Santa Clara Law Review

Volume 25 | Number 2 Article 6

1-1-1985

Federal Child-Care Income Tax Provisions: Legislative Initiatives in the Ninety-Ninth Congress

Norman Y. Mineta

FEDERAL CHILD-CARE INCOME TAX PROVISIONS: LEGISLATIVE INITIATIVES IN THE NINETY-NINTH CONGRESS

Norman Y. Mineta*

I. INTRODUCTION

A child-care crisis exists in the United States. The Congressional Budget Office estimates that the number of children in this nation under the age of ten will increase by nearly five million, from the approximately 33.0 million counted in the 1980 federal census to 37.8 million by 1990.[1] The Congressional Budget Office expects the number of children under the age of six to increase by seventeen percent.[2]

In addition to the increasing population of children, changes in social structures—particularly changes in family composition, and in employment trends—present a staggering demand for child care.[3] By the end of this decade, the United States House of Representatives' Select Committee on Children, Youth and Families projects that nearly one child in four will live in a single-parent household; and that in over half of the two-parent households, both parents will be employed.[4] The Select Committee projects that in 1990, half of the nation's labor force may be women, and that nearly three-fourths of them may become pregnant.[5] Although these statistics do not account

* The author is a member of the U.S. House of Representatives. He represents the 13th District in California which includes Santa Clara County. The author would like to express his grateful appreciation to Anthony A. Anderson, J.D., for his contribution in the preparation of this article. The author would also like to thank John A. Flaherty, J.D., for his assistance.

1. The Congressional Budget Office estimates were included in a report prepared for the House of Representatives Select Committee on Children, Youth and Families. HOUSE SELECT COMM. ON CHILDREN, YOUTH AND FAMILIES, 98TH CONG. 1ST SESS., DEMOGRAPHIC AND SOCIAL TRENDS: IMPLICATIONS FOR FEDERAL SUPPORT OF DEPENDENT-CARE SERVICES FOR CHILDREN AND THE ELDERLY 17 (Comm. Print 1983) [hereinafter cited as DEMOGRAPHICS AND SOCIAL TRENDS].

2. *Id.*

3. *Id.* at 16-29.

4. HOUSE SELECT COMM. ON CHILDREN, YOUTH AND FAMILIES, 98TH CONG., 2D SESS., FAMILIES AND CHILD CARE: IMPROVING THE OPTIONS v (Comm. Print 1984) [hereinafter cited as IMPROVING THE OPTIONS].

5. *See generally id.*

for fathers leaving the labor force to care for their children, the fact that every third person in the work force may become pregnant reflects a substantial and immediate impact on the demand for child-care services provided outside the home.

Making child-care services available is only part of the problem. The child-care services that are available are often prohibitively expensive for many working parents. The Children's Defense Fund, relying upon United States Bureau of the Census data, reported that in 1983 over twenty-two percent of all children lived in poverty. Of these children, at least fifty-five percent lived in single-parent families.[6] The availability of adequate and affordable child-care services may determine whether many of the parents who head families such as these will continue to enter or remain in the work force.

The federal government has the ability to address this crisis. Federal programs such as the Social Services Block Grant authorized under title XX of the Social Security Act,[7] and Aid to Families with Dependent Children authorized under title IV-A of the same act address some of these concerns.[8] Moreover, the largest federal subsidy for child-care expenses is provided by the Internal Revenue Code. The provisions of the Code offer Congress an opportunity to respond to the child-care crisis. This article focuses on bills introduced during the first session of the Ninety-ninth Congress which would, if enacted, alter sections of the Internal Revenue Code affecting child care.

Justice Oliver Wendell Holmes, dissenting in *Compania General de Tabacos v. Collector*,[9] stated that "Taxes are what we pay for civilized society. . . ."[10] Few statements could be more true. However, it should be stated that the Internal Revenue Code has shown that taxes excused by a government are often as essential to establishing and maintaining a civilized society as the taxes collected

6. Children's Defense Fund, Black and White Children in America: Key Facts 52 (1985).

7. Social Services Block Grant, Social Security Act, 42 U.S.C. § 602(a)(8)(iii) (West Supp. 1981).

8. Aid to Families with Dependent Children, Social Security Act, 42 U.S.C. §§ 602(a)(7), 602(a)(8)(A)(1982).

9. 275 U.S. 87 (1927). This case concerned a Spanish-based corporation doing business in the Philippines, which challenged the Philippine government's power to impose taxes upon the plaintiff corporation. When the U.S. Supreme Court decided the case, the Philippines were still a possession of the U.S. government. *Compania* reached the Court after plaintiff appealed a judgment by the Supreme Court of the Philippine Islands. The Court had affirmed a lower court's dismissal of an action brought by plaintiff to recover money demanded from the company by the Philippine Collector of Internal Revenue as taxes on insurance premiums.

10. *Id.* at 100 (Holmes, J., dissenting).

by that government.

Since the creation of the modern federal income tax,[11] Congress has created networks of deductions and credits in order to accomplish a myriad of societal goals.[12] Deductions and credits enable Congress to subsidize activities indirectly by partially relieving taxpayers of their tax burden. In the area of child care, this subsidy appears primarily in the form of the personal deduction allowance for dependents authorized under section 151(e) of the Internal Revenue Code, and in the form of a tax credit authorized under section 21 of the Code for "[e]xpenses for household and dependent care services necessary for gainful employment."

In a report published by the House of Representatives' Select Committee of Children, Youth and Families in September of 1984, the Select Committee concluded that the Internal Revenue Code (section 151 personal deduction, together with section 21 credit) represented the largest source of support for child-care services.[13] Therefore, during the first session of the Ninety-ninth Congress, several members of Congress introduced various pieces of legislation designed to improve upon the existing Internal Revenue Code provisions that affect child-care services.[14]

II. The Household and Dependent-Care Credit

Section 21 of the Internal Revenue Code provides a tax credit for household and child-care expenses incurred by taxpayers whose households include at least one dependent under the age of fifteen. The section 21 credit is available to married couples when both spouses work or when one spouse works and the other is a full-time student;[15] to working single parents; and to working, custodial, di-

11. For the purposes of this article, the modern federal income tax is measured from the enactment of the Internal Revenue Code of 1939, 53 Stat. 1 (1939).

12. For example, the Internal Revenue Code of 1939 included: a deduction for charitable corporate contributions, I.R.C. § 23(a)(2), to encourage corporate altruism; and a credit for interest received on federal obligations, I.R.C. § 25(a), to encourage investment in federal financial instruments.

13. Improving the Options, *supra* note 4, at 82.

14. At least 15 members of both Houses have introduced a minimum of 13 bills that would amend or add child-care provisions to the Internal Revenue Code. For the purposes of this discussion, identical bills that have been introduced in both the House of Representatives and the Senate are treated as one bill.

15. I.R.C. § 21(d) (Supp. 1985) stipulates that the amount of the household and dependent care credit cannot exceed the earned income of the taxpayer or of the taxpayer's spouse. For the purposes of determining the amount of the credit when the taxpayer's spouse is a full-time student, I.R.C. § 21(d)(2) assumes an earned income of not less than $200, if one qualifying dependent is claimed, and $400, if two or more are claimed, for each month that the

vorced, or separated parents.[16] The Code limits the amount of the section 21 credit available to thirty percent of applicable household and child-care expenses incurred, provided that the expenses do not exceed $2,400 for one qualifying dependent and $4,800 for two or more qualifying dependents.[17] This limitation caps the section 21 credit at $720 for one child and $1,440 for two or more children. Section 21(a)(2) requires that the percentage of applicable expenses for which a taxpayer can claim a section 21 credit be reduced by one percent for each $2,000 that his or her adjusted gross income exceeds $10,000.[18] However, section 21(a)(2) provides that a qualifying parent cannot reduce the creditable percentage below twenty percent.

The section 21 credit and the similar provisions which preceded it provide a substantial federal subsidy to working parents.[19] According to estimates provided to the House Select Committee on Children, Youth and Families by the Joint Committee on Taxation, taxpayers claimed federal household and dependent care credits of $1.2 billion in 1981 alone, $1.35 billion in 1982, $1.52 billion in 1983, and $1.77 billion in 1984.[20] In 1981, 4.6 million families claimed a dependent-care credit.[21]

The popularity of this subsidy has led members in Congress to introduce at least ten bills which would alter or expand the section 21 credit.[22] Some of the proposed legislation, such as the Fair Tax

---

spouse is registered at a qualified educational institution.

16. I.R.C. § 21(e) (Supp. 1985).

17. I.R.C. § 21(a)(2) and 21(c) (Supp. 1985).

18. I.R.C. § 21(a)(2) (Supp. 1985).

19. Section 21 resulted from a renumbering of a similar provision set forth in I.R.C. § 44A. The Deficit Reduction Act of 1984, Pub. L. No. 98-369, §§ 423(c)(4), 471(c), 474(b)(1), and (c), 98 Stat. 801, 826, 830 (1984). Congress created the I.R.C. 44A credit as part of the Tax Reform Act of 1976, Pub. L. No. 94-455, § 504, 90 Stat. 1563 (1976). The Tax Reform Act of 1976 also repealed a deduction authorized under I.R.C. § 214 of the Code for similar purposes. 90 Stat. 1565 (1976).

20. IMPROVING THE OPTIONS, *supra* note 4, at 82.

21. *Id.* at 83.

22. H.R. 200, 99th Cong., 1st Sess., 131 CONG. REC. H72 (daily ed. Jan. 3, 1985) (remarks of Rep. Siljander); H.R. 373, 99th Cong., 1st Sess., 131 CONG. REC. H104 (daily ed. Jan. 7, 1985) (remarks of Rep. Moore); H.R. 467, 99th Cong., 1st Sess., 131 CONG. REC. H106 (daily ed. Jan. 7, 1985) (remarks of Rep. Snowe); H.R. 777, 99th Cong., 1st Sess., 131 CONG. REC. H215 (daily ed. Jan. 30, 1985) (remarks of Rep. Kemp); H.R. 1040, 99th Cong., 1st Sess., 131 CONG. REC. H401 (daily ed. Feb. 7, 1985) (remarks of Rep. Rangel); H.R. 1677, 99th Cong., 1st Sess., 131 CONG. REC. H1378 (daily ed. Mar. 21, 1985) (remarks of Rep. Owens); H.R. 2527, 99th Cong., 1st Sess., 131 CONG. REC. H3264 (daily ed. May 15, 1985) (remarks of Rep. Snowe); The Economic Equality Act of 1985, S. 888, 99th Cong., 1st Sess., 131 CONG. REC. S4113 (daily ed. Apr. 3, 1985) (remarks of Sen. Durenberger); S. 912, 99th Cong., 1st Sess., 131 CONG. REC. S4216 (daily ed. Apr. 16, 1985) (remarks of Sen. D'Amato).

Act of 1985[23] and the Fair and Simple Tax Act of 1985,[24] would amend the section 21 credit as one element of an overall tax reform plan. Other bills seek only to amend section 21. Bills introduced by Representative Major Owens of New York,[25] Representative Thomas Carper of Delaware,[26] Representative Olympia Snowe of Maine,[27] Senator Dave Durenberger of Minnesota,[28] and Senator Alphonse D'Amato of New York,[29] if enacted, would expand the scope of the household and dependent-care expenses credit. All of these except the Owens bill, would increase the section 21 credit by removing the thirty percent credit cap on applicable expenses incurred. The thirty percent credit limitation would be raised to fifty percent in the Carper, Snowe, and Durenberger bills, and to forty percent in the D'Amato bill.[30] In addition, each bill would maintain mechanisms for reducing the applicable percentage of the section 21 credit for families earning more than $10,000.[31] Taken together,

23. The Bradley-Gephardt bill, H.R. 800, 99th Cong., 1st Sess., 131 CONG. REC. H215 (daily ed. Jan. 30, 1985) (remarks of Rep. Gephardt); S. 409, 99th Cong., 1st Sess., 131 CONG. REC. S1173 (daily ed. Feb. 6, 1985) (remarks of Sen. Bradley) [hereinafter cited as the Bradley-Gephardt bill].

24. The Kemp-Kasten bill, H.R. 2222, 99th Cong., 1st Sess., 131 CONG. REC. H2569 (daily ed. Apr. 25, 1985) (remarks of Rep. Kemp); S. 325, 99th Cong., 1st Sess., 131 CONG. REC. S883 (daily ed. Jan. 31, 1985) (remarks of Sen. Kasten).

25. H.R. 1677, 99th Cong., 1st Sess., 131 CONG. REC. H1378 (daily ed. Mar. 21, 1985).

26. H.R. 2272, 99th Cong., 1st Sess. (1985).

27. H.R. 2527, 99th Cong., 1st Sess., 131 CONG. REC. H3264 (daily ed. May 15, 1985).

28. The Economic Equity Act of 1985, S. 888, 99th Cong., 1st Sess., 131 CONG. REC. S4113 (daily ed. May 15, 1985).

29. S. 912, 99th Cong., 1st Sess., 131 CONG. REC. S4216 (daily ed. Apr. 16, 1985).

30. H.R. 2272, 99th Cong., 1st Sess., § 1(a) (1985); H.R. 2527, 99th Cong., 1st Sess., 131 CONG. REC. H3264 (daily ed. May 15, 1985); S. 888, 99th Cong., 1st Sess., § 201, 131 CONG. REC. S4113 (daily ed. Apr. 3, 1985); and S. 912, 99th Cong., 1st Sess., 131 CONG. REC. S4216 (daily ed. Apr. 16, 1985).

31. The Carper bill would reduce the percentage of the § 21 credit by one percent for each full $1,000 by which the taxpayer's adjusted gross income exceeds $10,000. Because the bill establishes no minimum percentage for the § 21 credit, the credit would diminish as the taxpayer's adjusted gross income approaches $60,000. H.R. 2272, 99th Cong., 1st Sess., § 1(a) (1985).

The Snowe bill would reduce the applicable percentage of the § 21 credit by one percent for each full $1,000 by which the taxpayer's adjusted gross income exceeds $11,000, but would allow a credit of 20% of eligible expenses to taxpayers with adjusted gross incomes in excess of $41,000. H.R. 2527, 99th Cong., 1st Sess., 131 CONG. REC. H3264 (daily ed. May 15, 1985).

The Durenberger bill would reduce the § 21 credit percentage by one percentage point for each $1,000 by which the taxpayer's adjusted gross income exceeds $10,000. Like the Snowe bill, the Durenberger bill would maintain a minimum credit of 20% of eligible expenses. S.888, 99th Cong., 1st Sess., 131 CONG. REC. S4113 (daily ed. Apr. 3, 1985).

Finally, the D'Amato bill would decrease the applicable percentage by two-thirds of one these amendments would target the benefits of the section 21 credit to families with adjusted gross incomes of less than $40,000 and would have a particular emphasis on families earning less than $10,000.[32] Senator Durenberger's Economic Equity Act of 1985 would go further by making the section 21 credit refundable to the taxpayer when the amount of the credit exceeds the taxpayer's liability.[33]

The approach suggested by the Carper, Snowe, Durenberger, and D'Amato bills to increase the section 21 credit in a manner that significantly benefits middle and low income taxpayers, affords Congress the opportunity to alleviate the financial burdens on some of the most needy parents and other working parents as well. Congress should therefore seriously consider the proposed legislation. To date, however, none of the bills have been reported by the appropriate committee to either House.[34]

Like the previously discussed bills, the Owens bill, H.R. 1677, has not been reported out of committee. H.R. 1677 would leave section 21 as it currently stands but would add a new deduction for "[e]xpenses for care of certain individuals at home or in a dependent care center." The new provision would permit the same class of taxpayers who are eligible for a section 21 credit to take a deduction either for household and dependent-care expenses incurred in the taxpayer's home,[35] or for expenses incurred for care at a qualified care center. The home care expense deduction would be restricted to $10,000 for one child, and to $15,000 for two or more children. For services provided in qualified care centers, the allowance under H.R. 1677 could not exceed $5,000 for one child and $7,000 for two or more children.[36] To qualify under the bill, a care center must comply with all applicable state and local laws and regulations.[37] H.R.

---

percent for each full $1,000 by which the taxpayer's adjusted gross income exceeds $10,000. The D'Amato bill also maintains a minimum credit of 20%. S. 912, 99th Cong., 1st Sess., 131 CONG. REC. S4216 (daily ed. Apr. 16, 1985).

32. Under all four bills, only taxpayers with adjusted gross incomes of less than $40,000 would experience an additional benefit over the current law. Taxpayers with adjusted gross incomes of less than $10,000 would receive the greatest additional benefit.

33. S. 888, 99th Cong., 1st Sess., § 203, 131 CONG. REC. S4113 (daily ed. April 3, 1985).

34. H.R. 2272 and H.R. 2527 were referred to the House Committee on Ways and Means on April 30, 1985, and May 15, 1985 respectively. S. 888 and S. 912 were referred to the Senate Committee on Finance on April 4, 1985, and April 16, 1985, respectively.

35. H.R. 1677, 99th Cong., 1st Sess., § 1(a) (1985).

36. These limits would be stipulated in new I.R.C. § 223(b). H.R. 1677, 99th Cong., 1st Sess., § 1(a) (1985).

37. I.R.C. at § 223(c)(4).

1677 would allow a taxpayer to elect between the dependent-care deduction and the section 21 credit. Taxpayers would also be able to receive both an H.R. 1677 deduction and a section 21 credit as long as none of the expenses claimed under section 21 are claimed under the new deduction.[38]

The major drawback of the Owens bill is that it assists upper-middle and upper income families considerably, while neglecting the needs of lower-middle and lower income families. For example, under H.R. 1677, a working married couple with two children and a combined adjusted gross income of $150,000 could get a tax deduction of $15,000 and a tax credit of $960. On the other hand, a working married couple with two children and a combined adjusted gross income of $15,000 would not benefit from the H.R. 1677 deduction unless the couple spent more than $4,800 on child care because the return on the tax credit would exceed the couple's marginal tax rate.[39] Any bill to improve the ability of parents to afford child-care services should focus more directly on lower income parents who need the tax credits and deductions the most. Therefore, H.R. 1677 remains an inadequate solution.

The Fair Tax Act of 1985 (Bradley-Gephardt)[40] and the Tax Equity and Simplification Act of 1985 (H.R. 1040, introduced by Charles Rangel of New York)[41] would revamp the entire Internal Revenue Code. The authors of both bills propose to reduce the number of marginal tax brackets and to establish three new tax rates each ranging between fourteen and thirty-five percent.[42] The Tax Equity and Simplification Act would increase the personal exemption authorized under section 151(e) for dependents from the current $1,000 to $2,000.[43] This increase in the section 151(e) exemption would more accurately reflect the costs associated with raising children than does the present section 151(e) exemption. However, this

38. *Id.* at § 223(f).

39. A couple with an adjusted gross income of $15,000 would be permited a § 21 credit of 27% of their eligible household and dependent care expenses up to $4,800. The 27% reflects a reduction of one percent in the § 21 credit for each $2,000, or part thereof, by which the couple's adjusted gross income exceeds $10,000. The couple's return on a deduction would be 16%, the marginal tax rate on a joint return for an adjusted gross income of $15,000.

40. The Bradley-Gephardt bill, *supra* note 23.

41. H.R. 1040, 99th Cong., 1st Sess., 131 CONG. REC. H401 (daily ed. Feb. 7, 1985).

42. The Rangel bill would establish new rates of 15, 25 and 35%. H.R. 1040, 99th Cong., 1st Sess., § 1101 (1985). The Bradley-Gephardt bill, *supra* note 23, would establish new rates of 14, 26 and 30%. H.R. 800, 99th Cong., 1st Sess., § 101, 131 CONG. REC. H215 (daily ed. Jan. 30, 1985).

43. H.R. 1040, 99th Cong., 1st Sess. § 1201, 131 CONG. REC. H401 (daily ed. Feb. 7, 1985).

benefit would be offset in both bills by replacing the section 21 credit with a deduction for expenses incurred for household and dependent-care services necessary for gainful employment.

In its report accompanying the Tax Reform Act of 1976,[44] the House Ways and Means Committee stated:

> Treating child care expenses as itemized deductions denies any beneficial tax recognition of such expenses to taxpayers who elect the standard deduction. [The House Ways and Means] [C]ommittee believes that such expenses should be viewed as a cost of earning income for which all working taxpayers may make a claim. One method for extending the allowance of child care expenses to all taxpayers, and not just 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.[45]

The Committee's statement is equally applicable to H.R. 1040, even though H.R. 1040 reduces the number of tax brackets.

The Select Committee finding that sixty-four percent of the families claiming a household and dependent-care credit in 1981 were above medium income levels suggests that the current dependent credit disproportionately benefits upper income families.[46] While lower income families might experience tax savings under H.R. 1040 based on the proposed section 151(e) personal exemption increase and the marginal tax rate reductions, replacing the dependent care credit with a deduction will put lower income families at a relative disadvantage *vis a vis* middle and upper income families.

The Bradley-Gephardt bill would also replace the section 21 credit with a deduction for the same purposes. Unfortunately, the bill would not soften the impact of the replacement because it would not increase the section 151(e) personal exemption for dependents.[47]

The shortcomings of the Bradley-Gephardt and the Rangel bills with respect to child care are slight in comparison to those flaws

---

44. Pub. L. No. 94-455, 90 Stat. 1563 (codified in scattered sections of the Internal Revenue Code (1976)).

45. H.R. REP. No. 658, 94th Cong., 1st Sess. 147 (1975).

46. IMPROVING THE OPTIONS, *supra* note 4, at 83.

47. Although the Bradley-Gephardt bill, *supra* note 23, would not increase the § 151(e) deduction for dependents, the bill would increase the § 151(b) personal exemption for the taxpayer and for the taxpayer's unemployed spouse to $1,600. H.R. 800 would also increase to $1,800 the § 151(b) exemption for heads of households. H.R. 800, 99th Cong., 1st Sess. § 111, 131 CONG. REC. H215 (daily ed. Jan. 30, 1985).

present in three other bills: H.R. 200, The Ten Percent Flat Tax Rate Act, (Rep. Siljander, Mich.);[48] H.R. 373, The Broad-Based Enhanced Savings Act of 1985, (Rep. Moore, La., and Sen. Roth, Del.);[49] and H.R. 777, the Fair and Simple Tax Act of 1985 (known as the Kemp-Kasten bill).[50] Like the Bradley-Gephardt legislative proposal and H.R. 1040, all three of these bills would lower marginal tax rates[51] and would eliminate the section 21 household and dependent care expense credit. Unlike Bradley-Gephardt and H.R. 1040, however, none of these three bills would replace the section 21 credit with a deduction for household and dependent care expenses to compensate working parents for dependent care expenses incurred.

Proponents of the bills would undoubtedly stress that, by cutting marginal tax rates and increasing the section 151(e) personal exemption, the authors actually place a majority of taxpayers in a better position to address their child-care related expenses. The argument, while not without merit with respect to lower income families, is far more persuasive when measuring the value of the proposed legislation to higher income families.[52]

Unfortunately, the Ten Percent Flat Tax Rate Act, The Broad-Based Enhanced Savings Tax Act of 1985, and The Fair and Simple Tax Act of 1985 fail in that they would reverse a long-standing federal policy of recognizing the need of working parents to obtain ade-

---

48. H.R. 200, 99th Cong., 1st Sess., 131 CONG. REC. H72 (daily ed. Jan. 3, 1985).

49. H.R. 373, 99th Cong., 1st Sess., 131 CONG. REC. H104 (daily ed. Jan. 7, 1985) (remarks of Rep. Moore); S. 411, 99th Cong., 1st Sess., 131 CONG. REC. S1187 (daily ed. Feb. 6, 1985) (remarks of Sen. Roth).

50. H.R. 777, 99th Cong., 1st Sess., 131 CONG. REC. H215 (daily ed. Jan. 30, 1985); H.R. 2222, 99th Cong., 1st Sess., 131 CONG. REC. H2569 (daily ed. Apr. 25, 1985) (remarks of Rep. Kemp); S. 325, 99th Cong., 1st Sess., 131 CONG. REC. S883 (daily ed. Jan. 31, 1985) (remarks of Sen. Kasten); S. 1006, 99th Cong., 1st Sess., 131 CONG. REC. S4751 (daily ed. Apr. 25, 1985).

51. The Siljander bill would establish a flat rate of 10% for all taxpayers. H.R. 200, 99th Cong., 1st Sess., 1, § 2, 131 CONG. REC. H72 (1985). The Moore-Roth bill would reduce the number of tax brackets to four brackets of 18, 26, 36 and 45%. H.R. 373, 99th Cong., 1st Sess., 1, § 101, 131 CONG. REC. H104 (daily ed. Jan. 7, 1985). Finally, the Kemp-Kasten bill would establish marginal tax rates of 15, 25 and 35%. H.R. 2222, 99th Cong., 1st Sess., § 102, 131 CONG. REC. H2569 (daily ed. 1985).

52. The elimination of the § 21 credit proposed in the Moore-Roth bill is almost certain to disadvantage § 21 claimants because the Moore-Roth bill would neither appreciably increase the § 151(e) personal exemption for dependents nor significantly reduce marginal tax rates.

The Siljander 10% flat rate would allow most taxpayers to retain a greater share of their earnings. However, this savings would be achieved to the relative detriment of lower-income taxpayers because it would abolish the progressive tax rate structure that has existed from the enactment of the Internal Revenue Code of 1939, 53 Stat. 1 (1939).

quate and affordable child-care services.

In March 1985, the House Ways and Means Committee conducted hearings on the various tax reform bills introduced in the House during this session of Congress. The Senate Finance Committee held similar hearings in May 1985, on the tax reform bills introduced in the Senate. Although both committees may report out tax reform bills to their respective chambers before the end of the session, neither have yet done so. Any tax reform legislation that Congress acts on, however, should achieve a greater balancing of equities than provided for in the Siljander, Kemp-Kasten, and Roth-Moore bills.

As the largest source of federal funding specifically for child-care services, the section 21 credit for household and dependent-care expenses is a valuable tool. It is one that Congress cannot afford to discard as quickly as the Kemp-Kasten and similar bills would. Congress must also cautiously avoid schemes, such as that in the Bradley-Gephardt bill, which redesign the section 21 credit in a manner which makes it unavailable to the very taxpayers who need it the most. Congress should amend the section 21 credit to favor lower income parents.

Among the recommendations set forth in its report,[53] the House Select Committee on Children, Youth and Families suggested:

> By placing an upper income limit on the Dependent Care Tax Credit, and limiting its use to lower and lower-middle income families, the Committee could find its $600 million to add to the Social Services Block Grant. Or, better yet, by restructuring the credit, allowing a larger percentage to low income families and a smaller percentage to above-average income families, the credit could provide these millions directly to families in need. And unlike the proposal to increase the block grant, this change would target funding on child care needs.[54]

Of all the legislation proposed to amend section 21, the Carper, Snowe, Durenberger, and D'Amato bills target a larger share of the dependent-care credit to lower income taxpayers. Only the Carper bill, however, also makes the section 21 credit unavailable to taxpayers with adjusted gross incomes that exceed $60,000. With this limitation, the Carper bill, H.R. 2272, more closely reflects the Select Committee's recommendation. Perhaps the bill could be improved by adding a provision which would make the credit refundable, similar

---

53. IMPROVING THE OPTIONS, *supra* note 4.
54. *Id.* at 149.

to that contained in Durenberger's Economic Equity Act of 1985. While H.R. 2272 may not be a perfect bill, it is an excellent starting point for Congress to amend section 21 credit for household and dependent-care expenses.

III. The Personal Exemption For Dependents

As previously mentioned, section 151(e) of the Internal Revenue Code allows taxpayers a deduction for personal exemption from tax liability for dependents. Section 151(e) makes the exemption generally available to a taxpayer for each of his or her children who is a student, or who has not yet reached the age of 19. The dependent must receive more than half of his or her financial support from the taxpayer.[55] Unlike section 21, which allows a credit only to working parents, section 151(e) provides an exemption to all taxpayers with dependents so as not to penalize those parents who choose to remain at home with their children.

The chief problem with the exemption is that the value of the exemption has decreased significantly over the past forty years, while the cost-of-living has increased. The Revenue Act of 1948[56] raised the exemption to $600 under section 25(b)(1)(D) of the Internal Revenue Code of 1939. Since then, Congress has increased the exemption to $1,000 with three separate sets of amendments.[57] During the same time period, the cost-of-living has increased by 420 percent.[58] In an attempt to address this deficiency, Congress enacted a new subsection to section 151 that will cause the section 151 exemption to be adjusted annually beginning in 1985 to reflect changes in the cost-of-living.[59] Indexing[60] will prevent further deterioration in

55. The § 151(e) personal exemption is not limited to the taxpayer's offspring. A taxpayer may claim a § 151(e) exemption for a specific list of relatives set forth in § 152(a) of the Code as long as the taxpayer provides more than half of the dependent's support. A taxpayer may also claim a § 151(e) exemption for nonrelatives and relatives not specifically listed in § 152(a) if the person for whom the exemption is taken is a member of the taxpayer's household and that person receives more than 50% of his or her support from the taxpayer. I.R.C. § 152.

56. Pub. L. No. 80-471, § 201(1)(a), 62 Stat. 110 (1948).

57. The Revenue Act of 1978, Pub. L. No. 95-600, § 102(a), 92 Stat. 2763 (1978); The Revenue Act of 1971, Pub. L. No. 92-178, § 201(a), 85 Stat. 497 (1971); and The Tax Reform Act of 1969, Pub. L. No. 91-172, § 801(a), 83 Stat. 487 (1969).

58. This calculation represents an averaging of all the monthly consumer price index figures supplied by the Bureau of Labor Statistics, U.S. Department of Labor, for each year beginning in 1948 and ending in 1984. The calculation also reflects an averaging of the consumer price index statistics for January through May 1985.

59. The Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 104(c)(2), 95 Stat. 172 (1981) (codified at I.R.C. § 151(f) (1982)).

60. Indexing is a means of adjusting the § 151 exemption amount by adding to the

the value of the section 151 personal exemption.

As indicated in the previous discussion of household and dependent-care expense credits, the legislative proposals to amend section 151(e) all raise the amount of the exemption. The Broad-Based Enhanced Savings Tax Act of 1985 would adjust the section 151(e) exemption to $1,050 for 1985 and would retain indexing for future years.[61] The Ten Percent Flat Tax Rate Act,[62] The Tax and Equity Simplification Act of 1985,[63] and The Fair and Simple Tax Act of 1985[64] are more ambitious in their approach. All three would allow indexing and raise the section 151(e) exemption to $2,000.[65]

Increasing the section 151(e) personal exemption is necessary to assist parents, both working and nonworking, in providing for their children. The budget deficit, however, may prevent Congress from raising the section 151(e) to as much as $2,000.

IV. Other Proposals

Members of Congress have not restricted their proposed revisions to the Internal Revenue Code to the section 21 credit for employment-related expenses for household and dependent care services, or to the section 151(e) personal exemption for dependents. Three additional proposals would also amend the Code to target employer-provided dependent-care services.

Section 129 of the Code excludes from an employee-taxpayer's income certain care assistance provided by the taxpayer's employer for the taxpayer's dependents. Section 129(b) limits the amount of employer-provided assistance that can be excluded from a taxpayer's income to the lesser of taxpayer's earned income, or the earned income of the taxpayer's spouse. For spouses who are full-time students, section 129 allows the taxpayer to assume the student income levels set forth in section 21.

The Fair Tax Act of 1985 and The Tax Equity and Simplification Act of 1985, would eliminate the section 129 exclusion and thereby include employer-provided dependent-care services as income

---

exemption base level of $1,000 each year an amount equal to $1,000 multiplied by the cost-of-living index. Section 151(f) provides for any increase (or decrease) due to the cost-of-living adjustment to be rounded off to the nearest $10.

61. H.R. 373, 99th Cong., 1st Sess., § 103, 131 Cong. Rec. H104 (daily ed. Jan. 7, 1985).

62. H.R. 200, 99th Cong., 1st Sess., 131 Cong. Rec. H72 (1985).

63. H.R. 1040, 99th Cong., 1st Sess., 131 Cong. Rec. H401 (daily ed. Feb. 7, 1985).

64. H.R. 2222, 99th Cong., 1st Sess., 131 Cong. Rec.H2569 (1985).

65. H.R. 200, 99th Cong., 1st Sess., 131 Cong. Rec. H2569 (1985).

to the employees.[66] Representative Mario Biaggi and Senator Alphonse D'Amato, both of New York, have introduced The On-Site Day Care Privatization Act in both the Senate and the House.[67] The legislation would not only maintain the section 129 exclusion but would also permit employers to deduct specified expenses incurred as a result of providing day-care assistance to their employees' children.[68]

The House Select Committee on Children, Youth and Families reported that, "From the testimony and recommendations provided to the Committee it is clear that there is a major role for employers in the provision of child care benefits, and that the government can help promote these efforts."[69] The On-Site Day Care Privatization Act appears to be one such promotion.

In addition to the specific credit for household and dependent-care services, Congress created the earned income credit, which is a refundable credit authorized under section 32 of the Code. The earned income credit is available to taxpayers with adjusted gross incomes of less than $11,000 and whose household includes at least one dependent for whom the taxpayer is eligible to receive a section 151(e) personal exemption.[70] The maximum credit allowed under section 32 is $550 and the amount of the credit is gradually reduced for each dollar that the claiming taxpayer's adjusted gross income exceeds $6,500.[71] The Broad-Based Enhanced Savings Act of 1985 is designed to improve the earned income credit by increasing the maximum credit to $676, to index the credit to account for inflation, and to make the credit available to taxpayers with adjusted gross incomes below $12,308.[72]

66. H.R. 800, 99th Cong., 1st Sess., § 211(4), 131 CONG. REC. H215, H72 (daily ed. Jan. 3, 1985) and H.R. 1040, 99th Cong., 1st Sess., 131 CONG. REC. H401 (daily ed. Feb. 7,1985); H.R. 2222, 99th Cong., 1st Sess., § 111, 131 CONG. REC. H2569 (1985) and S. 409, 99th Cong., 1st Sess., § 211(4), 131 CONG. REC. S883 (1985); H.R. 1040, 99th Cong., 1st Sess., 131 CONG. REC. (1985).

67. H.R. 2532, 99th Cong., 1st Sess., 131 CONG. REC. H3312 (1985) (remarks of Rep. Biaggi) and S. 1125, 99th Cong., 1st Sess., 131 CONG. REC. S6076 (1985) (remarks of Sen. D'Amato).

68. H.R. 2532, 99th Cong., 1st Sess., § 2(a), 131 CONG. REC. H3312 (1985) and S. 1125, 99th Cong., 1st Sess., § 2(a), 131 CONG. REC. S6079 (1985).

69. IMPROVING THE OPTIONS, *supra* note 4, at 57.

70. I.R.C. § 32(c)(1) and (f) (1982).

71. I.R.C. § 32(f) (1984).

72. H.R. 373, 99th Cong., 1st Sess., § 102, 131 CONG. REC. H104 (daily ed. Jan. 7, 1985).

V. Conclusion

Statistics which indicate an increase in the demand for child care suggest that the social structure in our country is changing. The numbers of single-parent families, and families in which both parents work are increasing dramatically.

The tax system must adapt to the changing social structure. Our nation has a well-established policy of reducing the tax burden of taxpayers who have children. This policy is reflected primarily in the section 21 credit and the section 151(e) exemption. Congress must review and update the Internal Revenue Code provisions which address the increasing needs of those it seeks to assist. In the process of revising the tax statutes, Congress should seek to make adjustments in a manner more equitable to lower and middle income families.

The approach suggested by the Carper, Durenberger, Snowe and D'Amato bills, to increase the section 21 credit in a manner that significantly benefits lower and middle income taxpayers, allows Congress to alleviate the financial burden of some of the more needy parents as well as meeting the financial requirements of other working parents. Ideally, Congress will combine the better features of these bills: by increasing the thirty percent credit limitation to fifty percent as in the Carper, Snowe and Durenburger bills; disallowing the credit to taxpayers with adjusted gross incomes that exceed $60,000 as in the Carper bill; and making the credit refundable when the amount of the credit exceeds the taxpayer's liability as in the Durenberger bill.

Current attempts at tax simplification do not adequately address the child-care needs. Various legislative proposals give taxpayers an increase in the section 151(e) deduction but repeal the section 21 credit. Those with lower incomes would be especially hard hit in the simplification effort if the section 21 credit is eliminated. The bill that would provide needed relief by increasing the section 151(e) deduction and guaranteeing future indexing should be coupled with improvements to the section 21 credit for employment-related dependent-care expenses.

Finally, legislation such as The On-Site Day Care Privatization Act suggests that some members of Congress may finally be recognizing what those in the private sector have already come to realize: encouraging employers to provide child care for their employees results in more productive workers, better attendance, and better employee relations. The congressional effort to achieve these highly desirable goals suggests that Congress recognizes the need to support child care.