tax system only in the case of child care. This is because "[i]n the child care case . . . the taxpayer could not work but for her expenditure."[103] Child care must be provided "if only because to [fail] to do so would in most cases violate state law."[104] It is difficult to see why neutralizing home and marketplace labor provides the *reason* for the child care deduction, when we have abandoned the neutrality principle for all other forms of personal services. To defend deductibility on the ground that a parent must provide child care when he or she enters the marketplace is to say that such child

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102. *See, e.g.*, Popkin, *supra* note 89, at 239 ("wife . . . takes care of the house and children"); Andrews, *supra* note 66, at 382 ("the reason for allowing the deduction has to do with the working mother's loss of time to devote to household tasks as compared with the nonworking mother . . . ."). Popkin simply asserts that "the cost of household services should be deductible whether or not a child is being cared for." Popkin, *supra* note 89, at 247. He defends deduction of these "services by the wife," *id.*, on an imputed income theory. But, he must assume that such services (which he never defines in any detail) are necessary to enable the second earner to enter the workforce. Otherwise, his imputed income theory could justify the deduction of all personal services purchased in the marketplace. *See* text accompanying notes 99-101.

103. Schaffer and Berman, *supra* note 89, at 545.

104. *Id.*

care expenses are akin to business expenses; that they are necessary to the production of income.

An imputed income analysis only begs the question asked in part III: are employment-related child care expenses business or personal? I concluded in part III that there was no answer to that question; that, indeed, they could be perceived as either or both, and our conclusions would be more a function of our feelings about work and family life than of tax theory.

If we conclude that the child care expenses of working people are primarily incurred to satisfy personal desires, deducting such expenses on an imputed income theory is no more defensible than deducting the cost of any other consumption item. If, however, we believe that child care expenses should be treated like business expenses, the imputed income analysis is helpful in illustrating the magnitude of the tax system's nonneutral treatment of *all* nonmarket production as it applies specifically to a certain class of home producers who desire entrance to the labor force.

V. A Brief Social History of the Tax Treatment of Child Care Expenses

In part IV, I concluded that an analysis of the differential tax treatment between home production and marketplace employment does not logically compel a particular tax treatment of employment-related child care expenses. Rather, such an analysis merely throws us back to the original problem: whether such child care costs are business or personal.

In part III, however, I concluded that there was no way to neatly categorize employment-related child care because it could be seen as either business or personal or both, depending on the situation of the parent, the parent's purpose in purchasing child care services, and the amount expended for such services. More important, I indicated that once we have decided that employment-related child care expenses are somewhat different from ordinary purchases of consumption items, but not quite analagous to pure section 162 business expenses, our underlying values as to the importance of child care, the role of mothers in providing that care, and the desirability of women in the workforce begin to color our arguments. Indeed, I believe that primarily these values, not a desired adherence to a particular theory of taxation, have historically informed our judgments as to the proper tax treatment of employment-related child care expenses.

When the Board of Tax Appeals first addressed the issue of child care deductions in *Smith*,[105] it treated the Smiths' payments to their nursemaid in the abstract, without seriously considering the relationship of the expenditures to Lillie Smith's employment. The Board defended the deductibility for business-related entertainment, travel, and clothing,[106] typical borderline expenses, and curtly distinguished them from the Smiths' child care costs. The Board gave no legal basis for such a distinction. Rather, the basis for the distinction is found in the Board's discussion of women's roles in our society:

> We are told the working wife is a new phenomenon . . . . [I]f that is true it becomes all the more necessary to apply accepted principles to the novel facts. We are not prepared to say that the care of children, like similar aspects of family and household life, is other than a personal concern. *The wife's services as custodian of the home and protector of its children are ordinarily rendered without monetary compensation* . . . . [The wife's decision to work outside the home] does not deprive the [house]work performed by others of its same personal character.[107]

Ordinarily one might expect *new* principles to be applied to "novel facts." Instead the Board treated the wife "as custodian of the home and protector of its children" in spite of Lillie Smith's proven desire to escape that role.[108]

Congress limited the *Smith* holding in 1954 with the enactment of section 214. Section 214, as we know, was not a significant step toward deductibility of child care expenses because of its stringent dollar limitation on the deduction and its relatively low income eligibility standards. Moreover, its billing as a hardship provision was undermined primarily because its availability only to itemizers excluded large segments of the middle class and working poor.

Two provisions of the old section 214 are noteworthy for their embrace of the values evinced in *Smith*. First, the income eligibility phase-out and ceiling applied only to married couples who were

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105. 40 B.T.A. 1038 (1939).

106. *Id.* at 1039.

107. *Id.* (emphasis added).

108. *See also* Lorenz v. Comm'r, 8 T.C.M. 720 (1949) (couple gets no deduction for child care while wife works with husband in family business); *cf.* O'Connor v. Comm'r, 6 T.C. 323 (1966) (working mother filing separate return cannot take child care as a business deduction).

otherwise qualified under the section.[109] Unless a family was in need, *i.e.*, had an income below $4,500, the woman was expected to stay in the home, especially when she had young children to care for.[110] Indeed, according to prevailing mores, few mothers would want to work unless they were compelled to do so by reason of economic necessity.[111] On the other hand, no income ceiling applied to single mothers[112] who had no choice but to try to earn a living in the marketplace. Therefore, there was no need to try to discourage them from doing so.[113]

Second, single men, except for widowers, were not permitted to take the deduction at all.[114] This reflects the assumption that upon the break-up of a marriage, the mother is best prepared to take care of the children. At the least, the single father should remarry as soon as possible to provide a mother for his children if for some strange reason he was given custody of the children.[115] In any event, the controlling assumption was clear; men are not and should not be involved in childrearing.

It is questionable, given the various other strong social and economic pressures to either work in the labor force or engage in home production, whether the result in *Smith* or the sex-based discrimination in section 214 had any significant effect on behavior. Nevertheless, implicit in section 214 and in the language of *Smith* was a strong defense of the traditional nuclear family.[116]

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109. *See supra* note 14 and accompanying text.

110. *See supra* text accompanying note 13.

111. Of course, whether this value was genuinely believed is questionable given the fact that Congress was unwilling to chance its undermining by eliminating nonneutral tax treatment of housework and wage work through full deductibility. *Cf. generally supra* part IV.

112. It did not apply to widowers either. *See supra* note 14. Of course, the number of single men caring for children in this country is very small when compared to the number of single mothers caring for children. This discrepancy was probably much greater in 1954 when males were simply considered unfit to perform childrearing tasks.

113. Although in economic terms the provision would discourage single mothers from marrying.

114. *See supra* note 15 and accompanying text.

115. Here, there is an incentive to marry. Compare the following situations: As a single father, I pay my housekeeper $200 per week to take care of my children. We both pay taxes on that money, *i.e.*, I pay the housekeeper with after-tax dollars. But if I marry my housekeeper and continue to earn the same income, the child care now goes untaxed. *See generally supra* part IV.

116. Regarding the old § 214, *see* D.T. SMITH, *Federal Tax Reform* 111-112 (1961), quoted in Blumberg, *supra* note 5, at 72 ("Congressional discussion reflected differences of opinion based on urban and rural attitudes and occupations and on religious and philosophical approaches to the role and proper places of mothers. The final result gave relief where it was felt to be needed, but the intent was to prevent giving any tax inducement to a mother

By late 1971, the women's movement had begun to force this society to reexamine its assumptions about women's roles as workers, wives and mothers. It is no coincidence that the Code has undergone a number of expansive revisions with respect to child care between 1971 and the present, an era in which the movement has had significant impact on family life and in the work place

The new section 214, passed in December 1971, was the tax revision which had the most expansive effect; it increased the maximum amounts deductible for qualifying parents more than fivefold and it raised the income eligibility guidelines to include the vast majority of the middle class.[117] Not surprisingly, it was at this point that the ideological battle over women's roles in the family and work place was fought among politicians and in the journals with respect to the tax treatment of child care. This battle merely reproduced the arguments, fomented by the women's movement, which were being heard on many other issues.

Senator Bennett debated the issue in Congress and argued vigorously against the expansion of the child care deduction. He claimed that child care expenses are business related only when the parent has to work, when the deduction quite literally enables him or her to maintain gainful employment:

> We are not providing tax relief to take care of the one-parent family where it is usually necessary for the mother to go out to work and she needs some help to pay for care necessary for her children. We are now moving into the range where we are providing tax relief for the wife who does not have to go out to work but who, in order to get a new automobile or better clothes . . . would like to go out and work.[118]

Implicit in the senator's statement was the belief that women should only work when they need to, and that when women married to middle income male earners take marketplace employment they do so for recreational, *i.e.*, to "get a new automobile or better clothes," not business reasons. And, yet, Bennett was simply advancing the view held by some that for more affluent married taxpayers child care should not be considered employment-related, if only because those taxpayers would probably purchase childcare regardless of the decision of the second earner to work outside the

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'to leave her children at home while she went out to earn money for a fur coat' . . . .").

117. *See supra* text accompanying notes 18-20.

118. 117 CONG. REC. 41,253 (1971).

home.[119]

He took the time, however, to give his genuine reasons for opposing expansion of the childcare deduction, and in doing so explicitly called upon the values which hung between the lines of the old section 214:

> I suppose the Senator from Utah is old fashioned. I can understand the sacrifice in relations with our children that a mother must make if she has to go out to work. But I am wondering whether we should provide tax incentive for a mother who does not have to go out to work, to leave her children in the care of hired domestics. We can read many sage observations on the part of psychologists and psychiatrists that many of our problems in society today grow out of the fact that there is no communication between parents and children, that the breakdown of the family and the home is one of the real causes of the very serious problems we face in the country today. Now we are being asked to provide a tax benefit to make it possible for that breakdown to be accelerated.
>
> The proposal makes it less costly for the wife of a middle-income taxpayer to pass off the motherly duty of child rearing.[120]

The above passage leaves little doubt as to what was bothering Senator Bennett about the new section 214, and it had little to do with adherence to particular tax principles. Rather, it reflects a deep fear of the direction in which America was going in 1971, tying expansion of the child care deduction to continued breakdown of traditional institutions and, more broadly, to general social disorder.

As discussed earlier,[121] Senator Tunney led the fight for expansion of the child care deduction, likening employment-related child care expenses to wages paid by a business person to his or her secretary. He recognized, as well, the particular impact child care expenses have on women:

> I just cannot agree with the distinguished Senator [Bennett]

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119. *See supra* notes 71-72 and accompanying text; *see also* Schaffer and Berman, *supra* note 89, at 542 ("[T]he income limitation may serve as a crude way of distinguishing between families who would probably have purchased child care services even if the wife did not hold a job and those who could not."). The problem with this analysis is that it does not apply to a single parent regardless of his or her income. The parent either stays home (has no income) and provides child care (surviving most likely on meager welfare or child support payments) or works in the marketplace and purchases child care (regardless of income level). Note also the cultural bias exhibited in the assumption which always denominates the wife as the second earner in a two-earner family.

120. 117 CONG. REC. 41,253 (1971).

121. *See supra* text accompanying notes 60-61.

> from Utah that this represents a loophole, any more than it represents a loophole in a tax law to allow a businessman to claim a business expense for . . . a secretary.
>
> I do not know of any distinction between the two cases, other than the fact that in one case we are talking about a man and in the other case we are talking about a woman. I feel strongly that if we are going to give equal rights to women as well as men, a woman should be given the opportunity to have a business expense writeoff for the cost of her doing business.[122]

It was Senator Long, however, who completely abandoned legal argument and challenged Senator Bennett's values head on. He explicitly and, it seems, rather begrudgingly attributed our value shift to the women's movement:

> Some may not like to recognize it, but it is true that the idea that a woman is entitled to take a job and help bring income into the family, particularly if she can make arrangements for someone to discharge the family responsibilities and take care of the domestic work that ordinarily would be her task, has caught on in this country. It is accepted. The idea that a woman's place is in the home and that she cannot hire someone to do the household work in order to increase the family income is no longer current. Rather, it is recognized today as a right of women to do so. Some may not like it but at least, to that extent, the women's liberation movement has caught on.[123]

The forces of the women's movement, and Senators Long and Tunney, had their way.[124] As we know, not only were the economic benefits of the deduction greatly increased, but the distinctions between men and women, and married and single people were eliminated.[125]

At the same time politicians were debating the efficacy of the new section 214, commentators were busy considering the proper tax treatment of child care expenditures. Their views regarding family life and the proper roles of women in our society crept into their analyses, although sometimes rather subtly.

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122. 117 CONG. REC. 41,253 (1971). Senator Tunney also rejected Senator Bennett's argument regarding breakdown of the traditional family. *Id.*

123. 117 CONG. REC. 41,254 (1971).

124. *Id.* at 41,256. The Senate passed the increase in income eligibility for child care deduction by 59-24. I do not mean to suggest that Senators Tunney and Long, and the women's movement shared the same political perspective, even on the role of mothers in the work place. They had their way only in the sense that Congress passed a child care provision which all of them favored.

125. *See supra* text accompanying notes 22-23.

As mentioned previously, Feld concluded that employment-related child care expenses have both business and personal components, but because of the difficulty of separating the two "the tax base should not be further eroded by permitting a deduction."[126] Feld built his argument on the premise that a working wife will probably receive gratification from knowing that her child has child care.[127] Therefore, he maintained, the child care expenditure is at least part personal in nature. I have shown, however, that measurement of personal gratification cannot be the basis of any administrable tax system; moreover, such a criterion is irrelevant if the system's purpose is to tax the individual's ability to consume real goods and services. Without this argument, Feld's opposition to the child care deduction ultimately rested on a more explicitly value-laden analysis:

> A second argument in opposition to deductibility is that a tax disincentive to the gainful employment of mothers is desirable and should be retained. Young children, it is argued, should receive the loving attention of their natural mothers rather than be left to the care of strangers. To allow deductibility of child care expenses would be to subsidize mothers leaving their children with others, would erode the family structure and would harm the upbringing of children. While a tax subsidy might be justified where the family is in great economic need, as was provided under old section 214, it is unsound for the family not subject to such overriding economic pressure.[128]

What is striking about the above statement is not its opposition to deductibility, but its confusion of tax theory. If the failure to permit a deduction acts as a "disincentive" to gainful employment, that suggests that a deduction would tend to provide a needed neutrality between home production and wage work, the deduction being an accurate refinement of income. This contention would seem to be in contradiction to Feld's basic argument that child care expenses are not sufficiently related to employment to justify a deduction. If, on the other hand, as Feld stated, "deductibility of child care expenses would . . . subsidize mothers," a deduction for child care should be seen as a nonneutral incentive for wage labor, a pure tax expenditure which shelters economic in-

126. Feld, *supra* note 73, at 429; *see also supra* text accompanying note 73.

127. Note that Feld makes no mention of the gratification received by the father in knowing that his child is being cared for.

128. Feld, *supra* note 73, at 429.

come. It cannot work both ways at the same time.

Although his tax argumentation was inconsistent, Feld's underlying beliefs[129] were expressed clearly—mothers who work may be subsidized if they are "in great economic need,"[130] but otherwise, women should not be expected to work. At least, the government should not play a part in encouraging women who do not need to work to leave their children with strangers.

Other arguments against deductibility are less explicit, but they suggest nontax values at play. Take, for example, the claim that because the origin of a parent's child care expenses is in the decision to have a child such expenses are personal in nature. But, the origin test merely serves as a means by which we analyze a borderline expense. We *choose* which event in the causal chain that produced the expense is most significant. By doing so, we decide whether the expense is business or personal.

One commentator, however, has put great stock in the origin test, coming to the conclusion that a business person's yacht used for entertaining clients "originates in a need of the business," while employment-related child care expenses "originate in personal . . . choice."[131] The use of the origin argument to both justify deductibility for one of the most explicitly consumptive aspects of business life and deny deductibility to employment-related child care costs calls into question the writer's unstated assumptions. Why is it that the yacht's so-called origin in the business is determinative? Why is a poor working person's child care seen as originating in the family as opposed to a need for employment? More importantly, why is the yacht "a *need* of the business," while the child care is seen as arising out of "personal *choice*." One can only guess that traditional values led to assumptions which caused these questions to go unasked. What is clear is that reference to tax theory, whether it be an origin test or some other analysis, will not bring us to logical answers to these questions.

Similarly, commentators who base their arguments for deductibility on imputed income theories must be maintaining, at least inadvertently, that wage work should be given parity with housework but no other form of imputed personal service income. This

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129. I do not know if the quoted statement reflects Feld's *personal* beliefs (he states it in the passive voice), but it certainly reflects beliefs held by many.

130. As we know, the old § 214 did not help those most in need because it was an itemized deduction. *See supra* text accompanying note 16.

131. Comment, *supra* note 84, at 276.

is true because an imputed income analysis provides no independent justification for deductibility of employment-related child care costs.[132]

Popkin admitted that the imputed income issue was "of current social significance in the context of the women's movement because women are the major producers of housework . . . ."[133] He believed, however, that determining the proper treatment of household services and child care were of broader concern because it requires consideration of fundamental concepts of equity and neutrality in the tax and welfare structure.[134] I believe, on the contrary, that no one would start with the "paramount objective" of providing tax equality between housework and wage work unless he or she believed women should be given nontraditional choices regarding work and family life.

By 1976, when section 214 was repealed and replaced by the section 44A credit, the political battle to establish a child care provision had been won. By structuring section 44A as a credit, Congress made a special effort to direct tax benefits toward low and middle income parents.[135] Again, Congress must have understood that its action would have a particularly beneficial impact upon women.

In this short history I have shown that in dealing with the difficult borderline issue of child care expenses, the tax system has reacted more to our changing assumptions about women, work and family than to abstract economic or tax theories. It is not surprising that in 1939 the Board of Tax Appeals viewed women's child care expenses as personal, integral to family life, almost without regard to the context in which the woman before the Board had incurred those expenses. Nor can we be surprised that Congress' first attempt to legislate in this area in 1954 embodied the notion that middle class wives should not work outside the home. As women began to take on business as well as family roles in increasing numbers in the 1970s, the child care provision understandably changed both to recognize and facilitate the work place revolution that was occurring.[136] These changes also recognized, perhaps in-

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132. *See supra* text accompanying notes 98-99.

133. Popkin, *supra* note 89, at 238.

134. Id.

135. *See supra* part II.D.

136. I do not mean to imply by any means that the work place has been "revolutionized" in all respects, but simply to say that many more women are working outside the home. The work place barriers to women in terms of pay, advancement and the like are

advertantly, that many women in this country, mostly lower class women, have always worked.

It really could not have happened any other way. Concepts like comprehensive income tax, tax expenditure and business deduction do not direct us to treat child care expenditures in any given way. Once we concede, and I think we must, that employment-related child care expenses are neither pure consumption items nor typical business expenses, we must look to values extraneous to the tax system to inform our judgment about what type of child care provision, if any, we should have.

VI. What Type of Child Care Provision Should We Have?

I begin with the belief that employment-related child care is in many instances enough like a business expense that the Code must make some provision for excluding all or part of it from the tax base.

A straight business deduction, however, would be inappropriate. First, no matter what type of child care provision exists—exclusion, deduction or credit—there must be a limitation on the dollar amount of child care services against which the provision can be applied. This limitation should be calculated to reasonably reflect the cost of safe and well-supervised day care.[137] To have no limitation would allow wealthy taxpayers to indulge their children at the government's expense. It would be as indefensible as allowing a deduction for a child's food, clothing or recreation.

Second, a child care deduction for those in high income brackets seems ill-advised even if a dollar limitation is imposed. For those taxpayers, child care may often have a large consumption component because the decision to provide commercial child care is unrelated to marketplace employment. Of course, there will be some affluent taxpayers whose child care expenses do indeed enable them to work.[138] The problem is that it is impossible to tell what a taxpayer's purpose is in purchasing child care.[139] While I

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prevalent and well documented. One well known example is that average market earnings for women are less than 60% those of men. *See generally* Frug, *Securing Job Equality for Women: Labor Market Hostility Toward Working Mothers*, 59 B.U. L. Rev. 55 (1979).

137. Day care costs vary widely. One private, well-regarded day care center in Boston costs $323 per month for a four year-old preschooler. Interview with Charlotte Watkins, working mother (May 9, 1983).

138. *See supra* note 119.

139. *See supra* text accompanying notes 70-72. One way to illustrate the problem is to ask: Did the parent purchase the child care so that he or she could work or *vice versa*?

admit that some high income parents would be denied a deduction for a true cost of going to work, I oppose a deduction because it would often subsidize a large personal component of wealthy parents' child care expenses.[140]

The primary concern of any child care provision should be lower and middle income parents for whom child care is almost always a cost of going to work. Thus, the section 44A credit, especially the recent addition of the reverse graduated benefit scheme, is appropriate.[141]

While it is true that the credit grants a tax benefit to low and moderate income parents which at times exceeds that which they would have gained by a deduction, that is no reason to oppose it. Governmental assistance has reduced the chance that economic necessity will force low income parents to leave their children unattended or with inadequate care.[142] Those who otherwise could not afford it should be encouraged to provide decent day care for their children.[143]

Concomitantly, the current law would be improved if the credit were made refundable so that the poorest of the working poor could obtain reimbursement for their employment-related child care expenses despite an absence of taxable income. Refundability seems a fair and efficient policy as long as the credit cannot exceed the earned income of the taxpayer.[144]

My support for the child care credit is strengthened by the

There is no way for the Service to know the answer to that question. Often, I would imagine, even the parent could not answer it precisely.

140. *But see* Comment, *supra* note 60, at 468. This comment claims that "[o]nly a section 162 deduction from gross income makes it at all feasible for a mother in the upper income brackets to work outside her home." *Id.* That is no reason why wealthy people should get tax deductions for child care if such care is not business-related. The phenomenon that this commentator should really be addressing is the fact that spouses, often wives, of high income taxpayers must enter the work force at the latter's tax bracket. This can occur in a marriage whether or not there are children. *See* I.R.C. § 221 (1983) (deduction for two-earner families).

141. *See supra* text accompanying notes 33-34.

142. Indeed, this was one of Senator Long's major reasons for supporting the new § 214. He explained on the Senate floor that two children who lived near him died in a fire because the children had been left unattended. 117 CONG. REC. 41,253 (1971).

143. There are also direct day care assistance programs which aid the working poor. The two most prominent programs exist under Title XX of the Social Security Act and the Aid to Families with Dependent Children legislation. *See*U.S. DEPARTMENT OF LABOR, OFFICE OF THE SECRETARY, WOMEN'S BUREAU, EMPLOYERS AND CHILD CARE: ESTABLISHING SERVICES THROUGH THE WORKPLACE 33-34 (1982). These programs are outside the scope of this paper.

144. *See supra* text accompanying notes 35-36.

understanding that child care expenses primarily burden women. For married mothers earning imputed child care income in the home, there exists a disincentive for them to enter the marketplace where the fruits of their productive activity will be taxed. This disincentive should be undone, not because there is an overriding need to create tax parity among all forms of production, or even between production inside and outside the home per se, but because there is a need to equalize opportunities for mothers who want to or must work outside the home.

For single working mothers, and married mothers in low income households who work outside the home, the credit is appropriate simply because child care is a prerequisite to gainful employment. The credit's lack of an income eligibility ceiling suggests that some higher income parents are being subsidized for non-work-related child care expenses. While a deduction for such expenses is inappropriate, allowing all parents to take advantage of the credit (which is limited in dollar amount) will facilitate the entry of women into nontraditional employment and encourage the redefinition of family roles. Therefore, the credit should be maintained in its current form with regard to income eligibility despite the fact that it will do more than simply refine the incomes of higher income working parents.

On the other hand, section 129, providing dependent care assistance programs, should be repealed. Because it is structured as an income exclusion without any dollar limitations, it will allow the sheltering of income—through extravagant child care deductions—at high marginal tax rates. In fact, section 129 seems to be designed particularly for more affluent taxpayers. For example, a married couple filing a joint return will always do better using the section 44A credit unless its adjusted gross income exceeds $24,000 per year.[145] In 1978, approximately eighty-five percent of all tax returns showed adjusted gross incomes below that level.[146] Moreover, the fact that section 129 has no dollar limitation on exclud-

145. Note, *Income Tax Treatment of Child and Dependent Care Costs: The 1981 Amendments*, 60 TEX. L. REV. 321, 347-48 (1982). In fact, the § 129 exclusion would be preferable at an adjusted gross income of somewhat less than $24,000. The above-cited article fails to recognize that the exclusion also negates social security taxes on the excluded amount which a taxpayer taking advantage of § 44A would have to pay. I.R.C. § 3121(a)(18) (1982) (wages subject to FICA does not include a payment or benefit "if it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section . . . 129").

146. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 270, Table No. 450 (1980).

ability also indicates that it was designed for those who can afford to give their children the best.

Recent discussions of section 129 have stressed its importance in encouraging on-site employer child care,[147] a development which many child care advocates favor.[148] It is not certain that section 129 will have that effect because there is no requirement that the child care be on-site. If the goal is to encourage on-site child care, section 44A can achieve that just as well, with employees paying for the child care and being partly reimbursed for the expense by the section 44A credit.

Section 129 should be recognized for what it is—an erosion of the tax base which will confer benefits on people who are already economically advantaged.

147. *See, e.g.*, Curwood, *Tax Changes Ease Curbs on Day-care Deductions*, Boston Globe, Feb. 15, 1983, at 33, col. 1.

148. *See, e.g.*, G. MORGAN, CARING ABOUT CHILDREN IN MASSACHUSETTS 105-12 (1982).