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Child Care and Federal Tax Policy (Symposium: Women, Equity and Federal Tax Policy: Open Questions)

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SYMPOSIUM 1999
Women, Equity and Federal Tax Policy: Open Questions

Panel III:
Child Care and Federal Tax Policy

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PROF. THOMAS: Our luncheon speaker, Dr. Alison Hagy, is an economist. She is currently on leave from the Center for Economic Studies, U.S. Bureau of the Census, and this semester, she is a Visiting Assistant Professor of Economics at Duke University. Her areas of specialization are labor economics, public finance and industrial organization. Of particular interest to us today is Dr. Hagy's work on the demand for quality child care.

I would like to introduce the whole subject of child care tax policy with a couple of brief comments and a small piece of tax history. Child care and its treatment in the income tax is one of those areas in which there is a tremendous amount of social policy wrapped up in a few provisions of the Internal Revenue Code.

The first encounter of a taxpayer seeking tax relief in the courts for child care expenses was that of a New York City woman whose name was Lillie Smith and who lived on West 11th Street.[1] She went to tax court trying to get a deduction for her child care expenses. After her baby was six weeks old, Lillie Smith went back to work at a hospital where she was a medical researcher. She and her lawyer husband went to court, *pro se*, to try to win a tax deduction for their child care expenses.

Unfortunately, it was 1937 and it was the height of the Great Depression. It was also the height of an era in the history of the market employment of women that is known as the "Marriage Bar Era."[2] It was a time when, as a matter of local, state and federal

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[1] Smith v. Comm'r of Internal Revenue, 40 B.T.A. 1038 (1938), *aff'd per curiam*, 113 F.2d 114 (2d Cir. 1940).

[2] *See* LOIS SCHARF, TO WORK AND TO WED: FEMALE EMPLOYMENT,

policy, the rule was one family–one job. Married women were routinely, and sometimes by statute or regulation, excluded from employment. That was the marriage bar. If you were a woman, as soon as you married, you were disemployed.

The Smiths did not meet a happy reception in the tax court. Judge Opper said, speaking for himself and, I guess, the tax law:

> We are not prepared to say that the care of children, like similar aspects of family and household life, is other than a personal concern. The wife's services as custodian of the home and protector of the children are ordinarily rendered without monetary compensation.[3]

On the basis of this piece of social analysis, Judge Opper concluded that child care expenses could not possibly be an ordinary and necessary business expense and the basic holding of the *Smith* case remains the law.

Although child care expenses are not considered a deductible ordinary and necessary business expense, since 1954 Congress has carved out some tax relief for working mothers in the Internal Revenue Code. The current statutory scheme of child care credits and exclusions — all exceptions to the general tax rule that child care is a personal expense — will be Dr. Hagy's subject this afternoon. I think it is good to keep in focus what the gap is between the tax treatment of ordinary and necessary business expenses — the services of your office assistant and rent that you pay in an office — and child care expenses. Generally, office expenses are deductible in unlimited amounts.[4] Child care expenses are confined, or perhaps regulated, very narrowly. Dr. Hagy, thank you for joining us here today.

FEMINISM, AND THE GREAT DEPRESSION (1980).

[3] *Smith*, 40 B.T.A. at 1039.

[4] Deductions for salaries paid to employees are subject only to a reasonableness standard. *See* I.R.C.§ 162 (a)(1) (1999).