

TAX DEDUCTIONS FOR FAMILY CARE EXPENSES

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In 1954 Congress introduced into the income tax laws a provision allowing, in certain circumstances, a limited deduction of expenses for care of dependents incurred by working people. In 1971 Congress made sweeping changes in that provision, greatly expanding the deductions that may be claimed for caring for dependents and allowing for the first time a deduction for household expenses not related to such care. The details of both the present and the earlier provisions and of their legislative history have been amply researched and described in recently published papers.¹ Consequently, the present article offers only a review of the highlights of the current law and its ancestors, and focuses instead on the questions of its economic effects and implicit or explicit sociological assumptions. The article will discuss the effect of the 1971 amendments on the taxpayer's decisions to work and to have children, the interrelationship between these two decisions, and the potential impact of the new law on the creation of new jobs in child care and domestic service. Finally, the question of the fairness of allowing a child care deduction will be examined.

I. PAST AND CURRENT LAW

Nonstatutory Doctrine

Prior to 1954 the only Code section under which a deduction for dependent-care expenses might plausibly have been allowed was the general provision, the predecessor of section 162, allowing a deduction for the "ordinary and necessary expenses [of] carrying on any trade or business."² The leading case denying the deduction under that

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¹ Feld, *Deductibility of Expenses for Child Care and Household Services*; New Section 214, 27 Tax L. Rev. 415 (1972); Hjorth, *A Tax Subsidy for Child Care*: Sec. 210 of the Internal Revenue Act of 1971, 50 Taxes 133 (1972); Keane, *Federal Income Taxation of Child Care Expenses*, 10 Harv. J. on Legis. 1 (1972) (this article came to the author's attention after submission of this manuscript and therefore no further reference is made to it); Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 Buffalo L. Rev. 49 (1971); Comment, *The Child Care Deduction: Issues Raised by Michael and Elizabeth Nammack and the Pending Amendment to Section 214*, 13 B.C. Ind. & Com. L. Rev. 270 (1971); Note, 41 U. Cin. L. Rev. 264 (1972); Note, *Sex and the Single Man: Discrimination in the Dependent Care Deduction*, 5 Valparaiso L. Rev. 415 (1971).

² Int. Rev. Code of 1939, § 23(a)(1). In one case, in a rather unique set of circumstances, a deduction for child care expenses was claimed as a medical expense under the predecessor of § 213, on the theory that the taxpayer's health was imperiled by the necessity of caring for the children. The deduction was denied. *Ochs v. Commissioner*, 195 F.2d 692 (2d Cir. 1952).

language was *Henry C. Smith*.³ While the opinion is not enlightening, it is sufficiently provocative to warrant careful examination. The facts are simply stated. Mr. and Mrs. Smith were both employed and filed a joint return⁴ in which they claimed a deduction for the expense of hiring someone to care for their young child. According to the opinion of the Board of Tax Appeals, the Smiths' argument was simply that "but for" the fact that Mrs. Smith was working the child care expense need not have been incurred.⁵ Since there was no suggestion that the Smiths would have hired a caretaker for the child even if one of them had been unemployed, the "but for" argument seemed to have considerable force, and the Board's rebuttal to this argument missed the point. Adopting a *reductio ad absurdum* approach, the Board stated that if the Smiths' argument were accepted, then a deduction for food and shelter should also be allowed as a business expense since without food and shelter a person would be physically unable to work. The obvious irrelevance of that observation lies in the fact that the cost of food and shelter is unavoidable for nonworkers as well as workers, whereas child care expenses are unavoidable only for workers.⁶

The Board's attack on the "but for" argument would have been more persuasive if it had been launched from another angle. The Board neglected the fact that child care expenses are not incurred by all workers, but only by those who have children. The expense, therefore, is attributable not only to the decision to work—taking children as given—but also to the decision to have children—taking work as given. In other words, the expense at issue can be looked upon in part as a cost of working and in part as a cost of having children—that is, as a trade or business expense and a personal expense—but not as either one alone. Such an observation scarcely resolves the question of deductibility, but at least it avoids spurious causative analysis⁷ and brings into sharper focus the central issue of the case.

Passing from its discussion of the "but for" or causative argument, the Board referred to the notion of the wife (not, it may be noted, the husband) as a provider of "services as custodian of the

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

⁴ The case arose before the era of split income, but even then married couples were permitted to file a joint return and in certain circumstances could gain a modest advantage by doing so. See B. Bittker & L. Stone, *Federal Income, Estate, and Gift Taxation* 348 (4th ed. 1972).

⁵ It was no doubt a sign of the times that the possibility was not even considered that Mr. Smith, rather than Mrs. Smith, could have been the child's caretaker.

⁶ The Board might have found in the denial of deductions for commuting expenses a more useful example for rebuttal. Cf. Klein, *Income Taxation and Commuting Expenses: Tax Policy and the Need for Nonsimplistic Analysis of "Simple" Problems*, 54 Cornell L. Rev. 871 (1969).

⁷ Cf. *id.* at 876-77, 890-92.

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home and protector of its children,"⁸ and pointed out that ordinarily these services are provided without financial reward. To use the jargon of the present-day economist, the nonworking spouse, husband or wife, provides imputed income in the form of services to the household or family. What is curious about the Board's observation is that it may be used to support rather than undercut the allowance of a deduction for child care expense.⁹ Because the cash income of the working wife is taxed while the imputed income of the nonworking wife is not, a deduction for child care can be defended as a means of mitigating the inequality in tax results. This argument seems to have escaped the Board.¹⁰

Finally, the Board reached what was probably the soundest basis for its holding: the observation that the expenses incurred for child care were simply not "ordinary" business expenses. This observation is accurate because of two characteristics of child care expenses: first, they do not belong to a class of expenses that are incurred by all business people and, second, that class of expenses that includes child care is defined by a nonbusiness phenomenon. Thus, even if one were prepared to concede that child care expenses should, in certain circumstances,¹¹ be deductible by working people, one might deny that such expenses are within the class of "ordinary and necessary expenses . . . incurred . . . in carrying on a trade or business"¹² as contemplated by Congress when it adopted that language. This latter view gains force from the fact that the deduction had never been allowed under the provision for deduction of business and trade expenses relied on by the Smiths—a provision that had been in effect over a period of more than twenty-five years.¹³

The 1954 Act

In 1954 Congress responded to the claims of people like the Smiths with a new deduction provision,¹⁴ but the response was meager and somewhat chaotic. Instead of developing a rational, coherent set

⁸ 40 B.T.A. at 1039.

⁹ See discussion in text at notes 107-09 *infra*.

¹⁰ It is true that the working spouse may well earn a large amount of imputed income by doing the housework in the evening and on weekends, as may the single working person without dependents, but that would result in a reduction in their imputed income from leisure.

¹¹ Such situations may include instances where the wife's work is absolutely necessary to support the family.

¹² Int. Rev. Code of 1954, § 162(a). The language of this section was taken from § 23(a)(1)(B) of the 1939 Code.

¹³ See Int. Rev. Code of 1939, § 23(a)(1)(B).

¹⁴ Int. Rev. Code of 1954, § 214 (originally enacted as Act of Aug. 16, 1954, ch. 736, § 214, 68A Stat. 70) [hereinafter references to this provision as it stood in 1954 will be cited as 1954 Code].

of rules based on sound principles of taxation consistently applied, Congress seems to have proceeded by a process of accretion from intuitive reactions to concrete situations, and by that process of accretion covered both too much and too little—mostly too little.

The paradigm from which the original version of the statute seems to have been developed was that of the impoverished young widow, forced by her pitiable state to work in order to support herself and her infant child.¹⁵ It is by no means difficult to argue in favor of giving such a person a deduction for child care expenses on grounds of simple compassion or as a means of reducing the welfare budget. But the strongest argument from a tax policy standpoint was that relied upon in one statement in the House Report that compared the expenses of the widow who was forced to work with business expenses:¹⁶ the rationale implicit in the statement is that in such a case child care is properly regarded as more significantly related to the decision to work than to the earlier decision to have children. Here, however, a caveat is in order. An examination of the legislative history in conjunction with the terms of the provision suggests that this argument may have been a rationalization for a decision reached on non-rational grounds.¹⁷ The congressional starting point appears to have been the concrete need of the widowed mother, and its reaction was

¹⁵ See House Comm. on Ways and Means, Int. Rev. Code of 1954, H.R. Rep. No. 1337, 83d Cong., 2d Sess. 30 (1954):

Your Committee has added this deduction to the code because it recognizes that a widow or a widower with young children must incur these expenses in order to earn a livelihood and that they, therefore, are comparable to an employee's business expenses.

¹⁶ *Id.* See also Senate Comm. on Finance, Int. Rev. Code of 1954, S. Rep. No. 1622, 83d Cong., 2d Sess. 36 (1954). The statement by the House was not accompanied by any discussion or explanation of the business nature of the expense. The Senate Report utilized the same statement but also left it standing without any tax analysis.

¹⁷ As mentioned in note 16 *supra*, the statement comparing child care expenses to business expenses was not followed by any tax analysis regarding distinctions between business and personal expenses. This fact should be viewed in conjunction with the remarks of congressmen, none of whose arguments utilized tax analysis. Rather, they seemed motivated by the desire to provide for the widowed mother and others whose plight appeared similar. See 100 Cong. Rec. 3451 (1954) (remarks of Rep. Forand), and Hearings on H.R. 8300 Before the Senate Comm. on Finance, 83d Cong., 2d Sess. 1057 (1954).

Moreover, an analysis of the legislative intention must consider what provisions Congress actually enacted: the statute as enacted in 1954 limited the deduction in terms of who could claim it and the amount that could be claimed. In addition, the Senate Committee explicitly rejected the Kerr-Smith Amendment, a proposal that would have extended the deduction to men. See *id.* at 1798. Such treatment is inconsistent with normal business expense deduction theory. Finally, the legislative history of subsequent amendments to the child care provision substantiates the conclusion that Congress viewed the deduction as a relief measure for certain needy individuals and not as analogues to a business expense. See, e.g., Senate Comm. on Finance, Revenue Act of 1964, S. Rep. No. 830, 88th Cong., 2d Sess. (1964), reprinted in U.S. Code Cong. & Ad. News 1741 (1964).

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to provide relief for that particular need, whose appeal no constituency could deny, rather than to assess that need systematically as a part of a larger problem of tax policy. Had Congress followed the latter route, it might have been forced to analyze the expense in terms of its business and/or personal nature and to have constructed the deduction, or denied it, as an across-the-board provision applicable to all taxpayers who incurred comparable expenses. No such analysis is apparent in the legislative history referred to above.

The illogical quirks that are revealed in the ensuing discussion, quirks that characterized the deduction from its inception, are best understood as manifestations of the proposition that it was originally conceived more in the heart than the head. At the same time one cannot reject the notion—implicit in the idea of conditioning the deduction on a decision to work¹⁸ and explicit in the one statement referred to above¹⁹—that the deduction was regarded as related to the production of income. Starting from the second of these propositions, it is not surprising that Congress granted the deduction to all widowed and divorced women; the appeal to compassion in such cases seems plain. But the absence of careful analysis is revealed in the failure to impose limits. The language of the statute made the deduction available not only to the impoverished widow but also to a working widow of immense wealth,²⁰ who might well have had abundant household help whether or not she worked, or to a woman with very high earnings, for whom child care and other household help might equally be thought of as a normal consumption item rather than a business expense. The congressional expansiveness in allowing the deduction in such cases is particularly noteworthy and significant in light of the income limit imposed on married couples²¹—in light of the fact, that is, that Congress knew perfectly well how to take the deduction away as income rose, and that there is no apparent reason why this rule could not have been made applicable to single women.

Given the decision to allow a deduction for widows with children,

¹⁸ 1954 Code § 214(a).

¹⁹ See note 15 *supra*.

²⁰ The statute contains a requirement that the expense must be incurred "for the purpose of enabling the taxpayer to be gainfully employed." 1954 Code § 214(a). Arguably the deduction could be denied under this language to a person with an independent income, or even to anyone whose earned income is so high that nursemaids would have been hired without regard to the inability of the earner to provide caretaker services. But the Treasury appears to have taken that position only in extreme situations, such as where the widow's job is part-time at a low salary and the child has been attending boarding school for several years before the job was taken. See Treas. Reg. §§ 1.214-1(f)(4) and (f)(5), Ex. 4 (1956). A similar argument can be made for denying the deduction for all household expenses under the 1971 amendments; see text at notes 65-68 *infra*.

²¹ See text at note 38 *infra*.

it is easy enough to understand why Congress accepted a series of extensions of the basic principle implicitly adopted in arriving at that decision. Thus it is easy to see why the deduction was given to all unmarried women with children,²² as well as to widowers and divorced (or legally separated) men.²³ A further extension of the paradigm case permitted the deduction of expenses for caring for certain dependents other than children—those who were incapable of caring for themselves.²⁴ Again, this is an extension that can easily be accepted without the necessity of defining precisely the principle being applied. But how can we explain Congress' refusal of the deduction to never-married men with incapacitated dependents?²⁵ Surely, if a widower could deduct the cost of caring for his invalid dependent mother, as plainly he could, a never-married man should be entitled to the same deduction. Indeed, a statute drawing a distinction between the two cases might seem so capricious as to violate the Constitution's requirement of due process in its application to the never-married man,²⁶ and in a recent court of appeals decision the statutory provision that had precluded the never-married man from taking the dependent care deduction was in fact held unconstitutional.²⁷

The plight of the never-married man, however, can readily be attributed simply to hurried draftsmanship or, more probably, to the kind of legislative myopia associated with statutes springing from concrete cases rather than general principles, and, in any event, the problem can be dismissed as relatively insignificant. The same cannot be said, however, of the provision limiting the deduction to \$600 a year.²⁸ Surely, even in 1954, Congress could not have believed that widows and others who were forced to work to support themselves and their families, including small children, could hire baby sitters

²² This particular extension was the handiwork of the Senate Finance Committee, which exhibited a commendable display of forbearance from using the tax laws to punish unwed mothers for their antisocial (at least by the mores of 1954) conduct. See S. Rep. No. 1622, *supra* note 16, at 36. Never-married men with illegitimate children in their care were not gathered in under the same protective umbrella. 1954 Code §§ 214(a), (c)(2).

²³ This last result was accomplished by use of the Alice-in-Wonderland device of defining the term "widower" to include men who were divorced or legally separated. 1954 Code § 214(c)(2).

²⁴ 1954 Code § 214(c)(1)(B), another extension of coverage added by the Senate Finance Committee. See S. Rep. No. 1622, *supra* note 16, at 36.

²⁵ See note 22 *supra*.

²⁶ We are so inured to the pervasiveness of injustice in the Code that most experienced tax people would quickly dismiss such an argument.

²⁷ *Moritz v. Commissioner*, CCH 1972 Stand. Fed. Tax Rep., U.S. Tax Cas. ¶ 9759, at 85,908 (10th Cir., Nov. 22, 1972), rev'g *Charles E. Moritz*, 55 T.C. 113 (1970). See discussion in Note, 5 Valparaiso L. Rev., *supra* note 1. Cf. note 32 *infra*.

²⁸ 1954 Code § 214(b)(1)(A).

for \$12 a week.²⁹ If one accepts the principle that for such taxpayers caretaker expenses were properly regarded as business expenses,³⁰ the allowance of a deduction lower than the full amount reasonably required cannot be justified. For a person such as the wealthy widow, who might well have nursemaids around the clock even if she were unemployed, it can be argued that there should be no deduction at all since the expense is not related to the job.³¹ But that reasoning cannot support a dollar limitation on the deduction for all taxpayers.³² All that it would justify is a phase-out of the deduction as income rises, a technique that was in fact applied to married couples³³ and thus was one with which Congress was at the time quite familiar. Hence the imposition of the dollar limitation even on those for whom the costs could arguably be called business expenses—those who could not choose not to work—would appear inexplicable, save as an arbitrary revenue-saving device. It has been suggested, in fact, that the smallness of the deduction allowed—together with other restrictions that are wholly illogical if one assumes that Congress intended to grant a quasi-business deduction—supports the theory that in 1954 the legislature envisioned the deduction primarily as a relief measure.³⁴ Even so, to the extent that the 1954 Congress did, rightly or wrongly, regard the deduction as analogous to a business expense, the dollar limitation is irrational.

To the same extent, the 1954 provisions were irrational in treating the expense as an itemized deduction—one that must be sacrificed if the standard deduction is claimed. As a practical matter this treatment meant that the value of the deduction was substantially reduced, or more probably eliminated, for low-income people.³⁵ Although it can be argued that the deduction should not be viewed as a form of poverty

²⁹ This is not to suggest that such a bargain rate would never be possible, only that it would be quite uncommon, at least if the care of an infant were involved.

³⁰ See note 15 *supra*.

³¹ See Pechman, *Individual Income Tax Provisions of the 1954 Code*, 8 *Nat'l Tax J.* 114, 121 (1955), defending the \$600 limit by reference to this kind of situation.

³² In *Michael P. Nammack*, 56 T.C. 1379, 1385 (1971), *aff'd per curiam*, 459 F.2d 1045 (2d Cir. 1972), it was argued, unsuccessfully, that the dollar limitation was so arbitrary as to be unconstitutional.

It has also been argued by the Treasury that the limitation could be justified as a method of protecting the revenue. See Note, 5 *Valparaiso L. Rev.*, *supra* note 1, at 423. By the same token, however, it could be argued that all business expense deductions should be limited to, say, 90% of the actual outlay, in order to produce revenue. Even if one accepted such a generalized approach, however, it would be absurd to limit it to arbitrarily selected categories of business expenses.

³³ See text at note 38 *infra*.

³⁴ See Comment, 13 *B.C. Ind. & Com. L. Rev.*, *supra* note 1, at 277-78, 280-82.

³⁵ Persons with low incomes usually do not have sufficient deductions to make itemization worthwhile and generally claim the standard deduction, which provides them with a greater after-tax benefit.

relief,³⁶ it may still be true that of the expenses poor people incur, child care expenses are most clearly equivalent to, or at least closely analogous to, business expenses. Thus, once the decision is made to justify the deductions as business related, refusal to treat them like other business expenses, as adjustments to gross income³⁷ rather than as itemized personal deductions, seems tantamount to taxing a poor working person on more than his or her true net income.

The rules relating to married couples seem even more curious than those that have already been outlined. The overriding rule was that the maximum \$600 deduction was phased out, dollar for dollar, as income rose above \$4,500, so that for couples with a joint income above \$5,100 there would be no deduction at all.³⁸ The rationale for this limitation, though unstated in the legislative history, seems self-evident—a married woman's place was in the home, unless she was forced to work in order to keep the family above a very minimal economic level of existence.³⁹ If we assume again that the cost of child care is to be regarded as a business expense, then it is accurate to say that denial of the deduction will tend to promote a policy of inducing those married women who might want to work to stay home and take care of their children instead. Therefore the phase-out of the deduction was not neutral in its impact of the issue of whether a woman should or should not work. The implication of the statute was clear, that women with husbands should not be encouraged to go to work and hire others to take care of their children unless the family was poor.⁴⁰ In light of this implication it does not seem strange that in the middle and late 1960's, when women finally rebelled at being deprived of free choice as to the role they would occupy, the statute came under attack.⁴¹

The policies and reasoning underlying other aspects of the statute are equally perplexing. For example, if a woman's husband were incapable of supporting the family because of physical or mental disability, then presumably the woman could no longer afford to stay

³⁶ See Blumberg, *supra* note 1, at 78.

³⁷ See Int. Rev. Code of 1954, § 62.

³⁸ 1954 Code § 214(b)(2)(B).

³⁹ See Blumberg, *supra* note 1, at 71; Note, 5 Valparaiso L. Rev., *supra* note 1, at 429. The rationale suggested in the text does not explain the generosity extended toward widows with large independent incomes. See note 18 *supra*. One wonders what the *Moritz* court (see note 25 *supra*) would do about this quirk in the statute. Would it or could it deny the deduction to such widows? Or would it extend the deduction to everyone, regardless of income? Or would it strike down the entire provision?

⁴⁰ In *Michael P. Nammack*, 56 T.C. 1379 (1971), *aff'd per curiam*, 459 F.2d 1045 (2d Cir. 1972), a constitutional attack on this treatment of non-poor married women was rejected.

⁴¹ *Id.*

at home,⁴² and the rationale for denying the deduction would not ordinarily apply.⁴³ In such cases, therefore, the statute in effect treated the husband as a nonperson and allowed the deduction without regard to the family income. On the other hand, if it were the woman who was physically disabled to the point where she was incapable of performing her role as caretaker of the children, the family's child care deduction was nevertheless subjected to the income phase-out. It seems illogical to treat the husband in this situation any differently from the wife, a widower or a divorced man. The fact is, again inexplicably, that he was treated differently.

These, then, were the basic guidelines for a provision with some rather inexplicable twists and turns: single women, formerly married men, and couples with low incomes could claim a deduction up to \$600 per year for the care of certain dependents; others could deduct nothing.

The 1963 and 1964 Amendments.

In 1963 the House Ways and Means Committee offered a set of modest changes designed to broaden somewhat the scope of the dependent care deduction while retaining its basic structure and approach.⁴⁴ For some reason, only one change passed the Senate Finance Committee⁴⁵ and became law.⁴⁶ This change extended the deduction to women whose husbands had deserted them; previously, only formally divorced women qualified. Deserted husbands were ignored.

In 1964 the Ways and Means Committee renewed its recommendations of 1963⁴⁷ and, with some modification, these were accepted by the Senate Committee⁴⁸ and enacted.⁴⁹ The income level at which

⁴² The statute, another example of inept draftsmanship, did not take into account the possibility that the husband, though incapable of working, might continue to enjoy a substantial income.

⁴³ It seems to have been assumed that a man incapable of supporting his family was also incapable of caring for the children. Perhaps the assumption was that even if a man incapable of working could nonetheless care for his children, he could not be expected as a matter of course to make himself available for that role.

It is also possible here that the expense in this situation is not business related at all, that is, the husband would have worked whether or not the wife was disabled but the wife would not work unless the husband were disabled. Thus, in the wife's case, the child care expense is more directly related to her returning to work.

⁴⁴ See House Comm. on Ways and Means, Revenue Act of 1963, H.R. Rep. No. 749, 88th Cong., 1st Sess. 57-58 (1963).

⁴⁵ Senate Comm. on Finance, Income Tax Deduction for Child-Care Expenses in Case of Woman Deserted by Husband, S. Rep. No. 69, 88th Cong., 1st Sess. (1963).

⁴⁶ Pub. L. No. 88-4, 77 Stat. 4 (1963).

⁴⁷ H.R. Rep. No. 749, 88th Cong., 1st Sess. (1963).

⁴⁸ Senate Comm. on Finance, Revenue Act of 1964, S. Rep. No. 830, 88th Cong., 2d Sess. 68-70 (1964). The most significant modification was an increase in the income level at which the deduction phase-out began. See also Conf. Rep. No. 1149, 88th Cong., 2d Sess. 29 (1964).

⁴⁹ Pub. L. No. 88-272, tit. II, § 212(a), 78 Stat. 49 (1964).

the phase-out of the deduction began was raised from \$4,500 to \$6,000,⁵⁰ in order "to carry out the original intention of Congress with respect to this provision," and the intention to cover "the average case where the wife has found it *necessary* to supplement the husband's income by working."⁵¹ The maximum age of a child for whose care a deduction could be claimed, without regard to disability, was raised from eleven to twelve.⁵² The deduction was made available to a married man whose wife was incapacitated or institutionalized.⁵³

One modification achieved by the 1964 amendments merits some comment. The maximum deduction was raised, for families with two or more dependents, from \$600 (which continued to be the maximum for one dependent) to \$900.⁵⁴ This change certainly made some sense, on the very reasonable assumption that it will often cost more to care for two dependents than one and that the law should take account of this reality. As the Report of the Ways and Means Committee stated, the flat \$600 limitation "fails to take into account the fact that costs of caring for dependents, particularly where they must be cared for outside the home, increases as the number of dependents increases."⁵⁵ But that statement raises the question, why stop with two? If two cost more than one, and if the intended policy behind the statute was to account for this increased cost by increasing the maximum deduction, why not provide further increases in the deduction as the number of dependents is further increased?⁵⁶ I raise this question partly to justify offering the following speculation about congressional concepts of the family and of childbearing habits and attitudes: the unexpressed and perhaps subconscious rationale behind limiting the increase in the deduction to two children could have been

⁵⁰ Int. Rev. Code of 1954, § 214, as amended, Act of Feb. 20, 1964, Pub. L. No. 88-272, tit. II, § 212(a), 78 Stat. 49 (codified at Int. Rev. Code of 1954, § 214(b)(2)(B) (1964) [hereinafter references to this provision as it stood in 1964 will be cited as 1964 Code]. This change was initiated in the Senate. See text at note 48 *supra*.

⁵¹ S. Rep. No. 830, *supra* note 48, at 68 (emphasis added).

⁵² 1964 Code § 214(d)(1)(A).

⁵³ 1964 Code § 214(a). In such cases the deduction was subject to the income-related phase-out if the wife was merely incapacitated, but not if she was "institutionalized . . . for a period of at least 90 consecutive days . . . or a shorter period if terminated by her death." 1964 Code § 214(b)(2)(B). See also 1964 Code §§ 214(c), (d)(4). Presumably the idea behind this rule was that people with incomes above \$6,000 per year might hire baby sitters for personal reasons and might try to feign incapacity and that it would be difficult to deal with the factual issue presented in such cases. The idea seems a bit paranoid (as tax rules often are) but certainly is not wholly irrational, although it leaves room for quibbling over the level of income selected as the arbitrary cutoff point.

⁵⁴ 1964 Code § 214(b)(1)(B).

⁵⁵ H.R. Rep. No. 749, *supra* note 44, at 57.

⁵⁶ The Senate Finance Committee in fact suggested a further increase to \$1,000 for three or more dependents. S. Rep. No. 830, *supra* note 48, at 69.

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that it was perfectly "normal"—indeed, almost nonvolitional—to have two children, but beyond that point having children was a purely "personal," volitional decision for which one ought to be prepared to bear the full costs, including the costs of baby sitters in the event that a later decision to work made it necessary to incur such costs.⁵⁷ In other words, the law may reflect the idea that a married person has little choice but to have at least one or two children, and that consequently the cost of child care, in the event that both parents work, cannot be regarded as a product of a personal decision to have children. In such cases, then, the child care cost can properly be regarded as a product of the decision to work and should be deductible as analogous to a business expense. The statute may then be thought to reflect the further idea that when people decide to have more than two children they are making a personal decision to have children and that therefore the child care expense is a product of the decision to have children and should not be deductible. In this situation, the married person is off on a lark of his or her own and must be prepared to pay the full costs of his or her deviant behavior.

The 1971 Act

In 1971 Congress set out to expand substantially the scope of the dependent care deduction. Although the draftsmen retained some remnants of its predecessor, they changed the basic format and approach of the provision and added a deduction for the expenses of caring for the household as well as for people⁵⁸—that is, under certain

⁵⁷ See generally Klein, *supra* note 6, developing an analogous notion of variable and nonvariable necessary conditions to incurring commuting expenses.

⁵⁸ Act of Dec. 10, 1971, Pub. L. No. 92-178, 85 Stat. 497, amending Act of Aug. 16, 1954, ch. 736, § 214, 68A Stat. 70 (codified at Int. Rev. Code of 1954, § 214(a) (1972)). [Hereinafter references to this provision as it stood following the 1971 amendments will be cited as Int. Rev. Code of 1954.]

At the same time that Congress passed the 1971 amendments, it had under consideration a welfare reform bill that contained provisions relying heavily on providing poor people with subsidized child care. See House Comm. on Ways and Means, Social Security Amendments of 1971, H.R. Rep. No. 92-231, 92d Cong., 1st Sess. 166-68 (1971). See also Senate Finance Comm., 92d Cong., 2d Sess., Summary of the Principal Provisions of H.R. 1 as Determined by the Committee on Finance 91-92 (Comm. Print, June 13, 1972). The Ways and Means Committee Report on that bill also suggested that amendments to § 214 of the Internal Revenue Code of 1954 would help poor people. H.R. Rep. No. 92-231, *supra* at 6. That suggestion seems unjustified in light of the fact that poor people pay little if any income tax and are taxed at low marginal rates so that a deduction is not nearly so significant to them as it is to the non-poor. Moreover, both before and after 1971, the deduction under § 214 was an itemized deduction and thus was of little or no use to most poor people.

Already there have been efforts to expand § 214 beyond its present scope. See "Senate Widens Tax Deductions in Child Care," *Los Angeles Times*, Oct. 6, 1972, at 11, col. 8; "Bigger Tax Break for Working Parents Killed," *Los Angeles Times*, Oct. 16, 1972, at 21, col. 1.

conditions at least part of the wages of cleaning people and cooks can now be deducted by those eligible to take the deduction for dependent care.

The old approach of dealing separately with widows, widowers and divorced people on the one hand, and married couples on the other, was for the most part abandoned.⁵⁹ Instead, the basic requirement for eligibility for the deduction is simply that the taxpayer have a "qualifying individual"—that is, a dependent who by statutory definition needs care—in his or her household.⁶⁰ Insofar as it relates to the dependent care expenses of married couples this requirement seems sensible and innocuous⁶¹—without a dependent there will be no expenses for care. However, it does seem to produce some troublesome results in case of divorce.⁶² To be a "qualifying individual" a child must be a dependent of the taxpayer claiming the deduction. If the noncustodial parent makes child support payments, the child may turn out not to be the custodial parent's dependent.⁶³ Thus it may turn out that neither parent will be able to claim a deduction for child care and household expenses, even if both are working and even if their joint income is below that phase-out level. The deduction can thus be lost by virtue of a divorce whenever the non-custodial parent pays child support rather than alimony. Unfortunately the payment of child support rather than alimony seems most likely to occur in those situations in which the custodial parent is producing an income, so that the natural financial arrangement will tend to produce seemingly unfair tax results. Taxpayers will have a strong incentive to characterize payments as alimony for tax purposes⁶⁴ even

⁵⁹ Married persons do receive special, adverse treatment in that they are not allowed to claim the deduction unless they file a joint return; moreover, the income level at which the deduction is phased out is the same for a married couple as it is for a single person. See discussion in text at notes 75-78 *infra*.

⁶⁰ A qualifying individual is:

(A) a dependent of the taxpayer who is under the age of 15 and with respect to whom the taxpayer is entitled to a deduction under section 15(e), (B) a dependent of the taxpayer who is physically or mentally incapable of caring for himself, or (C) the spouse of the taxpayer, if he is physically or mentally incapable of caring for himself.

Int. Rev. Code of 1954, § 214(b)(1).

⁶¹ As it affects the newly available deduction for household expenses, this requirement is far more difficult to justify. See discussion in text following note 68 *infra*.

⁶² See Hjorth, *A Tax Subsidy for Child Care*: Sec. 210 of the Internal Revenue Act of 1971, 50 *Taxes* 133, 141 (1972).

⁶³ Under Int. Rev. Code of 1954, § 152(a), a dependent is defined as a person "over half of whose support" is supplied by the taxpayer.

⁶⁴ Under present law taxpayers have considerable freedom to characterize payments as alimony even though they are in substance child support. See *Commissioner v. Lester*, 366 U.S. 299 (1961). A characterization as alimony will permit the "qualifying" individual to be regarded as the custodial parent's dependent and thus enable this parent to claim the child care and household expense deduction.

though, for other tax and nontax reasons, they might have preferred not to do so. In addition, taxpayers with existing arrangements geared to the pre-1971 tax picture may find that they have in effect sacrificed a valuable deduction that would now be available.

Another change, of far greater significance, permits the deduction not only of the expense of caring for dependents but also of "expenses for household services."⁶⁵ The statute does require, as did earlier versions, that the expenses must be "incurred to enable the taxpayer to be gainfully employed."⁶⁶ Taken literally, however, this requirement would presumably eliminate the possibility of anyone ever claiming the much-heralded deduction of household expenses because, unlike child care, household services do not have to be performed at any particular time. Since a working taxpayer can always clean the house on weekends and cook meals after work or eat out, it is almost never true that others must of necessity be hired to perform those services in order to enable the taxpayer to work. Congress surely did not intend that the Service and the courts inquire into the taxpayer's mental process and try to determine whether an individual taxpayer thought that buying household services was a means of increasing leisure time, given the decision to work, or whether the purchase of household services was somehow thought of as a condition precedent to taking a job.⁶⁷ Since Congress must have intended to allow some deductions for the expense of household services, we must read the "in order to enable" language out of the statute as it applies to those expenses and we must then infer that the deduction can be claimed without regard to motive whenever a taxpayer (or, in the case of married couples, each taxpayer) is in fact working.⁶⁸

The allowance of the deduction for the cost of household care is, like the deduction for dependent care, conditioned on the presence in the household of a "qualifying dependent." A strange, and it is hoped unintended, effect of this requirement can be illustrated by the example of a couple losing a deduction of as much as \$4,800, for the cost of hiring someone to clean their house and cook their dinners, on the occasion of, and because of, their only child's fifteenth birthday. Of course, the basic idea of allowing a deduction for household expenses is at best questionable⁶⁹ but surely there is no adequate reason

⁶⁵ Int. Rev. Code of 1954, § 214(b)(2)(A).

⁶⁶ Int. Rev. Code of 1954, § 214(b)(2).

⁶⁷ Cf. Hjorth, *supra* note 62.

⁶⁸ See discussion of a similar problem under the pre-1971 law in note 20 *supra*. The "enable" requirement might also cause some trouble where the taxpayer maintains a parent in a nursing home.

⁶⁹ See discussion in text following notes 97 and 119 *infra*.

for allowing this kind of deduction only to workers whose households contain a qualifying individual rather than to all workers.

The 1971 Act also raised dramatically the amount that can be deducted, from a maximum of \$900 per year to a maximum of \$400 per month.⁷⁰ There is an exception, however, under which the maximum deduction is reduced where dependents are cared for outside the home.⁷¹ Since ordinarily one would expect that the cost of care outside the home would be greater than care inside the home, this limitation seems somewhat anomalous. Possibly the reason for the reduced maximum for care outside the home is that such care would not include household services, and separation of the cost of household and dependent care services within the home was not considered feasible.⁷²

Another dramatic change in the 1971 Act was the increase in the income level at which the deduction is phased out from \$6,000 to \$18,000.⁷³ Above \$18,000 the deduction is phased out at the rate of one dollar of deduction for every two dollars of additional income,⁷⁴

⁷⁰ Int. Rev. Code of 1954, § 214(c)(1). Putting the expenditure limitation on a monthly rather than a yearly basis seems sensible enough in terms of fairness, but it is quite a remarkable departure from the far more convenient yearly accounting period that predominates in the Code. In another provision, combining yearly and monthly concepts, the phase-out of the deduction is based on *monthly* income if and only if *yearly* income rises above \$18,000. Int. Rev. Code of 1954, § 213(d). No one familiar with the timing problems under annual accounting methods could take lightly the potential problems of a monthly accounting period. Apart from theoretical and doctrinal issues, there is the practical problem that many employers may not pay or report income to their employees on a calendar month basis. Can there be a "fiscal" month? And what if an employee arranges to lump into one or two months all income above the monthly phase-out level of \$1,500? Such questions are merely suggestive of the problems of monthly accounting.

⁷¹ The maximum is \$200 per month for one dependent, \$300 for two dependents, and \$400 for three or more dependents, for such care. Int. Rev. Code of 1954, § 214(c)(2)(B). Note that this limitation applies not just to the cost of sending children to day-care centers but to the cost of maintaining a parent in a nursing home.

⁷² Another possible explanation might have been a fear that care outside the home would include educational, rather than purely custodial, services (though even within the home a person receiving \$400 per month for taking care of one child would be likely to provide some sort of educational services). Senate Comm. on Finance, Revenue Act of 1971, S. Rep. No. 92-437, 92d Cong., 1st Sess. 61 (1971), specifically states that "expenses outside of the home cannot . . . include educational expenses incurred for a child in the first or higher grade level since these expenses are not necessary for the taxpayer to be gainfully employed." Is it proper to draw the negative inference that the cost of education (as opposed to mere custody) in the kindergarten and pre-kindergarten years is properly deductible?

⁷³ Int. Rev. Code of 1954, § 214(d). The original bill was amended in conference so as to make the phase-out applicable to all taxpayers, whereas the earlier phase-out had been applicable only to certain married persons. 1964 Code § 214(b)(2). Thus some people who were allowed a deduction under the old law will lose it under the new law.

⁷⁴ The provision works rather oddly in that the deduction is phased out *entirely* at an annual income level of \$22,800 (evenly spread over the twelve months) for a person with expenses of \$200 per month, but is phased out *entirely* only at an annual

rather than the former dollar for dollar phase-out mechanism. Thus the deduction can provide benefits for individuals or couples with incomes as high as \$27,600, making it a benefit for the middle class.

While the phase-out applies equally to single people and to married couples, married couples are placed at some disadvantage since they cannot claim the deduction unless both are working⁷⁶ and they file a joint return.⁷⁰ To illustrate the adverse effects of this set of rules, imagine a working woman with a young child and with a taxable income of \$18,000 before applying the section 214 deduction. To make it an admittedly extreme, but not impossible, example, suppose she pays \$400 per month for child care. The tax saving resulting from the deduction of the \$4,800 per year outlay will be about \$1,400.⁷⁷ Now suppose that she marries a man in identical circumstances. Neither will be able to claim any deduction after their marriage because their combined income is such that the phase-out would have eliminated the deduction and, by virtue of the operation of section 214, their taxes will increase by about \$2,800 simply because of their marriage!⁷⁸ This totally unjustifiable result could have been avoided by allowing married couples to file separate returns and still claim the deduction (*i.e.*, by allowing a married couple making \$36,000 to file separately and claim the benefits of the deduction) and by then gearing the deduction to single-earner situations.⁷⁹ It would not have been necessary to abandon the requirement that both spouses work.

Several other aspects of the 1971 Act deserve brief mention. For example, Congress raised from twelve to fourteen the maximum age of

income of \$27,600 for a person with expenses of \$400 per month. See Hjorth, *supra* note 62, at 135.

⁷⁶ Int. Rev. Code of 1954, § 214(e)(2). There is an exception to this requirement where one spouse is "physically or mentally incapable of caring for himself." Int. Rev. Code of 1954, §§ 214(b)(1)(C), (e)(2).

⁷⁰ Int. Rev. Code of 1954, § 214(e)(1).

⁷⁷ Using the head of household rates under Int. Rev. Code of 1954, § 1(b).

⁷⁸ To make matters worse, they would suffer an additional loss by virtue of the fact that the rate structures produce a tax of \$10,340 for a married couple with a combined income of \$36,000, regardless of whether they file jointly or separately (Int. Rev. Code of 1954, §§ 1(a), (d)), while the tax on two heads of household with incomes of \$18,000 each would be \$4,160 each or a total of \$8,320. Int. Rev. Code of 1954, § 1(b).

It is true, of course, that in most cases of the sort I refer to in the text there will be a reduction in the combined cost of child care after marriage, so the effects will not be as disastrous as my partial analysis would suggest. But the full effect would be felt where, for example, both parents had been maintaining disabled children in institutions, or sending young children to day-care centers, and therefore could achieve no economy by virtue of their marriage, though admittedly the cost of institutional care might be deductible as a medical expense under Int. Rev. Code of 1954, § 213.

⁷⁹ Possibly the reason for failing to adopt such an approach is that it might have required that allocations of income under state law in community property states be ignored for tax purposes (or at least for this tax purpose). Otherwise an unwarranted advantage might arise by virtue of living in a community property state, since earned income would be split between husband and wife even if one of them earned all of it.

a dependent for whom the expense of care is deductible without regard to disability. Also of interest is the retention of the rule, referred to earlier,⁸⁰ that makes the deduction available to a married couple only if both spouses are working. This rule is not limited to situations in which one might reasonably expect the nonworking spouse to care for the qualifying dependent—as, for example, where the nonworking spouse is the dependent's parent. It applies equally where there is no such natural obligation, as, for example, where a widower with a disabled parent living with him marries a woman who has been living on a modest pension. The denial of a deduction for payments for dependent care or household services made to certain relatives, including grandparents, nieces and nephews, aunts and uncles, and in-laws was also carried over from earlier law. This retained element of seemingly excessive stringency seems oddly inconsistent with overall generosity reflected in the new law.⁸¹

II. IMPACT OF THE PRESENT LAW

Economic Effects

I turn now to the major purpose of this article—an effort to appraise the present law and to comment on some of its objectives, beginning with some thoughts about its economic effects.

Analysis of the economic effects of the deduction of expenses for dependent care—as opposed to expenses for household service—can become a surprisingly complex undertaking. As suggested earlier,⁸² child care expenses are not strictly comparable to business expenses such as wages, costs of goods sold, and so forth, because the former are incurred only by a certain class of earners—those with children—and that class is defined by a nonbusiness phenomenon. Such a characterization, however, does not require disallowance of the deduction for dependent care expenses in the interests of economic neutrality.⁸³

⁸⁰ See note 59 and text at note 76 *supra*.

⁸¹ Although such stringency may be necessary in view of the possibility of abuse of the deduction, it seems much stricter than is necessary. For example, the deduction is unavailable even where the relative is not a member of the taxpayer's household. It seems fair to assume that the relative will in fact be paid, and that he may be the cheapest source of child care. Thus the risk of nonpayment or overpayment of relatives does not seem to be sufficient grounds for denying the deduction in this situation.

⁸² See text following notes 7 and 10 *supra*.

⁸³ "The theoretical underpinning for economic neutrality as a criterion of tax policy is the idea that ordinarily any distortion of the allocation of resources that would be generated by uncontrolled market decisions represents a deviation from the economic optimum." Klein, *Income Taxation and Commuting Expenses: Tax Policy and the Need For Nonsimplistic Analysis of "Simple" Problems*, 54 Cornell L. Rev. 871, 879 (1969). A tax rule is neutral unless "decisions affecting the use or allocation of resources are different when the tax rule is in effect than they would be in the absence of tax considerations." *Id.*

In other words, the admitted distinction between dependent-care and other business-related expenses does not necessarily require that any deduction for the latter be characterized as a "subsidy" to child-bearing⁸⁴ any more than a deduction of wages by a manufacturer is a "subsidy" to manufacturing.⁸⁵ To reach general conclusions regarding the proper characterization or treatment of the dependent care deduction, in relation to the goal of economic neutrality, would require an economic analysis far more detailed and sophisticated than seems justified for the purposes of this article.⁸⁶ I offer the suggestion, however, that anyone who attempts such an analysis will quickly discover that the issues cannot be resolved easily or in simple terms, but that if one makes certain assumptions⁸⁷ it is plainly the case that the dependent care deduction is not a "subsidy."⁸⁸ Even if it were feasible to engage here in a complete inquiry into what would be an economically neutral tax rule for the dependent care expenses there is reason to

⁸⁴ The "subsidy" label plainly implies that the deduction offends the criterion of economic neutrality. That label was attached to the deduction unequivocally by Hjorth, *supra* note 62. One of Hjorth's arguments was that dependent care expenses are no more entitled to be treated as costs of producing income than are commuting expenses. *Id.* at 139. It was Hjorth's implicit assumption in this line of argument that in no circumstances could it be argued that commuting expenses are equivalent to business expenses. I have argued essentially to the contrary, though I tried to avoid basing my conclusions on considerations such as the appropriateness of a particular label or on causative analysis. Klein, *supra* note 83.

⁸⁵ No one would bother to observe that a deduction for wages means more to a high-bracket manufacturer than to a low-bracket manufacturer, but the same kind of observation about the dependent care deduction has been made (indeed, belabored) by some sophisticated tax experts. 1 S. Surrey, W. Warren, P. McDaniel & H. Ault, *Federal Income Taxation* 641-44 (1972). Their observation (from which I infer that they view the deduction as a subsidy) was preceded by the more cautious, and correct (though totally unenlightening), statement: "To the extent that Section 214 . . . permits deductions for child care . . . expenditures in excess of those that would be properly allowable as costs incurred for the production of income, the deduction constitutes a tax expenditure." *Id.* at 641. The phrase "tax expenditure" seems to be functionally equivalent in this context to the word "subsidy."

⁸⁶ The kind of analysis I refer to would require examination of the kinds of decisions that would be made—in all types of individual circumstances, with and without a tax system and with and without a deduction—as to whether or not to work, and for how many hours, and whether or not to have children. The variety of types of individual circumstances (including, for example, different states of mind about work and child bearing, and different family circumstances) is large, and the analysis is complicated by the fact that our interest is in a deduction, but the deduction can be examined only in the context of a tax system and that tax system itself has significant effects on the work decision and, possibly, on the childbearing decision.

⁸⁷ One such assumption would be that the decision whether or not to work arises after a decision to have children has already been made and carried out (as where a widow with young children seriously contemplates working only after the death of her husband); another, that the child care services provide no personal gratification. See discussion in text at note 91 *infra*. These situations are comparable to a situation in which one is offered a job which, if taken, will result in unavoidable commuting expenses. See Klein, *supra* note 83, at 895-96.

⁸⁸ *Id.* at 879-83.

doubt the value of such an effort, since other provisions of the tax law⁸⁹ as well as other social and economic pressures⁹⁰ are blatantly non-neutral as they relate to the work and childbearing decisions.

One can, nonetheless, make certain limited but valuable observations about the effect of the deduction on decisions to work and decisions to have children. We can begin by asking what effects a deduction for dependent care expenses will have on a person's decision to work, given the fact that the family has a dependent requiring care during working hours. Once we take such a dependent as given, and once we assume that the dependent care services provide the taxpayer with no significant personal benefit,⁹¹ the financial reward from working, the amount that provides the incentive to work, is the net figure arrived at by subtracting the dependent care expenses from earnings (net of other expenses). If the deduction were disallowed, a person would be taxed on more than his or her net income, and for such persons the financial reward of working would be reduced to a net figure below that of other persons with similar net incomes but with no dependents needing care. This observation by itself implies an economic distortion. Moreover, if the deduction is allowed the financial reward for working will be increased for those people who hire others to perform dependent care services, but, disregarding the possibility of a personal return from the purchase of such services,⁹² the effect of allowing the deduction will certainly not be to increase the financial reward

⁸⁹ For example, the provisions that make it advantageous for married couples to file joint returns (Int. Rev. Code of 1954, § 1) have the effect of imposing on the secondary worker (in our society, usually the childbearing wife) a marginal tax rate determined with reference not to his or her own income but rather with reference to that income plus the income of the primary worker. See Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 *Buffalo L. Rev.* 49, 52-54 (1971).

⁹⁰ For example, job discrimination against women and family, community, or religious pressure to have children.

⁹¹ For purposes of the present analysis I will assume away the possibility of personal benefit. To the extent that the dependent care services provide personal gratification, the offset for the cost of those services should be reduced by the value of that personal benefit. At one extreme is the case in which a person would have paid for such services even if he or she had not been working, in which case no deduction can be justified. In less extreme situations, the services may still provide some personal return that should reduce the amount allowed as a deduction. Cf. Klein, *The Deductibility of Transportation Expenses of a Combination Business and Pleasure Trip—A Conceptual Analysis*, 18 *Stan. L. Rev.* 1099, 1102-03 (1966). The phase-out of the deduction can be justified on the ground that the personal benefit to the taxpayer is likely to rise as income rises. However, even with the high phase-out in the present law, the assumption of no personal benefit worth worrying about does not seem highly unrealistic, particularly since many people enjoy caring for children. Still, that assumption is weakened if we also assume that a significant amount of household work will be provided by the provider of dependent care: such provision must be classified as personally gratifying.

⁹² See note 91 *supra*.

of working above what it would be in the absence of any tax system.⁹³ On certain assumptions, then, the tax rule permitting the deduction is economically neutral.

In the preceding paragraph I deliberately avoided any prediction as to the effect on work effort of an increase in the financial rewards of working stemming from the allowance of the dependent care deduction. The increased reward obviously makes work more attractive and should tend to increase the amount of work undertaken, especially by secondary workers, who generally are women. At the same time, however, the increase in the net income that will be earned from working a given number of hours may make additional hours of work less attractive than increased leisure.⁹⁴ This effect would tend to decrease the amount of work undertaken, at least in situations in which the number of hours of work can fairly readily be varied. Accordingly, it is not possible, *a priori*, to predict the net effect of the deduction on the amount of work undertaken.⁹⁵ It does seem safe to predict that some unemployed people will be induced by the newly increased level of after-tax economic reward to join the work force,⁹⁶ but this effect may be offset by a reduction of working hours by other people.

Let us turn now to the effect of the dependent-care deduction on the decision to have children. I will avoid a discussion of the extent to which people's childbearing decisions are affected by economic considerations, but assert that as a matter of common observation, the cost of having children does, for some significant number of people, have a significant effect on the decision to have children. Thus, it follows that a rule that makes children less costly will tend to increase the birth rate. The dependent care deduction is such a rule. Compared with a tax system that provides no such deduction, the dependent care deduction plainly reduces the cost of having children for people who work after having the children. Whether the deduction "encourages" childbearing, or nondeduction would "discourage" childbearing, in comparison with some neutral state of affairs, is not at issue here. The point is that we can expect people to have more children if there is a deduction than if there is not.⁹⁷

⁹³ Note also that if the deduction increases the supply of labor above what the supply would be without the deduction, it will tend by the same token to drive down the before-tax-effect wage rate.

⁹⁴ In other words, if one finds that he can earn a given amount by working fewer hours, he may decide to keep his income constant and increase his leisure, or to take a combination of higher income and greater leisure.

⁹⁵ See R. Musgrave, *The Theory of Public Finance* 233-38 (1959).

⁹⁶ This effect might be offset by a reduction in the number of hours of work by people previously in the work force.

⁹⁷ It is not inconceivable, I suppose, that if in the long run the deduction induced

Turning now from the expenses of dependent care to the expenses of household services, a few succinct observations about economic effects can be made. In the first place, since the deduction for household expenses is conditioned on having a qualifying dependent in the household, the law will provide some financial incentive to child-bearing and acquiring dependents by other means. In addition, it is obvious that the after-tax-effect cost of household services will be reduced,⁹⁸ and presumably more will be purchased. Thus the cost of buying increased amounts of leisure, by hiring others to perform household chores, will decrease and more leisure will be purchased.

Creating Jobs?

One of the announced goals of the 1971 revision of section 214 was to create new jobs "in child care and domestic service."⁹⁹ The idea behind this policy seems to have been that the deduction would allow working middle-class housewives to provide others with jobs by hiring baby sitters and maids or by patronizing day-care centers.¹⁰⁰ That expectation, at least in this simple form, seems quite unrealistic.

As I have pointed out above,¹⁰¹ one cannot predict a priori that the newly expanded deduction will in fact increase the total number of hours of work expended outside the home by middle-class housewives. The deduction may give such women a higher hourly rate of return for their services,¹⁰² but the effect may well be to induce them to work fewer hours rather than more, since they can do so without reducing their total earnings. Moreover, the congressional expectation is based on a rather bizarre picture of the nature of the labor market. The assumption seems to be that there is a large pool of potential baby sitters and maids eager for jobs at the existing wage rate, yet that somehow these eager job seekers do not increase the number of job opportunities by competitively driving down the wage rate and making their services available to more people.¹⁰³ The far more rea-

women to get out of the home, their attitudes might change and the effect of that change might be a decline in the birth rate. After that effect occurred, however, the effect predicted in the text would continue to operate.

⁹⁸ Presumably the before-tax-effect cost of such services will rise in response to the tax-induced increase in demand.

⁹⁹ Senate Comm. on Finance, Revenue Act of 1971, S. Rep. No. 92-437, 92d Cong., 1st Sess. 13 (1971). The report further stated that the new law "can be expected to give large numbers of individuals who are now receiving public assistance the opportunity to perform socially desirable jobs which are vitally needed." *Id.* at 14.

¹⁰⁰ *Id.* at 60.

¹⁰¹ See text at note 95 *supra*.

¹⁰² One must be cautious about this proposition, since an increase in the labor supply will tend to drive down the wage rate.

¹⁰³ This assumption is made about the one labor market in which it is least plausible—a market that is one of the last bastions of unrestrained market forces.

sonable assumption, of course, is that little if any involuntary unemployment exists among potential baby sitters and maids, but that the wage rate for such services is such that the potential suppliers of those services have rationally decided to take other jobs or not to work at all.¹⁰⁴ Assuming that the deduction will in fact result in increased decisions to go to work on the part of the middle-class housewives, the effect simply will be to increase the total demand for child care and household services. Ordinarily one would expect the effect to be some combination of greater use of such services—more jobs held—and an increase in the wage rate, but not an increase in the number of jobs held without a rise in the wage level. To adapt the common parlance, good (that is, inexpensive) domestics would be even harder to find (that is, more costly to hire).

Curiously, if one accepts the congressional economic assumptions, the probable effect on the job market seems even less propitious than if one rejects them. The assumptions are that job opportunities in household work are in short supply and that the job market defies the commonly observed normal forces of supply and demand. But if it is true that the woman who goes to work creates a new job in her home, it should be equally true that she takes up an existing job, displacing some other worker.¹⁰⁵ Hence the net effect of the deduction may be to shift unemployment from one sector of the labor market to another.¹⁰⁶

Fairness

One's views on whether fairness requires that the income tax system include a provision for deduction of the expenses of caring for dependents can be significantly affected by the kind of comparison one makes in examining the issue. In most economic analyses it seems to be assumed that all adults are married and have children and that the only relevant variable is whether or not the wife works. The children are taken as given, but the wife's job is not.¹⁰⁷ The comparison is then drawn between two families with dependent children and with equal

¹⁰⁴ It must be remembered that the women who might serve as baby sitters and maids are likely to incur very large costs by accepting employment: transportation expenses, costs of caring for their own children, and, often, the loss of welfare benefits.

¹⁰⁵ See Hjorth, *supra* note 62, at 143.

¹⁰⁶ There is, of course, the possibility that economic forces in one labor market are entirely different from those in the other. But I cannot take that possibility very seriously. That is, I cannot take seriously the idea that the level of employment of middle class housewives is significantly affected by the wage rate but that the level of employment of potential baby sitters and maids is not.

¹⁰⁷ See, e.g., W. Vickrey, *Agenda for Progressive Taxation* 32-33 (1947); M. White, *Proper Income Tax Treatment of Deductions for Personal Expense*, 1 *Tax Revision Compendium*, House Comm. on Ways and Means, 86th Cong., 1st Sess. 365, 371-72 (1959).

total earnings; in one of the families the wife does not work while in the other she does. Unfairness results from the fact that the nonworking wife performs child care services for the family unit. That family is therefore said to have imputed income from those services—income that should be taxed in the interests of fairness but cannot be taxed because of other considerations.¹⁰⁸ On the other hand, the family with the working wife must pay for child care services with after-tax dollars. To reduce the unfairness resulting from the nontaxation of imputed income to the first family, the deduction for child care expenses is offered to the second family.¹⁰⁹

A similar conclusion can be reached more directly simply by observing that the family with a working wife must of necessity incur an expense that the other family does not incur and that the purchase of the service, by hypothesis,¹¹⁰ does not provide the family purchasing the service with any personal benefit.¹¹¹ However, stating the comparison in this manner should give us pause. In one sense it is true that the expense is one that "must of necessity" be incurred, but in another sense it is not. The correctness of the conclusion may be thought to depend on one's time perspective. The expense is necessary at a given point in time only because the couple had previously made a decision to have children.¹¹²

To pursue this last point from a different perspective, consider a comparison between two families, one consisting of husband and wife, without children, and the other of husband, wife and child. Assume also that in both families the wife is working. Obviously the childless couple avoids an expense that the couple with a child must incur. But what is the significance of that observation? One approach¹¹³ is to conclude that the couple with the child has an added expense stemming

¹⁰⁸ See J. Sneed, *The Configurations of Gross Income 93-94* (1967).

¹⁰⁹ See M. White, *supra* note 107, at 372; Pechman, *Individual Income Tax Provisions of the 1954 Code*, 8 *Nat'l Tax J.* 114, 120 (1955).

¹¹⁰ See note 91 *supra*. There appears to be no disagreement over the proposition that the expense should not be deductible to the extent that the service relieves the family of an expense that it would have incurred regardless of the job, or to the extent that it provides the family with a personal benefit. Obviously it will be difficult to draw the distinctions suggested by this statement and arbitrary rules will be required. The phase-out of the deduction as income rises above \$18,000 is such a rule and seems to me to be a sensible one, though perhaps a bit generous.

¹¹¹ See Klein, *supra* note 83, at 889, arguing for the deductibility of outlays that are nonvolitional and that do not improve the taxpayer's position.

¹¹² I think it is reasonably clear that having children is not always an involuntary decision and that some people may, for economic reasons, decide not to have children. See text at notes 96-97 *supra*.

¹¹³ A different approach might be called for if it is assumed that economic considerations have little or nothing to do with the child-bearing decision, either by couples with children or by childless couples.

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in part from their decision to have children.¹¹⁴ Another approach is to take the perspective of the childless couple and conclude that one consequence of their decision to remain childless is that they save money on child care. It seems perfectly reasonable and just that their saving should be available to them for other pleasures. From this perspective, fairness does not seem to require a deduction for child care expenses.¹¹⁵

With this perspective in mind we can profitably return to the original comparison of the two couples, both with children, only one of which has a working wife. Assume that the couple with the working wife made a deliberate, conscious decision to have a child, knowing that one of the costs of that decision would be the expense of hiring baby sitters while both the husband and wife were working. In this situation it would appear that the child care expense is more properly regarded as a cost of having children—a cost of personal consumption—and not a cost of working. On this assumption, then, it would be difficult to argue that fairness requires a deduction of the child care expense for such a couple, except for the troublesome fact that their counterpart family with the wife not working has the benefit of the wife's untaxed services in kind.¹¹⁶ However, this result is part of a much broader problem, which is that many taxpayers or taxpaying couples with identical earnings have different amounts of free time available either for leisure or for the performance of services for themselves; this is a general problem of tax policy, not limited to the area of child care. It creates a dilemma for which there is no entirely satisfactory solution.¹¹⁷

The preceding analysis should suggest that the question of fairness is subject to the same complexities and uncertainties as is the question of economic effects. Consequently I will venture only this tentative generality: if we assume that childbearing will increasingly be seen as a conscious, volitional phenomenon, and if we assume that people

¹¹⁴ There are obviously two prominent and necessary conditions to incurring the expense: the child and the job. The mere fact of having the child presumably is a personal benefit (unless the parents made a serious mistake) and it seems fair, therefore, to treat the costs incidental to achieving that benefit as personal. Note that I refer here to the benefit of having children, not to the benefit or the necessity of hiring a baby sitter once the child is born.

¹¹⁵ The couple with the child spends a portion of their income on having children and the childless couple spends a comparable amount on some other pleasure. The point is that no deduction is required in order that they be treated equally under the tax system.

¹¹⁶ Suppose that all women worked and that the only variable was whether they bore children and retained responsibility for them. In such circumstances, I can think of no sound basis for allowing a deduction for child care expenses unless there were some good reason for wanting to increase the population.

¹¹⁷ Perhaps the best solution to this dilemma is an earned income credit. See Blumberg, *supra* note 89, at 61-62.

as time goes by will increase their leisure time in proportion to their working time, the "fairness" argument for allowing the deduction for child care expenses will weaken.¹¹⁸

The deduction for household expenses again requires only brief comment. In the first place, whatever may be the justification for a deduction for such expenses on grounds of fairness, there is no defense whatever for conditioning the deduction on having a qualifying dependent in the household.¹¹⁹ Second, it may be true that the allowance of the deduction improves the fairness of the system by offsetting the advantage a couple can achieve where one spouse stays home and performs untaxed services for the family. At the same time, however, household chores, unlike dependent care duties, can be accomplished after working hours and on the weekends. Thus the major effect of allowing the deduction may be simply to allow people to purchase more leisure time. The potential invidious effects of this phenomenon are aptly described by the economist Richard Goode:

Even if certain expenses could be identified as costs, a deduction for them would be unfair to families—usually those with low and low-middle incomes—in which the household work is done by the working wife or other family members in the evenings or on weekends compared with families which hire household help and enjoy more leisure. The practical effect of an allowance for expenses for household help would be discrimination in favor of upper-middle income groups.¹²⁰

Nondiscretionary Outlays

Canada's Carter Commission Report developed the notion that the proper basis for taxation—the proper standard for fairness in the distribution of a tax based on ability to pay—should be "discretionary economic power"¹²¹ rather than the somewhat broader Haig-Simons concept of income that has been in vogue among tax theorists in this country over at least the past generation.¹²² For present purposes it is not necessary to examine the Carter Commission's general model or all

¹¹⁸ My analysis implicitly dismissed two theories of childbearing that might have required more attention in an earlier time or in other countries. Both theories would deny that children are produced for the personal gratification of the parents. One would assert that children are produced as economic assets with future returns to the parents and the other would claim that children are produced out of a sense of obligation to God or society.

¹¹⁹ See text following note 68 *supra*.

¹²⁰ R. Goode, *The Individual Income Tax* 81 (1964).

¹²¹ 3 Report of the [Canadian] Royal Commission on Taxation 5 (1966) [hereinafter cited as *Canadian Report*].

¹²² See H. Simons, *Personal Income Taxation* 41-58 (1938).

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its ramifications.¹²³ It is sufficient simply to extract the essential appeal to fairness implicit in the phrase "discretionary economic power"—namely the thought that the only amount that should be subject to taxation is the amount that a taxpayer has left after subtracting certain payments over which he or she has no control.¹²⁴ This principle seems to me to serve as a simple and appealing basis for deduction of the cost of caring for certain classes of dependents other than children. The moral obligation to provide care for dependent parents, siblings and other relations seems to me to make the cost of doing so involuntary in the usual sense of that term.¹²⁵ Since the money so spent is not available for paying taxes, the proper base for taxation is the amount of income left after that cost has been subtracted.¹²⁶ The care of children, however, cannot properly be viewed in this manner. As suggested above,¹²⁷ the cost of caring for children can be thought of as a voluntary outlay—as a matter of consumption, if you will.¹²⁸ This observation does not resolve the question of whether such expenses should, in some circumstances, be deductible. That is a difficult, complex question—although I am prepared to offer my own tentative view that the present trend toward expansion of the deduction should be resisted.

¹²³ For a discussion of discretionary economic power see Bittker, *Income Tax Reform in Canada: The Report of the Royal Commission on Taxation*, 35 U. Chi. L. Rev. 637, 638-45 (1967).

¹²⁴ Cf. C. Kahn, *Personal Deductions in the Federal Income Tax* 13 (1960), presenting an argument for deduction of "unavoidable" expenses. One might want to add the requirement that the outlay must be one that produces no personal gratification, though arguably that requirement is redundant with the requirement of involuntariness. To avoid ambiguity I prefer to express the idea as a dual requirement. See text following note 111 *supra*.

¹²⁵ See 3 Canadian Report, *supra* note 121, at 228.

¹²⁶ Other outlays for which the deduction can be defended according to the same theory are medical expenses, alimony child support payments, and, perhaps, certain gifts to religious or charitable organizations.

¹²⁷ See text at notes 97-98 *supra*.

¹²⁸ But see 3 Canadian Report, *supra* note 121, at 34, 193, treating child care expenses as nondiscretionary where both parents are working.