

OVERTAXING THE WORKING FAMILY: UNCLE SAM AND THE CHILDCARE SQUEEZE

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Today, many working parents are caught in a “childcare squeeze”: while they require two incomes just to make ends meet, they end up spending a strikingly large percentage of their income on childcare so that they can work outside the home. Worse still, some parents find themselves “squeezed out” of the market entirely, unable to earn the additional income their families require because they cannot find jobs that pay enough to offset soaring childcare expenses. This Article argues that the tax laws have played an important role in aggravating these hardships. Currently, the Internal Revenue Code treats the childcare costs incurred by working parents as personal expenses, subject to various dollar limitations, percentage limits, and phaseouts. Once these limitations are applied, working parents will receive tax relief for only a small fraction of the childcare costs they actually incur. This Article shows that this is inappropriate as a matter of fundamental tax policy and results in the overtaxation of the working family. It then provides a blueprint for meaningful reform that would properly treat working childcare costs like other costs of earning income and keep the tax laws from worsening the working family’s economic plight.

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INTRODUCTION

The economic plight of the working family is worsening. This cry has been made in the recent campaign speeches of many political candidates,¹ by lawmakers on both sides of the aisle,² and by the President of the United

1. See, e.g., Laurel Elder & Steven Greene, *Politicians Love to Talk About Families. But Maybe Not Yours.*, WASH. POST (Sept. 7, 2012), http://www.washingtonpost.com/opinions/politicians-love-to-talk-about-family-but-maybe-not-yours/2012/09/07/0be2edea-f218-11e1-adc6-87dfa8eff430_story.html [<http://perma.cc/79KS-6KVN>] (“Odes to families—their values, their struggles to make ends meet, their efforts to protect their children—have been broadcast in nearly every political campaign in recent times. Mitt Romney, in his speech accepting the Republican nomination last month, made the promise ‘to help you and your family’ his central message. Obama, in his convention speech, argued that this election will have a huge impact ‘on our children’s lives for decades.’ And at both conventions combined, ‘families’ was the fourth-most-mentioned word or phrase, right behind ‘jobs,’ ‘Romney’ and ‘Obama.’”).

2. See, e.g., Lauren French & John Bresnahan, *House Democrats Outline Agenda*, POLITICO (July 16, 2014, 11:28 AM), <http://www.politico.com/story/2014/07/house-democrats-100-day-action-plan-nancy-pelosi-108985.html> [<http://perma.cc/Y7Z3-APP7>] (discussing the “100-day action plan” meant to help the middle class and working families that House Democrats recently released); see also Working Families Flexibility Act of 2013, H.R. 1406, 113th Cong. (2013) (describing the Working Families Flexibility Act, introduced by Republican Congresswoman Martha Roby, which has passed the U.S. House of Representatives and, as its name suggests, is meant to provide help to the working family).

States in more than one State of the Union Address.³ The White House recently hosted a daylong summit devoted to the struggles today's working families face,⁴ which are also chronicled in books,⁵ op-ed pieces,⁶ and proposals for legislative reform.⁷ And current data that confirm there are good reasons to be concerned about the working family's continuing ability to "make ends meet,"⁸ let alone thrive.⁹

Childcare expenses represent one of the highest household costs incurred by young families in the United States.¹⁰ Moreover, although middle-

3. See President Barack Obama, State of the Union Address (Jan. 20, 2015), <http://www.whitehouse.gov/the-press-office/2015/01/20/remarks-president-state-union-address-january-20-2015> [<http://perma.cc/QW43-F7U4>] ("So what does middle-class economics require in our time? First, middle-class economics means helping working families feel more secure in a world of constant change. That means helping folks afford childcare, college, health care, a home, retirement."); see also President Barack Obama, State of the Union Address (Jan. 28, 2014), <http://www.whitehouse.gov/the-press-office/2014/01/28/president-barack-obamas-state-union-address> [<http://perma.cc/5VQJ-PVMB>] ("Over more than three decades, even before the Great Recession hit, massive shifts in technology and global competition had eliminated a lot of good, middle-class jobs, and weakened the economic foundations that families depend on.").

4. On June 23, 2014, the White House, the Department of Labor (DOL) and the Center for American Progress (CAP), hosted a summit with a special focus on women and their families. WHITE HOUSE SUMMIT ON WORKING FAMILIES, <http://workingfamiliessummit.org> [<http://perma.cc/T3A8-HTSA>].

5. See, e.g., ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO-INCOME TRAP: WHY MIDDLE-CLASS MOTHERS AND FATHERS ARE GOING BROKE* (2003) (explaining the economic hardships faced by dual-earner couples).

6. See, e.g., Jillian Berman, *When Being a Stay-at-Home Mom Isn't a Choice*, HUFFINGTON POST (June 30, 2014, 7:32 AM), http://www.huffingtonpost.com/2014/06/30/stay-at-home-moms_n_5537503.html [<http://perma.cc/73Z4-9G7X>]; Belinda Luscombe, *Most Stay at Home Dads Not There by Choice*, TIME (June 5, 2014), <http://time.com/2827314/most-stay-at-home-dads-not-there-by-choice/> [<http://perma.cc/9QEX-XPFD>]; Judith Warner, *The Opt-Out Generation Wants Back In*, N.Y. TIMES (Aug. 7, 2013), <http://www.nytimes.com/2013/08/11/magazine/the-opt-out-generation-wants-back-in.html> [<http://perma.cc/YCC8-K7CB>].

7. Notably, on February 2, 2015, President Barack Obama released his budget for fiscal year 2016, asking Congress to help him "bring middle-class economics into the 21st Century," and explaining that "middle-class economics means helping working families afford the cornerstones of economic security: child care, college, health care, a home, and retirement." President Barack Obama, *The Budget Message of the President* (Feb. 2, 2015), <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2016/assets/message.pdf> [<http://perma.cc/B9ZJ-C8P4>]. Additionally, Democratic Senator Kirsten Gillibrand has discussed tax reform as part of her overall agenda to make childcare more affordable to parents. See *Making Childcare Affordable and Available*, KIRSTEN GILLIBRAND, <http://www.gillibrand.senate.gov/agenda/making-childcare-affordable-and-available> [<http://perma.cc/9T7M-4V9S>].

8. WHITE HOUSE SUMMIT ON WORKING FAMILIES, *supra* note 4 ("Too many working Americans—both women and men—are living paycheck to paycheck, struggling to make ends meet and respond to the competing demands of work and family.").

9. See, e.g., Sarah Jane Glynn, *The New Breadwinners: 2010 Update*, CTR. FOR AM. PROGRESS (Apr. 16, 2012), <http://www.americanprogress.org/issues/labor/report/2012/04/16/11377/the-new-breadwinners-2010-update/> [<http://perma.cc/45MP-D847>] (discussing post-recession income statistics of the working family).

10. CHILD CARE AWARE OF AM., *PARENTS AND THE HIGH COST OF CHILDCARE 20–23* (2014), <http://www.usa.childcareaware.org/advocacy/reports-research/costofcare/> [<http://per>

class income levels have been declining for well over a decade,¹¹ the costs of childcare have consistently climbed.¹² Today, most two-parent families consist of two earners and require at least two incomes to meet their needs.¹³ The pressure to find work is even greater for single parents, who may bear the primary responsibilities of generating income and caring for their children alone. But parents lucky enough to find themselves employed will also find themselves in the “childcare squeeze,”¹⁴ spending a strikingly large percentage of their income on childcare to work outside the home.¹⁵ Worse still,

ma.cc/8F67-D47N]; see also Tara Siegel Bernard, *Choosing Child Care When You Go Back to Work*, N.Y. TIMES (Nov. 22, 2013), <http://www.nytimes.com/2013/11/23/your-money/choosing-child-care-when-you-go-back-to-work.html> [http://perma.cc/6J67-G5WK].

11. Keith Miller & David Madland, *What the New Census Data Show About the Continuing Struggles of the Middle Class*, CTR. FOR AM. PROGRESS (Sept. 16, 2014), <https://www.americanprogress.org/issues/economy/news/2014/09/16/97203/what-the-new-census-data-show-about-the-continuing-struggles-of-the-middle-class/> [http://perma.cc/36ED-B7DN]; Rome Neal, *Broke on Two Incomes*, CBS NEWS (Sept. 9, 2003, 9:15 PM), <http://www.cbsnews.com/news/broke-on-two-incomes/> [http://perma.cc/2FRQ-V4J6]; Alicia Parlapiano et al., *The Shrinking American Middle Class*, N.Y. TIMES (Jan. 26, 2015), <http://www.nytimes.com/interactive/2015/01/25/upshot/shrinking-middle-class.html> [http://perma.cc/ACK6-K4PX]; Dionne Searcey & Robert Gebeloff, *Middle Class Shrinks Further as More Fall Out Instead of Climbing Up*, N.Y. TIMES (Jan. 25, 2015), <http://www.nytimes.com/2015/01/26/business/economy/middle-class-shrinks-further-as-more-fall-out-instead-of-climbing-up.html> [http://perma.cc/A9Tp-DEPH].

12. See Bradford Plumer, *The Two-Income Trap*, MOTHER JONES (Nov. 8, 2004, 4:00 AM), <http://www.motherjones.com/politics/2004/11/two-income-trap> [http://perma.cc/796D-VMDE] (discussing WARREN & TYAGI, *supra* note 5) (“Two-income families are almost always worse off than their single-income counterparts were a generation ago, even though they pull in 75 percent more in income. The problem is that so many fixed costs are rising—health care, child care, finding a good home—that two-income families today actually have less discretionary money left over than those single-earner families did.”).

13. See D’VERA COHN ET AL., PEW RESEARCH CTR., AFTER DECADES OF DECLINE, A RISE IN STAY-AT-HOME MOTHERS 5 (2014), http://www.pewsocialtrends.org/files/2014/04/Moms-At-Home_04-08-2014.pdf [http://perma.cc/4YD5-UZGC] (“The share of mothers who do not work outside the home rose to 29% in 2012, up from a modern-era low of 23% in 1999, according to a new Pew Research Center analysis of government data.”); see also Glynn, *supra* note 9 (“[M]ost children today are growing up in families without a full-time, stay-at-home caregiver. In 2010, among families with children, nearly half (44.8 percent) were headed by two working parents and another one in four (26.1 percent) were headed by a single parent. As a result, fewer than one in three (28.7 percent) children now have a stay-at-home parent, compared to more than half (52.6 percent) in 1975, only a generation ago.”).

14. See Carol Morello & Scott Clement, “Happy Days” No More: Middle-Class Families Squeezed as Expenses Soar, Wages Stall, WASH. POST (Apr. 26, 2014), http://www.washingtonpost.com/local/happy-days-no-more-middle-class-families-squeezed-as-expenses-soar-wages-stall/2014/04/26/f4a857f0-7a47-11e3-b1c5-739e63e9c9a7_story.html [http://perma.cc/4WRL-Z2WK]; David Riley, *Many Families Caught in Child Care Squeeze*, DEMOCRAT & CHRON. (Aug. 11, 2014, 11:35 AM), <http://www.democratandchronicle.com/story/news/2014/08/09/childcare-monroe-county-elaine-spaul/13780719/> [http://perma.cc/HYD9-ZF9J]; Melissa Schorr, *The Day Care Squeeze: How Families Cope in the Highest-Priced Child-Care Market in the Nation*, BOSTON.COM (Dec. 12, 2010), http://www.boston.com/lifestyle/articles/2010/12/12/the_day_care_squeeze/ [http://perma.cc/9GZM-BGU2].

15. See CHILDCARE AWARE OF AM., *supra* note 10, at 20–23 (showing childcare as one of the highest costs in a family’s budget).

other parents find themselves “squeezed out” of the job market entirely, unable to earn the additional income their family requires because they cannot find jobs that pay enough to offset soaring childcare expenses.¹⁶

This Article argues that §§ 21 and 129 of the Internal Revenue Code, which provide stringently limited tax relief for the costs of childcare incurred by working parents, have played an important role in aggravating these hardships. Currently, the Code treats the childcare costs incurred by working parents as personal expenses, subject to various dollar limitations, percentage limits, and phaseouts.¹⁷ Once these limitations are applied, working parents receive tax relief for only a small fraction of the childcare costs they incur. This Article shows that this is inappropriate as a matter of fundamental tax policy and results in the overtaxation of the working family. It then provides a blueprint for meaningful reform. Specifically, this Article urges lawmakers to resist the temptation to reform tax laws by simply relaxing current limitations, as this would leave parents vulnerable to the same legislative dysfunction that allowed tax relief for working families to become so limited in the first place. Instead, this Article asks lawmakers to allow parents to deduct working childcare costs under the same methods as other costs of earning income, which are not generally subject to stringent limitations.

This Article is not the first to notice that the tax laws are stacked against working parents.¹⁸ But previous scholars wrote in a social context in which one parent generally had the choice to forego work in order to care for her children¹⁹ and the salary of the secondary wage earner—almost always a woman’s—was discretionary.²⁰ Accordingly, past scholarship has tended to

16. See Berman, *supra* note 6 (chronicling stories of parents looking for work who only find jobs offering wages that barely cover childcare costs); see also COHN ET AL., *supra* note 13, at 6 (“A growing share of stay-at-home mothers (6% in 2012, compared with 1% in 2000) say they are home with their children because they cannot find a job. With incomes stagnant in recent years for all but the college-educated, less educated workers in particular may weigh the cost of child care against wages and decide it makes more economic sense to stay home.”).

17. See, e.g., I.R.C. § 21 (2012).

18. See, e.g., Britten D. Richards, *Discrimination Against Married Couples Under Present Income Tax Laws*, 49 TAXES 526 (1971); Kenneth J. White, *The Tax Structure and Discrimination Against Working Wives: A Comment*, 26 NAT’L TAX J. 119 (1973).

19. For ease of reading, this Article will use the gender pronouns “him” and “her” to represent all individuals on the gender spectrum.

20. See Grace Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 BUFF. L. REV. 49, 49 (1971) (“The Code will be examined in its current social context. Thus, the observation that American working wives are predominantly secondary family earners is not intended to express a social ideal. It merely reflects a contemporary social reality. Women workers generally earn substantially less than their male counterparts. Working wives earn less than their employed husbands. The American wife’s working career is likely to be broken by child-bearing and rearing. Unless prompted by economic necessity, her return to work is generally considered discretionary. Even when she is earning a substantial salary, her husband is unlikely to view his employment as discretionary.” (footnotes omitted)); see also Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389, 1433 (1975) (“These burdens on the two-job married couple are often castigated as a deterrent to the employment of married women outside the home. In theory, of course, the

focus on how the tax laws provide disincentives for married women to enter the workforce and has proposed reforms designed to create more desirable behavioral incentives.²¹ These conversations, however, are increasingly off target. Today, two-parent families can rarely afford to have one parent stay home to provide childcare, a luxury that single parents are even less likely to enjoy. This Article, therefore, stands poised to be the first academic piece to critically address how a reformed tax system should tax the modern working family.

Part I of this Article describes how Internal Revenue Code §§ 21 and 129 severely limit the ability of working parents to reduce their taxable income to reflect today's high childcare costs. Part II discusses the basic principles of tax law that govern whether a taxpayer should be able to reduce her tax liability to reflect a particular expenditure. Applying these principles, Part III argues that working childcare costs should be treated primarily, if not entirely, as nonconsumptive expenses, justifying a tax reduction for at least almost the entire cost. Because current law mistreats childcare expenses as consumptive personal costs, Part IV urges lawmakers to reform the tax laws by properly treating working childcare expenses like other nonconsumptive costs of earning income. Part V concludes that while the tax laws cannot (and should not) solve all problems facing today's working family, the reforms this Article proposes would help prevent overtaxing working families and at least ease their economic struggles.

I. CURRENT LAW: THE LIMITED TAX RELIEF PROVIDED TO WORKING FAMILIES

There are several mechanisms by which the Internal Revenue Code allows a taxpayer to reduce her tax liability, providing some degree of tax relief. For instance, some provisions of the Code allow a taxpayer to deduct expenses she has incurred from her taxable income or credit them against

burden arises whether the 'secondary' wage-earner is the husband or the wife, and hence falls on the couple jointly. In a society that takes the husband's job for granted and views the wife as the secondary wage earner, however, it is reasonable to describe the existing state of affairs as biased against women.").

21. See, e.g., Bittker, *supra* note 20, at 1433; Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 UCLA L. REV. 983, 987 (1993) ("[T]he Article explores how the tax laws provide behavioral incentives that affect three types of decisions: whether to marry, whether to form a one- or a two-earner household, and whether to work full or part time."); Margaret Ryznar, *To Work, or Not to Work? The Immortal Tax Disincentives for Married Women*, 13 LEWIS & CLARK L. REV. 921, 921 (2009) ("Among the most fundamental barriers to the aggressive participation of many married women in the work force are the disincentives for secondary income earners embedded in the federal tax code."); Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571, 1573 (1996) ("The market-oriented approach to women's equality and liberation acknowledges the material costs associated with performing unpaid labor and the role it plays in preventing women from obtaining the level of wages and benefits that men receive in the market. To remedy this problem, the market-oriented scholars have devised practical solutions that would, in effect, provide women with greater returns on their market labor.").

her tax liability.²² Other provisions provide exemptions by allowing taxpayers to exclude from their taxable income amounts or benefits that would otherwise be included in income and subject to taxation.²³

Currently, the law provides very limited tax relief for the costs of caring for one's dependents, including children (the focus of this Article) as well as the elderly and disabled.²⁴ The available tax relief can be separated into relief for two categories of costs: relief for childcare expenses that enable taxpayer parents to work ("working childcare costs") and relief for child-related expenses that are not associated with income production ("nonworking childcare costs"). Part II further explains the significance of this. After discussing the various tax provisions, which provide relief for these different costs, this Part shows that the Code currently allows tax relief for only a fraction of the childcare costs working parents can be expected to incur.

A. Tax Relief for Nonworking Childcare Expenses

Sections 151 and 24 of the Internal Revenue Code allow a parent to reduce her tax liability by set amounts that reflect a portion of the costs she can be expected to incur to care for her children. The availability of the relief these provisions offer is not tied to whether parents incur these expenses while working; nor is it tied to whether parents work at all. Instead, these provisions allow taxpayer parents to make downward adjustments to their income tax liability to reflect the inevitable costs of child rearing, which taxpayers without parental obligations do not incur.²⁵

22. See, e.g., I.R.C. § 162.

23. See, e.g., *id.* § 129. For the tax novice, if a specific code provision allows a taxpayer to deduct an expense, that taxpayer may subtract the cost from her taxable income. Suppose, for instance, that a taxpayer earned \$100,000 gross income this year and incurred \$6,000 deductible expenses. After the deduction, the taxpayer would be able to reduce her income from \$100,000 to \$94,000. An exemption, on the other hand, allows a taxpayer to exclude from her taxable income items that would otherwise be includible. Thus, suppose the taxpayer earned \$100,000 gross income this year, consisting of \$94,000 of cash and \$6,000 of noncash benefits (such as healthcare, childcare, etc.). Generally, a taxpayer must include in income the fair market value of benefits received and thus, in this scenario, the taxpayer would, as a general matter, have taxable income equal to \$100,000. If, however, a provision of the Internal Revenue Code allowed the taxpayer to exclude the benefits—put another way, these benefits were exempt from taxation—the taxpayer would have to include only \$94,000 in her taxable income. A tax credit provides a dollar-for-dollar reduction of a taxpayer's tax liability. Contrast this with a deduction, which instead reduces one's taxable *income*—the amount on which relevant tax rates are applied to determine final tax liability.

24. See *id.* § 152 (defining dependents).

25. Put another way, these sections reflect the judgment that if two taxpayers earn the same income but only one cares for dependent children, the caretaker should have a lower tax liability to reflect these costs. This Article does not cover the Earned Income Tax Credit, which allows taxpayers to take a dollar-for-dollar credit if their adjusted gross income is below a certain threshold. Both the applicable threshold and credit increase as the number of children dependent on the taxpayer increases.

As a default matter, § 151 allows a taxpayer to exclude from her taxable income a personal-dependency exemption amount,²⁶ which is \$4,000 for the 2015 tax year.²⁷ A married couple filing jointly is entitled to claim two personal-dependency exemptions (one for each spouse) and an additional personal exemption for each of the couple's dependents.²⁸ A single parent with full custody of his two children would claim three personal exemptions on his income taxes.²⁹

Section 151 helps to define a minimum level of income below which no taxation will be levied. To illustrate, § 151 initially allows a childless couple filing jointly to exclude \$8,000 from its taxable income, and a married couple with two children to exclude \$16,000. Thus, if the former and latter couples were to earn less than \$8,000 or \$16,000, respectively, they would have no taxable income once they had claimed the personal exemptions to which they were entitled.

Of course, § 151 will not completely eliminate the tax liability of all taxpayers, but may still reduce that liability to a significant extent. For instance, a married couple without children that earned \$100,000 taxable income in 2015 would, after claiming exemptions, pay taxes on \$92,000, resulting in a \$14,587 tax liability³⁰; a married couple with two children earning the same \$100,000 would only pay tax on \$84,000, resulting in a \$12,587 tax liability.³¹

The personal-dependency exemption amount “phases out” for taxpayers at even higher income levels—that is, taxpayers begin to lose a percentage of the exemption amount once their earnings surpass a designated threshold, and they lose a greater percentage of the exemption as income rises past that amount.³² In 2015, a married couple filing jointly begins to lose a percentage of its exemption amount once the couple's combined income reaches \$309,900, and it will lose the entire exemption amount once its income exceeds \$432,400.³³ A single parent filing as a head of household will begin to lose the benefit of the personal-dependency exemption once income reaches \$284,050 and will lose the entire exemption once income reaches \$406,550.³⁴

26. I.R.C. § 151(b)–(c).

27. Rev. Proc. 2014-61, 2014-47 I.R.B. 860, 866, <http://www.irs.gov/pub/irs-irbs/irb14-47.pdf> [<http://perma.cc/9ZDP-LPVZ>].

28. I.R.C. § 151.

29. *See id.* § 152(c)(4)(B) (allowing exemption for custodial parent).

30. *See id.* § 1(a); Rev. Proc. 2014-61, 2014-47 I.R.B. 860, 861. All hypotheticals assume all income is ordinary income, unless otherwise stated.

31. *See* sources cited *supra* note 30.

32. *See* Rev. Proc. 2014-61, 2014-47 I.R.B. 860, 866.

33. *Id.*

34. *Id.*

A single parent filing as unmarried will begin to lose the benefit once income reaches \$258,250 and will lose the entire exemption once income reaches \$380,750.³⁵

In 1997, Congress added § 24 to the Code to supplement the tax relief provided to families by § 151.³⁶ Before phaseouts, current § 24 allows taxpayers to claim a \$1,000 “child tax credit”—that is, a \$1,000 reduction in the taxpayer’s tax liability³⁷—for each dependent child.³⁸ Building on the example above, the childless couple earning \$100,000 would have a \$14,587 tax liability while the couple with two children would have a tax liability of \$12,587 less \$2,000, or \$10,587.

Like § 151’s personal-dependency exemption, § 24’s child tax credit phases out for taxpayers at higher income levels; but the child tax credit phases out far more quickly. In 2015, for instance, a married couple filing jointly begins to lose a portion of the credit once income rises above \$110,000, and it loses the credit completely once income exceeds \$130,000.³⁹ A single parent begins to lose a portion of the credit once income exceeds \$75,000, and she loses the credit completely once income exceeds \$95,000.⁴⁰

The purpose of §§ 151 and 24 is to “reduce the individual income tax burden of . . . families [and] . . . better recognize the financial responsibilities of raising dependent children.”⁴¹ The availability of the tax relief provided by these sections is not tied to actual expenses incurred and does not depend on whether the expenses are related to the caregiver’s work. A different pair of Code sections provides relief to taxpayers who incur childcare costs, which enables them to earn income. As discussed further in Part II, this distinction between nonworking and working childcare expenses is crucial, and providing tax relief for these two types of costs should be viewed as serving entirely distinct purposes.

35. *Id.*; see also IRS, PUBLICATION 501, EXEMPTIONS, STANDARD DEDUCTION, AND FILING INFORMATION 8 (2014), <http://www.irs.gov/pub/irs-pdf/p501.pdf> [<http://perma.cc/T264-B93K>] (indicating when a single parent may file for head of household).

36. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 101(a), 111 Stat. 788, 796 (codified as amended at I.R.C. § 24(a) (2012)). In the legislative history of the original version of the bill passed by the House, lawmakers stated:

The Committee believes that the individual income tax structure does not reduce tax liability by enough to reflect a family’s reduced ability to pay taxes as family size increases. In part, this is because over the last 50 years the value of the dependent personal exemption has declined in real terms by over one-third. The Committee believes that a tax credit for families with dependent children will reduce the individual income tax burden of those families, will better recognize the financial responsibilities of raising dependent children, and will promote family values.

H.R. REP. NO. 105-148, at 309–10 (1997).

37. I.R.C. § 24(a) (2012). The original version of § 24 allowed a \$500 credit per child. § 101(a), 111 Stat. at 796.

38. I.R.C. § 24(c) defines “qualifying child.”

39. *See id.*

40. *See id.*

41. H.R. REP. NO. 105-148, at 309–10.

B. Tax Relief for Working Childcare Expenses

Section 21 of the Internal Revenue Code allows a taxpayer to reduce her taxable income to reflect childcare expenses that “enable [her] to be gainfully employed.”⁴² The original version of § 21, enacted in 1954, allowed some taxpayers to deduct up to \$600 of these working childcare expenses.⁴³ By 1971, the maximum deduction allowed by any taxpayer was \$4,800.⁴⁴ To illustrate, suppose that the Smiths (married and filing jointly) earned \$100,000. Imagine also that the Smiths both work and have two very small boys. Therefore, they spend \$3,000 per year for day care. The 1971 version of § 21 allowed the Smiths to reduce their taxable income from \$100,000 to \$97,000. If the Smiths were in a 30% marginal tax bracket, meaning the rate at which the taxpayer’s next dollar of income would be taxed, this would result in a tax savings of \$900 (the product of 30% and the \$3,000 reduction in taxable income).

Congress, however, was disturbed by the “upside-down-subsidy effect” created by the original § 21.⁴⁵ That is, because the tax relief for working childcare expenses took the form of a deduction, wealthier taxpayers benefited more than the less well off. In the example above, the Smiths saved \$900 in income taxes as a result of the original § 21 deduction because they earned enough to put them in a 30% marginal tax bracket. Suppose, however, that the Smiths only earned enough to be in a 20% marginal tax bracket but still incurred \$3,000 in working childcare expenses. In this case, the tax savings from the original § 21’s deduction would be reduced to \$600 (the product of 20% and \$3,000), resulting in the upside-down-subsidy effect.

The Code provides for many deductions, each of which, as a matter of mathematics, inevitably results in this upside-down-subsidy effect. Congress, however, was apparently particularly disturbed by this effect in the context

42. I.R.C. § 21(b)(2)(A) defines employment-related expenses as:

amounts paid for the following expenses, but only if such expenses are incurred to enable the taxpayer to be gainfully employed for any period for which there are 1 or more qualifying individuals with respect to the taxpayer:

- (i) expenses for household services, and
- (ii) expenses for the care of a qualifying individual.

Such term shall not include any amount paid for services outside the taxpayer’s household at a camp where the qualifying individual stays overnight.

I.R.C. § 21(b)(2)(A).

43. H.R. REP. NO. 83-1337, at A61 (1954). For a full discussion of the early history of then-section 214 see Alan L. Feld, *Deductibility of Expenses for Child Care and Household Services: New Section 214*, 27 TAX L. REV. 415 (1972).

44. I.R.C. § 214(c) (1971) (repealed 1976); S. REP. NO. 94-1236, at 48–51 (1976).

45. See S. REP. NO. 94-938, at 132–33 (1976).

of the childcare deduction. Initially, Congress attempted to mitigate this effect by phasing down the deductible expenses allowed as the taxpayer's income rose.⁴⁶ But in 1976, Congress responded more directly to the perceived upside-down-subsidy problem and amended § 21, replacing the deduction with a tax credit for a percentage of working childcare expenses.⁴⁷ The 1976 version of § 21 allowed a taxpayer to claim a credit equal to 20% of childcare expenses that enabled her to be gainfully employed.⁴⁸ Thus, all taxpayers incurring \$3,000 of working childcare expenses (such as the Smiths) could subtract \$600 from their tax bill. The original credit, therefore, eliminated the upside-down-subsidy effect created by § 21's original deduction by allowing all taxpayers to reduce their taxable income by the same percentage of working childcare costs.

In changing the working childcare deduction to a credit, Congress explicitly rejected income-based "phaseouts."⁴⁹ First, Congress believed the phaseout was no longer necessary since the upside-down-subsidy effect of the deduction was eliminated.⁵⁰ Further, Congress thought the phaseout inappropriate because working childcare expenses were "cost[s] of earning income"⁵¹ and, therefore, not the type of expenses that should ever be subject to phaseouts, a concept that the Article discusses further at Part IV.⁵²

Nevertheless, in 1981, perhaps having lost sight of § 21's history, Congress amended that provision to include income phaseouts.⁵³ Currently, a taxpayer—for example, a married couple filing jointly with children, or a single custodial parent—may deduct 35% of working childcare expenses if the taxpayer earns \$15,000 or less.⁵⁴ Once the taxpayer's income rises above the \$15,000 threshold, the percentage of creditable working childcare expenses is reduced. Taxpayers earning over \$43,000 may credit only 20% of

46. Specifically, the maximum \$4,800 deduction was reduced by one dollar for every two dollars a taxpayer's income exceeded \$35,000. STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., SUMMARY OF THE TAX REFORM ACT OF 1976 (H.R. 10612, 94TH CONG., PUBLIC LAW 94-455) 20–21 (Comm. Print. 1976).

47. *Id.*

48. Tax Reform Act of 1976, Pub. L. No. 94-455, § 504(a)(1), 90 Stat. 1520, 1563.

49. S. REP. NO. 94-938, at 133 ("The committee views qualified child care expenses as a cost of earning income and believes that an income ceiling on those entitled to the allowance has minimal revenue impact, if the allowance is in the form of a credit. Therefore, it considers it appropriate and feasible to eliminate the income phaseout and to allow all taxpayers to claim such expenses regardless of their income level.").

50. *Id.* at 132 ("One method for extending the allowance of child care expenses to all taxpayers, and not just to 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 the lower brackets.").

51. *Id.* ("The committee believes that [working childcare] expenses should be viewed as a cost of earning income for which all working taxpayers may make a claim.").

52. See *infra* Section IV.A.

53. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, 198.

54. I.R.C. § 21(a)(2) (2012).

these expenses and the percentage remains at 20% for all income levels exceeding this threshold.⁵⁵ Considering that in 2014, the poverty level for a family with two children was \$23,850,⁵⁶ these phaseouts are extremely steep.

Further, § 21 was soon amended to include dollar limitations. Currently, creditable working childcare expenses are limited to \$3,000 for one child and \$6,000 for two or more children.⁵⁷ Thus, the maximum credit allowed for all taxpayers earning over \$43,000 is \$1,200 (20% of \$6,000). If a taxpayer's marginal tax rate is 30%, this equates to a \$4,000 deduction, compared to the \$4,800 deduction allowed by the 1971 version of § 21.⁵⁸ Congress has, therefore, not only failed to adjust § 21 for inflation—the dollar limitations found in § 21 have not been changed for well over a decade⁵⁹—but has also allowed today's version of § 21 to provide working families with a *non-indexed* dollar tax savings that is less than the *non-indexed* savings allowed four decades ago. It is, therefore, not particularly surprising that § 21 allows working families tax relief for only a small fraction of the childcare costs they actually incur. Part II explores this reality in greater detail.

Before proceeding to that discussion, however, an additional section of the Code provides another method parents may use to reduce their taxable income to reflect working childcare costs. In 1981, Congress added what is now § 129 to the Code.⁶⁰ While § 21 provides tax relief to taxpayers who directly incur working childcare expenses, § 129 provides tax relief to taxpayers who, as a result of their employment, receive childcare services or other benefits that lessen the costs of childcare.⁶¹

For instance, an employer might provide its employees on-site day care for free or at a discounted cost. Ordinarily, the fair-market value of those services (or the value of the discount) would be included in the taxpayer's income.⁶² Section 129, however, allows taxpayers to exclude up to \$5,000

55. *See id.*

56. 2014 Poverty Guidelines, 79 Fed. Reg. 3593, 3593 (Jan. 22, 2014), <http://www.gpo.gov/fdsys/pkg/FR-2014-01-22/pdf/2014-01303.pdf> [<http://perma.cc/K5NQ-CNQA>].

57. I.R.C. § 21(c).

58. A deduction reduces a taxpayer's taxable *income*, which is then used to calculate the taxpayer's tax liability using applicable tax rates. If a taxpayer is in a 30% marginal tax rate—that is, his next dollar of income will be taxed at a rate of 30%—a \$4,000 reduction in his taxable income will result in a tax savings of \$1,200 (30% of the \$4,000). Thus, a \$1,200 credit (which provides a dollar-for-dollar reduction from tax *liability*) produces the same tax savings as a \$4,000 deduction.

59. In 2001, the limits were adjusted to their current levels. *See* Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38, 49.

60. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 172, 199–200 (codified as amended at I.R.C. § 129).

61. *Compare* I.R.C. § 21, *with* I.R.C. § 129.

62. 26 C.F.R. § 1.61-2(d)(1) (2015) (“If services are paid for in exchange for other services, the fair market value of such other services taken in payment must be included in income as compensation.”).

worth of employer-provided dependent-care assistance—for example, employer-provided childcare—from their taxable income.⁶³ Section 129 also allows an employer to establish dependent-care flexible-spending accounts (FSAs), into which employees may divert up to \$5,000 of their earnings free from taxation, so long as those funds are used to cover working childcare costs.⁶⁴

To illustrate, recall the Smith family discussed above. Suppose that rather than paying \$3,000 directly to their sons' day care, the Smiths decide to take advantage of their employer's dependent-care flexible-spending plan and set aside \$3,000 of their \$30,000 earnings. Section 129 allows the Smiths to exclude that "earmarked" \$3,000, reducing their taxable income to \$27,000. If the Smiths are in a 30% marginal tax bracket, this results in a \$900 tax savings (the product of 30% and \$3,000).

Unlike § 21, § 129 does not provide phaseouts and does not change dollar limitations based on number of children. But like § 21, the dollar limitations provided in § 129 are likely to represent only a small fraction of the childcare costs incurred by working families.

Several things are worth noting before discussing the currently high cost of childcare. First, § 129 inevitably results in the upside-down-subsidy effect Congress attempted to eliminate in 1976 when it changed the mechanism of tax relief provided in § 21 from a deduction to a percentage credit.⁶⁵ While the Smiths, who are presumptively in a 30% marginal tax bracket, will enjoy \$900 in tax savings as a result of excluding the \$3,000 set aside in the dependent-care FSA, a taxpayer who earns only enough to be in a 20% marginal tax bracket will enjoy a lesser \$600 savings from setting aside the same amount.

Second, together §§ 21 and 129 create an odd situation in which two taxpayers in identical economic situations are taxed differently.⁶⁶ Using current § 21's phaseouts, when the Smiths paid for day care directly, they could claim a credit equal to 20% of their \$3,000 expenses, reducing their tax liability by \$600. If, however, they decided to use a dependent-care FSA to pay the \$3,000, they would reduce their tax liability by \$900 as a result of § 129's exclusion. Whether it is preferable to pay for working childcare expenses directly (so that one may claim the § 21 credit) or to use a dependent-care FSA (so that one may claim the § 129 exclusion) depends, among other things, on one's marginal tax bracket. To the extent that taxpayers can choose how to fund childcare, this is at best silly and at worst a trap for the unwary. The situation is more troubling, however, since some taxpayers may

63. I.R.C. § 129(a)(2)(A). See *infra* notes 209–223 and accompanying text for a more detailed illustration that shows, among other things, that some taxpayers may be entitled to both a § 129 exclusion and § 21 credit. This additional detail does not affect the substantive points of this Section.

64. IRS, INSTRUCTIONS FOR FORM 2441: CHILD AND DEPENDENT CARE EXPENSES (2014), <http://www.irs.gov/pub/irs-pdf/i2441.pdf> [<http://perma.cc/7DQJ-ZMMC>].

65. See *supra* notes 47–50 and accompanying text.

66. See *infra* Section IV.B for a more detailed illustration.

not work for employers that have established dependent-care FSAs. Nevertheless, the discrepant treatment of economically identical taxpayers is unavoidable so long as the Code uses different mechanisms to provide tax relief in §§ 21 and 129—that is, a phased-out percentage credit and an exclusion from taxable income.

Finally, and of critical import for the analysis of this Article, the hypothetical above illustrates that § 21's working childcare credit and § 129's exclusion for income diverted to a dependent-care FSA (hereinafter the FSA exclusion) should be analyzed in exactly the same manner. There is no economic difference between a taxpayer directly paying her caregiver and a taxpayer diverting amounts to a dependent-care FSA, which is then used to pay that caregiver. While the Code currently uses two different mechanisms to provide tax relief for these economically identical transactions—namely, a credit for the former transaction and exclusion in the latter—there is no reason why these transactions should not be taxed the same. Thus, if one were to conclude that § 21's credit does not offer adequate tax relief for working families, one would also need to apply that reasoning to determine the adequacy of the FSA exclusion allowed by § 129. In light of this, the remainder of this Article will refer collectively to § 21's percentage credit and § 129's FSA exclusion as the working childcare provisions and to the relief provided by those sections—that is, the percentage credit and FSA exclusion—as working childcare relief.⁶⁷

C. *The Reality Faced by Working Families: What Is the Effect (or Lack Thereof) of the Working Childcare Provisions?*

Just as all families look different from one another, the ways in which families earn income and care for their children vary dramatically. In two-parent families, one parent may earn all of the income while the other provides childcare; alternatively, both parents may work. But the dual-earner family is extremely likely to incur significant additional expenses to provide childcare during working hours, especially in families with preschool-aged children.⁶⁸ And the significance of these expenses magnifies for single parents, who may alone bear the primary responsibilities of producing income and caring for their children.

67. Section 129 also allows taxpayers to exclude from their taxable income up to \$5,000 worth of childcare services provided by their employers—for example, day care provided by an employer. I.R.C. § 129(a)(2)(A). I do not see any reason why the analysis of this Article would not also extend to the exclusion of these in-kind benefits.

68. Census data shows that in families in which the mother is employed and children are younger than five years of age, roughly 88 percent of families require some regular childcare. See LYNDIA LAUGHLIN, U.S. CENSUS BUREAU, No. P70-135, WHO'S MINDING THE KIDS? CHILD CARE ARRANGEMENTS: SPRING 2011, at 5 (2013), <http://www.census.gov/content/dam/Census/library/publications/2013/demo/p70-135.pdf> [<http://perma.cc/QW8A-W88Z>] (“In the spring of 2011, 88 percent of the 10.9 million preschoolers of employed mothers . . . were in at least one child care arrangement on a regular basis.”).

Childcare is very costly in the United States and represents one of the highest household costs families incur.⁶⁹ Childcare “often exceeds the cost of housing, college tuition, transportation or food.” And these expenses tend to be incurred “at a time when families can least afford them.”⁷⁰

The cost of childcare varies significantly by state⁷¹ and by whether the care is provided in an urban or rural environment, with the former being far costlier.⁷² The cost also depends greatly on the age of the children; care for infants and preschool-aged children is appreciably more expensive than care for school-aged children.⁷³

One of the most common options available to working parents is the “child care center,”⁷⁴ a day-care facility defined formally by a leading study on childcare costs as “[a]n early care and education facility that is licensed/licensed exempt by the state and operates under a proprietary or not-for-profit status, independently, or as part of a large chain of facilities or a faith-based organization.”⁷⁵ In the ten most expensive states, the cost of caring for one infant—that is, a child under one year of age—in a childcare center ranged from \$10,787 to \$14,508 per year, representing between 47.1% and 56.0% of the median salary of a single parent in those states, and between 13.8% and 15.9% of the median salary of a married couple.⁷⁶ In Washington D.C., the cost of similar care is \$21,948, representing a staggering 83.4% of the median salary of a single parent in the District⁷⁷ and a still-high 13.5% of the median salary of couples.

And that is just for one child. In New York, the state with the highest cost of childcare by reference to median salary, parents pay \$26,788 per year to provide care for an infant and preschool-aged child in a childcare center.⁷⁸ In Washington State and Minnesota, a day-care center for two young children costs over \$21,000 and \$24,000, respectively.⁷⁹ In Washington, D.C., parents with two preschool-aged children pay the highest costs in the country—around \$34,000.⁸⁰ Even in the most affordable states, care in a childcare

69. CHILD CARE AWARE OF AM., *supra* note 10; *see also* Bernard, *supra* note 10.

70. CHILD CARE AWARE OF AM., *supra* note 10, at 4 (quoting Lynette M. Fraga, Executive Director, Childcare Aware of America).

71. *Id.* at 14.

72. *See id.*

73. *Id.* apps. 2–4 at 42–47.

74. Approximately 25 percent of childcare arrangements for children under five are made through childcare centers. LAUGHLIN, *supra* note 68, at 9 tbl.3. This represents, by far, the largest percentage of nonrelative arrangements.

75. CHILD CARE AWARE OF AM., *supra* note 10, at 39.

76. *Id.* at 16 tbl.2.

77. *Id.* app. 2 at 42. The unusual figures for the District of Columbia are because it is an exclusively urban area, with large income disparities between single-parent and two-parent families. *Id.* at 19.

78. *See id.* app. 1 at 40.

79. *See id.* app. 1 at 40–41.

80. *See id.* app. 3 at 44.

center costs slightly over \$10,000 for an infant and a toddler, and prices range between these points in other states.⁸¹

Of course, “child care centers” are not the only form of childcare, though they are the most common form of paid care.⁸² Popular mostly in rural areas, “family child care homes”—that is, “[c]hild care offered in a caregiver’s own home [that], depending on the state’s licensing regulations, may be licensed or exempt from licensing”—carries with it lower costs than day-care arrangements.⁸³

It is also common for working parents to hire a “nanny,” an individual who will provide care for children in the home of the parent, a friend, or a neighbor.⁸⁴ This option is often more expensive than the childcare center. One recent report estimates that parents pay around \$37,000 per year for a full-time nanny.⁸⁵ This estimate is a logical one. Suppose a dual-earner couple or single parent works forty hours each week and therefore needs care for forty-five hours each week to account for commuting time. Even if parents paid the caregiver \$10 an hour, since five hours would be considered overtime and payable at time and a half,⁸⁶ the caregiver’s yearly salary would be \$24,700. In reality, an individual caregiver caring for two children will (and should) require much more than \$10 per hour, which is barely the minimum wage in many states.⁸⁷ If parents paid an individual caregiver \$15 per hour, for instance, her salary would be well over \$35,000.

There are various reasons why parents might choose or need to use this more expensive option. The wait-lists at many day-care facilities are notoriously long.⁸⁸ Further, day-care facilities will often refuse care for infants⁸⁹

81. See *id.* apps. 2–3 at 42–45.

82. LAUGHLIN, *supra* note 68, at 9 tbl.3.

83. CHILDCARE AWARE OF AM., *supra* note 10, at 39.

84. Nanny care provided either in a parent’s home or the nanny’s home is a popular paid childcare option, representing 12.9 percent of arrangements. LAUGHLIN, *supra* note 68, at 9 tbl.3.

85. Hannah Seligson, *The True Cost of Leaning In*, DAILY BEAST (Mar. 22, 2013, 4:45 AM), <http://www.thedailybeast.com/articles/2013/03/22/the-true-cost-of-leaning-in.html> [<http://perma.cc/W2Z-7B85>].

86. *Overtime Pay*, U.S. DEP’T LAB., http://www.dol.gov/whd/overtime_pay.htm [<http://perma.cc/YD46-MDWX>].

87. See *Minimum Wage Laws in the States—January 1, 2015*, U.S. DEP’T LAB., <http://www.dol.gov/whd/minwage/america.htm> [<http://perma.cc/5ACC-ZSJZ>]. In Washington State, the minimum wage is \$9.47. *Minimum Wage*, WASH. ST. DEP’T LAB. & INDUSTRIES, <http://www.lni.wa.gov/WORKPLACERIGHTS/WAGES/MINIMUM/DEFAULT.ASP> [<http://perma.cc/5RZL-UH76>].

88. Sue Shellenbarger, *Day Care? Take a Number, Baby*, WALL STREET J. (June 9, 2010, 12:01 AM), <http://www.wsj.com/articles/SB10001424052748704256604575294523680479314> [<http://perma.cc/HWL6-GF2S>]; see also Alissa Quart, *Opinion, Crushed by the Cost of Child Care*, N.Y. TIMES (Aug. 17, 2013, 2:30 PM), <http://opinionator.blogs.nytimes.com/2013/08/17/crushed-by-the-cost-of-child-care/> [<http://perma.cc/LX9Q-VFTM>] (“Among the mothers I spoke to, one . . . signed up for a slot at a local day care when she was newly pregnant. Her daughter is now 5, and she is still on the wait list.”).

89. See Shellenbarger, *supra* note 88. This is likely due, at least in significant part, to more stringent limitations being placed on infant-care facilities (as opposed to facilities that

and almost all (if not all) facilities will not care for ill children.⁹⁰ Considering how frequently small children are sick—the average child will catch anywhere from six to ten colds each year⁹¹—parents using day-care options will often need to miss (or be late to) work to tend to their sick children.⁹² In fact, one study that chronicled cases in which parents were fired for missing or being tardy to work because they were caring for their ill children concluded that many parents are only “one sick child away from being fired.”⁹³ An individual caretaker, by contrast, can provide care even when children are ill. Finally, parents may simply feel more comfortable having one individual care for their children in a home environment, rather than transporting children to what might be seen as a more impersonal setting with rotating caregivers.

What this data make clear is that the relief provided by § 21 and 129 does not do much to relieve working parents of the financial burdens of childcare. The percentage credit in § 21 and the FSA exclusion in § 129 allow parents to credit or exclude a mere fraction of the costs actually incurred for employment-related childcare. Furthermore, this data makes clear that § 21’s phaseouts are astonishingly steep. The relief provided by § 21 begins to phase out once a parent’s *income* exceeds \$15,000.⁹⁴ In many states, this falls short—often far short—of the amount needed just to provide *care* for two young children while working full-time hours.⁹⁵ Furthermore, the percentage credit phases down to its lowest level of 20 percent of childcare costs (subject to dollar limitations) once a taxpayer’s income reaches \$43,000.⁹⁶ In Washington, D.C., the cost of caring for an infant and a four year old in a

care only for older children) that wish to maintain their state certifications. For instance, legally required infant-to-caregiver ratios are far lower than the noninfant-to-caregiver ratios. E.g., ARK. DEP’T OF HUMAN SERVS., DIV. OF CHILD CARE & EARLY CHILDHOOD EDUC., MINIMUM LICENSING REQUIREMENTS FOR CHILD CARE CENTERS 22 (rev. 2015), http://humanservices.arkansas.gov/dcece/licensing_docs/2014%20A1%20CCC%20Clean%20Copy%20Final%20Filing.pdf [<http://perma.cc/MME5-YG6X>] (requiring infant-to-caregiver ratio of 1:6 for infants less than eighteen months; 1:9 for children between eighteen and thirty-six months; 1:12 for ages two-and-a-half through three years; 1:15 for four years; 1:18 for five years to kindergarten; and 1:20 for kindergarten and above).

90. Julie Revelant, *Too Sick for Daycare? Experts Weigh In*, Fox News (Sept. 5, 2012), <http://www.foxnews.com/health/2012/09/04/too-sick-for-day-care-experts-weigh-in/> [<http://perma.cc/MGN9-CT3L>] (“Most daycare centers have a sick child policy which outlines when kids should stay home. And although it’s not always feasible to take a day off of work, it’s a good idea to take into account the other children as well.”).

91. *Id.*; see also JOAN C. WILLIAMS, WORK LIFE LAW, UC HASTINGS COLL. OF THE LAW, ONE SICK CHILD AWAY FROM BEING FIRED: WHEN “OPTING OUT” IS NOT AN OPTION 12 (2006) <http://www.worklifelaw.org/pubs/onesickchild.pdf> [<http://perma.cc/NT2K-4USY>] (“Routine childhood illness is a major concern.”).

92. See WILLIAMS, *supra* note 91, at 12–13.

93. *Id.* at 3, 5.

94. I.R.C. § 21(a)(2) (2012).

95. See *supra* notes 76–81 and accompanying text.

96. See I.R.C. § 21(a)(2).

childcare center is \$39,252,⁹⁷ let alone the cost of an individual caretaker, which may be even higher.⁹⁸

The situation should be taken seriously. As noted in the Introduction, most two-parent families are made up of two earners and require at least two incomes.⁹⁹ Single parents face even greater pressure to find work to adequately care for their children. And, although middle-class incomes have generally decreased in recent decades,¹⁰⁰ the costs of childcare have steadily risen.¹⁰¹ As a result, many working parents are in a “childcare squeeze,” spending a significant portion of their earnings on childcare to simply make it possible for them to work.¹⁰²

Even worse, recent data suggest that more parents are finding themselves “squeezed out” of the market completely because they cannot find jobs that pay enough to offset soaring childcare expenses. According to a study conducted by the Pew Research Center, the percentage of stay-at-home mothers started to decline in the mid-1960s and continued to do so until it reached an all-time low of 23 percent in 1999.¹⁰³ But the percentage of stay-at-home mothers started to rise in 1999 and has climbed ever since, representing a “reversal of a long-term decline in ‘stay-at-home’ mothers that had persisted for the last three decades of the 20th century.”¹⁰⁴ Unfortunately, many of these parents are not staying home by choice,¹⁰⁵ but because they have found that potential wages would barely cover childcare costs.¹⁰⁶

97. CHILD CARE AWARE OF AM., *supra* note 10, apps. 2–3.

98. *See supra* notes 85–87 and accompanying text.

99. *See* Glynn, *supra* note 9, at 2 (“[M]ost children today are growing up in families without a full-time, stay-at-home caregiver. In 2010, among families with children, nearly half (44.8 percent) were headed by two working parents and another one in four (26.1 percent) were headed by a single parent. As a result, fewer than one in three (28.7 percent) children now have a stay-at-home parent, compared to more than half (52.6 percent) in 1975, only a generation ago.”); Neal, *supra* note 11.

100. *See* Parlapiano et al., *supra* note 11.

101. *See*, Plumer, *supra*, note 12 (discussing WARREN & TYAGI, *supra* note 5) (“Two-income families are almost always worse off than their single-income counterparts were a generation ago, even though they pull in 75 percent more in income. The problem is that so many fixed costs are rising—health care, child care, finding a good home—that two-income families today actually have less discretionary money left over than those single-earner families did.”).

102. While the average family spends approximately 18 percent of its income on childcare costs, families with young children will almost surely spend far more. *See infra* Part III; *see also* Bernard, *supra* note 10; Morello & Clement, *supra* note 14; Riley, *supra* note 14; Schorr, *supra* note 14.

103. COHN ET AL., *supra* note 13, at 5.

104. *Id.*

105. *See id.* at 6 (“A growing share of stay-at-home mothers (6% in 2012, compared with 1% in 2000) say they are home with their children because they cannot find a job. With incomes stagnant in recent years for all but the college-educated, less educated workers in particular may weigh the cost of child care against wages and decide it makes more economic sense to stay home.”).

106. *See* Berman, *supra* note 6 (“Chelsea Belander, 22 and single, lives at her mother’s house rent free with her one-year-old son, Finn. Belander doesn’t have any income besides the child support payments she receives from Finn’s dad and cash she earns from doing small jobs

It is important to recognize not only the short-term but also the long-term effects of “squeezing” a parent out of work. While it might be tempting (and comforting) to believe that a parent’s job opportunities will be revitalized once her children reach school age, even small gaps in one’s resume can make an already challenging job market even harder to conquer.¹⁰⁷ A parent “squeezed” out of the job market may find herself out for good.

Disturbing as these trends are, not all problems are for the Internal Revenue Code to solve. Just because childcare is expensive does not mean that the tax system should allow taxpayers to reduce their taxable income to reflect those costs. If a taxpayer purchases a Mercedes-Benz every year, the cost of the vehicle may eat up a great deal of her income, causing her great financial stress.¹⁰⁸ This does not mean that the Code should—in fact, it unequivocally should not—allow her to reduce her taxable income to reflect these costs. To determine whether and to what extent the current tax relief §§ 21 and 129 provide is inadequate, one needs to understand certain basic principles of tax law, specifically those guiding the decision to grant or deny taxpayers relief—that is, deductions, percentage credits, or exclusions—for certain expenses. Once introduced, this Article will apply these general principles to show that parents should receive tax relief for a far more significant portion of working childcare expenses than current laws provide.

II. FUNDAMENTAL TAX POLICIES: FOR WHAT EXPENSES SHOULD TAX RELIEF BE GRANTED?

The ultimate goal of any tax regime is to accurately measure a taxpayer’s tax liability, which requires the accurate measurement of taxable income (that is, the base amount on which tax is levied). In order to do so, the Internal Revenue Code must allow taxpayers to make adjustments for certain costs. For instance, an income tax must allow taxpayers to deduct the costs of earning income.¹⁰⁹ These adjustments are sacrosanct in the tax law

like mowing the lawn. But she’s calculated that the \$8 to \$10 an hour she’d make at the jobs available in her town of Brunswick, Maine, would barely cover the cost of child care, which runs \$250 per week for a half day. “That seems stupid to me,” Belander said of working just to pay for day care.”).

107. See Warner, *supra* note 6 (“Eighty-nine percent of those who ‘off-ramped’ . . . said they wanted to resume work; but only 73 percent of these succeeded in getting back in, and only 40 percent got full-time jobs.”).

108. And this may be about what it costs to provide annual full-time care for one’s children while working. Cf. Schorr, *supra* note 14 (“One mom friend who has returned to a full-time job in finance confides she’s paying her nanny an annual salary of, oh, roughly the price of a 2010 Mercedes SUV.”).

109. See Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 724 (1970) (“An income tax is a tax on *net* income and not a tax on gross receipts; therefore the deductions from gross income required to produce the net income base must be allowed. Those deductions, generally speaking, are the expenses and costs incurred in the process of producing or earning the gross income received by the taxpayer.”).

and limiting them would compromise the accurate calculation of net income,¹¹⁰ the tax base the United States seeks (and has always sought) to tax.¹¹¹

By contrast, an income tax should not provide tax relief for the costs of consuming goods and services.¹¹² While certain provisions of the Code allow taxpayers to deduct or credit designated consumptive expenditures, these sections seek to accomplish a series of nontax objectives. For instance, the Code allows a taxpayer to deduct interest associated with her home mortgage, not to calculate properly the taxpayer's liability but to encourage homeownership. Congress could, therefore, limit or repeal these provisions at any time without undermining the proper measurement of the income tax base. Somewhere between these two extremes are costs for activities that have both consumptive and nonconsumptive elements. Congress may limit the relief these provisions provide but must be wary of the extent to which it does so, as overly stringent limitations might frustrate the tax-related goals of these provisions, leading to unfairness. Section II.A describes purely consumptive expenses, for which no tax relief is warranted. Section II.B describes purely nonconsumptive expenses, for which full tax relief is necessary. Section II.C turns to hybrid expenses—expenses that have both consumptive and nonconsumptive aspects—noting that working childcare expenses will likely fall within this final categorization.

A. *Unnecessary Adjustments: Tax Reductions for Consumptive Expenses*

A theoretically pure income tax should not allow taxpayers to deduct (or credit) the costs of consuming goods and services.¹¹³ For instance, a taxpayer does not need to deduct (or receive any tax relief to reflect) the costs of purchasing toys for his children in order to accurately calculate his net income. These expenses are purely consumptive and there is, therefore, no

110. *See id.*

111. *E.g.*, *Bank of Am. Nat'l Trust & Savings Ass'n v. United States*, 459 F.2d 513, 518 (Ct. Cl. 1972) (“[F]rom 1913 on, Congress has always directed the domestic levy at some net gain or profit . . .”).

112. This tenet derives from the Haig-Simons definition of income, which generally provides that income is the sum of one's consumption (for example, costs of purchasing goods for personal enjoyment) and accumulation (for example, savings). *See* Robert Murray Haig, *The Concept of Income*, in *THE FEDERAL INCOME TAX* 7 (Robert Murray Haig ed. 1921), *reprinted in* RICHARD A. MUSGRAVE & CARL S. SHOUP, *AM. ECON. ASS'N, READINGS IN THE ECONOMICS OF TAXATION* 54 (1959) (arguing that income is consumption plus accumulation); *see also, e.g.*, William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 *HARV. L. REV.* 309, 330 (1972) (“The adjustments by which taxable income can be made to give a more refined reflection of aggregate personal consumption and accumulation may be positive or negative. If a substantial item of personal consumption is enjoyed without any cash expenditure, then the appropriate adjustment is to add the value of that item to money income. On the other hand, if the concept of consumption is elaborated in a way that does not include some items for which money is spent, then the appropriate adjustment is to deduct the amount of those expenditures from money income.”); Boris I. Bittker, *A “Comprehensive Tax Base” as a Goal of Income Tax Reform*, 80 *HARV. L. REV.* 925, 929 (1967).

113. *See* sources cited *supra* note 112.

tax-related reason why a taxpayer should be able to reduce his tax liability to reflect them. The taxpayer in this hypothetical is not truly poorer by the amount of the expense—he has simply transformed cash into goods (here, toys) that benefit his household at least as much as the cost incurred. If the benefit were not this great, the taxpayer would not have purchased the toys, as his choice to do so was all his own.

As a default matter, Internal Revenue Code § 262 disallows deductions for “personal, living, or family expenses.”¹¹⁴ Section 262’s rule may be reasonably viewed as one that uses personal, living, and family expenditures as a proxy for consumptive expenses. Put another way, § 262 reflects that most personal, living, and family expenses are consumptive. Accordingly, in addition to disallowing a deduction for expenses associated with purchasing toys for his children, § 262 ensures that a taxpayer may not (absent a statutory exception) deduct the costs of purchasing other items for his family and children, such as food and clothing.¹¹⁵

Furthermore, a taxpayer may not deduct the costs of “babysitters” hired to alleviate him of childcare responsibilities that are not associated with his work—for example, babysitters hired for personal engagements, date nights with his spouse or partner, or perhaps sorely needed breaks from child-rearing.¹¹⁶ Again, this disallowance makes sense, as the taxpayer’s wealth has not been decreased as a result of this expense. Instead, he has used cash to purchase babysitting services that he must have thought were worth at least the cost incurred; otherwise, he would not have made the exchange.

As discussed in Part I, the tax law currently allows some limited relief for these nonworking childcare expenses in §§ 154 and 21. But these are exceptions Congress has grafted—they are a matter of “legislative grace”¹¹⁷—and Congress could curtail or repeal them entirely without compromising the accurate calculation of a taxpayer’s net income. By contrast, the Code must make adjustments for nonconsumptive costs in order to properly compute a taxpayer’s net profit.¹¹⁸

B. *Necessary Adjustments: Tax Reductions for Nonconsumptive Expenditures*

Since its inception, the U.S. system of taxation has aimed to tax net income—that is, a taxpayer’s profits.¹¹⁹ Thus, if a taxpayer were to purchase

114. I.R.C. § 262(a) (2012) (“Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.”).

115. *See id.*

116. *See id.*

117. *Cf.* *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934) (“Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.”).

118. *See Surrey, supra* note 109; *supra* text accompanying note 109.

119. *E.g., Bank of Am. Nat’l Trust & Savings Ass’n v. United States*, 459 F.2d 513, 518 (Ct. Cl. 1972) (“[F]rom 1913 on, Congress has always directed the domestic levy at some net gain or profit, and for almost 60 years the concept that the income tax seeks out net gain has been

and sell a widget—say, for \$15 and \$20, respectively—that taxpayer should not be taxed on the full sales price received but rather the sales price less the cost of the widget (\$20 less \$15). The \$15 expense produced no consumptive benefit and instead was aimed purely at income production. It has, therefore, long been accepted that the tax system may not tax one’s “return of capital” (the \$15), a requirement that seems to rise (at least almost) to the level of constitutional necessity.¹²⁰

Similarly, to accurately measure net income, the Code allows taxpayers to deduct the “ordinary and necessary” expenses associated with activities aimed at earning a profit (as opposed to activities pursued for enjoyment).¹²¹ Section 162 of the Internal Revenue Code, for instance, allows taxpayers to deduct “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business”¹²² and § 212 allows the deduction of expenses associated with other income-producing activities that are not quite “continuous” and “regular” enough to rise to the level of a trade or business.¹²³ To illustrate, suppose Tony Toymaker is in the business of making and selling adorable handmade toys. In addition to deducting the costs of making the toys that he sells to customers (such as the cost of raw materials),¹²⁴ which ensures that Tony has not been taxed on his return of capital, Tony may also deduct other necessary costs associated with his toy business. For instance, if he received a loan to purchase the space he uses to make and sell the toys, he may deduct the interest on that loan;¹²⁵ if he instead rents the space, he may deduct the rental payments.¹²⁶ If he hires an employee to help him in his shop, he may deduct the employee’s salary.¹²⁷ Tony may not, however, deduct any of the costs associated with toys made

inherent in our system of taxation. That is the ‘well-understood meaning to be derived from an examination of the [United States] statutes which provide for the laying and collection of income taxes’—the basic test set forth in *Biddle v. Commissioner of Internal Revenue*” (alteration in original) (quoting *Biddle v. Comm’r*, 302 U.S. 573, 579 (1938))).

120. See MERTENS LAW OF FEDERAL INCOME TAXATION §§ 5.06, 5.13 (Hertsel Shadian ed., 2008). See generally *Eisner v. Macomber*, 252 U.S. 189 (1920); *Doyle v. Mitchell Bros.*, 247 U.S. 179 (1918); *Sullenger v. Comm’r*, 11 T.C. 1076 (1948).

121. I.R.C. § 162(a) (2012); see *Surrey*, *supra* note 109, at 705–13 (explaining how business expenses must be deducted in order to properly calculate one’s tax liability).

122. I.R.C. § 162(a).

123. See, e.g., *Higgins v. Comm’r*, 312 U.S. 212 (1941) (stating general rule that a taxpayer may be engaged in a trade or business if his activities are extensive, regular, continuous, and undertaken with a profit motive).

124. I.R.C. § 1012 (providing a general rule that one’s basis in an asset is its cost); see *id.* § 1001 (defining taxable gain as amount realized minus basis).

125. *Id.* § 163.

126. *Id.* § 162(a)(3) (allowing deduction for “rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business”).

127. *Id.* § 162(a)(1) (allowing deduction for “a reasonable allowance for salaries or other compensation for personal services actually rendered”).

for his children, as these costs fall under § 262's auspices,¹²⁸ a result which is also theoretically sensible since these costs are purely consumptive.

Thus, tax relief for nonconsumptive costs such as deductions for costs associated with income-producing activities are necessary adjustments needed to properly measure taxable income. Congress cannot limit these sacrosanct adjustments without compromising the accurate calculation of the tax base.

C. Hybrid Expenses

While some expenses can be easily placed in the “consumptive” or “nonconsumptive” categories, other expenses are associated with activities that have both elements. For instance, consider Larry Lawyer who takes his client to lunch at Lawyer's favorite restaurant to discuss a pending case.¹²⁹ Is the expense a consumptive expenditure or is it associated with income production? The answer is clearly both. On one hand, the lawyer has had the opportunity to eat, which he needed to do regardless of his work on the client's case. On the other hand, had he not had matters to discuss with his client (who might be a person of very fine taste, requiring some degree of pampering), he may well have eaten a peanut butter sandwich at his desk.¹³⁰ As Professor Surrey puts it:

An individual is . . . regarded for tax purposes as having two personalities: one is a seeker after profit who can deduct the expenses incurred in that search; the other is a creature satisfying his needs as a human and those of his family but who cannot deduct such consumption and related expenditures.¹³¹

Thus, if it were possible to tease out the motives of Larry Lawyer, he could not deduct the portion of the meal cost that represents the sustenance and enjoyment he derived from eating—the consumptive element—but could deduct the portion that was related to his business with the client, that

128. *See id.* § 262.

129. Expenses associated with business-related travel, meals, and entertainment are often cited as a classic example of expenses that are difficult to categorize. *See generally* Daniel I. Halperin, *Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem*, 122 U. PA. L. REV. 859 (1974).

130. In *Moss v. Comm'r*, 758 F.2d 211, 212 (1985), Judge Posner presented the problem colorfully as follows:

Suppose a theatrical agent takes his clients out to lunch at the expensive restaurants that the clients demand. Of course he can deduct the expense of their meals, from which he derives no pleasure or sustenance, but can he also deduct the expense of his own? He can, because he cannot eat more cheaply; he cannot munch surreptitiously on a peanut butter and jelly sandwich brought from home while his client is wolfing down tournedos Rossini followed by soufflé au grand marnier.

131. 1 STANLEY S. SURREY ET AL., *FEDERAL INCOME TAXATION* 496 (1972).

is, the additional cost, if any, he incurred to take the client to lunch compared to the lunch he would have eaten otherwise.¹³²

In reality, it would be impractical (if not impossible) to make these differentiations and, as discussed further in Part III, the tax law would have to determine a practical, though almost always imperfect, way to handle these hybrid expenses. But presently, it is important for the reader to see that childcare expenses that enable a taxpayer to work as opposed to other childcare expenses—the costs of hiring babysitters for date nights, for example—may at least as an initial, intuitive matter be seen to fall somewhere in this middling area.

Further, it is important that the reader see that the tax relief provided in §§ 151 and 24, the sections allowing for the nonworking childcare credit and personal exemption discussed in Part I, is very different than the tax relief with which this Article is concerned—namely, tax relief to reflect childcare expenses associated with a taxpayer's income-driven activities. As a matter of tax policy, Congress need not provide any relief for the expenses of caring for one's children unrelated to work, as these represent purely consumptive expenses. By contrast, to the extent that working childcare costs are nonconsumptive expenditures, the Code should, as a matter of fundamental policy, offer tax relief to accurately calculate that taxpayer's net income. Part III explores where working childcare expenses fall on this "expense spectrum."

III. ANALYZING THE WORKING CHILDCARE EXPENSE

It seems almost intuitive that working childcare expenses are at least partly nonconsumptive costs of earning income and not purely consumptive costs.¹³³ In fact, as discussed in Part I, when Congress changed § 21's tax relief from a phased down deduction to a percentage credit, it "believe[d] that [working childcare] expenses should be viewed as a cost of earning income for which all working taxpayers may make a claim."¹³⁴

Nonetheless, some argue that all childcare expenses are purely personal expenditures, suggesting that tax relief is unnecessary. These arguments have some superficial appeal. But, as Section III.A shows, once this argument is analyzed more closely, it is entirely unpersuasive.

132. See Halperin, *supra* note 129, at 859–60; see also Moss, 758 F.2d at 212–13 ("Although an argument can thus be made for disallowing any deduction for business meals, on the theory that people have to eat whether they work or not, the result would be excessive taxation of people who spend more money on business meals because they are business meals than they would spend on their meals if they were not working.")

133. Indeed, many share the intuition. See, e.g., Bittker, *supra* note 112, at 953 ("If the mother of small children takes a job outside the home, she may have to hire a nurse or babysitter; thus, [allowing a deduction for childcare expenses] is a plausible way to reflect the fact that the working mother's salary is not all gravy."); Feld, *supra* note 43, at 415–16, 447 (characterizing expense as at least in part an expense of earning income); William A. Klein, *Tax Deductions for Family Care Expenses*, 14 B.C. L. REV. 917, 919 (1973) (stating the same categorization); Daniel C. Schaffer & Donald A. Berman, *Two Cheers for the Child Care Deduction*, 28 TAX L. REV. 535, 536 (1973) (explicitly agreeing with Feld's characterization).

134. S. REP. NO. 94-938, at 132 (1976).

A. Working Childcare Costs as Purely Personal Costs

It is often argued that parents make the personal choice to have a child and that, therefore, all expenses associated with that initial choice—including childcare costs that enable a taxpayer to work—should not be used to reduce one's tax liability.¹³⁵ It is easier to address this argument if it is broken into parts:

- Premise 1: The decision to have children is a personal choice.
- Conclusion 1: Thus, all expenses associated with children are personal expenses.
- Premise 2: No tax relief should be provided for any personal expenses.
- Conclusion 2: No tax relief should be provided for any expenses associated with children, since they are personal expenses.

In addition to seeming harsh (which is not in and of itself a failing), there are several weaknesses in this argument. First, the jump from Premise 1 to Conclusion 1 is incomplete. While some families are carefully planned, not every caregiver would say that she chose to have children. Many pregnancies are unplanned.¹³⁶ Sometimes a caregiver gains custody of children after a loved one passes. And some individuals believe that their God prohibits birth control and that He alone is able to choose the number of children they should have.¹³⁷ If it is the initial choice to have a child that renders all expenses associated with that child's care unworthy of tax relief, may a family deduct the expenses if its members can show they did not wish to have the child? It is odd to think that tax relief would hinge on the circumstances under which each child was conceived.

Further, even for perfectly planned pregnancies, the "choice" to have children is a different choice than the choice to subscribe to Netflix or use an iPhone. In Article 16 of its Declaration of Human Rights, the United Nations recognizes the "family [as] the natural and fundamental group unit of society" and provides that "[m]en and women of full age, without any limitation due to race, nationality or religion, have the right to marry and to

135. See, e.g., Halperin, *supra* note 129, at 865 ("The nondeductibility of [childcare expenses] is probably not caused by any doubt that these expenses are business related, but by the belief that they are based on underlying personal decisions which give rise to personal satisfaction.").

136. According to one study in 2006, 49 percent of pregnancies were unintended—a slight increase from 48 percent in 2001. *Unintended Pregnancy Prevention*, CENTERS FOR DISEASE CONTROL & PREVENTION (citing Lawrence B. Finer & Mia R. Zolna, *Unintended Pregnancy in the United States: Incidence and Disparities, 2006*, 84 *CONTRACEPTION* 478 (2011)), <http://www.cdc.gov/reproductivehealth/unintendedpregnancy/> [<http://perma.cc/NGU6-NF4J>].

137. For instance, among traditional interpretations of the Torah, active prevention of pregnancy is in violation of the commandment "be fruitful and multiply." *Genesis* 1:28.

found a family.”¹³⁸ In other words, for many, having children is not a choice so much as it part of the basic human experience.

In light of this and the original intent of Congress in enacting § 21’s percentage credit,¹³⁹ it is better to think that the initial choice to procreate does not coat all expenses associated with one’s offspring with the taint of nondeductibility. But even if one were to take the rather staunch view that those costs are purely personal, Premise 2—that no tax relief should be given for any personal costs—is theoretically immature despite its ostensible statutory support. As discussed, § 262’s default rule that “personal, living, or family expenses”¹⁴⁰ are nondeductible can be reasonably viewed as a proxy rule reflecting the more theoretically mature notion that consumptive costs should not reduce one’s tax liability because they do not represent a decrease in one’s wealth.

The question, therefore, is whether working childcare costs are purely consumptive expenses that should not be deducted because, in paying a caregiver to tend to one’s children, a working parent has simply transformed her wealth from cash to childcare services. Unlike the case in which parents pay caregivers to tend to personal matters, such as babysitting costs that facilitate date nights, there are compelling reasons to think that net wealth decreases when parents incur childcare costs to work.

Imagine Spouse and Partner (S&P), a married couple filing jointly, have two children. Suppose that Spouse, the primary wage earner, earns \$150,000 this year and that S&P have decided their family requires \$50,000 additional disposable income to meet its needs.¹⁴¹ Luckily, Partner has a job offer which will enable her to earn \$70,000 annually. To do so, however, S&P must incur childcare expenses so that their children are cared for during working hours. After a vigorous search, S&P determine that the only option that meets their needs will cost \$20,000. Spouse and Partner think the services are probably worth about half this cost and would never choose to pay the \$20,000 if they had full, free choices. But they do not. Assuming this is their best or only choice in childcare, S&P will still pay \$20,000 because doing so will enable them to earn the additional income they require.

Importantly, this hypothetical is not simply a play with numbers. As discussed in Part I, there are various reasons why options for full-time care are limited. For instance, day-care centers have notoriously long wait-lists and are often unwilling (or uncertified) to care for young infants.¹⁴² Furthermore, a couple may feel the need to hire an expensive, individual caregiver

138. G.A. Res. 217 (III) A, art. 16, Universal Declaration of Human Rights (Dec. 10, 1948), <http://www.un.org/en/documents/udhr/index.shtml#a16> [<http://perma.cc/XAN5-JWWR>].

139. See *supra* Section I.A.

140. I.R.C. § 262 (2012).

141. The hypothetical assumes, for simplicity, that all income is ordinary income and that the earned amounts are in post-tax dollars.

142. See *supra* Section I.A.

to ensure childcare coverage even when children are sick.¹⁴³ There is, therefore, strong cause to doubt the driving assumption that childcare costs are purely consumptive expenses. One cannot so easily assume that parents incurring working childcare costs (as opposed to nonworking costs) have paid caregivers at least as much as the perceived value of those services. This creates a convincing argument that at least some tax relief for working childcare costs is needed.

Moreover, even if parents valued the working childcare services purchased at cost, the purchase is still involuntary, driven by the need to find care for one's children while working. The forced nature of this transaction further suggests that costs for working childcare are not consumptive in the traditional sense. And not allowing a deduction for these somewhat involuntary expenses creates issues of horizontal equity—that is, it compromises the notion that similarly situated taxpayers should be taxed the same. In a seminal article, Professor Andrews raises similar arguments to defend the tax law's allowing a deduction for some of a taxpayer's medical expenses.¹⁴⁴ While the ill taxpayer may value at cost the medical services needed to make him well again, these services simply put him back in the same position as the taxpayer that was fortunate enough to enjoy good health.¹⁴⁵ A deduction, Andrews argued, seems to preserve horizontal equity so that similarly situated taxpayers are taxed the same.¹⁴⁶ Similarly, it makes sense to compare the situations of a family with a “stay-at-home” parent who provides childcare with those of dual-earner and single parent families that, while each earning the same income as the first family, must incur the significant additional costs of childcare. The working childcare expenses incurred by these latter families simply restore them to the position of the first, single-earner couple, and a deduction for at least a portion of these expenses, like the medical expense deduction, seems justified on these grounds.

Similar reasoning might (and should) be applied to criticize other tax laws, which disallow tax relief for other significantly nonconsumptive costs. For instance, the tax laws do not allow taxpayers to reduce their taxable income to reflect commuting costs¹⁴⁷ or the costs of many graduate schools, such as law school, that enable the taxpayer to enter a new profession.¹⁴⁸ Like working childcare costs, the fact that these expenses are not deductible “is

143. See *supra* Section I.A.

144. Andrews, *supra* note 112, at 331–43.

145. *Id.* at 314 (“As between two people with otherwise similar patterns of personal consumption and accumulation, a greater utilization of medical services by one is likely not to reflect any greater material well-being or taxable capacity, but rather only greater medical need.”).

146. *Id.* at 331–43.

147. IRS, PUBLICATION 463, TRAVEL, ENTERTAINMENT, GIFT AND CAR EXPENSES 14 (2014), <http://www.irs.gov/pub/irs-pdf/p463.pdf> [<http://perma.cc/UV6A-GMAW>] (“Daily transportation expenses you incur while traveling from home to one or more regular places of business are generally nondeductible commuting expenses.”).

148. IRS, PUBLICATION 970, TAX BENEFITS FOR EDUCATION 67 (2014), <http://www.irs.gov/pub/irs-pdf/p970.pdf> [<http://perma.cc/MCB6-WNRS>] (“Education to maintain or improve

probably not caused by any doubt that these expenses are business related, but by the belief that they are based on underlying personal decisions which give rise to personal satisfaction.”¹⁴⁹ As shown in this Part, this argument is theoretically incomplete and does not justify disallowing a deduction for these costs. This Article, however, focuses only on the working childcare cost, and a companion paper will address more broadly the tax law’s failure to allow individual taxpayers to deduct various nonconsumptive costs.

Having dismantled the argument that working childcare costs are purely consumptive expenses, this Article turns to what seems the more persuasive argument—that working childcare costs are, at least in part, nonconsumptive expenditures. As discussed, to the extent that expenses are nonconsumptive, tax relief must be granted to accurately measure income.¹⁵⁰ Ideally then, one would situate working childcare costs along the “expense spectrum” described in Section II, the ends of which consist of purely nonconsumptive costs (for which a full deduction is warranted) and purely consumptive costs (for which no deduction is warranted) and provide a tax reduction representing only the nonconsumptive portion of the expense.

As the next Section shows, for most taxpayers, working childcare costs fall far toward the nonconsumptive end of the expense spectrum, suggesting that the stringently limited relief §§ 21 and 129 provide is inadequate as a matter of fundamental tax policy.

B. *To What Extent Are Working Childcare Costs Consumptive?*

1. A Framework for Analyzing Hybrid Costs

This Section attempts to situate working childcare costs, along with several other hybrid costs, on the expense spectrum described in Part II. To do so, one must tease out the consumptive and nonconsumptive elements of these costs. Of course, this cannot be done with exact precision because each taxpayer derives a different mix of benefits from various costs. But a meaningful approximation of where a particular cost would fall on the expense spectrum, and hence how much tax relief is warranted, can be made by estimating the size of three subsets of taxpayers:¹⁵¹

- i.) *The Full Consumption Subset*: The subset of taxpayers that would incur a particular cost regardless of work. In the case of working childcare costs, a parent will fall within this subset if the consumptive benefits of working childcare are so great that she would have purchased that care even if it did not enable her to earn any income.

skills needed in your present work is not [deductible] qualifying education if it will also qualify you for a new trade or business.”).

149. Halperin, *supra* note 129, at 865.

150. *See supra* Section II.B.

151. These subsets utilize the concepts developed by Professor Daniel Halperin in analyzing the problem of business-related meals and entertainment expenses. *See* Halperin, *supra* note 129, at 866.

ii.) *The Substantial Benefit Subset:* A taxpayer in this subset will enjoy substantial consumptive benefits from the goods or services purchased, but will not enjoy benefits substantial enough to put the taxpayer in the Full Consumption Subset. In the case of working childcare costs, a parent would fall in this subset if she would not incur these costs if the purchased childcare did not enable her to earn income, but the income required to make the childcare costs worthwhile is quite a bit less than the total cost of care.

iii.) *Insubstantial Benefit Subset:* The subset of taxpayers that will derive only insubstantial consumptive benefits from a specific cost. In the case of working childcare costs, other than the ability to earn income, parents in this subset will enjoy only slight benefits from the childcare purchased and would, therefore, incur few childcare costs if they were not working outside the home.

By considering census and other collected data, the next Section shows that most parents who incur working childcare costs fall within this last subset, suggesting that working childcare costs are largely nonconsumptive expenditures for which substantial tax relief is required.

2. Analyzing the Working Childcare Cost

In 1972, two commentators wrote:

The working wife who hires a babysitter, or sends her children to a day care center, can be viewed as spending money to enable herself to work, or, just as easily, as working so that she can afford the luxury of . . . child care help.¹⁵²

This characterization leads one to believe that in 1972 some significant percentage of secondary wage earners (at this time, almost certainly mothers) could be expected to fall within the Full Consumption Subset. If this portrayal is true, there may have once been good reasons to limit the tax relief provided for working childcare costs. Regardless of the veracity of this caricature, however, the picture one finds today is quite different. Today, the income of the secondary wage earner is generally not “discretionary”¹⁵³ and families increasingly report that they need two incomes just to meet daily needs.¹⁵⁴

Furthermore, the 1972 caricature places the mother in a somewhat enjoyable, part-time job. But whatever one thinks about her children, few parents work a full-time schedule in order to avoid them. Perhaps there exists working parents who despise spending time with their children and gleefully

152. Schaffer & Berman, *supra* note 133, at 536.

153. See *supra* note 20 and accompanying text.

154. See *supra* note 12 and accompanying text.

dispose of them each weekday for nine hours. But the more common feelings of working women and men seem to be ambivalence and guilt.¹⁵⁵ Furthermore, as discussed in Part I, in today's economic environment, childcare costs represent a strikingly large percentage of a family's combined salary, and a family with two young children may easily find itself spending over \$35,000 per year on childcare.¹⁵⁶ Few parents can be expected to incur these high costs unless that care enables them to work.

Of course, it is common for stay-at-home parents to hire help to care for their children. Parents sometimes hire mother's helpers and nurses when children are young,¹⁵⁷ and they sometimes send their toddlers to preschool and pre-kindergarten programs.¹⁵⁸ But recent census data suggest that an extremely large majority of families with stay-at-home parents do not use any of these arrangements and therefore incur none of the childcare costs incurred by dual-earner and single-parent families. In 2011, approximately 88 percent of families with working mothers used "regular childcare"—that is, a childcare arrangement used at least once per week—for children under five years of age.¹⁵⁹ By contrast, only 28.2 percent of single-earner families with preschool-aged children used any form of childcare on even a weekly basis.¹⁶⁰ In other words, in an extremely large majority of cases, parents tend to care for their young children themselves, unless work prohibits it.

These data not only suggest that, in the case of working childcare costs, the Full Consumption Subset will be sparsely populated, but also that the Substantial Benefit Subset—parents who only require a small amount of additional income to make childcare costs worthwhile—will be small. One might initially expect a sizable percentage of parents to fall within this subset. After all, many working parents likely believe that their selected caregiving facility or caregiver provides their children valuable opportunities for socialization and education.¹⁶¹ But this does not mean that these parents would incur the costs associated with this care in the absence of work. While working parents may be pleased that their child is benefiting from working childcare, these parents may have provided the same (if not, at least in their opinions, superior) benefits to their children at free or lesser cost if they

155. See Margie Warrell, *Letter to Working Mothers: Stop Feeling So Guilty*, FORBES (June 25, 2013, 6:08 AM), <http://www.forbes.com/sites/margiewarrell/2013/06/25/dear-working-mother-stop-feeling-so-guilty/> [<http://perma.cc/R4BN-BJK7>]; see also Kim Parker & Wendy Wang, *Modern Parenthood: Roles of Moms and Dads Converge as They Balance Work and Family*, PEW RES. CTR. (Mar. 14, 2013), <http://www.pewsocialtrends.org/2013/03/14/modern-parenthood-roles-of-moms-and-dads-converge-as-they-balance-work-and-family/> [<http://perma.cc/D8HS-GK9J>] (“[A] nearly equal share of mothers and fathers say they wish they could be at home raising their children rather than working . . .”).

156. See *supra* Section I.C.

157. LAUGHLIN, *supra* note 68, at 3–4, 10–11.

158. *Id.* at 3–4.

159. *Id.* at 5.

160. *Id.*

161. See Julie Revelant, *6 for Kids—And Moms Too*, FOX NEWS (Dec. 1, 2013), <http://www.foxnews.com/health/2013/12/01/6—for-kidsand-moms-too/> [<http://perma.cc/63DN-VUNF>].

were not working outside the home. For instance, play dates, homeschooling, and parent-driven activities provide far cheaper and often-utilized methods of providing socialization and educational opportunities for young children.¹⁶² The census data described above support these intuitions—over 70 percent of families with young children and stay-at-home parents entirely forewent any form of regular outside care.¹⁶³

Furthermore, while some small percentage of nonworking parents seek outside care, they employ that care for only a fraction of the time that working parents do.¹⁶⁴ And families with stay-at-home parents are far more likely to rely solely on relatives such as grandparents for childcare—an arrangement that may come at little to no monetary cost—since these parents will generally require care for far fewer hours than dual-earner and single-working parents.¹⁶⁵ Thus, in the case of working childcare costs, the lion's share of working parents will fit most easily into the Insubstantial Benefit Subset.

This analysis shows that working childcare costs are largely nonconsumptive and that parents should, therefore, receive tax relief for a sizable percentage of these costs. As discussed in Part I, however, the tax law comes nowhere close to providing this. Taxpayers earning over \$43,000 can, at maximum, claim the equivalent of a \$4,000 deduction under § 21 (assuming a 30 percent marginal tax bracket), or \$5,000 under § 129's FSA exclusion. In even the very cheapest of states, this amounts to less than half the costs of providing full-time care for an infant and toddler. In the most expensive states, this will amount to less than one-sixth of the cost of providing full-time care for two young children in a childcare center and may amount to a deduction of about one-tenth of the costs of hiring an individual caretaker like a nanny.¹⁶⁶

This Article next considers the way in which the tax laws treat other hybrid expenses. As explained in Section III.A, this Article does not address the tax law's failure to allow tax relief for commuting and various educational expenses, saving that discussion for a companion paper. In failing to address these costs, however, the next Section does not seek to fully survey the ways in which the tax laws treat all hybrid expenditures but instead seeks to show that the tax law currently allows greater relief for some hybrid expenditures that are more consumptive than working childcare expenses, further strengthening the argument that the limitations found in §§ 21 and 129 are far too stringent.

162. See *Do Kids Really Need Preschool?*, HUFFINGTON POST (Mar. 21, 2013, 12:04 PM), http://www.huffingtonpost.com/learnvest/do-kids-need-preschool_b_2917827.html [<http://perma.cc/3667-JM9C>] (discussing alternatives to formal preschools, including play dates, parks, classes, and museums).

163. LAUGHLIN, *supra* note 68, at 4.

164. See *id.* at 5–6.

165. See *id.* at 5.

166. See *supra* notes 74–87 and accompanying text.

C. *Comparing Working Childcare Costs to Other Hybrid Expenses*

1. *Business-Related Meal and Entertainment Expenditures*

Suppose that Larry Lawyer flies to his favorite city to discuss a pending case with a client who lives there. He stays in his favorite hotel and orders room service for breakfast. He also takes the client to Larry's favorite restaurant, where they discuss the case. After dinner, Larry brings the client to watch Larry's favorite baseball team. May Larry deduct the costs of traveling to and staying in his favorite city? May he deduct the entertainment costs of taking himself and his client to dinner and a ball game? There are evident challenges in determining what tax relief is warranted for these meal and entertainment expenditures. Like working childcare costs, these expenditures are associated with both nonconsumptive and consumptive activities. But the consumptive aspect of the meal and entertainment expense seems far more significant.

For one thing, the subset of taxpayers falling within the Full Consumption Subset described in Section III.B will be sizable—that is, it is easy to imagine taxpayers incurring meal and entertainment expenditures without work-related reasons for doing so. For instance, regardless of his client's existence, Larry Lawyer may well have visited his favorite city, stayed in his favorite hotel, dined on a fancy dinner, and purchased tickets to watch his favorite team play baseball. People attend happy hours, restaurants, shows, and sporting events without work-related reasons for doing so. In contrast, nonworking parents do not tend to send their children to childcare for forty-five hours per week—and, in fact, census data show that most families, absent the necessity of work, do not use any form of outside childcare at all. Thus, the Full Consumption Subset will be much more populated in the case of meal and entertainment expenses when compared to the case of working childcare costs.

Further, in the case of meal and entertainment expenditures, the Substantial Consumption Subset will be sizable. Even if Larry Lawyer would not have incurred the described expenses had he not needed to attend to his client's business, he would nonetheless have derived some personal pleasure from the activities. At the very least, Larry would have eaten even if he were not on the business trip.¹⁶⁷ Thus, while census data suggest that relatively few working parents can be expected to fall within the Substantial Consumption Subset, most taxpayers incurring meal and entertainment expenditures should fall within this group (if not within the Full Consumption Subset). As a result, the Insubstantial Benefit Subset can be expected to be far smaller in the case of meal and entertainment expenses when compared to the case of the working childcare cost.

One would, therefore, expect the tax law to provide more tax relief for working childcare costs than it does for meal and entertainment expenses. In

167. See Halperin, *supra* note 129, at 860–61 (discussing the consumptive nature of meal and entertainment expenses).

almost all cases, however, the tax law allows for the reverse. Currently, taxpayers may claim a deduction of 50 percent of “entertainment, amusement, or recreation”¹⁶⁸ expenses, like expenses for dining and ball games, so long as the activity is not “lavish” and the activity is sufficiently related to the taxpayer’s business.¹⁶⁹ But working parents requiring full-time childcare are generally entitled to tax relief that is worth far less than a deduction for half of their costs.

2. Business-Related Moving Expenses

Currently, the tax law allows taxpayers to deduct most moving expenses that are “incurred . . . in connection with the commencement of work”¹⁷⁰ so long as the taxpayer’s move occurs within one year of receiving the new job, and the new job is “at least 50 miles farther from [the taxpayer’s] former home than [her] old main job location was from [her] former home.”¹⁷¹ In fact, if the taxpayer moves separately from his family, both sets of moving costs may be deducted.¹⁷² Clearly, however, the reasons for moving from one’s current residence are varied and not solely motivated by the desire to earn income.

Families, for instance, may move for more housing space, a lower cost of living, or better school districts for their children. A taxpayer, in deciding to leave his current location, may wish to live closer (or farther) from his family, or find a community whose interests and beliefs align more closely to his own. Thus, while a family may not move until work is found, many, if not

168. I.R.C. § 274(n)(1) (2012).

169. See I.R.C. § 274(a) (stating that the activity must either be directly related to or associated with the taxpayer’s trade or business). These laws were arrived at after a period of considerable debate and thought. In 1962—the *Mad Men* age of the two-martini lunch—President Kennedy, in his Special Message to Congress on Taxation, expressed his grave concern that “expense account living ha[d] become a byword in the American scene” and that “[t]oo many firms and individuals ha[d] devised means of deducting too many personal living expenses as business expenses, thereby charging a large part of their cost to the Federal Government.” President Kennedy “recommend[ed] that the cost of such business entertainment . . . be disallowed in full as a tax deduction and that restrictions be imposed on the deductibility of . . . expenses of business trips combined with vacations, and excessive personal living expenses incurred on business travel away from home.” President John F. Kennedy, Special Message to the Congress on Taxation (Apr. 20, 1961), <http://www.presidency.ucsb.edu/ws/?pid=8074> [<http://perma.cc/K935-2BCV>]. But Congress did not go nearly as far as President Kennedy urged.

170. I.R.C. § 217 (“There shall be allowed as a deduction moving expenses paid or incurred during the taxable year in connection with the commencement of work by the taxpayer as an employee or as a self-employed individual at a new principal place of work.”); IRS, PUBLICATION 521, MOVING EXPENSES 2–4 (2013), <http://www.irs.gov/pub/irs-pdf/p521.pdf> [<http://perma.cc/JML9-RMWN>]. Not all expenses qualify. For instance, closing costs on house purchases are nondeductible. See *id.* at 9.

171. IRS, *supra* note 170, at 2–5. Notably, the fifty-mile distance test is slightly different when a taxpayer has a principal place of work prior to the move.

172. See *id.* at 8.

most, families choose to move for various nonwork related reasons. Therefore, although the Full Consumption Subset may not be very populated in the case of business-related moving expenses—for many, attaining new employment will be a necessary condition of moving—most taxpayers that incur deductible moving expenses fall within the Substantial Consumption Subset. As a result, only a small minority of taxpayers fall within the Insubstantial Subset—that is, will have moved solely for employment and not because the relocation offered other significant consumptive benefits.

This suggests that the percentage of working childcare costs that may be deducted should be at least as great as the percentage of business-related moving expenses eligible for a deduction. This is again not so, however, as the tax law allows a full deduction for qualifying moving costs and only allows parents tax relief equivalent to a deduction for a fraction of working childcare costs.

3. Hobby Expenses¹⁷³

Consider finally how the tax law handles expenses associated with activities that are “not for profit,”¹⁷⁴ more colloquially referred to as “hobby expenses.” Suppose, for instance, that Jack and Jill (J&J) together earn \$50,000. Suppose, however, that J&J do not have children and so do not incur childcare expenses. They do, however, really enjoy racing their yacht and incur \$20,000 of expenses, including travel expenses, entrance fees, and boat maintenance to do so. J&J incur these expenses for the love of their hobby and do not care whether they win or lose. But they are very lucky one year and win \$30,000. Should J&J be able to deduct the yacht racing expenses?

Many hobbyists will fall into the Full Consumption Subset because they are willing to incur the expense of engaging in these activities regardless of whether they earn any income. The remainder fall within the Significant Consumption Subset, only requiring a relatively slight amount of income (that need not exceed costs) in order to incur the hobby expenses. The Insignificant Consumption Subset will be, by definition, unpopulated since the activity is presumptively not profit motivated. It would, therefore, not be at all unreasonable to fully disallow deductions for hobby expenses—in many cases, such as the case of J&J, the hobbyist is not truly poorer by the amount of his hobby expenses because he received enjoyment (consumptive value) at least equal to the cost incurred.

Nonetheless, § 183 of the Code allows taxpayers to deduct these costs with several limitations. In this example, for instance, J&J may only deduct

173. This Section will assume away the Alternative Minimum Tax to show how § 183 applies as a default matter to hobby expenses. The hypothetical has purposefully presented a situation in which the taxpayer’s income falls below the exemption amount so that the AMT will not apply. For more about the AMT, see *What You Should Know About AMT*, IRS (Feb. 10, 2014), <http://www.irs.gov/uac/Newsroom/What-You-Should-Know-about-AMT> [<http://perma.cc/W3C8-PQ3M>].

174. I.R.C. § 183.

an amount equal to their gain on the transaction¹⁷⁵—here because J&J’s gain is \$30,000, J&J may, before other limits, deduct the entire \$20,000. They must then subtract 2% of their adjusted gross income from this amount (here \$1,600),¹⁷⁶ so J&J are left with \$18,400 expenses to deduct.¹⁷⁷

Astonishingly, then, § 183 may provide more tax relief for the hobbyist than full-time working parents. Compare J&J’s situation to the situation of a married couple that together earns \$80,000—the same amount of income as J&J. But instead of spending \$20,000 on yacht racing, this couple spends \$20,000 on childcare while they are working. Section 21 allows the couple a 20% credit of up to \$6,000 expenses, an equivalent of only a \$4,000 deduction if the couple’s marginal tax bracket is 30%.¹⁷⁸

The preceding analysis strongly suggests that working childcare costs are, at least in significant part, nonconsumptive expenditures for which substantial tax relief is warranted. As also shown, however, the current law does nothing close to this. Instead, current law limits the relief provided to taxpayers incurring working childcare costs more severely than it limits the relief for more consumptive expenditures. The next Part develops a proposal that would achieve meaningful reform and help prevent the overtaxation of the modern working family.

IV. PROPOSAL FOR REFORM: PREVENTING THE OVERTAXATION OF THE WORKING FAMILY

A. *The Method of Reform Matters*

Given that the tax relief Code §§ 21 and 129 provide is inadequate, lawmakers seeking to change these laws must be careful when choosing an avenue of reform. It might, for instance, seem sufficient to raise the current dollar limitations, percentage limits, and phaseouts in these sections, which together ensure that parents receive tax relief for only a fraction of the working childcare costs they incur. But while this would certainly be a step in the right direction, it would leave these reformed laws vulnerable to the same legislative dysfunction that allowed the tax relief provided to working families to become so inadequate in the first place.

As discussed in Section I.B, Congress originally enabled working parents to deduct working childcare expenses, properly characterizing these expenses as nonconsumptive costs of earning income.¹⁷⁹ Congress, however,

175. *See id.* § 183(b).

176. *See id.* § 67 (establishing a 2 percent floor for miscellaneous itemized deductions like the one in this example).

177. If J&J had been in a higher tax bracket, they might have been subject to limitations in § 68. *See id.* § 68(a)–(b). Further, J&J might lose the benefit of deducting hobby expenses if the Alternative Minimum Tax were to apply. *See id.* § 55. As discussed *supra* note 173, I mean only to show how § 183 treats hobby expenses as a default matter.

178. *See supra* Section I.B. Alternatively, had S&P funded the day care through an FSA, they could have received the equivalent of a \$5,000 deduction. *See supra* Section I.B.

179. *See supra* Section I.B.

later changed the mechanism for providing tax relief for working childcare expenses from a deduction to a percentage credit in order to eliminate the upside-down-subsidy effect of the deduction.¹⁸⁰ While doing so, it expressly rejected the idea of phasing down the credit because it is inappropriate to phase down costs of earning income.¹⁸¹

Section 21's current phaseouts are, therefore, directly inconsistent with Congress's express intent. Furthermore, Congress's failure to index the dollar limitations in both §§ 21 and 129 for inflation and rising costs is inconsistent with Congress's general intent to treat working childcare costs as costs of earning income. Although it is theoretically possible that subsequent Congresses rejected the original intent of these sections, there is no indication whatsoever that this is the case. Instead, it is exceedingly likely that lawmakers became confused by the fact that working childcare costs are creditable, as opposed to deductible, under § 21.¹⁸² In general, the average individual taxpayer is allowed to deduct his costs of earning income. By contrast, when Congress grants individuals tax relief for nonconsumptive expenditures, which it need not do to accurately calculate net income, it often does so by providing a tax credit.¹⁸³ Thus, as time left the historical purposes of § 21 forgotten, lawmakers likely assumed that § 21's credit served a nontax purpose (since that is the function that many other individual tax credits serve) and that working childcare costs were nonconsumptive costs (like the expenses for which many other individual tax credits are granted).

Other factors likely contributed to this misunderstanding. Frankly, some confusion might be attributable to the skeptical eye with which many lawmakers view the Internal Revenue Code. Unfortunately, many lawmakers lack respect for the tax law and more generally fail to make any effort to understand the Code as even a semicoherent body of law. While the intensity of the problem seems to have increased as of late, this is certainly not a new issue. As Professor Surrey laments:

[Some lawmakers] . . . see the income tax as only the composite or jumble of statutory provisions resulting from numerous ad hoc legislative decisions. Such an anarchistic view of the tax structure has the consequence of making tax policy formulation a task to be performed without criteria,

180. See *supra* Section I.B.

181. See *supra* Section I.B.

182. Consider even two sections located right before and after Code § 24. Code § 23 allows taxpayers a \$10,000 tax credit for adopting a special-needs child, regardless of whether those expenses are even incurred. See I.R.C. § 23(a)(3). Section 25C provides a tax credit to encourage taxpayers to invest in energy-efficient improvements. *Id.* § 25C. These sections are congressional "giveaways" and serve entirely nontax purposes. Specifically, § 23's credit is a subsidy meant to encourage citizens to adopt special-needs children and § 25C's credit subsidizes and encourages taxpayer to invest in energy-efficient improvements. Despite how laudable these goals are, Congress could repeal the tax relief in these sections at any time without compromising the accurate calculation of tax.

183. See *supra* note 182 and accompanying text.

guidelines, or standards, and any policy official who has tried to approach the tax conscientiously would reject that view.¹⁸⁴

But while congressional attitudes may play some part in misunderstanding the role of §§ 21 and 129, there are also more understandable reasons why lawmakers might have become confused. In addition to the fact that most credits serve nontax purposes and are not the method by which tax relief for costs of earning income are granted, lawmakers were probably misled by the Joint Committee on Taxation's questionable decision to include §§ 21 and 129 on its list of so-called tax expenditures. For the nontax expert, some background on this list is in order.

In the 1960s, Stanley Surrey, in his capacity as Assistant Secretary of Treasury for Tax Policy,¹⁸⁵ first expressed concern over the number of tax provisions that provided tax reductions for expenditures that were not associated with the cost of earning income (which he called "tax expenditures") and, therefore, not necessary adjustments to accurately calculate tax liability.¹⁸⁶ Thus, while Surrey recognized that some tax provisions—such as the deduction for ordinary and necessary business expenses—should be considered "structural provisions necessary to the application of a normal income tax,"¹⁸⁷ he also recognized that many other provisions were best viewed as "special preferences."¹⁸⁸ Surrey explained:

These special preferences, often called tax incentives or tax subsidies, are departures from the normal tax structure and are designed to favor a particular industry, activity, or class of persons. They partake of many forms, such as permanent exclusions from income, deductions, deferrals of tax liabilities, credits against tax, or special rates. Whatever their form, these departures from the "normative" income tax structure essentially represent government spending for the favored activities or groups made through the tax system rather than through direct grants, loans, or other forms of government assistance.¹⁸⁹

In this "rhetorically brilliant move"¹⁹⁰ Surrey urged lawmakers to view these "tax expenditure provisions" as direct government spending programs¹⁹¹ in order to encourage lawmakers to subject these provisions to a higher level of scrutiny than they were then receiving. To illustrate, suppose a taxpayer received a loan to purchase a home for his family, using that

184. Stanley S. Surrey & Paul R. McDaniel, *The Tax Expenditure Concept and the Budget Reform Act of 1974*, 17 B.C. INDUS. & COM. L. REV. 679, 687–88 (1976) (footnote omitted).

185. Surrey served as Assistant Secretary from 1961 to 1969 while on leave from his position as a professor at Harvard Law School. Erwin N. Griswold, *A True Public Servant*, 98 HARV. L. REV. 329, 330 (1984).

186. See STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* vii–viii (1973).

187. Surrey & McDaniel, *supra* note 184, at 680.

188. *Id.*

189. *Id.*

190. Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155, 1158.

191. Surrey & McDaniel, *supra* note 184, at 718.

residence to secure the loan. Under the basic principles discussed in Part II, the taxpayer should not be able to deduct the interest payments associated with this home mortgage.¹⁹² This interest is a purely consumptive cost. The tax law, however, allows taxpayers to (up to generous limitations) deduct this interest by providing for a specific exception in Code § 163(h).¹⁹³ While there are reasons lawmakers might wish to do this—for example, the deduction might encourage home ownership¹⁹⁴—these reasons have nothing to do with accurately calculating the homeowner’s income tax liability. By encouraging lawmakers to view this provision as a direct spending program,¹⁹⁵ Surrey hoped lawmakers would scrutinize the wisdom of granting the home mortgage interest deduction in the same way it would scrutinize the wisdom of a program that directly paid a portion of the interest on a homeowner’s mortgage.¹⁹⁶

In response to Surrey’s pleas, the Congressional Budget and Impoundment Control Act of 1974 (CBICA) created a requirement that the Congressional Budget Office (CBO) and the Treasury Department each publish an annual list of tax expenditure estimates¹⁹⁷ that would “measure the decrease in individual and corporate income tax liabilities that result from [tax expenditure provisions].”¹⁹⁸ CBICA defines “tax expenditures” as “revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”¹⁹⁹

The concept of tax expenditure is not elucidated further in CBICA and its legislative history only states that tax expenditures should be viewed as departures from a “normal” tax structure.²⁰⁰ Thus, to fulfill the responsibilities created by CBICA, both the CBO and the Treasury Department must determine which tax provisions represent “tax expenditures.” With only the explicit guidance that these provisions are “special,” the Joint Committee on

192. See *supra* Part II. See generally I.R.C. § 163 (2012).

193. I.R.C. § 163(h).

194. But see Dorothy A. Brown, *Shades of the American Dream*, 87 WASH. U. L. REV. 329, 336–37 (2009) (arguing that tax benefits do not impact the decision to purchase a home).

195. Thuronyi, *supra* note 190, at 1155 (“The concept of ‘tax expenditures’ holds that certain provisions of the tax laws are not really tax provisions, but are actually government spending programs disguised in tax language.”).

196. In many instances, Surrey believed that this analysis would often reveal that the tax expenditure was an absurd use of government funds. See, e.g., SURREY, *supra* note 186, at 223–32 (explaining how the charitable deduction, if reformulated as a direct spending program, would look absurd).

197. Pub. L. No. 93-344, §§ 3, 301(d)(6), 601, 88 Stat. 297, 299, 308, 323–24 (1974) (codified as amended at 2 U.S.C. §§ 622, 632, and 31 U.S.C. § 1105(a)(16) (2012)).

198. STAFF OF JOINT COMM. ON TAXATION, 97TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 1982–1987, at 2 (Comm. Print 1982) [hereinafter 1982–1987 ESTIMATES].

199. Pub. L. No. 93-344, § 3(3), 88 Stat. at 299 (1974).

200. See 1982–1987 ESTIMATES, *supra* note 198, at 2–3.

Taxation²⁰¹ (on behalf of the CBO)²⁰² and the Treasury Department have developed various methodologies for separating tax expenditures from other tax provisions.²⁰³

Since issuing its first report, the Joint Committee on Taxation (the JCT) has characterized §§ 129 and 21 as tax expenditure provisions.²⁰⁴ Considering this characterization, which this Article later shows to be misguided, it is not surprising that lawmakers have mischaracterized the tax relief provided by these sections as legislative giveaways that could be limited or repealed without compromising the accurate calculation of tax. Perhaps highlighting this confusion, some recent legislative proposals have actually called for the complete repeal of § 21's credit. For instance, in 2014, David Camp, then-Chairman for the House Committee on Ways and Means, released a proposal to overhaul the United States' individual tax regime and suggested that § 21's credit be repealed along with a host of other provisions that grant tax relief for purely consumptive expenditures.²⁰⁵

Considering this historical background, if lawmakers wish to enact long-lasting reform that truly protects the working family, they should not simply provide first aid to §§ 21 and 129. Instead, Congress should allow parents to deduct the costs of childcare in the same way that other costs of earning income are deducted. The next Part provides a blueprint for enacting this reform.

201. As explained on its website, the committee "is a nonpartisan committee of the United States Congress, originally established under the Revenue Act of 1926. The Joint Committee operates with an experienced professional staff of Ph.D economists, attorneys, and accountants, who assist Members of the majority and minority parties in both houses of Congress on tax legislation." *About Us: Overview*, JOINT COMMITTEE ON TAX'N, <https://www.jct.gov/about-us/overview.html> [<http://perma.cc/F4GX-TF94>].

202. STAFF OF JOINT COMM. ON TAXATION, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012–2017, at 2 n.4 (Comm. Print 2013) (citing Act of Dec. 12, 1985, Pub. L. No. 99-177, § 273, 99 Stat. 1037, 1098 (codified as amended at 2 U.S.C. § 601(f) (2012))) ("The Joint Committee staff issued reports prior to the statutory obligation placed on the CBO and continued to do so thereafter. In light of this precedent and a subsequent statutory requirement that the CBO rely exclusively on Joint Committee staff estimates when considering the revenue effects of proposed legislation, the CBO has always relied on the Joint Committee staff for the production of its annual tax expenditure publication.").

203. See generally STAFF OF JOINT COMM. ON TAXATION, 114TH CONG., BACKGROUND INFORMATION ON TAX EXPENDITURE ANALYSIS AND HISTORICAL SURVEY OF TAX EXPENDITURE ESTIMATES (2015).

204. STAFF OF U.S. DEP'T OF THE TREASURY & JOINT COMM. ON INTERNAL REVENUE TAXATION, 93RD CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES 5 (Comm. Print 1973).

205. In explaining reasons for repealing the credit, the proposal explains "[t]he dependent care credit is complex and overlaps with other tax provisions that provide tax benefits for families" and that "[c]onsolidating redundant and complex family tax benefits, such as the dependent care credit, into an increased child credit and standard deduction would result in significant simplification." COMM. ON WAYS & MEANS MAJORITY TAX STAFF, 113TH CONG., TAX REFORM ACT OF 2014 DISCUSSION DRAFT 13 (Comm. Print. 2014). This reflects a fundamental misunderstanding of the tax laws. As discussed in Part I, tax relief for working expenses and nonworking expenses serve entirely different purposes in the tax law.

B. *A Blueprint for Enacting Meaningful Reform*

Congress should do five things to reform the tax laws so that working childcare costs are treated like other costs of earning income.

First, lawmakers should replace the percentage credit in § 21 with a deduction. In general, the law allows taxpayers to deduct (not credit) the costs of earning income.²⁰⁶ Thus, § 21's percentage credit mechanism stands working childcare costs apart from other costs of earning income and seems to invite misunderstanding by lawmakers who may assume that the credit (like many other credits) serves nontax related purposes.²⁰⁷ As discussed, this misconception may partially explain why the dollar limitations found in § 21 have not been changed for well over a decade.²⁰⁸ Thus, treating working childcare expenses the same as other costs of earning income, in addition to promoting consistency in the Code, would provide an important and apparently needed signal to Congress that these costs cannot be repealed without compromising the accurate calculation of net income.

Second, the proposed deduction for working childcare costs should be an "above-the-line" deduction used to calculate a taxpayer's adjusted gross income (AGI) (an essential figure needed to calculate one's tax liability that will be discussed below). There are two types of deductions in the tax law, colloquially referred to as "above-the-line" and "below-the-line" deductions. Generally, consumptive personal expenditures fall below the line and do not reduce a taxpayer's AGI.²⁰⁹ By contrast, most expenses that are "ordinary and necessary" to one's trade or business, such as business-related moving expenses²¹⁰ and meal and entertainment expenses,²¹¹ to which working childcare costs can easily be analogized, may be deducted above the line,²¹² thereby reducing a taxpayer's AGI.

206. Compare *supra* Section II.B (discussing the tax law's tendency—and need—to allow taxpayers to deduct the cost of doing business from the calculation of their income), with *supra* Section II.A (explaining why purely consumptive expenses are generally not deductible).

207. See *supra* note 182 (discussing credits with nontax related goals).

208. See *supra* notes 53–59 and accompanying text.

209. See I.R.C. § 62(a) (2012) (listing above-the-line deductions and not including most personal deductions). But see *id.* § 62(a)(10) (allowing alimony, a purely personal expense, to be deducted above the line).

210. *Id.* §§ 62(a)(15), 217.

211. *Id.* §§ 62(a)(1), 162(a).

212. Unreimbursed expenses incurred by an employee fall "below the line," under § 62(a)(2)(A), in order to subject him to certain limitations that are inapplicable to above-the-line deductions. *Id.* § 62(a)(2)(A). Thus, to the extent an employee incurs deductible expenses that are not reimbursed under his employer's reimbursement plan, those expenses will not be used to calculate adjusted gross income. *Id.* This likely reflects skepticism that employee expenses that an employer is unwilling to reimburse are truly nonconsumptive expenditures. Clearly, this reasoning in no way implicates the working childcare deduction, and it would be patently absurd to allow parents engaged in their own trade or businesses (for example, the solo law practice) to deduct working childcare costs above the line while having employee-parents (like lawyers working for a law firm) deduct costs below the line.

“Above-the-line” deductions also include a somewhat motley assortment of other costs such as certain expenses of performing artists,²¹³ elementary and secondary school teachers,²¹⁴ and alimony.²¹⁵ While a coherent theory for determining what expenses should be used to calculate AGI seems lacking from this list, one can form a better opinion of how working childcare expenses should be characterized by considering the importance of the AGI amount. AGI is calculated by subtracting above-the-line deductions from one’s gross income.²¹⁶ AGI, in turn, determines the extent to which the personal exemption amount,²¹⁷ various “below-the-line” deductions, and credits²¹⁸ may be claimed to reduce one’s tax liability. In most instances, as one’s AGI increases, one’s ability to claim these tax reductions decreases.²¹⁹ For example, a taxpayer may deduct medical expenses and casualty losses to personal property caused by fire, storm, or other unexpected events to the extent that each of these expenses or losses exceeds 10 percent of his AGI.²²⁰ The higher his AGI, the higher the floor.

It is essential that taxpayers be allowed to reduce their AGI to reflect working childcare expenses. As this Article shows, because parents may only deduct a fraction of their working childcare costs, their income is overstated. By failing to allow any of these costs to reduce adjusted gross income (at least those that are directly incurred, as opposed to diverted through a dependent-care FSA), working parents will also be entitled to deduct fewer below-the-line costs than similarly situated families that do not require childcare, further exacerbating the problem.

Consider, for instance, Families A, B, and C and suppose the following: Mrs. A earns \$150,000 each year while Mr. A cares for their two small children; both Mr. and Mrs. B together earn \$170,000 and directly pay a day care \$20,000 to care for their children while they work, entitling them to § 21’s percentage credit; and Mr. and Mrs. C collectively earn \$170,000 but divert the \$20,000 they need for childcare to a dependent-care FSA, entitling them to § 129’s exclusion. Suppose finally that each of these families incurs \$25,000 of medical expenses and suffers a \$20,000 casualty loss, each which

213. *Id.* § 62(a)(2)(B).

214. *Id.* § 62(a)(2)(D).

215. *Id.* § 62 (a)(10).

216. *Id.* § 62(a) (defining AGI).

217. *Id.* § 151(d)(3) (providing phaseout of the personal exemption amount based on AGI). For a discussion of the personal exemption, *see supra* Section I.A.

218. *See, e.g., id.* §§ 21, 24 (providing credits that phase out based on AGI).

219. *See, e.g., id.* § 67(a) (creating overall limitation that certain below-the-line deductions may be claimed only to the extent they exceed 2 percent of AGI); *id.* § 68 (creating an overall limitation on ability to claim most personal deductions based on AGI); *id.* § 165(c), (h) (providing deduction for casualty losses to the extent expenses exceed 10 percent of AGI); *id.* § 213(a) (providing deduction for medical expenses to the extent expenses exceed 10 percent of AGI). *But see id.* § 170 (providing that charitable contributions may be deducted up to a 50 percent of AGI ceiling, thus allowing wealthier taxpayers to deduct more than less well-off taxpayers).

220. *See, e.g., id.* §§ 165(c), (h), 213(a).

may be deducted to the extent the expenses or losses exceed 10 percent of the taxpayer's AGI.

After childcare costs are paid, each family has \$150,000 income at their disposal. Nonetheless, each taxpayer's adjusted gross income will be different. Family A will have adjusted gross income of \$150,000, which seems to correctly reflect net income. B will have adjusted gross income of \$170,000 because working childcare expenses may not be deducted above the line. And C will have adjusted gross income of \$165,000 because \$5,000 of the expenses diverted to the FSA may be excluded under § 129.²²¹ As a result, the extent to which each of these similarly situated families may claim the "below-the-line" medical and casualty loss deductions will be different, as will each family's final tax liability. The following chart quantifies these observations:

TABLE 1²²²

	A	B	C
Income	\$150,000	\$170,000	\$165,000
Childcare	-----	\$20,000	\$20,000
AGI	\$150,000	\$170,000	\$165,000
Medical Expense Deduction	\$10,000	\$8,000	\$8,500
Casualty Loss Deduction	\$5,000	\$3,000	\$3,500
Personal Exemption	\$16,000	\$16,000	\$16,000
Taxable income	\$119,000	\$143,000	\$137,000
Pre-credit Tax	\$21,337.50	\$27,337.50	\$25,837.50
Child Tax Credit	-----	-----	-----
Working Child Care Credit	\$0	\$1,200	\$200
Final Tax	\$21,337.50	\$26,137.50	\$25,637.50

221. *Id.* § 129(a).

222. A few notes about Table 1: The numbers are based on 2015 tax rates, and the Table assumes a \$4,000 personal exemption amount. *See* Rev. Proc. 2014-61, 2014-47 I.R.B., 866, <http://www.irs.gov/pub/irs-irbs/irb14-47.pdf> [<http://perma.cc/9ZDP-LPVZ>].

While Family C has earned \$170,000, it has diverted \$20,000 into an FSA. Section 129 allows it to exclude \$5,000 of that amount, bringing its gross income down to \$165,000. I.R.C. § 129(a)(2)(A).

The child tax credit, discussed *supra* in Section I.A., will be completely phased out for each of these taxpayers. *See id.* § 24(a)-(b).

Family C receives a \$200 credit as a result of the interplay between §§ 129 and 21. Because § 129 only allows taxpayers to exclude \$5,000 but § 21 allows a credit up to \$6,000 in

As this example illustrates, the tax liabilities of working Families B and C are over 20 percent higher than the tax liability of single-earner Family A, even though each of these families has the same disposable income after accounting for working childcare costs. This chasm is, of course, created largely by the working families' inability to reduce their taxable incomes to reflect most of their childcare costs. But this chart also shows how the failure to allow deductions above the line whittles away other deductions. For instance, Family B's medical and casualty loss deductions are, respectively, 20 percent and 40 percent lower than that of Family A. This disparity can be corrected by allowing deductions for working childcare costs to fall above the line.

Finally, transforming the percentage credit to an above-the-line deduction would enable the relief provided by § 21 to be equated with the relief provided by § 129's FSA exclusion and eliminate the strange situation in which Family B is taxed more than Family C, despite being in economically identical positions. As a result, § 129's FSA exclusion would be rendered duplicative of the new deduction and could be omitted to simplify the current system.²²³

Third, the new deduction should not phase out. As discussed in Section I.B.1, § 21's credit "phases out" as income levels rise. But the Code does not phase out deductions for costs of earning income because to do so would be to misunderstand the reason behind allowing these deductions—namely, to accurately measure a taxpayer's net income. One cannot phase out a deduction based on income level when that deduction is needed to accurately calculate income in the first place.

Nor is a phaseout appropriate to limit the upside-down-subsidy effect, discussed in Part I.B, which occurs as a result of a deduction. While it is a worthy goal to temper this effect when caused by deductions of purely consumptive expenses, it cannot be modified for costs of earning income, at least so long as the United States continues to (as it always has) tax net income progressively. Put differently, deductions for the cost of earning income will inevitably result in the greatest tax savings for taxpayers in the highest marginal tax brackets; but these deductions cannot be altered because they are needed to calculate net income. Comparing the richer widget salesman to the struggling one, the former will receive more value when he deducts the costs of widget parts, for traveling to widget conventions, and for taking potential widget purchasers to lunch. There is no reason to be more concerned about this fact in the context of working childcare costs.

Fourth, the proposed deduction should not include the "earned income limitation" found in both §§ 21 and 129. Currently, §§ 21 and 129 provide that a single taxpayer may not credit expenses that exceed her taxable income for the year and that a couple filing jointly may not credit or exclude

expenses, Family C may claim the additional \$1,000 as a percentage credit. Because the phased down percentage is 20%, a credit of \$200 is allowed. *See id.* §§ 21, 129.

223. Specifically Code § 129 could be revised to apply only to in-kind benefits, such as when an employer provides employees discounted on-site day care.

expenses that exceed the income of the lowest wage earner.²²⁴ To illustrate, suppose Harry earned \$100,000 this year while Sally earned \$5,000, incurring \$6,000 in working childcare expenses. Although the dollar limitations of § 21 would allow a percentage credit for \$6,000 of expenses,²²⁵ Harry and Sally, assuming they are married and filing jointly, are limited to a percentage credit of \$5,000 expenses, Sally's salary. The rationale is probably that the tax law should only encourage taxpayers to work outside the home when that work will enhance efficiency, apparently defined as work that produces annual income exceeding the annual cost of childcare. But this rationale is shortsighted. Even small resume gaps can drastically hinder the ability of an individual to return to the workforce.²²⁶ At the same time, infant and preschool care is by far the most expensive care.²²⁷ Thus, a nonprimary wage earner caring for an infant or preschool-aged child might rationally choose to work in a position that does not cover her current childcare costs in order to preserve future earning capacity. The Code's judgment that this represents inefficient behavior is shortsighted.

Fifth, the reformed deduction should not contain dollar limitations on the amount of expenses for which tax relief may be granted. As discussed in Section I.B, both §§ 21 and 129 impose dollar limitations on the amount of work-related childcare expenses that can be credited or excluded.²²⁸ As discussed in Section I.C, these limitation amounts represent a mere fraction of the costs most families will incur to provide full-time childcare, particularly if the family has multiple or young children. These childcare costs are merely one of many costs of earning income. But the Code does not impose dollar limitations on other costs of earning income—it does not insist that the car manufacturer use parts that are not too pricey or that the restaurateur be sufficiently frugal with his ingredients.

Still, one might want to impose *some* limits on working childcare costs since, unlike expenses for car parts or food ingredients, such costs have a consumptive whiff. To do so, an easy analogue is available in the tax laws

224. Code § 21(d) provides an “earned income limitation” that reads as follows:

(1) In general

Except as otherwise provided in this subsection, the amount of the employment-related expenses incurred during any taxable year which may be taken into account under subsection (a) shall not exceed—

(A) in the case of an individual who is not married at the close of such year, such individual's earned income for such year, or

(B) in the case of an individual who is married at the close of such year, the lesser of such individual's earned income or the earned income of his spouse for such year.

I.R.C. § 21(d).

225. *Id.* § 21.

226. See Warner, *supra* note 6 (“Sylvia Ann Hewlett, an economist and the founding president of the Center for Talent Innovation in New York, surveyed thousands of women in 2004 and after the financial crisis in 2009. She has found that roughly a third of ‘highly qualified women’ leave their jobs to spend extended time at home. . . . Most of the women, Hewlett found, stayed home longer than they had hoped.”).

227. See *supra* note 73 and accompanying text.

228. See *supra* notes 57–64 and accompanying text.

providing deductions for business-related entertainment and meal expenses, which limit possible expenses to those that are not “lavish or extravagant.”²²⁹ As applied, this standard aims to curb only the most profligate spending. As explained by the IRS,

An expense is not considered lavish or extravagant if it is reasonable considering the facts and circumstances. Expenses will not be disallowed just because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts.²³⁰

Disallowing a deduction for “lavish and extravagant” working childcare expenses seems perfectly appropriate, so long as the standard is applied in the same weak-toothed manner as it is in the meal and entertainment context. Just as attending to business at a deluxe restaurant is not a lavish or extravagant business expense,²³¹ neither is it lavish or extravagant for a working parent to select an individual caregiver—as opposed to, for instance, using a cheaper day care—to tend to her children, particularly since this choice is sometimes a parent’s only feasible option.²³² Nevertheless, this standard does provide some limitations on the expenses that taxpayers may incur with Uncle Sam’s help. If a company purchases its clients and employees seats in a luxury skybox, it may only deduct the costs of nonluxury seats.²³³ Similarly, if a parent sends her child to a fancy day camp in which professional golfers instruct children to perfect their drives, she may only deduct the nonlavish cost of, for instance, hiring an individual caregiver for the time spent at camp.

These five items provide a basic framework for aligning tax relief for working childcare expenses with the tax relief for other costs of earning income. No further limitations are needed or appropriate. But if lawmakers sought further limitations, Congress might consider a percentage limitation like that found in § 274. Under this provision, taxpayers may only deduct 50 percent of business-related meal and entertainment expenses.²³⁴ In this context, the idea that the government and taxpayer should split these expenses seems justifiable, if not slightly arbitrary. It can easily be argued, for instance, that while any particular taxpayer may have had business reasons for a meal, he nonetheless would have had to eat anyway. In other words, the substantial consumptive element is somewhat irrefutable in this context.

On the other hand, one cannot unequivocally say that a parent would have needed childcare regardless of her being at work—as discussed above, many families with stay-at-home parents forego regular childcare entirely. Hence, there is little reason why the taxpayer should have to split the tax

229. IRS, *supra* note 147, at 12.

230. *Id.*

231. *Id.*

232. See *supra* notes 84–93 and accompanying text.

233. For instance, if a firm were to purchase a skybox to entertain ten clients, it may deduct only the cost of ten nonluxury seats. IRS, *supra* note 147, at 13.

234. I.R.C. § 274(n) (2012).

savings with the government down the middle. As shown in Part III, meal and entertainment expenditures are far more consumptive than working childcare costs. Therefore, a more appropriate percentage limitation—if one were insisted on—would significantly exceed 50 percent and be somewhere close to 100 percent. If this change were implemented, Congress could ensure that no parents were adversely impacted by the change by allowing taxpayers to receive tax relief equal to the greater of the tax savings currently allowed under §§ 21 and 129 and a deduction for (say) 90 percent of actual working childcare expenses. Given the soaring costs of childcare and the severe limits of the current tax laws, the reformed deduction would likely be chosen in almost all cases.

Other tax laws allow taxpayers to deduct expenses up to a specified ceiling amount. For instance, taxpayers may deduct amounts contributed to charity but only to the extent that donations do not exceed 50 percent of the taxpayer's income.²³⁵ This ceiling reflects the notion that, at some point, the taxpayer is diverting an exorbitantly large portion of his income away from the government's reach. But these income caps are somewhat curious in that the cap is increased as income increases. Furthermore, the "lavish and extravagant" limitation suggested above would seem to capture costs exceeding this ceiling anyway. Nonetheless, if Congress wished to impose some additional limitation on the ability of families to reduce their taxable income to reflect working childcare expenses, an income cap could also be considered.

C. *Potential Objections Hindering Future Reform*

As with any suggested reform, potential objections might hinder its progress. The most obvious objection to the proposed reform is that too much revenue will be foregone. First, this objection is, at least in large part, fundamentally unsound. One does not ask whether it costs too much to allow the car manufacturer to deduct the costs of parts or the storeowner to deduct the costs of his employees. These adjustments are necessary to accurately calculate tax and it does not matter how much revenue is lost. To the extent that working childcare costs are nonconsumptive costs of earning income, foregone tax revenue is beside the point.²³⁶

Furthermore, while some revenue is sure to be lost if the proposed reforms are implemented, it may not be nearly as much as one initially thinks. It is currently likely that many transactions occurring between parents and caregivers occur in cash, which increases the chance that the caregiver will

235. *Id.* § 170(b)(1)(A).

236. See Schaffer & Berman, *supra* note 133, at 536–37. It is particularly inappropriate to oppose childcare deductions on the grounds that the tax base should not be further eroded. There is no doubt much to be said for the principle that the key to reform of the federal income tax is to reduce as far as possible all exclusions from gross income, and, more to the point here, all or most personal deductions. The resulting increase in the tax base would enable us to reduce tax rates, finance more government services or both. But the principle has nothing to do with the childcare deduction. Even those who insist on the most comprehensive of tax bases agree that the cost of generating income must be deductible.

underreport her income.²³⁷ Put more colloquially, parents often pay caregivers “under the table.” The current tax system, which provides tax relief for only a fraction of actual childcare costs, does little to prevent this. Under the proposed reforms, however, parents would be able to obtain tax relief for most, if not all, of their working childcare costs. To do so, the tax laws might require parents to identify the caregivers paid, creating a mechanism for the IRS to check for underreporting.

Furthermore, if the proposed reforms were implemented, more nonprimary wage earners would be able to work. The importance of this should not be understated. Even small resume gaps can pose trouble for an individual re-entering the workforce.²³⁸ Therefore, making it affordable for parents to work through the early years of their children’s lives not only results in their earning additional (taxable) income in those years, but also preserves their ability to work, and, therefore, contribute to the tax base, for the remainder of their lives.

Another possible objection to the proposed reform is that the tax law should neither encourage nor discourage nonprimary wage earners to work. There are a number of responses to this argument. Most importantly, to the extent that working childcare costs are a cost of earning income, the objection is once again fundamentally unsound. As discussed in Part II, a taxpayer must be able to deduct the costs of earning income in order to properly calculate her tax liability. Thus, allowing the toymaker (or gun maker) a deduction for costs of making toys (or guns) might be said to encourage toy (or gun) production. But whatever one thinks of toys (or guns) the tax law needs to allow the deduction to accurately capture income. Similarly, to the extent providing a deduction for working childcare expenses is a necessary adjustment to reflect income, it does not matter whether one believes parents should be encouraged to work or that a woman’s place is in the home.

Next, the objection that the proposed reforms would encourage nonprimary wage earners to enter the workforce very arguably has it backward. The current system should be viewed as causing behavioral distortions by discouraging nonprimary wage earners from working. Thus, the proposed reforms are better viewed as eliminating (and not causing) economic distortions. Put another way, the proposed reforms would equalize the treatment of a couple with children, one of whom provides childcare and therefore

237. See, e.g., Ilan Benshalom, *Taxing Cash*, 4 COLUM. J. TAX L. 65, 67 (2012). (“[I]ndividuals use [cash] to conceal certain transactions from their creditors and the state. . . . Cash allows income underreporting, which is the most significant source of tax evasion”); Kathleen DeLaney Thomas, *Presumptive Collection: A Prospect Theory Approach to Increasing Small Business Tax Compliance*, 67 TAX L. REV. 111, 112 (2013) (“At one end of the spectrum are wage-earning employees, who demonstrate a near perfect rate of compliance [with income tax law]. At the other end of the spectrum are self-employed individuals earning business income, whose overall compliance rate is less than 50%. Tax evasion is a particular problem among self-employed individuals engaged in cash businesses, who are estimated to report a staggeringly low 19% of their income.” (footnotes omitted)).

238. See Warner, *supra* note 6.

incurs no working childcare costs, and a similarly situated working family that must incur these costs. Finally, couples increasingly need two incomes to meet their needs.²³⁹ Thus, the concern that the proposed reform would change a taxpayer's decision as to whether to enter the workforce breaks down significantly, since parents increasingly have little choice in the matter.

It is also important when enacting a change in the tax laws to consider who can actually be expected to benefit from the reforms—that is, to ask whether the intended beneficiaries will truly enjoy the tax savings produced or whether the reformed tax laws will really end up helping an unintended group. If the tax law changes to allow families to deduct working childcare costs from their income, it will obviously produce great benefits to working parents. But some part of the tax savings produced by a reformed childcare deduction might inure to the benefit of childcare workers in the form of higher wages. Specifically, because the proposed reform would lower the post-tax cost of childcare, childcare workers might demand—and parents might be able to afford—an increase in salary. Lawmakers should welcome this possible secondary effect, as childcare workers have long fought to earn even a living wage.²⁴⁰

D. *Protecting Progress: How to Prevent the Reoccurrence of Past Mistakes*

As discussed in Section IV.A, the tax relief provided to working families through § 21's childcare credit and § 129's FSA exclusion may have become so inadequate due in large part to the Joint Committee on Taxation's decision to place these provisions on its list of tax expenditures, signaling to Congress that they were "special" tax provisions that could be limited or repealed without compromising the accurate calculation of the income tax. This characterization is inappropriate, however. The question of how one should separate tax expenditure provisions from other tax provisions has long been a subject of debate. Both the Joint Committee on Taxation, acting on behalf of Congress, and the Treasury Department have vacillated between two methodologies,²⁴¹ indicating that even the actors statutorily required to identify tax expenditures understand the question to be murky.

Given the multiple methodologies used by the JCT and Treasury to identify tax expenditures (and given that the JCT and Treasury have reached inconsistent conclusions even when using almost identical methods), it is unsurprising that scholars have also weighed in on how to best separate tax expenditure provisions from other provisions of the Code. But while it is unclear which methodology is best suited to identify tax expenditures provisions, a look at each of these methodologies reveals that it is quite clear that

239. See *supra* notes 13–16 and accompanying text.

240. E. Tammy Kim, *Why Do the People Raising Our Children Earn Poverty Wages?*, NATION (July 31, 2013), <http://www.thenation.com/article/why-do-people-raising-our-children-earn-poverty-wages/> [<http://perma.cc/ZD3D-5BB2>]; Claire Zillman, *Child Care Workers Join Fast Food Workers' Fight for \$15 an Hour*, FORTUNE (Mar. 30, 2015, 9:44 PM), <http://fortune.com/2015/03/30/child-care-workers-pay/> [<http://perma.cc/B5X4-PL89>].

241. See *infra* Sections IV.D.1–3.

the working childcare provisions should not be included on this list. By applying each of the methodologies for identifying tax expenditures developed by the JCT and the Treasury Department, as well as several developed by scholars and economists, this Section shows that the far stronger argument is that neither § 21 nor 129 should be characterized as a tax expenditure provision. In order to prevent future misunderstandings that leave working families vulnerable to overtaxation, provisions providing tax relief for working childcare costs should be excluded from all future tax expenditure lists.

1. The Joint Committee on Taxation's Predominant Model

The predominant model the Joint Committee on Taxation (on behalf of the Congressional Budget Office) used to define tax expenditures seizes on the legislative history of the Congressional Budget and Impoundment Control Act of 1974 (CBICA), which created the requirement that the CBO and the Treasury Department each publish an annual list of tax expenditure estimates.²⁴² This legislative history simply states that tax expenditures are deviations from the “normal tax structure”²⁴³ without further explanation. Thus, the JCT generally considers all tax provisions that deviate from this hypothetically normal income tax as tax expenditures to be referenced and estimated in its annual reports.²⁴⁴

To perhaps state the obvious, this puts enormous pressure on the definition of a “normal” tax structure and, as a result, this standard is highly (and rightly) criticized as overly ambiguous if not completely devoid of substance. As Professor Bittker puts it: “[E]very man can create his own set of tax expenditures, but it will be no more than his collection of disparities between the income tax law as it is, and as he thinks it ought to be.”²⁴⁵

Nonetheless, for nearly four decades, the JCT has clung to the idea of using the normal tax structure as a reference point.²⁴⁶ According to it, the

242. Pub. L. No. 93-344, §§ 3, 301(d)(6), 601, 88 Stat. 297, 299, 308, 323–24 (1974) (codified as amended at 2 U.S.C. §§ 622, 632, 31 U.S.C. § 1105(a)(16) (2012)).

243. The JCT's reports specifically reference legislative history for the first time in 1982, seeming to then adopt the idea of normal tax. The 1982 report states as follows: “The legislative history of the Act indicates that tax expenditures are to be defined with reference to a ‘normal’ tax structure.” 1982–1987 ESTIMATES, *supra* note 198, at 2. Before that time, mention was sometimes made to the normal tax structure but it is not entirely clear that the concept had been formally adopted.

244. In 2008, an alternative methodology was used. STAFF OF JOINT COMM. ON TAXATION, 110TH CONG., ESTIMATE OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2008–2012, at 3–10 (Comm. Print 2008) [hereinafter 2008–2012 ESTIMATES]. In 2009, however, the JCT returned to the previous method. STAFF OF JOINT COMM. ON TAXATION, 111TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2009–2013, at 4–5 (Comm. Print 2010) [hereinafter 2009–2013 ESTIMATES]. The alternative methodology is discussed *infra* in Section IV.C.

245. Boris I. Bittker, *Accounting for “Tax Subsidies” in the National Budget*, 22 NAT'L TAX J. 244, 260 (1969); see also Thuronyi, *supra* note 190, at 1158.

246. This is not necessarily to criticize the JCT, which is trying to fulfill the CBO's statutory responsibilities to the best of its ability. In fact, the JCT often recognizes the imperfect nature of its model. In its 1984 report, for instance, the JCT states:

normal tax structure includes, among other things, the personal exemptions provided to each taxpayer and her dependents (discussed at Section I.A), the standard deduction (to be discussed more below) and “deductions for costs incurred in producing net income, e.g., investment expenses or the cost of the tool that a mechanic purchases for use on his job.”²⁴⁷ In other words, these items, as part of the normal tax structure are not, by definition, deviations from that structure and, therefore, not tax expenditures.

The JCT has always characterized tax relief for working childcare expenses, whether it took the form of the older phased-out deduction, the current percentage credit, or the exclusion for employer-provided childcare, as tax expenditures.²⁴⁸ But even under the JCT’s own definition of a normal income tax, this seems incorrect for at least two reasons.

First, the JCT states that a “normal” income tax does not include various costs of earning income.²⁴⁹ This is an uncontroversial premise, and while it is likely that each person’s definition of what constitutes a normal income tax will differ in some respects, no well-reasoned articulation of a normal

The staff acknowledges that its concept of a normal tax structure may err on the side of being too narrow and that its definition of tax expenditures may err on the side of being too broad. The staff’s approach traditionally has been to list any item as a tax expenditure for which there is a reasonable basis for such classification and a revenue loss above a *de minimis* amount. The staff emphasizes, however, that in the process of listing tax expenditure items no judgment is made, nor any inference intended, about the desirability of any special provision as public policy, or about the effectiveness of the tax approach relative to other methods available to the Federal Government for achieving the particular public policy goals intended.

STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES 1984–1989, at 4 (Comm. Print 1984) [hereinafter 1984–1989 ESTIMATES].

247. *Id.* at 4. The concept of normal income tax was not expressed exactly the same in all JCT annual reports, but in all reports a normal income tax was seen to include the personal exemption amounts and included some expression that costs of earning income should be included as well. The 1984 report also stated as follows:

Under the individual income tax, this normal tax structure includes a single personal exemption for each taxpayer and one for each dependent; the zero bracket amount, which serves as a general minimum standard deduction for all taxpayers; the progressive tax rate structure; the exclusions for various types of imputed income, such as the rental value of owner-occupied homes; and deductions for costs incurred in producing net income, e.g., investment expenses or the cost of the tool that a mechanic purchases for use on his job.

Id. at 3–4. The JCT’s 2001 Report stated as follows:

Under the Joint Committee staff methodology, the normal structure of the individual income tax includes the following major components: one personal exemption for each taxpayer and one for each dependent, the standard deduction, the existing tax rate schedule, and deductions for investment and employee business expenses. Most other tax benefits to individual taxpayers can be classified as exceptions to normal income tax law.

STAFF OF JOINT COMM. ON TAXATION, 107TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2001–2005, at 3 (Comm. Print 2001).

248. See, e.g., 1984–1989 ESTIMATES, *supra* note 246, at 14 tbl.1.

249. *Id.* at 4 (“Deductions for costs incurred in producing income are considered part of the normal tax structure and, therefore, are not listed as tax expenditures.”).

income tax could possibly exclude adjustments for the costs of earning income.²⁵⁰ The JCT does not provide further guidance on how to make the determination of what costs are sufficiently associated with the cost of earning income that they become part of the normal tax structure and fall entirely outside of the tax expenditure categorization. Nonetheless, one gains some information about the JCT's thought process by looking at the types of expenses it puts in the "cost of earning income" basket. For instance, the JCT does not include on its list of tax expenditures "deductions for business-related travel expenses," entertainment expenses, and "moving expenses."²⁵¹ But, as discussed in Part III, these expenses are more consumptive than working childcare costs. If these deductions are not characterized as tax expenditures, than the tax relief provided by §§ 21 and 129 (or by a reformed childcare deduction) should not be either.

Furthermore, the JCT explains its reasons for including the personal exemption amounts and standard deduction in its version of a normal income tax structure—that is, not classifying the personal exemption amount or standard deduction as tax expenditures—as follows:

The staff does not include as tax expenditures either the zero bracket amount or the personal exemption for the taxpayer and dependents because Congress believes these amounts approximate the level of income below which it would be difficult for an individual or a family to obtain minimal amounts of food, clothing and shelter.²⁵²

The "zero bracket" amount refers to the "standard deduction" provided to all taxpayers regardless of expenses actually incurred. In 2014, for instance, a married couple filing jointly may claim a standard deduction of \$12,400 along with a personal exemption amount of \$3,950 for each spouse and each dependent.²⁵³ Thus, a married couple with two children earning anything under \$28,500 will not have any taxable income (and thus find themselves in a "zero bracket") for 2014.

But under this reasoning, it seems that tax relief for working childcare costs might be viewed in a similar way as the standard deduction and personal exemption amount are viewed, not as a tax expenditure but as part of a normal income tax. A simple illustration drives home the point. Consider Couples A and B, each with two young children and each earning a combined salary of \$29,500. Suppose that one member of Couple A earns \$29,500 by herself while the other member of that couple cares for their children. Congress has determined couples need \$28,500 to simply survive

250. See *supra* Part II.

251. See, e.g., 1984–1989 ESTIMATES, *supra* note 246, at 4–5 ("Deductions for costs incurred in producing income . . . are not listed as tax expenditures. These include deductions for moving expenses, employee business expenses, investment expenses, and business-related travel expenses.").

252. *Id.* at 4.

253. In 2014, *Various Tax Benefits Increase Due to Inflation Adjustments*, IRS (Oct. 31, 2013), <http://www.irs.gov/uac/Newsroom/In-2014,-Various-Tax-Benefits-Increase-Due-to-Inflation-Adjustments> [<http://perma.cc/35PZ-ZNFC>].

and, therefore, Couple A should only be taxed on the \$1,000 income that exceeds that critical amount. The government should not, in other words, burden the amount needed for subsistence. The personal exemption and standard deduction amounts ensure that this is true.

Now suppose that, in contrast to Couple A, both members of Couple B work, together earning \$29,500. When both members of Couple B are at work, they incur \$1,000 additional cost for childcare. Couple B has only the \$28,500 Congress believes it needs to provide basic necessities. But without relief for working childcare costs, Couple B would (like Couple A) be taxed on \$1,000 and would (unlike Couple A) be unable to survive. In this way, the percentage credit allowed in § 21 seems to provide needed adjustments to the dual-earner and single-parent families' tax liability that ensures that they, like single-earner couples, are not taxed on the basic amount needed for mere survival. There is, therefore, a rather compelling case that working childcare relief should not be viewed as a "tax expenditure" at all but, like the personal exemption and standard deduction, as part of the normal tax structure defining a minimum level of income below which no taxation will be levied.

As discussed, using the highly malleable concept of a normal income tax to differentiate tax expenditures from other tax provisions has received much criticism. As a result, in 2008 the JCT developed an alternative methodology for characterizing tax provisions.²⁵⁴ After only one year of using this alternative model, however, it returned to the predominate model just described.²⁵⁵ Nonetheless, the alternative model provides a different way to think about whether provisions that allow tax relief for working childcare costs should be characterized as tax expenditures. This alternative analysis also suggests that the working childcare provisions should be removed from the tax expenditure list.

2. The Joint Committee on Taxation's Alternative Model

In 2008, under the direction of now-Professor, then-JCT Chief of Staff Edward Kleinbard, the Joint Committee on Taxation made a valiant attempt to respond to the many criticisms of its predominant model, relying on a "normal" income tax. In its pamphlet entitled, *A Reconsideration of Tax Expenditure Analysis*, the JCT wrote:

Tax expenditure analysis no longer provides policymakers with credible insights into the equity, efficiency, and ease of administration issues raised by a new proposal or by present law, because the premise of the analysis (the validity of the "normal" tax base) is not universally accepted. Driven off track by seemingly endless debates about what should and should not be

254. 2008–2012 ESTIMATES, *supra* note 244, at 3–10.

255. 2009–2013 ESTIMATES, *supra* note 244, at 4–5.

included in the “normal” tax base, tax expenditure analysis today does not advance . . . the . . . goals that inspired its original proponents²⁵⁶

The JCT’s alternative approach separated tax expenditures into two categories: “Tax Subsidies,” which consist mainly of those provisions that were generally categorized under the predominant approach as tax expenditures, and a new category called “Tax-Induced Structural Distortions.”²⁵⁷ Under this alternative model, provisions granting relief for working childcare costs could only feasibly fall within the “Tax Subsidies” category.²⁵⁸

A “Tax Subsidy” was defined “as a specific tax provision that is deliberately inconsistent with an identifiable general rule of the present tax law (not a hypothetical ‘normal’ tax), and that collects less revenue than does the general rule.”²⁵⁹ “Tax-Induced Structural Distortions” were defined as follows: “structural elements of the Internal Revenue Code (not deviations from any clearly identifiable general tax rule and thus not Tax Subsidies in our classification) that materially affect economic decisions in a manner that imposes substantial efficiency costs.”²⁶⁰ In this way, while the new approach “cover[ed] much the same ground”²⁶¹ as the predominant approach, it defined tax expenditures without “relying on a hypothetical ‘normal’ tax.”²⁶² In theory, this alternative methodology would solidify the concept of tax expenditures by requiring the JCT to identify the general rule from which any given provision identified as a tax subsidy (and hence a tax expenditure) departs. In reality, however, “[c]ountless sets of rules can be characterized as the general rules of the current income tax, with other rules constituting the exceptions.”²⁶³ This problem emerges when one tries to determine whether tax relief for working childcare costs should be characterized as a tax subsidy.

256. STAFF OF JOINT COMM. ON TAXATION, 110TH CONG., A RECONSIDERATION OF TAX EXPENDITURE ANALYSIS I (2008).

257. *Id.* (“The two categories together cover much the same ground as does the current definition of tax expenditures, and in some cases extend the application of the concept further. The revised approach does so, however, without relying on a hypothetical ‘normal’ tax to determine what constitutes a tax expenditure, and without holding up that ‘normal’ tax as an implicit criticism of present law. The result should be a more principled and neutral approach to the issues.”).

258. *See id.* at 12 (classifying the distinction between debt and equity as a Tax-Induced Structural Distortion but “not a tax expenditure (Tax Subsidy) in the narrow sense, because there is no clear consensus as to what general rule of tax law, if any, the debt-equity distinction might violate”). Other examples provided were the deferral of foreign earnings earned through foreign corporations and the capital gains preference. *Id.* at 10, 22.

259. *Id.* at 9.

260. *Id.* at 41.

261. *Id.* at 39.

262. *Id.*

263. Thuronyi, *supra* note 190, at 1185 (“These problems with developing a set of objective general rules, as well as the absence of criteria for distinguishing ‘special’ from ‘general’ rules, show that the general/special dichotomy is as arbitrary and subjective as an ideal income tax.”).

Section 61 of the Code provides the general rule that “gross income means all income from whatever source derived.”²⁶⁴ Thus, one might argue that all exclusions from gross income constitute deviations from that all-important section.²⁶⁵ The Joint Committee on Taxation took this approach during the couple of years in which it utilized its alternative formulation of tax expenditures.²⁶⁶ Specifically, in 2008 and 2009, the JCT characterized a variety of exclusions as “Tax Subsidies,” including the exclusion for “employer-provided health care,”²⁶⁷ and “miscellaneous fringe benefits,”²⁶⁸ along with § 129’s FSA exclusion and § 21’s credit.²⁶⁹ It explained as follows:

All employee compensation is subject to tax unless the Code contains a specific exclusion for the income. Specific exclusions for employer-provided benefits include the following: coverage under accident and health plans, accident and disability insurance, group term life insurance, educational assistance, tuition reduction benefits, transportation benefits (parking, van pools, bicycles, and transit passes), dependent care assistance, adoption assistance, meals and lodging furnished for the convenience of the employer, employee awards, and other miscellaneous fringe benefits (e.g., employee discounts, services provided to employees at no additional cost to employers, and *de minimis* fringe benefits).²⁷⁰

Thus, it seems that the JCT simply lumped § 129’s FSA exclusion with a variety of exclusions properly characterized as “Tax Subsidies” because those provisions carve out exceptions to § 61’s general rule that gross income is income derived from all sources, that is, by exempting various otherwise includible items from being taxable;²⁷¹ and with § 129 so-pegged, § 21’s

264. I.R.C. § 61 (2012).

265. Thuronyi, *supra* note 190, at 1158.

266. For instance, in its 2008 Report the JCT explains as follows:

The exclusion from gross income for employer-provided health care benefits is an exception to the Code’s general rule that all compensation for services constitutes gross income. The value of health care benefits that an employer provides to its employees constitutes gross income to each employee in this general sense. Fringe benefits are included in an employee’s gross income unless specifically excluded under a provision in the Code. For this reason, the provisions that exclude employer-provided health care benefits from income are exceptions to the general rule and are Tax Subsidies under our revised classification.

2008–2012 ESTIMATES, *supra* note 244, at 15 (footnotes omitted).

267. The JCT cited exclusions for employer-provided healthcare as an example of a Social Spending Tax Subsidies, explaining that this exclusion “can be traced back to the 1940’s, when employers offered fringe benefits in order to attract labor in a period of tight wage controls.” *Id.*

268. *Id.* at 38.

269. *Id.*

270. *Id.* (footnote omitted).

271. A closer look at the JCT’s 2008 and 2009 reports further suggests that the working childcare tax relief provisions may have been improperly characterized as “Tax Subsidies.” The JCT listed these provisions under “Social Spending,” one of three sub-categories of “Tax Subsidies.” *Id.* at 55; see also 2009–2013 ESTIMATES, *supra* note 244, at 41. The JCT defined its newly created sub-category of “Social Spending” provisions as those “Tax Subsidies related to the

mirror credit provision became inevitably attached.²⁷²

But as the analysis in Part III reveals, there are far better ways to view the tax relief provided by §§ 21 and 129. Specifically, §§ 21 and 129, like many other sections of the Code, provide necessary tax relief (however inadequate) for the costs of earning income. In other words, these sections are not exceptions to any general rule at all but instead create their own first-order rules. This view is consistent with the legislative history of § 21 discussed in Part I. Furthermore, it has been embraced by the Treasury Department in its Tax Expenditure Estimate Reports discussed in the next Section, which fulfill the department's own responsibilities under CBICA.

3. Treasury's Tax Expenditure Model

Initially, the Treasury Department identified tax expenditures by employing a model very similar to the JCT's predominant model. Specifically, Treasury identified tax expenditures as tax provisions that departed from a "normal tax" and defined normal tax in the same way as the JCT. Thus, at first, there was little disparity between the tax expenditure lists of the JCT and Treasury.²⁷³

In 1983, however, Treasury began to use a different model that is quite similar to the alternative model used by the JCT. Treasury exclusively used this methodology in both 1983 and 1984.²⁷⁴ Starting in 1985, apparently concerned that having its estimates differ substantially from those of the JCT

supply of labor" and those "intended to subsidize or induce behavior unrelated to the production of business income." 2008–2012 ESTIMATES, *supra* note 244, at 6. It is not clear for which of these two reasons the JCT placed working childcare tax relief provisions in the "Social Spending" bucket, but it does not appear to belong in either. As explained in Part II, the legislative history of § 21 is quite different, emphasizing the percentage credit as a mechanism for providing a deduction equivalent for the cost of earning income. It is also possible that the JCT just made an error and characterized tax relief for working child care as a cost "unrelated to the production of business income"—the other way to earn a place in the "Social Spending category." *Id.* at 6. This characterization is blatantly incorrect given the plain language of the Tax Code. Section 21 states that the percentage credit allowed only applies to "employment-related expenses" defined as "amounts paid for the following expenses, but only if such expenses are incurred to enable the taxpayer to be gainfully employed." I.R.C. § 21 (2012). Section 129 limits the amounts that may be excluded from income by being diverted into an FSA to these same expenses. *Id.* § 129.

272. See *supra* note 67 and accompanying text.

273. Prior to 1983, Treasury's listing of "tax expenditures"—labeled Special Analysis G—generally matched those published by the CBO and the JCT. This close correspondence of tax expenditure lists resulted because the concept of a "normal" tax used by both executive branch and congressional staffs was a variant of a comprehensive income tax, albeit with several major exceptions, that had not deviated significantly from the concept used in the first tax expenditure listings. OFFICE OF MGMT. & BUDGET, SPECIAL ANALYSES, BUDGET OF THE UNITED STATES GOVERNMENT, FY 1985, at G-1, http://fraser.stlouisfed.org/docs/publications/usspa/Specanalyses_1985.pdf [<http://perma.cc/5GC2-M983>] [hereinafter 1985 BUDGET].

274. See *id.*; OFFICE OF MGMT. & BUDGET, SPECIAL ANALYSES, BUDGET OF THE UNITED STATES GOVERNMENT, FISCAL YEAR 1984, at G-11, http://fraser.stlouisfed.org/docs/publications/usspa/Specanalyses_1984.pdf [<http://perma.cc/FRY4-GJQF>] [hereinafter 1984 BUDGET].

might cause confusion,²⁷⁵ it began to publish two lists of tax expenditures in its required reports—one using this methodology and one using the JCT’s predominant methodology, which focused on deviations from the “normal” tax.²⁷⁶

Under the Treasury’s alternative model, for a tax provision to be characterized as a tax expenditure two conditions must be satisfied:

- The provision must be “special” in that it applies to a narrow class of transactions or taxpayers; and
- There must be a “general” provision to which the “special” provision is a clear exception.²⁷⁷

General provisions were defined as those provisions that were part of the Treasury’s so-called reference tax.²⁷⁸ According to Treasury, these reference tax provisions provide “structural features [that] must be dealt with in some manner in order to have an operational income tax. . . . [By contrast,] it would be possible to have a fully operational income tax that did not contain any of the special provisions that give rise to tax subsidies.”²⁷⁹ Using these concepts, Treasury defines its reference tax to include the following:

the definition of income subject to tax and allowable deductions, including cost recovery for depreciable assets; taxable units and their threshold levels of taxability; . . . the schedule of tax rates; the basic tax accounting rules, including the accounting period for taxation and whether income is taxed as it is realized or as it accrues.²⁸⁰

As discussed above, the JCT used a similar methodology to conclude that §§ 21 and 129 were tax expenditure provisions, apparently believing that these provisions, like the exclusion for fringe benefits and employer-provided healthcare, represent a deviation from the general rule in § 61 that gross income is income from whatever source derived. Treasury, however, reached an opposite conclusion, using a virtually identical test.

Treasury agreed with the JCT that many exclusions, like the exclusion for fringe benefits, constitute deviations from the general rule that all wages must be taxed.²⁸¹ It, however, did not believe that the working childcare

275. 1985 BUDGET, *supra* note 273, at G-5 (“Neither the Congressional Budget Office nor the Joint Committee on Taxation adopted these revisions. Those offices continued to use a modified income tax ‘norm,’ as described above, as the basis for identifying tax expenditures. As a consequence, Special Analysis G in the 1983 and 1984 budgets did not fully correspond to other ‘tax expenditure budgets,’ a condition some have found confusing.”).

276. *Id.*

277. *Id.*

278. *Id.* at G-1.

279. 1984 BUDGET, *supra* note 274, at G-1.

280. OFFICE OF MGMT. & BUDGET, BUDGET OF THE UNITED STATES GOVERNMENT, 1983: SPECIAL ANALYSIS G, at 4, http://fraser.stlouisfed.org/docs/publications/usspa/Specialanalyses_1983.pdf [<http://perma.cc/RHT5-7QCQ>].

281. *Id.* (“The inclusion of wages in the tax base is a clear example of reference tax structure, just as the exclusion of fringe benefits is due to special provisions, and therefore clearly constitute tax subsidies.”). On the other hand, Treasury did not believe that the exclusion for

credit belonged in this category and instead believed it was primarily a cost of earning income. It wrote: “in the absence of the credit, expenses for child and dependent care would be deductible as employee business expenses.”²⁸² Thus, for Treasury, the only portion of § 21’s percentage credit (and by extension § 129’s FSA exclusion) that constituted a tax expenditure was the “the excess of the value of the credit over the value of a deduction.”²⁸³ Of course, because §§ 21 and 129 only allow the equivalent of a deduction for a fraction of actual working childcare expenses, in almost all situations, this excess will not exist.

Given the multiple methodologies used by the JCT and Treasury to identify tax expenditures and the fact that the JCT and Treasury reached inconsistent conclusions even when using almost identical methods, it is unsurprising that scholars have also weighed in on how to best separate tax expenditure provisions from other provisions of the Code.

4. Academic Tax Expenditure Models

As discussed in Section IV.A, when Surrey first developed the idea of tax expenditures, he hoped that lawmakers would recognize that certain provisions of the Code are not tax provisions at all but operate as, and thus could be substitutes for, direct spending programs.²⁸⁴ As a result, some scholars have argued that tax expenditure analysis should be brought back to these roots.²⁸⁵

In his influential work,²⁸⁶ Seymour Fiekowsky argues that a provision should not be classified as a tax expenditure provision unless it is “possible to formulate an expenditure program administrable by a cognizant government agency that would achieve the same objective at equal, higher, or lower budgetary cost[].”²⁸⁷ Professor Thuronyi formulates a similar “substitutability” test for classifying tax expenditures that “involves two steps: (1) identifying a provision’s significant purposes, and (2) determining whether a nontax program can serve those purposes at least as well.”²⁸⁸ Professors

gifts was a special rule and instead was a general rule. *Id.* at 6. This is one of the only ways in which the Treasury’s reference tax base differs from the JCT’s reference tax base. This has no effect on the subject of this Article.

282. *Id.* at 24.

283. *Id.*

284. *See supra* Section IV.A.

285. Thuronyi, *supra* note 190, at 1186 (“The chief purpose of tax expenditure analysis should be to facilitate the replacement of tax expenditures with non-tax-based programs and to guide budgetary choices between tax-based and non-tax-based assistance.”).

286. Cited by JCT and Treasury in formulating alternative methodologies. In practice, Treasury does not use prong two. *See* Edward D. Kleinbard, Chief of Staff, Joint Comm. on Taxation, Rethinking Tax Expenditures 8 (May 1, 2008), http://www.jct.gov/Rethinking_Tax_Expenditures.pdf [<http://perma.cc/TP7K-AXRS>] (building on Fiekowsky’s work on tax subsidies).

287. Seymour Fiekowsky, *The Relation of Tax Expenditures to the Distribution of the “Fiscal Burden”*, 2 *CAN. TAX’N* 211, 215 (1980).

288. Thuronyi, *supra* note 190, at 1186.

Weisbach and Nussim have more recently argued that tax expenditure analysis should simply focus on whether the objectives of a particular tax expenditure could best be achieved through a direct spending program or through a tax program.²⁸⁹

Could the objectives, in Fiekowsky's words, and the "significant purposes," in Thuronyi's, of § 21's percentage credit and § 129's FSA exclusion be accomplished through a direct spending program? Congressional purposes are not always easy to discern, and when discernable may be very mixed. In the case of § 21, and by extension the case of § 129, however, Congress was rather clear—working childcare expenses were seen as costs of earning income and allowing tax relief for these costs seen as necessary to calculating tax. Congress did not, by contrast, mean to serve other nontax purposes, such as encouraging procreation or mothers to work. Thus, the question of whether a nontax program could serve as an adequate substitute for §§ 21 and 129 must be answered in the negative. These sections have the tax-related purpose of compensating working parents for the costs of childcare that enable them to earn income and should not be classified as tax expenditure provisions.

Considering the preceding discussion, it is quite clear that the JCT has long mischaracterized §§ 21 and 129 as tax expenditure provisions—that is, "provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."²⁹⁰ As a result, provisions providing tax relief for working childcare costs should be removed from future tax expenditures lists. This would help prevent the current tax laws from being misunderstood as they have been in the past and help protect the progress that Congress would make if it were to adopt the reforms suggested in this Article.²⁹¹

CONCLUSION

Just as all families look different from one another, the ways in which families earn income and care for their children vary dramatically. In two-parent families, one parent may earn all of the income while the other provides childcare; alternatively, both parents may work. And in single-parent families, one parent may alone bear the primary responsibilities of earning income and caring for her children. But unlike the first family, dual-earner

289. David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 *YALE L.J.* 955, 976 (2004).

290. Pub. L. No. 93-344, § 3(3), 88 Stat. 297, 299 (1974) (codified as amended at 2 U.S.C. § 622(3) (2012)).

291. Alternatively, costs such as business-related meal, entertainment, and moving expenses should be added to the JCT's list. If the latter approach is insisted on, the text of the JCT reports should highlight the ambiguities of making this characterization to underscore to future lawmakers that the tax relief provided by these provisions should be limited with greater care than the relief provided by provisions that are clearly best characterized as tax expenditures.

and single-parent families are exceedingly likely to incur significant additional expenses to provide childcare while at work.

Currently, §§ 21 and 129 of the Internal Revenue Code treat the childcare costs working parents incur as personal expenses, subject to various dollar limitations, percentage limits, and phaseouts. Once these limitations are applied, working parents will receive tax relief for only a small fraction of the childcare costs they incur. This Article shows that this is inappropriate as a matter of fundamental tax policy and that working childcare expenses should be treated as nonconsumptive costs of earning income.

Having determined that the tax relief provided by §§ 21 and 129 is inadequate, this Article encourages lawmakers to be careful when choosing an avenue of reform. It might, for instance, seem sufficient to provide first aid to current laws by simply altering their overly severe limits. But while this would be a step in the right direction, it would continue to leave the tax laws vulnerable to the same legislative dysfunction that allowed the tax relief provided to working families to become so inadequate in the first place. This Article instead urges lawmakers to provide parents the opportunity to deduct working childcare costs under the same methods as other costs of earning income, which are generally not subject to stringent limitations. In doing so, this Article suggests meaningful reform of the Internal Revenue Code that will help prevent the overtaxation of the modern working family. To be sure, the tax laws cannot (and should not) solve all problems facing today's working parents. The reforms proposed in this Article, however, could at least ease their economic struggles.