

## It's Time To Revisit The Tax Treatment of Working Childcare Costs

**Author :** Kathleen DeLaney Thomas

**Date :** April 20, 2016

Shannon Weeks McCormack, *Over-Taxing the Working Family: Uncle Sam and the Childcare Squeeze*, 114 **Mich. L. Rev.** \_\_\_\_ (2015), available at [SSRN](#).

Childcare costs have soared in recent years while wages remain stagnant. To make matters worse, relief by provided by the tax code is extremely limited. Parents may be able to claim a tax credit for a portion of their childcare costs and may be able to divert limited funds to a pretax flexible spending account. But in many cases, these tax benefits capture only a minor portion of parents' costs. It is no surprise, then, that with an election year upon us, a number of proposals to expand the current childcare tax credit have resurfaced in recent months. These proposals echo years of debate over whether the tax system discourages work by secondary earners and treats working parents unfairly vis-à-vis their non-parent counterparts.

But current proposals to modestly expand the childcare credit will make only a small dent in working parents' childcare costs. Recognizing the inadequacy of such an approach, [Shannon Weeks McCormack](#) proposes a more fundamental reform in her forthcoming article, *Over-Taxing the Working Family: Uncle Sam and the Childcare Squeeze*. The childcare tax credit, she argues, should be replaced with an above-the-line deduction for childcare expenses that is not subject to phase-outs or dollar limitations. In essence, Weeks McCormack calls for according childcare expenses the same treatment as deductible trade or business expenses.

The debate over whether childcare expenses represent personal consumption or the cost of earning income has been well documented by scholars. On the one hand, having children generally represents a personal choice and childcare expenses are not incurred by all workers. On the other hand, childcare expenses are often a "but for" cost of earning income, much like deductible business expenses. This debate began, however, in a time when secondary wages (generally earned by women) were often discretionary. In years past, a mother who "chose" to work and hire a caretaker for her children was, arguably, making an elective decision. What Weeks McCormack's article adds to this debate is a fresh and much-needed modern perspective.

As Weeks McCormack states, "Today, most two-parent families consist of two earners and require at least two incomes to meet their needs. The pressure to find work is even greater for single parents. . . ." Indeed, the reality today is that many (if not most) parents purchase childcare services because they must work outside the home to make ends meet. And, Weeks McCormack notes, childcare options are often limited. Daycares may have waitlists and working parents may purchase more expensive in-home childcare services because they cannot afford to take off of work if their child gets sick. These facts not only cut against the presumption that childcare costs are elective, but they also undermine the presumption that parents pay caregivers only the perceived consumption value of their services. When viewed in this light, childcare expenses look less like personal consumption today than they might have fifty years ago. To be sure, some taxpayers still receive significant consumptive benefits from childcare arrangements and would perhaps incur those expenses independent of the decision to work, a fact that Weeks McCormack acknowledges. However, because this group likely makes up a small and decreasing segment of working parents, policies that assume this potential consumptive benefit do not make sense. In other words, child care expenses in today's world are a necessary cost of earning income for most parents, which makes them more akin to deductible business expenses.

Weeks McCormack also has an insightful take on why expanding section 21's childcare tax credit is an unsatisfactory solution. Not only are tax credits prone to phase-outs, caps, and other limitations, but credits are often considered to be

tax expenditures. This is relevant because under the Haig-Simons definition of income, deductions that represent the cost of earning income (e.g., business expenses) must be taken into account to calculate net income and therefore are *not* considered to be tax expenditures. If childcare expenses are also considered to be a cost of earning income, a deduction or credit for these expenses should not be considered a tax expenditure either.

Interestingly, the original version of section 21 was a (somewhat limited) tax deduction for childcare costs, which Congress converted to a credit in 1976 in order to eliminate the upside-down subsidy effect of deductions. But, Weeks McCormack notes, the legislative history to that amendment specifically described childcare expenses as a cost of earning income, and Congress accordingly rejected the notion of an income-based phase-out of the credit. However, that message was lost over time, as the credit subsequently has been pared down and subjected to both income phase-outs and dollar limits. The Joint Committee on Taxation also included the working childcare tax provisions on its list of tax expenditures, which contradicts the notion that childcare expenses are a cost of earning income.

The result, Weeks McCormack observes, is likely confusion on the part of lawmakers, who view the working childcare tax provisions as legislative “giveaways” rather than a means of properly measuring income. When considered in this light, it’s not surprising that the current regime provides insubstantial support for many working parents. Thus, Weeks McCormack argues, meaningful tax reform requires not just expanding the scope of tax relief for working parents, but reframing that relief in a manner that reflects its purpose, i.e., removing it from the list of tax expenditures and converting it to a deduction that is necessary to accurately measure net income.

Weeks McCormack also offers some interesting practical suggestions for implementing her proposal. One possibility is to enact a deduction that looks something like section 274(n)’s 50 percent limitation on the deductibility of business meals. While Weeks McCormack thinks 50 percent deductibility is too low, I think this approach could offer an attractive political compromise that would still put many working parents ahead of the current regime. And while I don’t believe that a deduction would realistically encourage parents to go out and incur lavish childcare expenses, Weeks McCormack argues that such concerns could be assuaged by enacting limitations on lavish and extravagant expenses similar to those imposed on business entertainment and meal expenses.

As working parents continue to struggle financially, Weeks McCormack’s article is vitally important and timely. Politicians and other policymakers would be well-advised to pay attention.

Cite as: Kathleen DeLaney Thomas, *It’s Time To Revisit The Tax Treatment of Working Childcare Costs*, JOTWELL (April 20, 2016) (reviewing Shannon Weeks McCormack, *Over-Taxing the Working Family: Uncle Sam and the Childcare Squeeze*, 114 **Mich. L. Rev.** \_\_\_\_ (2015), available at SSRN), <http://tax.jotwell.com/its-time-to-revisit-the-tax-treatment-of-working-childcare-costs/>.