Ordinary People, Necessary Choices: A Comparative Study of Childcare Expenses

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This Article uses comparative analysis of childcare deductions in the U.S., Canada and Israel in order to expose the non-technical nature of the distinction between business and personal deductions. The comparative analysis reveals significant differences in the ways courts in the three jurisdictions have interpreted the distinction in the context of childcare expenses. Courts in these countries have dealt with the question in different eras and faced different legislative environments. The differences in time and legislative background not only help explain some of the differences among the courts' decisions in the three jurisdictions, but also expose the normative foundations of the seemingly technical distinction, demonstrating that the issue of childcare deductions in fact raises a question of baseline-setting. In allowing or disallowing the deduction of childcare, courts actually determine what counts — and more importantly what should count — for income tax purposes in general and deductions in particular. By exposing the baseline issues underlying questions of deduction, the Article demonstrates why it is preferable to explicitly use normative considerations in lieu of the so-called technical distinction between business and personal deductions. The comparative analysis further raises an institutional consideration; as shown, precisely because this is a baseline issue, legislatures, who enjoy a larger doctrinal tool box

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than courts, can offer greater flexibility as required when a variety of normative considerations should be taken into account.

INTRODUCTION

In many legal systems, when it comes to measuring taxable income, deductions are allowed for expenses incurred in carrying on trade or business, while deductions for personal expenses are disallowed. The business-personal distinction is deeply entrenched and enjoys wide support as one of the most basic elements of the Anglo-American income tax system. Traditional policy analysis of expenses takes as a given the allowance of expenses that are ordinary and necessary for the production of income, explaining it as an obvious (albeit not simple to apply) part of taxing net income. In its search for expenses that are "ordinary and necessary" for the production of income, conventional analysis focuses on a seemingly technical distinction between what is personal and what is business-related. Business-related items should be allowed, while personal items should (obviously) be disallowed. These accounts implicitly assume the existence of an obvious baseline from which these deductions are subtracted, and further assume that identifying this baseline is obvious, or — if not — is at least a matter of neutral observation, rather than of normative judgment.

The comparative analysis offered in this Article reveals significant differences in the ways in which courts in three different jurisdictions (the U.S., Canada, and Israel) have interpreted the distinction in the context of childcare expenses. Courts in the three countries have dealt with the question in very different eras — ranging from the 1930s in the U.S. to 2009 in Israel — suggesting a very different cultural setting in terms of gender equality and women's role in the work market. The three courts also faced very different legislative environments. Some courts dealt with the "business" nature of childcare deductions with a detailed legislative mechanism for considering childcare expenses in the background, while others had to decide whether or not childcare expenses would be recognized in any way. The differences in time and legislative background can not only help explain some of the differences between the courts' decisions in the three jurisdictions, but can also be used to expose the normative foundations of this seemingly technical distinction. By forcing us to transcend such technicalities, the comparative perspective helps us realize that the real problem underlying childcare deductions is the issue of baseline. As others have shown in such contexts as income or tax expenditures, technical distinctions in the context of deductions may work well if and only if the

baseline they reinforce is normatively solid. Thus, where the identification of the right (namely: the just) baseline is unclear, technical distinctions may merely conceal more disputes that they help settle. The comparative analysis offered here clarifies the baseline issue, and allows us to rethink the normative underpinnings of the personal-business distinction by presenting some viable interpretive and legislative alternatives for the tax treatment of childcare deductions.

Childcare — being one of the most personal items out there — was originally characterized as personal, and thus disallowed. Changing times have made this classification seem ill-suited. A narrative of the development of the jurisprudence of the three jurisdictions discussed below reveals that courts and legislatures have struggled with it. Courts have tried to modify the business-personal distinctions in keeping with changing times (some with more zeal than others). Legislatures have resorted to specifically crafted regimes of allowing some kinds of childcare. Both lines of action express discomfort with the result of disallowing childcare expenses.

Such discomfort suggests that either the original characterization of childcare as personal is essentially misguided, or that, as I argue, although childcare is indeed more personal than not, the personal-business distinction itself, in which these jurists were locked, is misguided as a conceptual framework for examining the question concerning which expenses should be taken into account for tax policy purposes and which should not.[1]

Legislatures — faced by political pressure — have simply bypassed the business-personal distinction by specifically allowing deductions or credits for childcare. Courts, on the other hand, have felt constrained by this entrenched distinction and found it hard to bypass. Not only has the business-personal distinction not provided them with the tools for reaching what they perceived as a just result, but it is actually this distinction that has made them struggle. In other words, perceiving the business-personal distinction as an essential part of tax policy has put courts in a straightjacket that limits their normative choices regarding the allowance of childcare. The pursuit of goals such as gender equality, efficiency, or supporting the choice of women to go out to work seemed beyond the reach of the technical, ostensibly scientific distinction that they perceived as an inherent part of tax law.

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1 For the distinction between these two arguments in the general context of income taxation, see Assaf Likhovski, *Categories of Gender and Class in Income Tax Legislation*, 24 TEL AVIV U. L. REV. 205, 216-17, 223 (2000) (Hebrew) and references there.

Contrary to the traditional perception of tax law and policy, I argue that the business-personal distinction is ill-suited for the job it is assigned to do. Instead of simply measuring the "correct" taxable income, using the business-personal distinction for measuring deductible expenses actually undermines the normative goals our tax laws seek to accomplish. Although at times it seems as if the distinction is perfectly suited for the job (e.g., when deciding that the costs of inventory should be deducted), this is only an elusive match because in such cases the baseline happens to be undisputed and the normative considerations align with the business-personal distinction. As a general matter, however, the business-personal test cannot encompass the variety of normative considerations involved. Instead, the technical distinctions used under traditional analysis of deductions assume away the normative considerations by referring to "ordinary" taxpayers as a neutral category. Thus, the business-personal distinction seems not only incapable of providing a clear distinction, but also misguided, as it essentially hides the underlying normative considerations it actually implicitly enlists.

As the discomfort of courts and legislatures with the traditional personal-business distinction in the context of childcare reveals, "ordinary and necessary for the production of income" is often the wrong question to ask. In looking for the items that could or couldn’t be allowed, we should not be looking at their personal or at their business-related nature. As the comparative case-study in the context of childcare deductions reveals, that distinction has little significance in itself and does not serve as a good proxy for the normative considerations that should guide us in designing tax systems. Therefore I suggest loosening the business-personal straightjacket and developing, in its stead, an alternative conceptual framework for analyzing deductions. That framework openly acknowledges the normative questions of a just baseline invoked by the questions of childcare deductions, without resorting to ad hoc unbridled judicial discretion. To do that, I suggest looking at the actual normative questions that include the traditional considerations of equity (distributive justice) and efficiency, as well as two additional considerations that are novel to tax policy analysis: individual identity and community. Identity refers to the way tax doctrines reflect, and at the same time shape, a certain image of an archetypal taxpayer — e.g., one that is healthy, married, childless, or living near her workplace. Community refers to the kind of communities we encourage or discourage through our tax system — e.g., two-earner families, communities that include people with disabilities or communities that are built around workplaces.

The Article proceeds as follows: In Part I, I look at the analysis of childcare expenses in three jurisdictions — the U.S., Canada and Israel — to demonstrate the difficulty in applying the standard distinction to the

normatively-charged case of childcare. I will discuss the struggle of courts and legislators in all three jurisdictions with the question of the deductibility of childcare expenses, as well as the discomfort they express with the results of a strict application of the business-personal distinction. Interestingly, although the solutions in the three jurisdictions vary, they all have one thing in common — they all stem from the same starting-point, where childcare is considered a decisively personal expense, and each has shifted away from disallowing a deduction (either through court decisions, legislation, or both).

Part II will highlight two important lessons to be learned from the comparative analysis: First, I will explain why the distinction is not and should not be based on a technical business-personal analysis, but rather (should) involve a set of normative considerations. Second, I will emphasize the difference in institutional capacities between courts and legislatures in solving the issues associated with childcare expenses. Part III will provide the normative analysis for handling childcare expenses. A Conclusion will follow.

I. COMPARATIVE CHILDCARE DEDUCTIONS

In Anglo-American legal systems, deductions are allowed for expenses incarrying on any trade or business,[2] while deductions for personal expenses[3] are disallowed. The business-personal distinction is deeply entrenched in the laws and court-decisions of all three jurisdictions discussed below — the

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2 In the U.S., I.R.C. § 162(a)(2) (2008) provides that "there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business . . . ." Furthermore, ordinary and necessary business expenses incurred by an individual for the production or collection of income are also deductible under section 212(1). In Canada, Income Tax Act, R.S.C., ch. 1 § 18(1)(a) (5th Supp. 1985) (Can.) provides that

> [i]n computing the income of a taxpayer from a business or property no deduction shall be made in respect of: (a) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property . . . .

In Israel, the Income Tax Ordinance [New Version], 5721-1961, § 17, 6 LSI 120 (1961) (Isr.) allows the deduction of "expenses incurred while producing income."

3 I.R.C. § 262(a) explicitly denies any deduction for "personal, living, or family expenses." Section 32 of the Israeli Income Tax Ordinance [New Version] disallows deductions for personal and household expenses. The section was explicitly amended in 2009 to disallow childcare deduction, commuting expenses, expenses for caring for another as well as other expenses that are not an integral part of the income producing process (i.e., expenses that are part of the natural process of producing income and the natural structure of the source of income).

U.S., Canada, and Israel — as well as many other countries,[4] and it enjoys wide support as one of the most basic elements of the income tax system. Traditional policy analysis of expenses takes as a given the allowance of expenses that are ordinary and necessary for the production of income, explaining it as an obvious (albeit not simple to apply) part of taxing net income.[5] Discussion thus focuses on whether a certain expense was "necessary for the production of income". In an effort to provide some guidance concerning the application of this test, courts, commentators, and administrators turn to intricate and often cyclic arguments of causation and/or motivation.[6]

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4 [I]n principle, every expense incurred in a business context should be deductible, unless it is: of a personal nature. . . . Virtually all countries follow this general structure, although there are peculiarities due to the history of the precise statutory terminology used and court decision. Limitations of deductions such as for entertainment and automobiles have become fairly common, although the structure and percentages allowed vary substantially. In the details there are significant policy differences on some items and there are some differences due to the statutory wording and judicial decisions, particularly on the dividing line between business and personal expenses and between capital and current expenses, but overall there is more harmony than divergence. One point of difference is on commuting expenses, which are considered personal in most countries, but of a business nature in Germany.

VICTOR THURONYI, COMPARATIVE TAX LAW 274-75 (2003).

5 The allowance of business expenses is commonly regarded as self-explanatory or so obvious that often no explanation is offered. It is often simply stated that it would be "unfair" to disallow business expenses. *See, e.g.*, Joel S. Newman, *The Story of Welch: The Use (and Misuse) of the "Ordinary and Necessary" Test for Deducting Business Expenses*, *in* TAX STORIES: AN IN-DEPTH LOOK AT TEN LEADING FEDERAL INCOME TAX CASES 155 (Paul L. Caron ed., 2003); Victor Thuronyi, *The Concept of Income*, 46 TAX L. REV. 45, 56 (1990). At other times, it is explained that taxing net income better simulates taxpayers' enrichment, which, in turn, is considered the best measure of the ability of taxpayers to take part in financing the government's expenses. *See, e.g.*, MARVIN A. CHIRELSTEIN, FEDERAL INCOME TAXATION 101 (9th ed. 2002). Other explanations rely on the electiveness of personal expenses as opposed to the nondiscretionary nature of business expenses. *Id.* at 101 ("Business expenses — the costs incurred by the taxpayer in earning gross income — are nondiscretionary in the sense that the income is conditioned on the outlay. Personal expenditures reflect the disposition which the taxpayer elects to make of the wealth that she has earned.").

6 *See, e.g.*, Tim Edgar, *The Concept of Taxable Consumption*, *in* TAX CONVERSATIONS: A GUIDE TO KEY ISSUES IN THE TAX REFORM DEBATE 293, 310 (Richard Krever ed., 1997); Daniel I. Halperin, *Business Deduction for Personal Living Expenses: A Uniform Approach to an Unsolved Problem*, 122 U. PA. L. REV. 859 (1974); Tsilly Dagan, *Tax Deductions*, 31 TEL AVIV U. L. REV. 257 (2009) (Hebrew) and references there.

However, as the comparative analysis below will show, the business-personal distinction is not very helpful in the normatively charged case of childcare. The development of the issue over the years is telling: All three countries started out from a decision, or at times simply an assumption, that childcare expenses were "personal" non-business expenses and thus should be disallowed. Courts discussing the issue in recent years, however, have either reconsidered the initial view or, at least, seemed to struggle with the analysis.

Childcare expenses have been traditionally characterized as personal, being a part of the traditional functions of the family household which had nothing to do with business functions or with the making of profit. As such, they fell under the extended umbrella of the personal, and were subject to the strict distinction between "personal" and "business" expenses, one that should be forcefully protected for fear of a slippery-slope type of argument, according to which if household choices are allowed as deductions, all other choices must be as well.

The distinction between the personal and the business could be tracked back to the British 1891 case of *Bowers v. Harding*, where a married couple employed a household servant in order to "enable [the] wife to have time to perform her duties as school-mistress." The Hardings argued that "but for" the housekeeper they would have been unable to earn the income. The court neither accepted the argument nor allowed the expense:

> [W]hen a man and woman accept an office there are certain detriments as well as profits, but this is in no sense an expenditure which enables them to earn the income in the sense of its being money expensed upon goods, or in the payment of clerks, whereby a tradesman or a merchant is enabled to earn an income . . . if we were to go into these questions with great nicety, we must consider the district in which the person lives, the altitude at which he lives, the price of meat and the character of the clothing that he would require . . . before we could come to any conclusion.[7]

Bowers as well as other early court decisions in other countries all followed a similar route — rigidly distinguishing between the "personal" and the "business" realm. Childcare was decisively on the personal side. This was true for all Anglo-American jurisdictions with no exception.[8] And there seemed to be no reason to reconsider such judgment.

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7 Bowers v. Harding, (1891) 1 Q.B. 560, 564.

8 The cases left questions related to the care of children firmly on the side of the personal. All these courts rejected an approach that would link

In a sense, childcare was a quintessential case of a "personal" expense, perhaps even the core of the private realm. Time, however, brought change in the social conception of the interaction between family and work. Such change created coalitions that operated politically, but have also affected the courts, upsetting their common wisdom and forcing them to realize that the obvious characterization of childcare as personal puts them in an uneasy position regarding their normative judgments. Such discomfort suggests that either the characterization of childcare as personal is misguided, or, as I later suggest, given the need to distinguish between personal and business deductions, childcare is indeed more personal than not, but the personal-business distinction itself is misguided, as it does not reflect the actual normative goals to which the tax system aspires.

The following subsections illustrate how change was facilitated in different countries. As we shall see, legislatures, courts and judges split in their views of the subject. Thus, while early decisions mostly look at childcare as a strictly personal expense, later views differ, with some courts (e.g., Israeli District and Supreme Court as well as Canadian courts) rethinking the personal characterization of childcare.

A. The United States

The U.S. Federal Tax code, just like the laws of many other countries, allows deductions for business expenses[9] as well as for expenses incurred for

> childcare to the ability to do business. Certainly, if one were thinking about reform to childcare, case law from other jurisdictions revealed that courts were uniformly reluctant to advance change through reinterpreting notions of public and private. The reluctance points in the direction of concerns related to the public/private, gendered roles with respect to family, and a latent sense that children were a matter of choice, and that deductions were perhaps inappropriate with respect to costs that were chosen rather than mandatory. Indeed the courts revealed themselves more commonly as adhering to traditional notions of private and as sustaining a separate private realm for questions related to children and their care.

REBECCA JOHNSON, TAXING CHOICES: THE INTERSECTION OF CLASS, GENDER, PARENTHOOD, AND THE LAW 24-25 (2002).

9 Section 162 of the Internal Revenue Code allows a deduction for "all the ordinary and necessary expenses paid or incurred . . . in carrying on any trade or business." I.R.C. § 162 (2008).

the production or collection of income,[10] and disallows[11] personal living and family expenses.[12] Yet, as Bittker, McMahon and Zelenak indicate,

> there is no possible way to reconcile all of the cases and rulings or the differing approaches of the various statutory provisions limiting deductions . . . . There is, unfortunately, no theoretically satisfactory boundary between business expenses that provide incidental personal benefits and personal expenditures that incidentally serve business purposes . . . .[13]

Childcare expenses — the focus of this Article — have been traditionally characterized as personal deductions. In the 1939 decision of *Smith v. Commissioner*,[14] the tax court held that a two-job married couple could not deduct as a business expense the cost of nursemaids employed to care for their young child during work hours. It is interesting to look at the language of the decision. The court was not unaware of changing times and practices: "We are told that the working wife is a new phenomenon. This is relied on to account for the apparent inconsistency that the expenses in issue are now a commonplace, yet have not been the subject of legislation, ruling, or adjudicated controversy."[15] Yet it saw no reason to abandon the old principles: "But if that is true it becomes all the more necessary to apply accepted principles to the novel facts."[16] The court chose instead to focus on what seems to be the inherently personal nature of childcare:

> 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

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10 Section 212 allows the "deduction of ordinary and necessary expenses . . . for the production or collection of income."

11 Section 272 forbids the deduction of personal, living and family expenses, except as otherwise expressly provided.

12 > In deciding whether expenses [are deductible] along the business-personal borderline . . . the IRS, courts, and congress have vacillated between four main approaches: The denial of any deduction for inherently personal expenses, allowing a deduction only if . . . the expense was increased by the exigencies of the taxpayer's business . . . allocate[ing] expenses between their business and personal componentså and allow[ing] a deduction for the full amount of the expense if it was incurred primarily for business . . . .
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> BORIS I. BITTKER, MARTIN J. MCMAHON, JR. & LAWRENCE A. ZELENAK, FEDERAL INCOME TAXATION OF INDIVIDUALS 11-14 (3d ed. 2002).

13 *Id.*

14 40 B.T.A. 1038 (1939), *aff'd per curiam*, 113 F.2d 114 (2d Cir. 1940).

15 *Id.* at 1039.

16 *Id.*

> wife's services as custodian of the home and protector of its children are ordinarily rendered without monetary compensation. There results no taxable income from the performance of this service and the correlative expenditure is personal and not susceptible of deduction. . . . Here the wife has chosen to employ others to discharge her domestic function and the services she performs are rendered outside the home. They are a source of actual income and taxable as such. But that does not deprive the same work performed by others of its personal character nor furnish a reason why its cost should be treated as an offset in the guise of a deductible item.[17]

What is the test, according to the court, for distinguishing between personal and business-related expenses?

> The line is not always an easy one to draw nor the test simple to apply. But we think its principle is clear. It may for practical purposes be said to constitute a distinction between those activities which, as a matter of common acceptance and universal experience, are "ordinary" or usual as the direct accompaniment of business pursuits, on the one hand; and those which, though they may in some indirect and tenuous degree relate to the circumstances of a profitable occupation, are nevertheless personal in their nature, of a character applicable to human beings generally, and which exist on that plane regardless of the occupation, though not necessarily of the station in life, of the individuals concerned.[18]

Childcare expenses were characterized as part of the latter category. In spite of harsh criticism the decision in *Smith* was never reversed, and is still valid today.[19] Nevertheless, recognition of the costs of child care has made its way into U.S. legislation although, as Ed McCaffery puts it, "[b]y seeing child-care expenses as a personal item when the issue first arose, the stage was set for the limited, begrudging, and rather openly manipulative legislation that has followed ever since".[20] This duality is no surprise, given

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17 *Id.*

18 *Id.*

19 For an extensive criticism and a review of the literature see EDWARD J. MCCAFFERY, TAXING WOMEN 111-14, 133 (1999) (concluding that "[t]he easiest answer to child-care expenses is to reverse the Smith case and allow deductions for such costs, up to the secondary earner's salary . . . . Child care should be thought of, contrary to the Smith case, a reasonably necessary cost of earning income for two-earner families").

20 MCCAFFERY, *supra* note 19, at 119.

that U.S. attitudes towards public financing for childcare have fluctuated between various and often conflicting values and goals. This inconsistency reflects a "continuing tension between public and private responsibility for the care of young children and a deep ambivalence toward 'other-than-mother' care on the part of the American public."[21] The sentiment against public funding was driven by several core American values, such as the belief in the freedom of individuals to raise their own children without government interference[22] (unless the family — or the country itself — is in crisis[23]), American ambivalence toward maternal employment, and the abovementioned strong distrust of other-than-mother care. On the other hand, other important values — such as equal opportunity and gender equality — supported public finance for childcare: early education for children was seen as a viable "antidote for social inequities." Affordable childcare has also been recognized as a vehicle to facilitate gender equality.[24] The sentiments against working mothers have softened somewhat over the past sixty years as increasing numbers of middle-class mothers of young children have entered the work force.[25] As more women entered the labor force, federal support for childcare was increasingly provided through the tax system rather than through subsidies or direct payments for childcare services.[26]

In 1954 Congress intervened and added a special dependent care deduction,[27] allowing tax deductions for childcare expenses to certain parents (e.g., single parents, poor families).[28] In 1976, the deduction was replaced by

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21 Abby J. Cohen, *A Brief History of Federal Financing for Child Care in the United States*, 6 FINANCING CHILD CARE 26 (1996) (citing ALICE KESSLER-HARRIS, OUT TO WORK: A HISTORY OF WAGE-EARNING WOMEN IN THE UNITED STATES (1982)).

22 *Id.* at 27 (citing Rochelle Beck, *White House Conferences on Children: An Historical Perspective, in* THE RIGHTS OF CHILDREN: REPRINT SERIES NO. 9, at 10 (Harv. Educ. Review ed., 1974)). The 1930 report issued by the White House Conference on Children declared: "No one should get the idea that Uncle Sam is going to rock the baby to sleep." *Id.*

23 *Id.*

24 In 1981, the U.S. Commission on Civil Rights issued a report that recognized the link between the availability of childcare and women's opportunities in society. The increase in the number of women in the paid labor force is at least partly attributable to women's efforts to attain equality and has broadened the constituency for public support. COMM'N ON CIVIL RIGHTS, CHILD CARE AND EQUAL OPPORTUNITY FOR WOMEN (Clearinghouse Publication No. 67, 1981).

25 Cohen, *supra* note 21, at 27.

26 *Id.* at 35.

27 I.R.C. § 214 (2008).

28 Cohen, *supra* note 21, at 36; BITTKER ET AL., *supra* note 12, ¶ 27.04. The legislation

a credit[29] of 20 percent of expenses up to a limit.[30] In 1981, the credit was revised again, to increase the amount of the benefit and to allow maximum tax benefit to lower-income taxpayers.[31] The current mechanism, *The Child and Dependent Care Tax Credit* (CDCTC), is a nonrefundable tax credit that covers a portion of one's employment-related child and dependent care expenses.[32] However, "[i]n all income ranges, the child-care credit is rare in its occurrence and limited in its generosity. Among the poorest couples, in particular, it is virtually nonexistent. A major reason for this is the fact that the credit is nonrefundable."[33]

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also made the credit available to couples in which one spouse worked fulltime and the other attended school fulltime, or one or both individuals worked part-time.

29 MCCAFFFERY, *supra* note 19, at 115. According to Cohen, "the change to a tax credit (rather than a deduction) reflected a desire on the part of policymakers to extend the child care payment to all taxpayers (not just those who itemized on their tax returns) and to help more taxpayers in the lower income brackets." Cohen, *supra* note 21, at 35.

30 BITTKER ET AL., *supra* note 12, ¶ 27.04.

31 *Id.*

32 Expenses are allowable for the care of children under thirteen and dependents of any age that are physically or mentally incapable of caring for themselves. The amount a family can claim with the CDCTC is delimited in four ways. First, the total amount of allowable expenses a family can claim is limited. Currently, the expense limit is $3,000 for families with one child in care and $6,000 for families with two or more children in care. Second, the amount a family claims cannot exceed the earned income of the lower earning taxpayer/spouse. Third, because the tax credit is not refundable, a family cannot benefit from the tax credit in excess of the amount they owe in federal income taxes. Finally, the credit is graduated on a sliding scale ranging from 20% for higher-income taxpayers to 35% for low-income taxpayers.

Nicole D. Forry & Elaine A. Anderson, *The Child and Dependent Care Tax Credit: A Policy Analysis*, *in* FAMILIES AND SOCIAL POLICY: NATIONAL AND INTERNATIONAL PERSPECTIVES 159, 162 (Linda Haas & Steven K. Wisensale eds., 2006). The CDCTC is designed to have differential impacts on families depending on the family's income level, with the maximum benefit targeted to the lowest income group of families (annual income of $15,000 or less) and declining proportionally for families with higher incomes. Despite the CDCTC being designed to maximize benefits for the lowest-income families, in reality, the opposite is often true. As this credit is nonrefundable, the only families who can fully realize the benefit of the credit are those with tax liability equal to or greater than the value of the credit. Thus, only moderate— and high-income families can obtain the full CDCTC for which they are eligible. *Id.* at 164. For a more detailed description see BITTKER ET AL., *supra* note 12, ¶ 27.04[1]-[2].

33 MCCAFFERY, *supra* note 19, at 117; *see also* Cohen, *supra* note 21, at 35-36 (arguing that thus, although current tax policy recognizes the relationship of child care to

Another way in which the U.S. code provides tax incentives for childcare is through the dependent care assistance programs, which allow employers to provide certain child and dependent care without considering them taxable fringe benefits.[34] The dependent-care assistance program requires an employer to establish a plan, and the employee to submit receipts for child care costs. Such plans are apparently not very popular.[35]

Equality-based constitutional challenges to the limited childcare deduction have in fact been attempted in the U.S. in the 1970s, but failed.[36] Hence, as mentioned, the *Smith* decision still holds: "Expenses for the care of children and other dependents that do not satisfy the statutory standards or that exceed its dollar limits continue to be nondeductible under the doctrine of the *Smith* case."[37]

B. Canada

Under the Canadian Income Tax Act (ITA), a taxpayer engaged in business is allowed to deduct expenses incurred for the purpose of earning income: Subsection 9(1) of the ITA defines income as "profit"[38] — a concept that is widely viewed as a net concept that "implicitly authorizes the deduction of

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income production and confers greater tax benefits on those with lower incomes, the dependent care tax credit has major limitations: It does not typically cover anything close to the full cost of care, it does not benefit all taxpayers, and it can be claimed only at the end of the year (after families have already had to pay their child care expenses). It remains, however, the largest public investment in child care and, as such, is critically important to the families that can utilize it).

34 I.R.C. § 129 (2008): "Gross income of an employee does not include amounts paid or incurred by the employer for dependent care assistance provided to such employee if the assistance is furnished pursuant to a program which is described in subsection (d)."

35 *See* MCCAFFERY, *supra* note 19, at 118 ("Somewhat surprisingly, given the potential tax savings, but not surprisingly, given the administrative inconvenience, only a small number of employees even have access to such plans."). McCaffery further argues that the provision was the result of the Regan's administration wish to support big businesses who were interested in solving their problems in "attracting retaining and increasing the productivity of their women employees" *Id.*

36 Namack v. Comm'r, 56 T.C. 1379 (1971), *aff'd.* 459 F.2d. 1045 (2d Cir. 1972), *and* Baldwin v. Comm'r, 36 T.C.M. (CCH) 995 (1977)), *cited in* JOHNSON, *supra* note 8, at 33-34.

37 BITTKER ET AL., *supra* note 12, ¶ 27.04.

38 Income Tax Act, R.S.C., ch. 1 § 9(1) (5th Supp. 1985) (Can.), as amended: "Subject to this part, a taxpayer's income for a taxation year from business or property is the taxpayer's profit from that business or property for the year."

legitimate expenses" incurred in order to earn income from the business to which the expenses relate.[39] Such legitimate expenses are the ones incurred by the taxpayer in accordance with well accepted principles of commercial trading.[40] Although potentially unnecessary,[41] section 18 of the ITA explicitly limits the deduction of expenses that are not incurred for purposes of earning business or property income,[42] and personal expenses.[43] Although personal or living expenses are generally not deductible in computing income from

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39 DAVID G. DUFF, BENJAMIN ALARIE, KIM BROOKS & LISA PHILIPPS, CANADIAN INCOME TAX LAW 570-71 (2d ed. 2006) (citing Tonn v. Canada, [1996] 1 C.T.C 205 (Fed. Ct.)). *See also* Daley v. Minister of Nat'l Revenue, [1950] C.T.C. 254, 260 (Can. Tax Ct.): "The deductibility of the . . . expenses that may properly be deducted 'in computing the amount of the profits or gains to be assessed' is inherent in the concept of 'annual net profit or gain.'"

40 This concept replaced the former deference to the accounting profession under the "ordinary principles of commercial trading or well accepted principles of business and accounting practice" that was used in Royal Trust Co. v. Minister of Nat'l Revenue, [1957] C.T.C. 32 (Ex. Ct.). See Iaacobucci J's judgment in Symes v. Canada, [1993] 4 S.C.R 695, 723:

> Any reference to GAAP connotes a degree of control by professional accountants which is inconsistent with a legal test for "profit" . . . . Further whereas an accountant questioning the propriety of a deduction may be motivated by a desire to present an appropriately conservative picture of current profitability, the income tax act is motivated by a different purpose: the raising of public revenues. For these reasons, it is more appropriate in considering the subsection 9(1) business test to speak of "well accepted principles of business (or accounting) practice" or "well accepted principles of commercial trading."

41 *See Symes*, [1993] 4 S.C.R. at 721. At one time, it was not clearly understood whether the authority for deducting business expenses was located within what is now section 9(1) or within what is now section 18(1)(a). In a series of decisions culminating in *Royal Trust Co.*, however, Thorson P. recognized that the deduction of business expenses is a necessary part of the section 9(1) "profit" calculation. "In other words, the 'profit' concept in section 9(1) is inherently a net concept which presupposes business expense deductions. It is now generally accepted that it is section 9(1) which authorizes the deduction of business expenses; the provisions of section 18(1) are limiting provisions only." *Symes*, [1993] 4 S.C.R. at 721.

42 Section 18(1)(a): "In computing the income of a taxpayer from a business or property no deduction shall be made in respect of (a) an outlay or expense except to the extent that it was made or incurred by the taxpayer for the purpose of gaining or producing income from the business or property."

43 Section 18(1)(h): "In computing the income of a taxpayer from a business or property no deduction shall be made in respect of . . . (h) Personal or living expenses of the taxpayer, other than travel expenses incurred by the taxpayer while away from home in the course of carrying on the taxpayer's business."

a business or property, courts' application of the distinction between the business and the personal demonstrates the faltering nature of the business-personal distinction, the results of which do not seem to align with normative intuitions.[44] Thus, for example, the wages of a housekeeper hired by a single farmer that was not to stay alone due to a stroke were characterized as personal,[45] but the fees paid by an employer for clubs joined by its employees were allowed, since membership in the clubs had produced profitable business for the appellant.[46] One would assume that — like the housekeeper in the first case — clubs' contribution to the income-earning nature of the business was "of a secondary nature"; however, the court ruled differently.

Our case-study — childcare expenses — provides an even more pointed

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44 See for example the minority opinion in *Symes*, [1993] 4 S.C.R. at 794: "In the past, the scope of deductible business disbursements has been expanded constantly. It has been held to include a wide array of expenditures, such as club dues, meals and entertainment expenses, car expenses, home office expenses, legal and accounting fees, to name only a few." The opinion goes on to survey some of these deductions, including the expenses which were incurred for Rolls Royce and BMW, to the extent that these automobiles were used for business, (as was ruled in Friedland v. The Queen, [1989] 89 D.T.C. 5341 (Fed. Ct.)), and cases in which an employer or a business was allowed a deduction for employees' salaries and for employer's contributions to an employee benefit package, with a daycare centre possibly included as such an employee benefit.

45 Thomas Harry Benton v. Minister of Nat'l Revenue, [1952] 6 Tax A.B.C. 230 (Can. Tax Ct.): Mr. Benton was single and operated a farm. Due to a slight stroke, he was not to stay alone. He thus had a housekeeper that also helped him with some of the farm's work. The court approved of the minister's decision to allow only part of her wages: "The evidence given satisfied me that Mrs. Reed was primarily a house-keeper engaged in the usual domestic duties performable on a farm and that her contribution to the income-earning work of the farm was necessarily of a secondary nature, however helpful it may have been to the appellant." *Id.* at 230.

46 The Royal Trust Co. — the taxpayer company had developed a policy of requiring certain of its employees to join social clubs and other community organizations. The company paid all fees involved. The courts approved it as a business deduction:

> [T]here is, in my opinion, no doubt that it was consistent with good business practice for a trust company like the appellant to make the payments in question. They were made as a matter of business policy that had been carefully considered, was well regulated and had been in effect for many years prior to the year in question . . . . Membership in the clubs had produced profitable business for the appellant . . . I have already found that the payments by the appellant were made in accordance with principles of good business practice for a trust company. It is equally clear, in my opinion, that they were made by the appellant for the purpose of gaining or producing income from its business.

Royal Trust Co. v. Minister of Nat'l Revenue, [1957] C.T.C. 32, para. 34 (Ex. Ct.).

example of the unsettling results of the traditional application of the business-personal distinction when viewed from a normative perspective. In Canada as well, childcare expenses were traditionally regarded as nondeductible personal expenses.[47] The early cases drew on reasoning similar to the 1891 English case of *Bowers*.[48] In one case, for example, the Canadian court determined that the payment for a nanny was disallowed, as the plaintiff might have had such an employee at her home "even if she had not been following [her] occupation."[49] Even as late as 1968, the Carter commission appointed to examine the entire federal tax system — still viewed childcare as strictly personal, explicitly recommending that "for greater certainty, and to ensure that some obvious personal living expenses would not be deducted, the regulations should specify those expenses that could not be deducted . . . such things as commuting expenses, the costs of child care and recreational club membership should be explicitly denied as deductions."[50]

Public debate put political pressure on the Canadian government to amend the tax act[51] and in 1972 the Canadian legislature introduced an amendment to the Income Tax Act that allowed a limited deduction for childcare expenses.[52]

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47 Brian J. Arnold, *The Deduction for Childcare Expenses in the United States and Canada: A Comparative Analysis*, 12 W. ONTARIO L. REV. 1, 26 (1973) and references there; DUFF ET AL., *supra* note 39, at 1169 and references there; *see, e.g.*, Lawlor v. Minister of Nat'l Revenue, [1970] Tax A.B.C. 369 (Can. Tax Ct.).

48 Bowers v. Harding, (1891) 1 Q.B. 560. *See, e.g.*, *Symes*, [1993] 4 S.C.R. at 794:

> It is sufficient to note, as did the trial judge below, that the line of reasoning supporting such a characterization is ultimately founded upon the English decision of Bowers v. Harding, supra, and brief examination of that case can help to explain the historical classification of child care expenses as personal expenses.

49 No. 68 v. Minister of Nat'l Revenue, [1952] 7 Tax A.B.C. 110, 110 (Can. Tax Ct.).

50 CAN. ROYAL COMM'N ON TAXATION, REPORT OF THE ROYAL COMMISSION ON TAXATION 274 (1968).

51 For a fuller description, see JOHNSON, *supra* note 8. The Canadian government's 1969 white paper on tax reform:, "[W]e consider it desirable on social as well as economic grounds to permit a tax deduction for child care expenses under carefully controlled terms." E.J. BENSON, CAN. GOV'T, PROPOSALS FOR TAX REFORM 15 (1969). Johnson explains the shift between the Carter commission and the white paper in its timing: "[C]onsultations for the 1969 white paper were conducted around the same historical juncture as the royal commission on the status of women . . . . Pressure was mounting to acknowledge the financial and economic costs carried by women because of childcare responsibilities. Indeed, the briefs submitted to the commission were virtually unanimous in their demand for more generous treatment of the expenses of childcare for working mothers." JOHNSON, *supra* note 8, at 26-27.

52 Income Tax Act, S.C 1970-71-72, c. 63 (Can.). The political turmoil around the deduction did not stop at that. For further description of the political process concerning the deduction of childcare, see JOHNSON, *supra* note 8, at 27-32.

According to the new provision, taxpayers may deduct amounts paid "as or on account of child care expenses incurred for services rendered in the year in respect of an eligible child of the taxpayer."[53] Such services must be provided "to enable the taxpayer or the supporting person of the child for the year . . . to perform the duties of an office or employment, carry on a business or research in respect of which the taxpayer received a grant or attend a secondary educational institution."[54]

In 1994 the Supreme Court of Canada reconsidered the deductibility of childcare expenses as a business expense.[55] The court explained why it was appropriate to reexamine whether childcare expenses are appropriately characterized as personal expenses. Quoting the trial judge, the Supreme Court agreed that

> there has been significant social change in the late 1970s and into the 1980s, in terms of the influx of women of child-bearing age into business and into the workplace . . . . The increased participation of women in the Canadian workforce is undoubtedly a change in the "social foundation" . . . . Accordingly I do not feel that I must slavishly follow those cases which have characterized child care expenses as personal in nature.[56]

This explanation seems to indicate that the *application* of the distinction in the case of childcare (rather than the distinction itself) might have been flawed.

Elisabeth Symes was a practicing lawyer and a mother of two children who asked to deduct her childcare costs as business-related expenses beyond the deduction allowed by section 63. The deduction was disallowed, as the expenses were characterized as personal or living expenses under section 18(1)(h).

At first glance it seems as if the case confirmed previous cases that

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53 Such amounts are subject to three general limitations: first, the amount that may be deducted cannot exceed $10,000 per year for each child who is disabled, $7000 for each child under seven years old, and $4000 for each other child; second, the amount deducted cannot exceed 2/3 of the taxpayer's earned income; and third, the deduction must be claimed by the parent with the lower income.

54 Income Tax Act, R.S.C., ch. 1 § 63(3) (5th Supp. 1985) (Can.) (definition of "child care expense").

55 Symes v. Canada, [1993] 4 S.C.R 695. Lisa Philipps sees this very decision not to follow tax precedent as a breakthrough in opening tax law to gender analysis. Lisa Philipps, Commentary, *Measuring the Effects of Feminist Legal Research: Looking Critically at "Failure" and "Success,"* 42 OSGOOD HALL L.J. 604 (2004).

56 *Symes*, [1993] 4 S.C.R at 728.

similarly characterized such a deduction. However, a closer look reveals a more nuanced approach by the Canadian Supreme Court to whether childcare expenses should be characterized as personal, or as business deductions due to the evolving background culture of the Canadian business community. The nine justices on the Supreme Court of Canada split in their decision. The majority disallowed the deduction, while dissenting Justices L'Heureux-Dubé and McLachlin ruled to allow the deduction of childcare.

But even the majority opinion, delivered by Justice Iacobucci, offers a nuanced approach to the question of concern to this Article. In fact, the court specifically declined to decide that such expenses were either personal or business related:

> [C]onsidering only ss. 9, 18(1)(a) and 18(1)(h), arguments can be made for and against the classification of the appellant's child care expenses as business expenses. In another case, the arguments might be differently balanced, since the existence of a business purpose within the meaning of s. 18(1)(a) is a question of fact, and that the relative weight to be given to the factors analyzed will vary from case to case. However, in general terms, I am of the view that child care expenses are unique: expenditures for child care can represent a significant percentage of taxpayers' income, such expenditures are generally linked to the taxpayer's ability to gain or produce income, yet such expenditures are also made in order to make a taxpayer available to the business, and the expenditures are incurred as part of the development of another human life. It can be difficult to weigh the personal and business elements at play . . . I am aware that if I were compelled to reach a conclusion with respect to the proper classification of child care expenses with reference to only ss. 9, 18(1)(a) and 18(1)(h) of the Act, such a conclusion would involve competing policy considerations.[57]

The major consideration in favor of disallowing childcare expenses was "the availability of the taxpayer to the job," or in the language of the decision:

> If a need exists even in the absence of business activity, and irrespective of whether the need was or might have been satisfied by an expenditure to a third party or by the opportunity cost of personal labour, then an expense to meet the need would traditionally be viewed as a personal expense. Expenses which can be identified in this way are expenses

57 *Id.* at 741-42.

> which are incurred by a taxpayer in order to relieve the taxpayer from personal duties and to make the taxpayer available to the business. Traditionally, expenses that simply make the taxpayer available to the business are not considered business expenses since the taxpayer is expected to be available to the business as a *quid pro quo* for business income received. This translates into the fundamental distinction often drawn between the earning or source of income on the one hand, and the receipt or use of income on the other hand.[58]

In other words, since parents should attend to their children with or without work, the fact that they would have done so themselves (thus incurring the opportunity costs of not earning another income) should not matter. To this, the minority decision made the following comment:

> In my view, such a test serves no purpose. The rationale of availability to the business is neither objective nor determinative. To be available for the business is the first requirement of doing business, otherwise, there can be no business. In this regard, it would be unthinkable for a businessperson's special needs, for example those associated with a disability, to be ineligible for deduction because they satisfy a "personal need." A woman's need for child care in order to do business is no different. One's personal needs can simply not be objectively determined, they are by their very definition subjective.[59]

On the other hand, the court did recognize the link between childcare and earning income. The court even went as far as acknowledging Prof. Macklin's "interesting" comments[60] that

> as long as business has been the exclusive domain of men, the commercial needs of business have been dictated by what men (think they) need to expend in order to produce income . . . . Women's needs in doing business will necessarily be different, and one might reasonably demand a reconceptualization of "business expenses" that reflects the changing composition of the business class,[61]

and admitted that

> It is difficult to argue that history has not conflated the "needs

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58 *Id.* at 738-39.

59 *Id.* at 791-92 (minority opinion).

60 Referring to Audrey Macklin, Symes v. M.N.R: *Where Sex Meets Class*, 5 CAN. J. WOMEN L. 498, 507-08 (1992).

61 *Symes*, [1993] 4 S.C.R at 743.

> of businessmen with the needs of business" as Professor Macklin suggests. Therefore, to the extent that traditional income tax law would classify child care expenses as "personal" simply because such expenses are incurred in order to make the taxpayer "available" to the business — and in the absence of s. 63 — it might be correct to assert that the changing composition of the business class and changing social structure demand a reconceptualization.[62]

This position was taken by the minority opinion, to necessitate the "logical conclusion" that the Act does not prevent the deduction of childcare expenses as business deductions. In the words of Justice L'Heureux-Dube: "In my view, the logical conclusion to my colleague's analysis, although he does not state it as such, is that ss. 9, 18(1)(a) and 18(1)(h) do not prevent the deduction of child care expenses as a business expense."[63]

The majority, however, declined to explicitly decide on the question whether or not childcare can be considered a business-related expense, determining that section 63's limited deduction was meant to exhaustively deal with the question of childcare.[64] In Justice Iacobucci's words:

> I find it unnecessary to determine whether reconceptualization is appropriate having regard to the presence of s. 63 . . . In fact, as I will now attempt to demonstrate, I do not believe that ss. 9, 18(1)(a) and 18(1)(h) can be interpreted to account for a child care business expense deduction, in light of the language used in s. 63.

And he concluded[65]:

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62 *Id.* at 743-44.

63 *Id.* at 787.

64 The Minority disagreed:

> First, there is nothing in the wording of s. 63 that overrides the application of s. 9. Second, such an interpretation is, in my view, in contradiction with the purpose and historical basis for the enactment of s. 63, with traditional approaches to diverse deductions under the Act and, finally, with the Charter.

Id. at 806.

65 The court further discussed section 15 of the Charter in order to determine whether section 63 of the Act has an adverse effect upon women in that it unintentionally creates a distinction on the basis of sex. Although at first glance the constitutional discussion does not seem to be directly linked to our discussion, it does demonstrate the limited scope attributed by the court to the Income Tax Act. The court concluded that no such adverse effect was proven. It made a distinction between "effects which are wholly caused, or are contributed to, by an impugned provision, and those social circumstances which exist independently of such a provision," and determined that, although women undoubtedly carry the social burden of childcare,

> the appellant taxpayer has failed to demonstrate an adverse effect created

> For these reasons, a straightforward approach to statutory interpretation has led me to conclude that the Act intends to address child care expenses, and does so in fact, entirely within s. 63. It is not necessary for me to decide whether, in the absence of s. 63, ss. 9, 18(1)(a) and 18(1)(h) are capable of comprehending a business expense deduction for child care. Given s. 63, however, it is clear that child care cannot be considered deductible under principles of income tax law applicable to business deductions.[66]

Taken as a whole, I believe that the Canadian Supreme Court decision in *Symes* cannot be read as a full-blown assertion regarding the personal nature of childcare expenses. It is hard to determine what conclusion the court might have reached absent section 63.[67] At the minimum, however, the decision in *Symes* represents a middle-of-the-road decision regarding the deductibility of childcare as a business expense — one that lies between the

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> or contributed to by s. 63, although she has overwhelmingly demonstrated how the issue of child care negatively affects women in employment terms. Unfortunately, proof that women pay social costs is not sufficient proof that women pay child care expenses. Those social costs, although very real, exist outside of the Act . . . .

The court thus concluded that section 63 did not violate section 15(1) of the Charter since the appellant had not proved that section 63 draws a distinction based upon the personal characteristic of sex. The court did not reject the possibility that such a distinction might be proved in another case: "The appellant in this case belongs to a particular subgroup of women, namely, married women who are entrepreneurs. It is important to realize that her evidentiary focus was skewed in this direction." *Id.* at 765-66 (majority opinion).

66 *Id.* at 750-51.

67 For the significance of the court's analysis, in spite of its final result, see Philipps, *supra* note 55, at 609-10:

> The Court then stated that "it is difficult to argue that history has not conflated the 'needs of businessmen with the needs of business' as Professor Macklin suggests." Having accepted this analysis, the Court appeared torn about how to characterize Symes' nanny expenses observing that "[i]t can be difficult to weigh the personal and business elements at play." Unfortunately, the majority decided it was not required to resolve this conundrum because the partial deduction allowed under section 63 was intended to be a complete code for deduction of child care expenses . . . . This was certainly a disappointing turn in the reasons. Given the majority's initial eagerness to get to the root of the business/personal distinction, and its refreshing openness to the possibility of gender bias in the conceptual foundations of tax law, it seemed to be a formalistic and disingenuous conclusion. However, this should take nothing away from the progress that was made in challenging the axiomatic treatment of child care expenses as personal, and in admitting the relevance of gender analysis to the interpretation of technical income tax rules.

rigid approach of the *Smith* and *Bowers* cases and the minority approach (shared by the Canadian district court as well as the Israeli district court and supreme court) towards childcare as "ordinary and necessary for the production of income." The important point, for our case, is that what started out in Canada as an obvious case of personal expenses, ended in the *Symes* decision with an indecisive result regarding the deductibility of childcare, based on "competing policy considerations."

C. Israel

Like other Anglo-American systems, the Israeli tax system too allows the deduction of expenses incurred for the production of income, and disallows personal expenses as well as expenses of the household.[68] The business-personal distinction is widely accepted as one of the very basic distinctions in the Israeli tax system.[69] The distinction is — as in other systems — not a simple one. Up until this year (2009), courts were the ones to interpret the distinction.[70] The Tel Aviv district court has decided that for an expense to be considered business-related it should be part of the "organic process" of income production:

> It is not enough that a person incurs the expense in order to produce income. If this were the case, he should have been able to deduct his private expenses for food and shelter, as one cannot work and produce income without food and sleep . . . . [T]he test is much narrower. Law views income production as an organic process, a matter of its own. The process is the sum of certain actions and phenomena, ordinary as well as extraordinary, belonging to such income-producing. What are such actions and phenomena and what are actions and phenomena beyond the production process? These questions should be answered

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68 Income Tax Ordinance [New Version], 5721-1961, § 32(1), 6 LSI 120 (1961) (Isr.). For a general discussion of the personal-business distinction and a critical analysis, see Likhovski, *supra* note 1, at 223.

69 *See, e.g.*, ALFRED WITKON & YAAKOV NE'EMAN, DINEI MISSIM [TAX LAWS] 157-58, 160 (1969) (Hebrew).

70 In 2009 the Income Tax Ordinance was amended to explicitly disallow "expenses that are not an integral part of the income producing process (i.e., expenses that are part of the natural process of producing income and the natural structure of the source of income." Amendment to Income Tax Ordinance (no. 170), 2009, 2202 S.H. 152.

> according to general accepted principles and the natural feeling of the courts.[71]

The distinction has focused on whether an expense was "incidental to the production process." This test implicitly assumes that each taxpayer has at least two capacities — private and income producing — and the two should not be mixed. The process of producing income is one that can (and should) be distinguished from other areas of life.[72] Using the incidental criteria, courts have denied deductions that are linked to taxpayers' life circumstances, whether such circumstances were under her control (such as childcare or commuting expenses) or not (health-related expenses), whether randomly distributed among the population (e.g., food) or not (e.g., disabilities).

For some years now, arguments have been made in support of the deduction of childcare expenses.[73] Although these claims drew the attention and at times the support of lawmakers, and even though there have been proposals to amend the law to allow some support for childcare,[74] until 2009 childcare deductions were not allowed by law, although a proposal to allow such deductions has gained significant support.[75]

Childcare expenses were traditionally characterized by the tax authorities as personal, and requests for their deduction were denied based on their assumed personal nature. The position of the tax authorities was that such expenses are similar to expenses on food, shelter, clothing, etc. Childcare expenses, they argued, are either inherently personal and non-incidental to the production of income or mixed business-personal expenses.[76]

Recently the issue of the deductibility of childcare expenses was brought

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71 Income Tax Appeal (TA) 5/50 A.Z. v. Assessing Officer, [1950] IsrDC 40(30) 456, 458-59.

72 *Id.* at 459.

73 *See, e.g.*, Yoram Margalioth, *On False Regressivity and the Taxation of the Family*, 2 NETHANYA L. REV. 351 (2002) (arguing that the expenses for the non-personal component of childcare, i.e., child-supervision, should be explicitly allowed as a business expense); Likhovski, *supra* note 1, at 270-71; Dagan, *supra* note 6, at 369-70.

74 For a comprehensive review and analysis of the legislative proposals see Margalioth, *supra* note 73; *see also* Tsilly Dagan, *The Costs of Childcare*, 25 MEHKAREY MISHPAT [BAR ILAN L. REV.] (forthcoming 2010) (Hebrew). A pilot program was launched in 2006 in a couple of cities to examine the effect of an additional credit for working mothers as compared with an increased subsidization for daycare. This pilot was criticized for its location — in unemployment-stricken cities.

75 See Draft Bill Amending the Income Tax Ordinance (no. 156), 2007, HH, 194 (allowing a credit and a deduction for childcare expenses) that passed the first stage of legislation on October 25, 2006.

76 See tax authorities' position as cited by the court in Income Tax Appeal (TA) 1213/04

before the district court in the case of a Vered Perry, a lawyer who claimed a deduction for the costs she incurred for childcare. The district court accepted the claim.[77] In a landmark decision, the Supreme Court approved the revolutionary decision of the district court.[78]

Distinguishing the costs of "supervising" children from the costs of various enrichment programs, and allowing the former as deductions "in the process of producing income,"[79] the district court ruled that while the mother was at work, the costs of supervising her kids are "in the production of income" and are incidental to the income producing process.[80]

The supreme court followed a similar route and interpreted the incidentality test as being designed to achieve the purpose of income taxation, which is to impose a "genuine tax." This purpose, Justice Rivlin stressed, teaches us that in order for it to be allowed, an expense need not be integral to the nature and design of the income producing process. Rather, it is enough that it is paid for (and only for) the production of income. Other expenses that have a real and direct connection to the income producing mechanism should be allowed, as well. Thus, the court approved

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Perry v. Assessing Officer Gush Dan, 22 MISSIM, at E-11 (Apr. 3, 2008) (district court decision).

77 *See id.*

78 See CA 4243/08 Assessing Officer Gush Dan v. Perry, Pador 884(9)09 (Apr. 30, 2009).

79 *Perry* (district court decision).

80 *Id.* at 11:

> The [tax authority] asks the court to conclude that the costs of supervising children are by their very nature not only personal but also are not incidental. That we are concerned with an expense that is setting the ground for the production of income but is not "in the production of income". [They] refer us to the costs of commuting that were disallowed since they are "expenses incurred in order to get to the site of income-production" and are not "in the production of income" . . . . The expenses on supervising children are unlike [expenses on] food and medication . . . since food and medication are consumed anyway, even when the person is not producing income. This is not the case for commuting expenses . . . . The [tax authority] stresses. . . that the test is not just the expense being necessary, but also that it is used in the income production. Commuting expenses are not used in such production, rather they are incurred to and from the workplace, and thus are not used while producing income . . . . If not for the need to get to work, the taxpayer would not have incurred the expense . . . as long as the taxpayer is at work; she can produce income only due to the fact that her children are under supervision . . . at the minimum, the cost of supervising the children is a cost of increasing [the parents'] productivity . . . .

the district court's decision to allow the costs of "supervising" children (as in hiring a babysitter or a nanny), but not the costs that entail an added educational or enrichment value. In other words, the Israeli court in the *Perry* case distinguished between two kinds of childcare — one that is predominantly personal (the enrichment part) and another that, although it entails some personal components, is predominantly business-related (the supervision part) — and was willing to see the supervision part as incidental to the income-producing process. Although this undoubtedly reflects a revolutionary position on the part of the court (in Israeli terms, as well as from a comparative perspective), it is important to note that the Israeli tax system, unlike the other systems discussed, did not — at the time — have a specific instruction permitting some level of deduction for childcare expenses.[81] The court called upon the legislature to handle the details required for the application of the new interpretation, noting that clarification of the distinction set by the court is required.

Following the Supreme Court's decision, a quick (and some would say hasty) legislative process took place. The Knesset (Israel's parliament) quickly approved an amendment to the Income Tax Ordinance, disallowing the deduction of childcare (along with other "borderline" expenses such as commuting expenses and the costs of caring for a disabled relative), but allowing instead a modest, nonrefundable credit for working mothers of children under the age of five, as well as a limited "negative income tax" for working mothers of children under the age of two.[82] As part of the same amendment, the Israeli legislator has reestablished the original test for distinguishing between business and personal deductions, explaining that allowed deductions are those that are "integral to the natural process of income-producing and which are an inseparable part thereof."[83]

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The bottom line is that we have seen quite a wide variety of interpretations of the "ordinary and necessary" phrase with regard to childcare among and within the various jurisdictions, alongside a wide variety of legislative

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81 The Israeli code did include a very limited credit for children of working mothers, under the age of eighteen but this is granted whether or not the family incurs childcare expenses. The Supreme Court was not convinced that this credit was designed in lieu of childcare expenses.

82 Amendment to Income Tax Ordinance (no. 170), 2009, 2202 S.H. 152.

83 Income Tax Ordinance [New Version], 5721-1961, § 32(1), 6 LSI 120 (1961) (Isr.) (as amended in 2009).

mechanisms. Such variety is a good indication of the fact that the business-personal distinction is neither technical nor in any way objective. Rather, it is a question of interpretation that is based on an assumed (and often not explicitly recognized) normative baseline. If that is the case, I will argue, tax law should more explicitly recognize the normative considerations at stake. To do that, I suggest going back to the normative considerations that underlie the tax system.

II. LESSONS FROM THE COMPARATIVE ANALYSIS

Attempting to determine whether childcare expenses are either business related or personal in nature, it seems that they easily fit into both categories: childcare expenses are highly personal and yet, at the same time, necessary for the production of income. This duality of childcare expenses illustrates the limits of the traditional distinction between business and personal expenses in setting the boundaries between deductible and nondeductible expenses. As the above comparative analysis of childcare shows, the business-personal distinction has not provided courts with the appropriate tools — such that would align their decisions with their normative sentiments regarding the appropriate results. Hence, in spite of the initial position viewing childcare as emphatically personal, in all three jurisdictions, there has also been evident discomfort with the characterization of childcare as strictly personal. This could certainly be interpreted as discomfort regarding the way in which the distinction between "personal" and "business" was drawn.[84] I suggest, however, that the problem goes deeper than that, to the very requirement to distinguish "personal" from "business" expenses absent a normative baseline. In other words, I suggest that when courts tried to move away from disallowing the costs of childcare, it was not because they felt childcare was, in fact, a business-related expense, but rather because they felt it was not right to disallow it, and yet business deductions were (and still are) the only ones allowed. Courts did not find it easy to weave their sentiments regarding gender equality and women's choice into characterizing childcare as business-related. That is not surprising. The business-personal distinction, I suggest, is simply not the right question to be presented by the law. Whether or not childcare expenses should be allowed is, in effect, a

84 For an analysis of the private-business distinction as a product of specific cultural conceptions identifying the private sphere with women (hence disallowing expenses relating to women), see Likhovski, *supra* note 1, at 225.

normative decision, that cannot be determined by characterizing the expense as personal or business-related. Naturally, such normative decisions will vary according to the different times, cultures and political environments in which they are made.[85]

In this Part, I will highlight two points that emerge from the comparative analysis: in Section A, I will criticize the conventional analysis that stresses the technical nature of the distinction, and argue that courts should be explicitly considering normative considerations in allowing the costs of childcare. In other words, instead of the seemingly technical business-non-business distinction, courts should explicitly consider the values that are at stake: equity, efficiency, identity and community. A normative approach, I suggest, would bring about preferable results. In Section B, I will take up the institutional angle and argue that when — as in the childcare context — the question is one of baseline rather than of fine-tuning a general principle, the legislature enjoys a relative institutional advantage.

A. The Inadequacy of Current Distinctions

In order to characterize expenses as business-related or as personal, traditional discourse has often looked for the "real" nature of childcare expenses. Conventional wisdom has made an effort to pinpoint the nature of the expense by attempting to more carefully distinguish the business-motivated expenses from the personal ones.

This attempt, however, is elusive, absent a normative baseline that establishes what *should* be considered business-related (and thus deductible) and what should not. Whether or not a deduction is business-related is not a question that can be answered by positively examining reality. This distinction raises substantive questions: when does a person stop being a parent, a family member, or a member of a community and becomes an income-producer? Can we really say that some expenses do not simply fulfill his preferences but rather serve the (external) goal of producing income? In order to argue that some expenses are indeed income-producing, we

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85 The minority in *Symes* explicitly recognized this:

> It is with these statistics and expert testimony in mind that we must consider whether child care expenses can be accommodated within the definition of a business expense. In this regard, I agree with Cullen J.'s thoughtful and thorough analysis of the complex issues in this case, which recognizes the evolution of our societal structure and mandates that the interpretation of statutes be done in context, not in a vacuum . . . .

Symes v. Canada, [1993] 4 S.C.R 695, 793.

have to implicitly assume a normative taxpayer (which — under traditional analysis — is often childless, healthy and living close to her workplace) and then consider any expense of an "abnormal" taxpayer as personal consumption. Setting this baseline is obviously a normative decision. In the context of childcare, this implicit normative baseline was most probably designed to reflect what was customary among businessmen of a former era. However, there is nothing natural or essential about it. We could, and in fact should, carefully design this baseline to explicitly reflect the normative considerations relevant to our time and culture.[86] These normative considerations should adhere to the differences among taxpayers that we consider relevant to the way the costs of public goods should be allocated, the incentives we wish to provide, as well as the desirable expressive messages we want to convey.

Moreover, the distinction between business and personal deductions is in itself not very convincing. Often, there is nothing inherently personal or inherently business-related in many of the expenses being labeled as such. It is our labeling that makes them one or the other, and hence allows or disallows them. In such cases, labeling an item as either personal or business-related without resorting to normative considerations is circular;[87] our labeling of an item as a business or personal expense depends on our assumptions as to what is "ordinary and necessary" for the production of income. What is considered ordinary and necessary is based on some assumptions as to what is normal, and at the same time constructs the very same norm. Hence, the seemingly innocuous decision regarding the deductibility of a certain expense is really about setting a normative baseline against which we compare our real-world taxpayers. Trying to determine that baseline by using

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86 *See* MCCAFFERY, *supra* note 19, at 163 ("Significant and significantly gendered features of modern tax laws were constructed in th 1930s, 1940s, and 1950s. These features were then legitimated by the tax policy academy, invoking concepts of logic, neutrality, and common sense at every turn. As the tax system expanded dramatically, first principles were not revisited.").

87 As Boris Bittker said years ago about the comprehensive tax base:

> Since the ideal of the advocates of a CTB is a tax on "net" income, they retain the distinction between the cost of living, which is not to be deductible, and the cost of *earning* a living. They cannot be blamed for the haziness of this distinction, of course, but . . . [the CTB concept] . . . is of no assistance in separating personal from business expenditures, or in deciding whether or how to allocate the cost of items that inextricably confer personal benefits on the taxpayer at the same time that they serve his business purpose.

Boris I. Bittker, *A "Comprehensive Tax Base" as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925, 952 (1967).

the business-personal distinction simply takes us back to the beginning.[88] In order to determine whether an expense is business or personal, we need to look beyond the business-personal distinction into considerations that might help us determine whether we would like that expense to be allowed or not. Labeling an expense as personal simply assumes what it needs to prove.

In other words, the very attempt by the traditional discourse to characterize expenses as either personal or business-related based on their "nature" is misguided. Thus, determining the dominant character of a childcare expense is an exercise in what Felix Cohen termed "transcendental nonsense,"[89] absent a *normative* decision as to which comes first — parenthood or the job: Is the person first and foremost a parent that has chosen to go out to work and hence finds it necessary to pay for care for her children, or is she first and foremost a worker who has chosen to have kids (just as other people might choose a hobby or even a pet), and hence has to take care of them — all within her personal capacity.[90] Thus, in order to design a meaningful and workable legal mechanism for the treatment of childcare expenses, a normative discourse should be held, in the context of which the relevant factors such as efficiency, distribution and gender equality

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88 See Justice Iaacobucci in *Symes*, [1993] 4 S.C.R at 736:

> Upon reflection, therefore, no test has been proposed which improves upon or which substantially modifies a test derived directly from the language of s. 18(1)(a). The analytical trail leads back to its source, and I simply ask the following: did the appellant incur child care expenses for the purpose of gaining or producing income from a business?

89 Felix Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809 (1935).

90 Even if we accept the business-personal distinction in general, we cannot escape the normative decisions. To put it another way, the distinction is impossible absent a normative decision as to what should be considered business-related and what should not. For example, as Justice Iaacobucci has put it in *Symes*, [1993] 4 S.C.R, at 798: "The definition of 'business expense' was shaped to reflect the experience of businessmen, and the ways in which they engaged in business." As Dorothy Smith points out, when only one sex is involved in defining the ideas, rules and values in a particular domain, that one-sided standpoint comes to be seen as natural, obvious and general. As a consequence, the male standard now frames the backdrop of assumptions against which expenses are determined to be, or not to be, legitimate business expenses. Against this backdrop, it is hardly surprising that childcare was seen as irrelevant to the end of gaining or producing income from business, but rather as a personal nondeductible expense. Dorothy Smith, *A Peculiar Eclipsing: Women's Exclusion from Man's Culture*, 1 WOMEN'S STUD. INT'L. Q. 281 (1978), *cited in Symes*, [1993] 4 S.C.R at 798.

are weighted and a specific mechanism is designed. This mechanism-design is, however, beyond the scope of this Article.[91]

As the comparative analysis has demonstrated, the seemingly neutral business-personal distinction can bring about a wide variety of results when courts feel constrained by it, yet are uneasy about disallowing childcare. The characterization of deductions as either personal or business-related is bound to run into normative considerations, even if not openly discussed, and the business-personal distinction is not helpful in deciphering them. In fact, the distinction blurs the picture in its underlying assumption that the items that should be disallowed are "personal" rather than ones that are normatively irrelevant for the purposes of income taxation. I thus suggest that normative considerations should explicitly affect the decision regarding which expenses should be allowed and which should not.[92] It is therefore important that we unveil the normative considerations involved. I will discuss these considerations in the next Part.

B. A Note on Baselines and on Institutional Means

The comparative analysis has demonstrated not only the wide variety of potential interpretations of the so-called technical distinction between business and personal deductions, but also a significant difference in the institutions that have taken the lead in designing the tax treatment of childcare. Whereas in Canada the Supreme Court has dealt with the issue following an extensive legislative process (and the decision was apparently influenced by the fact that the legislature has provided a reasonable mechanism for the treatment of childcare), in Israel the Supreme Court's decision came under a legislative regime that did not consider childcare expenses directly.[93] The hastened legislative process in Israel took place only thereafter and as a direct result of the court's decision. The *Smith* case in the

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91 For an analysis of such a mechanism see Tsilly Dagan, *Childcare Expenses — Proposals for New Legislation*, 25 BAR-ILAN U. L. REV. 889 (2009) (Hebrew). For a comprehensive policy that goes beyond traditional income taxation see MCCAFFERY, *supra* note 19, at 133-34.

92 To be sure, I do not mean to have a case-by-case analysis of the normative issues, but wide enough categories — such as childcare expenses, for example — definitely deserve to have the normative considerations explicitly discussed in landmark cases or by specific legislation.

93 As mentioned above, the standard credits granted by the Israeli law to working mothers of children under the age of eighteen were ruled by the court to have nothing to do with childcare expenses

U.S. was also decided in the absence of a specific legislative regime, yet its timing in the 1930s — when the needs of working mothers were much less acknowledged — probably explains the belated legislative response.

The institutional differences between the three regimes bring up the question which institution is better suited for dealing with childcare expenses: the courts or the legislature. In addition to the familiar differences between courts and legislatures, the most important difference in our context of childcare expenses is the variety of mechanisms that the legislature — unlike the courts — can use. Courts are constrained by the binary straightjacket of deductibility: they can either allow or disallow childcare expenses. Legislatures, by contrast, have a much broader repertoire of mechanisms to account for the costs of childcare. Legislatures can choose — in addition to deductions — lump sum credits, progressive credits (that allow a greater credit to taxpayers with lower income), payable credits (allowing a payment of credits in excess of tax liability), carry-forward credits or deductions (which taxpayers can bank on until their tax liability increases to allow the use of such credits or deductions), tax benefits to employers who provide childcare services, as well as direct subsidies to certain families or to daycare centers.[94]

If childcare were indeed merely a cost of producing income, and the baseline from which deductions are calculated merely a matter of factual observation, the lack of options available to courts would not have raised a problem, since the choice would have indeed been a binary one and could have been left to a technical distinction — either by courts or by the legislature. But because the real question which is raised in hard cases of deductions (as in hard cases of many other issues of tax policy) is one of baseline, and since the costs of childcare need not be necessarily distributed among the population only according to their tax liability, they may, and probably should, be allocated according to a larger set of normative criteria. This means that in our context the legislature enjoys a real advantage over the courts in determining the ways we recognize the costs of childcare (even setting aside issues of legitimacy and expertise).[95]

The comparative analysis nicely demonstrates this lesson, where even

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94 The discussion of whether tax incentives are preferable to direct subsidies in this context is beyond the scope of this Article.

95 On the other hand, there is a political issue to be considered. While business deductions are considered part of the accepted baseline, other tax incentives may be considered tax expenditures. As such, they may be more susceptible to political pressure if they become part of the tax expenditure budget and are potentially more open to political debate every once in a while.

though the routes taken were considerably different, all three countries eventually resorted to a legislative solution. In the U.S., the legislation came through many years after the court had refused to allow childcare deduction; In Canada, the legislative procedure preceded the court's decision (and seemingly reduced its willingness to allow further deductions). In Israel, the Supreme Court's decision is what seems to have pushed the specific legislation forward.

It is also interesting to note the variety in the dynamics of facilitating legal change. The Israeli court is a specifically good example in this case. The innovative interpretation of the business-personal distinction in the childcare context by the Israeli Supreme Court jumpstarted the legislative process by subjecting the government to the relatively high costs of allowing a deduction as compared to the previous status quo.[96] This turn of events is a good illustration of the potential role courts can play not only by denying remedies when they believe the remedy being sought is not optimal (hence leaving the job of motivating the legislature to public opinion), but also in allowing such remedy and thus forcing the legislature to fine-tune the result, and still initiating public discourse in criticizing the legislative fine-tuning.

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In sum, while the U.S. courts viewed the costs of childcare as strictly personal expenses, the U.S. legislature has amended the code to allow such deductions to a certain extent. The Israeli courts, in quite a dramatic move, decided such expenses (or at least the costs of supervising the children) were business related, yet the Israeli legislature intervened to disallow them (and provide a very modest credit in their stead). The Canadian court might have been less decisive on this issue (with the minority opinion characterizing childcate expenses as business-related and the majority declining to decide on the issue), since it had the legislative fallback position — of section 63 of the Income Tax Act — allowing some level of deduction anyway.

III. A NORMATIVE-BASED FRAMEWORK FOR CHILDCARE DEDUCTIONS

The normative considerations involved in allowing deductions are — not surprisingly perhaps — the same considerations motivating the inclusion or

96 Israeli authorities estimated the costs of the courts' decision to be two and a half billion NIS. *See* Explanations to Draft Bill Amending the Income Tax Ordinance (no. 170), 2009, HH, 433.

not of certain items in one's income. That is so because the same goals that guide us in measuring income should guide us in allowing or disallowing expenses.

To see why, we need only recall the obvious. Income tax is traditionally viewed as a vehicle for allocating the costs of government in an equitable and efficient manner.[97] Deductions are simply one (albeit negative) component of income. Items we include in a taxpayer's gross income increase her tax liability. Items we include in her deductions reduce it. Both serve the same goal — allocating the costs of government among taxpayers. Hence, deductions that reduce taxable income should be allowed if the reduction in taxable income and the reduced tax liability they entail conform to our conception of equitable and efficient allocation of governmental costs. Therefore, it really shouldn't be surprising that the same normative considerations that apply to imposing taxes (should) apply to allowing deductions. In what follows, I will consider the classic tax policy goals of efficiency and distributive justice along with two additional goals: identity and community. I will briefly describe each of the goals, and demonstrate how it operates in the case of childcare expenses.

A. Efficiency

According to traditional analysis, maximizing the social welfare pie given taxation requires "neutrality" — working to keep taxation from interfering with the free market.[98] The more recent approach to tax efficiency — optimal taxation[99] focuses on minimizing the deadweight loss caused by taxation. Optimal taxation thus recommends that we impose higher taxes on inelastic activities than on elastic ones, as the effect of tax on the latter would be greater, and with it the deadweight loss.[100] The same logic could be applied

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97 *See, e.g.*, LIAM MURPHY & THOMAS NAGEL, THE MYTH OF OWNERSHIP 12 (2002); *see also* MICHAEL J. GRAETZ & DEBORAH H. SCHENK, FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES 25-27 (4th ed. 2002).

98 *See, e.g.*, JOEL SLEMROD & JON BAKIJA, TAXING OURSELVES 103 (1996) ("Taxes interfere with that natural efficiency, causing economic choices to be distorted away from taxed activities to relatively untaxed ones, keeping us from making the best use of our resources.").

99 For a description of optimal taxation see MCCAFFERY, *supra* note 19, at 170-77; *see also* David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1655-56 (1999).

100 For the main implications of optimal taxation in the context of women's labor see MCCAFFERY, *supra* note 19, at 177:

> The principle idea of optimal income tax is, then, just the same as for optimal commodity tax: the inverse elasticity rule . . . its major recommendations of relevance to us . . . are twofold . . . . First, tax rates should generally

to the deduction front: maximizing social welfare must mean that we allow deductions that contribute to the maximization of the aggregate social welfare by minimizing the deadweight loss.

At first glance, the business-personal distinction seems to make a lot of sense. By disallowing business expenses, we affect income production decisions (and there is no reason to assume that the regulator knows better than market-players which expenses work best); by disallowing personal deductions, on the other hand, we leave the incentives for consumption, which we have no reason to encourage, intact. This makes the deduction of pure business expenses (assuming we can identify them) an easy case. The case of childcare, however, is different. Childcare — as the comparative analysis has demonstrated — entails a difficulty in determining whether it is personal or business-related. Hence, I suggest, we should go back to the basic question of optimal taxation and examine their deductibility according to the relative elasticity of behavior: which will cause the smallest deadweight loss — altering production practices by disallowing the expense, or increasing consumption by allowing it? The answer cannot depend simply on whether the motivation is more closely related to one's business or not.

A mother who stays at home to take care of her children produces imputed income. She can give up this imputed income, go out to work and produce taxable income, if she would hire paid-for childcare. Other things being equal, absent tax considerations, she will choose to work outside the home if her wages are greater than the costs of paid-for childcare.[101]

How do taxes affect that decision? In Canada, the U.S., and Israel, the imputed income of a stay-at-home mother is not taxed. If childcare expenses are disallowed, the mother's choice is between going out to work and earning taxable income while incurring disallowed childcare expenses, or producing nontaxable imputed income while taking care of her children at home and saving the expenses. Tax obviously tilts that decision in favor of the latter, especially given the relative elasticity of women's choice between

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be kept low, and perhaps ought to decline as income increases, because upper-income taxpayers tend to be more elastic than lower-income ones are. Second, married men should be taxed more than married women, because men are less elastic . . . .

101 For a discussion of imputed income in the context of housework and childcare, see Nancy C. Staudt, *Taxing Housework*, 84 GEO. L.J. 1571 (1996) (suggesting taxation of imputed income from housework as a mechanism to express its value, and further arguing that such taxation would not be commodifying since most women already work and would not necessarily benefit from staying out of the wage labor force).

working for pay or staying at home and caring for their children.[102] This result is inefficient as there will be cases where women would prefer not to work outside their home, although they can earn more than the value of their imputed income staying at home. Allowing the deduction of childcare (or, as an alternative, the taxation of home-care, which is beyond the scope of this Article) would mitigate this tax bias. Thus, allowing the deduction of childcare expenses would improve efficiency.

As noted, according to the theory of optimal taxation, we should impose a larger tax the more inelastic the activity is. Hence, when a woman's decision to go out to work is inelastic — if she would be inclined to go out to work regardless of the deduction — it would be more efficient to disallow the deduction of childcare expenses.[103] If we analyze the incentives ex ante, and incorporate the initial decision to have children, it is doubtful that disallowing the deduction will prove efficient: Assuming (as seems plausible) that the decision to have children is relatively inelastic, women will choose to have children regardless of the deductibility of the costs of their childcare. Once the children are born, however, the dilemma is whether to go out to work or stay at home. In times and cultures in which this decision — going out to work once one has children — is a relatively elastic one, it seems more efficient to allow the deduction than to disallow it.

Obviously, the efficiency analysis cannot be limited to the efficiency of the family's decision. A good policy decision — even one that focuses on the efficiency perspective only — would have to take into account a wider perspective and consider other policy alternatives such as direct subsidies for childcare facilities, benefits for employers who offer childcare services and publicly financed early-age education. These alternatives, however, are beyond the scope of this Article.

B. Equity

Allocating the costs of government in an equitable manner (determining what should be taxed and what constructs taxable income) requires some normative choices involving our ideal of equality among taxpayers. Specifically, it requires a decision regarding the attributes and activities that are relevant to the income tax context, where the purpose of comparing

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102 *See* MCCAFFERY, *supra* note 19, at 120-21, 178-82.

103 Facts seem to point to the opposite direction — that women's decision to go out to work is elastic, suggesting it would be more efficient to allow a deduction so as not to increase the tax costs of women's work. *See id.* at 179-82.

people is to equitably allocate the costs of government. The underlying rationale (of vertical equity) is that if a person is better-off than her peers in some *relevant sense*,[104] she should carry a greater burden of the costs of government.

On the deductions front, allocating the costs of government in an equitable manner requires that we allow deductions only for expenses that reflect a *relevant* difference between taxpayers. Money spent on personal consumption (e.g., chocolates, theater tickets and clothes) should not be allowed as a deduction, probably because we assume that personal consumption represents only differences in preferences which should be irrelevant for income tax purposes. Again, this almost obvious observation is probably what makes the disallowance of pure consumption an easy case.

Without going further into the general question regarding what should and what should not be considered relevant for tax purposes, the main idea is that whatever choice we make regarding the pertinence of a specific attribute for income tax purposes is a normative choice of whether or not to include it in our scheme of equality.

Moving on to the question of childcare, the question seems to be: Does the promotion of equity entail making childcare expenses deductible? Would allowing such a deduction enhance distributive justice? One way to answer these questions is to inquire how such expenses are currently distributed. If some taxpayers incur disproportionately higher childcare expenses than others, allowing a deduction for such expenses might benefit them more than others, in which case, we need to ask whether it is justified from a distributional perspective. To put it bluntly, the question is whether we should

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104 The question regarding the attributes that are relevant in comparing taxpayers is beyond the scope of this Article. Here it is sufficient to say that to discuss equality, distribution, or redistribution while focusing on only one aspect of taxpayers' lives — material wellbeing — is to leave out part of the picture. Attributes such as health, physical state, family status, gender, prestige, quality of living, and level of education do not necessarily translate into material differences, yet they certainly affect people's wellbeing. *See* AMARTYA SEN, INEQUALITY REEXAMINED 150 (1992); Edward J. McCaffery, *Tax's Empire*, 85 GEO. L.J. 71, 106 (1996). Distribution does not and should not focus on material wellbeing alone, and taxation — which is the main vehicle for redistribution — simply cannot ignore other attributes of taxpayers, especially when it is often advocated as the only appropriate tool for redistribution. *See, e.g.*, Louis Kaplow & Steven Shavell, *Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994). The fact that the result of our income tax code is the payment of money does not mean that money (or any other material difference) should be the only criterion by which tax liability is determined.

impose part of the costs of childrearing on society as a whole or restrict this burden to families only. Alternatively, instead of looking at the current costs of childcare we could — in order to compare the relative burdens — ask what price one would pay to avoid such costs. Since de-parenting is obviously not an option, the way to avoid childcare costs is to have the parent take care of the children herself — i.e., quit work. This option not only distinguishes between parents and non-parents, but also, given traditional family structure, social norms and the unequal labor market, is not equally distributed between women and men. Thus, the key question of distribution raised by the deduction of childcare costs is not only distribution between parents and non parents, but also one of gender equality.[105]

Hence, the deductibility of the costs of childcare is an issue that affects working mothers more than other groups within society. If we believe that motherhood — as opposed to a taste for chocolate or theater — is a difference among taxpayers that is relevant for the purposes of income taxation, then we should take into account the special costs involved in mothers' going out to work. If — as I believe — motherhood cannot be perceived as a sheer consumption choice, we should incorporate it into our equality function and think about children as part of taxpayers' baseline instead of as a post-baseline choice.

Beyond gender equality, there is also the question of equality between families based on their income. Even if we believe that parents are relevantly different from people without children, allowing deductions for childcare can have regressive effects.[106] First, some childcare services can be pricier than others — if we do not limit the amount of expenses allowed, those who are paying more for more lavish childcare will get a larger tax benefit. Second, allowing a deduction would provide women with higher marginal tax rates with a larger nominal benefit. According to the traditional analysis, this trait of deductions is not problematic, since the income of a taxpayer should be measured after we subtract allowable deductions. However, as I have stressed throughout the Article, the very inclusion of a certain expense in allowable deductions is a normative question rather than a simple technical choice. In allowing or disallowing deductions, we choose whether to take a specific feature into account when assessing one's income. That is not (and should not be) an abstract question. The allowance of a deduction is the result of a social choice. Therefore, the distributive results of allowing a deduction should be

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105 *See generally* MCCAFFERY, *supra* note 19 at 275-77. For a feminist analysis of the childcare deduction see Macklin, *supra* note 60.

106 But see Margalioth, *supra* note 73, for a differing opinion.

part of the decision whether to allow it or not. This is why I believe that providing women in the higher tax brackets with greater (nominal) amounts of public resources is a significant consideration against allowing childcare deductions.

C. Identity

Identity is a less traditional normative consideration that I believe should be taken into account. The scheme of equality that we choose draws on some image of an archetypal taxpayer, and shapes it at the same time.[107] When we ignore certain differences while acknowledging others, we rely on (and reinforce) a certain conception of a taxpayer and undermine alternatives. If we assume a taxpayer to be healthy, married, living near her workplace, or, in our case — childless, we fence out those who are disabled, single, parents, or living far away from their workplaces.[108]

This perception of a taxpayer affects (and is affected by) our decision regarding the allowance of deductions. Taxpayers who are (normatively) deemed childless are not allowed deductions for childcare expenses. Instead, given the childless baseline, such expenses are viewed as a personal choice. Supporters of the view that childcare expenses are purely a matter of personal preference assume an imaginary fence can be drawn between the "business" realm and the "personal" realm. That is not only unrealistic, but also entails prioritization.[109] The main problem with such an allegedly sharp distinction,

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107 That is why a similar idea could be expressed in terms of equity simply by considering a wider variety of attributes as subject to distribution and redistribution.

108 *See* Edgar, *supra* note 6, at 352; Tsilly Dagan, *Commuting*, 26 VA. TAX REV. 185 (2006).

109 As Justice Iaacobucci puts it, in a paragraph opposing the concept of an "income producing circle," distinguishing between expenses incurred in order to approach the income-producing circle (such as clothing and commuting expenses, for example), and those which are incurred within the circle itself:

> By suggesting that there is a line dividing business expenses per se and those expenses incurred in order to approach the realm of business, this so-called test does nothing more than restate the business/personal dichotomy already being examined. What is worse, by disguising this restatement as a test, the circle concept can have pernicious effects . . . it conjures up an image of an income-producing circle which is entirely separate and apart from a domestic circle. Taking commuting expenses as an example, one tends to imagine a taxpayer leaving the "home circle" and incurring expenses in order to approach the "income-producing circle." This is a simplistic vision of the modern business world. One need only consider the deduction available for the home office (s. 18(12) of the Act) to realize that a taxpayer's personal

as I see it, is that the marginalization of other (those termed "non-business") aspects of taxpayer identity — in this case their parenthood — conveys a problematic message.[110]

Children are considered, by many parents, a key component of their identity. Being a parent is not a marginal part of one's self-perception, and certainly not similar to consumer choices such as buying ice-cream or theater tickets. Ignoring a component as central as this in one's identity flattens it. Ignoring parenthood in the context of deductible expenses is especially problematic since it draws a line between childcare and the parts of our lives that are considered productive. Childcare — and the women who predominantly provide it — are thus portrayed as unproductive. This is a message that reinforces the stereotypical characterization of mothers as unproductive if they choose to stay at home.[111]

These (implicit) tax law choices are troublesome. The partial conception of people's identity as first and foremost workers does not merely overlook parts of who they are, but also plays a role in shaping the same reality as it (inaccurately) reflects and constructs a certain "taxpayer identity." To be sure, limiting law and having it deal with only certain parts of our lives is not necessarily inappropriate as a general matter. In fact, we often expect the law not to interfere in various spheres of our lives. Issues such as love, religion, and friendship are rightly considered in most cases beyond the reach of legal regulation and legal institutions. Typically, when we do not want the

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> and business activities may be closely related within the taxpayer's home itself. Further, to the extent that this Court is now asked to consider whether the needs of women have been disregarded in the definition of "business expenses," it is misleading to presuppose that activities occurring within the domestic environment are, for that reason alone, more likely to be excluded from the income-producing circle, since the concerns of women have been confined to the domestic environment as an historical matter.

Symes v. Canada, [1993] 4 S.C.R 695, 734.

110 Again, Justice Iaacobucci's decision strikes a similar note:

> Pregnancy and childbirth decisions are associated with a host of competing ethical, legal, religious, and socioeconomic influences, and to conclude that the decision to have children should — in tax terms — be characterized as an entirely personal choice, is to ignore these influences altogether. While it might be factually correct to regard this particular appellant's decision to have children as a personal choice, I suggest it is more appropriate to disregard any element of personal consumption which might be associated with it.

Id. at 740-41.

111 *See, e.g.*, Nancy C. Staudt, *The Political Economy of Taxation: A Critical Review of a Classic*, 30 LAW & SOC'Y REV. 651, 654, 662-64 (1996).

law to interfere in those spheres, it is because we would like people to be able to choose freely between alternatives so as to foster human pluralism. The case of childcare expenses, however, is different. Instead of fostering a multiplicity of available choices, making parental choice personal and thus irrelevant for tax purposes reinforces the perception of taxpayers as nothing but employees.

As the minority decision in *Symes* and the Israeli courts' decision demonstrate, there is nothing in the nature of income tax that necessitates this flat and partial perception of people's identity. If we value taxpayers' choices, if we seek to empower them to create their own roles, and if we are to respect their complex and multifaceted identities, we must adopt as our baseline a richer account of the taxpayer — as a person who is not only an employee, but also a family member, a community member, a parent, a person with wishes, preferences, and aspirations that are not necessarily connected to the way she produces income. By computing the taxpayer's income *after* she gets to work, allowing a deduction for childcare expenses treats parenthood as a relevant difference. Such treatment respects a taxpayer's parenthood as something that is not just a whim or consumption trend, but rather an important part of who she is, important enough to create a difference that is recognized by the tax system.

D. Community

Tax also interacts with the types of communities we live in. When the tax affects a group of taxpayers (e.g., married women, parents) or social institutions (e.g., families, workplaces) in similar ways, it takes part in designing the society in which we live.[112]

Here too deductions are no different than other areas of tax. When a specific group of people has a specific kind of expense, deciding whether or not to allow their deductions changes not only the incentives for the individual members of such a group, but also the incentive for certain interactions between members of such a group and other segments of society, and the social conventions regarding the expenses being allowed or disallowed.

Disallowing childcare expenses affects our communities in at least two

112 Tax can affect particular communities such as family or workplace, where it can influence the decision to go out to work, or to live near work. It can also affect the nature of society as a whole — whether it is philanthropic, encourages immigration, etc.

ways. First, it affects social conventions regarding the business community and business practices: by framing childcare as a personal rather than business-related expense, tax laws convey a gendered message as to what is and what isn't considered proper business culture.[113] Second is its effect on families: Disallowing deductions for childcare encourages one spouse to take care of the children and so encourages single-earner families; it can further affect the size of families or the ways (whether public or private) in which we cater for children's needs.

This systemic preference for single-earner families may impel families to choose between the two parents: having one parent stay at home and the other go out to work. The social landscape of women earning lower wages than men, the traditional view preferring women to men as domestic partners, and the tendency of many women to avoid conflict, all join together to result in single- earner families, where the stay-at-home partner is most often the woman. Women's staying at home may — in its turn — encourage larger families, and may also increase the popularity of at- home care for children. True, some would argue that this analysis imputes no fault to tax law, since the gendered result derives from a tilted society rather than unequal treatment under the law. Laws, however, should be read in context, and in a society where women are considered a more "natural" candidate for raising children, a seemingly neutral law may in fact be gender- discriminatory. In any event, if law can make a difference it *should* be interpreted to support a better-balanced society. Allowing childcare deductions can support such a result.

CONCLUSION

In this Article, I have used a comparative analysis of the issue of childcare deduction in order to explain the non-technical nature of the business-personal distinction between deductions. The comparative study allowed us to abstract the analysis from any domestic perspective, demonstrating that the issue of childcare deductions in fact raises a question of baseline setting. In allowing or disallowing the deduction of childcare, courts actually determine what counts (and more importantly what should count) for income tax purposes in general and deductions in particular. By exposing the baseline issues underlying questions of deduction, I have demonstrated why it is preferable that we use explicitly normative considerations in lieu

113 *See* my discussion *supra* note 90; *Symes*, [1993] 4 S.C.R at 798.

of the so-called technical distinction between business and non-business deductions. The comparative analysis further raises the institutional issue, highlighting the question regarding which institution is best suited to handle the subject of childcare. As shown, exactly because this is a baseline issue, legislatures, which enjoy a larger doctrinal tool box, can offer more flexibility as required when such a variety of normative considerations should be taken into account.