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ARTICLES

LIMIT DEDUCTIONS FOR MIXED PERSONAL/BUSINESS EXPENSES: CURB CURRENT ABUSES AND RESTORE SOME PROGRESSIVITY INTO THE TAX CODE

Wendy Gerzog Shaller*

Often, when one thinks of tax abuses apart from tax shelters, one focuses on mixed personal/business deductions. "When [such] expenses are deducted, the government effectively pays part of the cost of personal consumption that others must purchase with after-tax dollars."¹

While business deductions can be justified by their generation of taxable income, purely personal deductions cannot. Essentially, personal deductions reduce the tax base,² undermine an "ability to pay" tax policy,³ and add to

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² See id. at 77. The Treasury Department proposed curtailing or eliminating deductions for certain state and local taxes and for charitable gifts. Id. at 77-83.
³ That is, only the wealthy itemize and take advantage of these deductions; moreover, those with the greatest incomes (i.e., those in the highest tax brackets) benefit disproportionately. See STANLEY S. SURREY, PATHWAYS TO TAX REFORM 255-56 (1973). To counter such a result, the Treasury Department has concluded that "[t]he only way to achieve equal treatment of equals is to define the tax base comprehensively. If some items of income are omitted from the tax base, or if particular expenditures are treated preferentially, then taxpayers who are otherwise in equal positions will not be treated equally." 1 1984 TREASURY PLAN, supra note 1, at 14; see also Mark G. Kelman, Personal Deductions Revisited: Why They Fit Poorly in an "Ideal" Income Tax and Why They Fit Worse in a Far from Ideal World, 31 STAN. L. REV. 831 (1979). In fact, in order to maintain an integrity with a taxpayer's ability to pay, Congress has imposed adjusted gross income (AGI) floors on personal deductions, such as medical expenses and casualty losses, to insure that these deductions apply only to extraordinary expenses. See, e.g., S. REP. NO. 494, 97th Cong., 2d Sess. 113 (1982) [hereinafter 1982 S. REP.]
the complexity of the tax system. Because their function is questionable, personal deductions are often targeted for elimination or reduction whenever tax reform is made. By recently placing a floor on the deductibility of personal expenses for higher income taxpayers, while also phasing out and

(“Further, many of the losses which are small relative to income do not significantly reduce ability to pay taxes, especially since they could have been avoided by the purchase of insurance.”); S. REP. NO. 313, 99th Cong., 2d Sess. 59 (1986) [hereinafter 1986 S. REP.] (“Thus, the bill retains deductibility where the expenses for a year are so great that they absorb a substantial portion of the taxpayer's income and hence substantially affect the taxpayer's ability to pay taxes.”).


5. Some scholars maintain that certain personal deductions should be retained. For example, a case has been made for the charitable contribution deduction on such theories as a business deduction, a discharge of a moral obligation, a substitute for unpaid services, and as a reward for praiseworthy behavior. See Boris I. Bittker, Charitable Contributions: Tax Deductions or Matching Grants?, 28 TAX L. REV. 37, 56-60 (1972). Additionally, deductions for certain state and local taxes are recognized as having enabled the smaller governing authorities to raise needed revenues to benefit all income levels. If this deduction is repealed, it may aggravate inequities between taxpayers by overstating the taxable income of many taxpayers. See Brookes D. Billman, Jr. & Noel B. Cunningham, Nonbusiness State and Local Taxes: The Case for Deductibility, 85 TAX NOTES TODAY 174-96 (Sept. 3, 1985). Contra Bruce Bartlett, The Case for Eliminating Deductibility of State and Local Taxes, 85 TAX NOTES TODAY 174-97 (Sept. 3, 1985). State and local income taxes are deductible in some consumption-based tax models when they are viewed as non-consumption items. See, e.g., U.S. DEP'T OF THE TREASURY, BLUEPRINTS FOR BASIC TAX REFORM 117 (1977). Certain personal deductions have been justified on policy and income definition grounds. See, e.g., William D. Andrews, Personal Deductions in an Ideal Income Tax, 86 HARV. L. REV. 309, 314-15 (1972) (arguing that medical services and charitable contributions should be excluded from the calculation of an individual’s personal consumption for tax purposes). A thorough examination of this issue is beyond the scope of this Article.


7. For example, the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, raised the floors for both medical expenses, see sec. 202, 96 Stat. at 421 (amending I.R.C. § 213, increasing the threshold from 3 to 5% of AGI and casualty losses), see sec. 203, 96 Stat. at 422 (amending I.R.C. § 165(c)(3) and adding § 165(h), allowing this deduction only to the extent that the loss exceeds 10% of the taxpayer's AGI). The Tax Reform Act of 1986 further increased the floor for medical expenses to 7.5%, see sec. 113, 100 Stat. at 2116, and imposed a floor on miscellaneous itemized deductions, see sec. 132(a), 100 Stat. at 2115 (adding new I.R.C. § 67).

8. See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, sec. 11103, 104 Stat. 1388-400, 1388-406 (adding I.R.C. § 68 for year 1991 and beyond). Under this provision, where a taxpayer's AGI exceeds the applicable amount (i.e., $100,000, or $50,000
eliminating personal exemptions for those individuals,9 Congress has found a means to reimpose some progressivity into the tax system,10 which the Tax

9. When a taxpayer's AGI exceeds the threshold amount (i.e., $150,000 for marrieds filing jointly; $100,000 for singles), his exemption is reduced by 2% for each $2,500 (or part) of this excess. Like I.R.C. § 68, this provision is scheduled to expire for tax years after 1995. See sec. 11104, 104 Stat. at 1388-407 (amending I.R.C. § 151(d)); see also 1990 CONF. REP., supra note 8, at 3-4. But see 1992 Explanation, supra note 8, at S-29 (proposing to extend the phase-out of personal exemptions claimed by higher income individuals is an effective means of ensuring that the individual income tax system remains a sufficiently progressive means of raising revenue."). In 1991, a joint return filer with an AGI of $212,500 would receive half of the exemptions to which he was otherwise entitled. Id. at 4. This provision is indexed for inflation, sec. 11104, 104 Stat. at 1388-407, and is expected to raise $1,046,000,000 in 1991 and $2,028,000,000 in 1992, see 1990 Revenue Provisions, supra note 8, at 2.

10. Congress recognized that "[t]he degree of progressivity of the Federal tax system appears to have declined in the last 10 to 15 years." STAFF OF JOINT COMM. ON TAX'N, 102ND CONGRESS, 1ST SESS., TAX POLICY AND THE MACROECONOMY: STABILIZATION, GROWTH, AND INCOME DISTRIBUTION 5 (Jt. Comm. Print 1991). It felt that

The higher an individual's AGI, the less likely it is that an otherwise deductible expense will significantly affect the individual's ability to pay income taxes. Thus, . . . the goal of personalizing the Federal income tax based on each individual's ability to pay taxes is enhanced by adoption of a rule that imposes some limitation on the deductibility of amounts paid . . . .

Similarly, the 1990 Omnibus Budget Reconciliation Act imposes a luxury tax aimed at higher income bracket consumers. Sec. 11221, 104 Stat. at 1388-438 to -442 (adding I.R.C. §§ 4001-4004). The luxury tax is equal to 10% of the cost of an automobile over $30,000, of a boat over $100,000, of an aircraft over $250,000, of furs and jewelry over $10,000. Id. Congress has thus found that it must create progressivity by such indirect means, because the public generally resists raising taxes, even when it would not actually affect all taxpayers' tax
Reform Act of 1986 had removed through the elimination of many tax brackets and the lowering of tax rates.\footnote{11}

In light of the continued budget deficit,\footnote{12} the public's continued resistance to new taxes,\footnote{13} the need to restore some progressivity into the tax system,\footnote{14} and the perceived unfairness of many of the mixed personal/business deductions,\footnote{15} it is now time to re-evaluate this area in a general fashion. With the aim of targeting abuses and increasing the Tax Code's progressivity, this Article reviews the home office deduction, the deduction allowed for certain travel between home and work, the moving expense deduction, the exclusion for certain fringe benefits, the deductions for business meals and entertainment, and the childcare credit. This Article sets forth several legislative proposals to curtail these benefits, including the phase-out or elimination of liability. \textit{See} 136 CONG. REC. H13060-H13061 (daily ed. Oct. 26, 1990) (statement of Rep. Rostenkowski) [hereinafter 1990 Rostenkowski Statement]; \textit{see also infra} note 13.

11. \textit{See} Tax Reform Act of 1986, Pub. L. No. 99-514, sec. 101(a), 100 Stat. 2085, 2096 (amending I.R.C. \textsection{} 1). Prior to the enactment of the 1986 Tax Act, there were fifteen tax brackets, with a maximum tax rate of 50\%. With the passage of the 1986 Act, there were only two brackets, with the highest bracket being 28\%. The 1990 Tax Act introduced a third bracket of 31\%. \textit{See} Omnibus Budget Reconciliation Act, sec. 11101. Yet, there is still far less progressivity than before. Critics have complained that the tax burden has shifted to the middle class. \textit{See infra} note 14; \textit{see also} Joint Comm. on Tax’n, \textit{Summary of Proposals Relating to Middle Income Tax Relief and Economic Growth} (JCX-32-91) (Dec. 6, 1991).


13. People were angry at President Bush for breaking his promise: "Read my lips, no new taxes." \textit{See}, e.g., Walter v. Robinson, \textit{Loyalists in South Cool to Bush: Campaign '92, Boston Globe}, Mar. 2, 1992, at 1 (citing the appeal of candidate Patrick J. Buchanan as stemming from his promise not to raise taxes); Richard Benedetto, \textit{Anti-Bush Votes Give Boost to Buchanan, USA Today}, Feb. 19, 1992, at 3A (describing Buchanan supporters as voters angry at President Bush for breaking his pledge of no new taxes).

14. \textit{See} Poor, \textit{Middle-Class Hit by Higher Tax Burden in 1980's, JEC, Senate Budget Report Says}, [1991] Daily Tax Rep. (BNA) No. 47, at G-1 (March 11, 1991). According to a report of the Joint Economic Committee and Senate Budget Committee, the Tax Code is less progressive today than it was in 1980; specifically, the middle class tax rate is 4\% above 1980 rates, while the upper class (i.e., the wealthiest 1\%) pays effectively 9\% less. \textit{Id}. The report concluded that during the 1980s the rich improved their financial status, while the poor became increasingly impoverished. \textit{Id}.

While this indirect approach to re-introduce progressivity into the tax system is perhaps not the optimal or ideal way of making the tax system more equitable, because of the public's resistance to increasing taxes, \textit{see supra} note 12, it appears to be a more politically acceptable method and it is a logical extension of Congress' recent treatment of personal deductions and exemptions. \textit{See supra} notes 8 and 9.

15. \textit{See supra} notes 1-4 and accompanying text.
benefits for higher income taxpayers, while keeping in mind their individual justifications and legislative purposes.

I. THE HOME OFFICE DEDUCTION

A. Legislative and Administrative Background

The home office deduction originally was allowed like any other standard business deduction. Then, in 1962, the Internal Revenue Service (Service) issued a ruling requiring that a taxpayer first establish that his home office was a condition of his employment in order to claim the deduction. The courts, however, continued to involve the same standards that applied to any other business deduction. To be deductible, a taxpayer's business expense merely had to be "ordinary and necessary." Reacting to a Tax Court decision holding that expenses for a home office could be deducted if they were "appropriate and helpful," Congress created a special disallowance section

16. See infra part VII.
17. See, e.g., Best Universal Lock Co. v. Commissioner, 45 T.C. 1 (1965) (stating that a taxpayer's $300 per year deduction for the tax years of 1959-1961 under section 162 of the 1954 I.R.C. to be "undisputed" based upon the fact that the taxpayer, an inventor, used an office in his home in connection with his trade); Peiss v. Commissioner, 40 T.C. 78 (1963) (holding that a physiology professor who conducted research and prepared articles in his home was allowed to deduct a portion of his home office expenses as ordinary and necessary business expenses under section 162 of the I.R.C. of 1954); Bien v. Commissioner, 20 T.C. 49 (1953) (finding that taxpayers who maintained a business office in their home were permitted to deduct $400 as opposed to the claimed $600, since they produced insufficient facts proving the reasonableness of their claimed deduction).
20. See I.R.C. § 162. The expense also had to be incurred while carrying on a trade or business and paid or incurred in the current tax year. Id. Under Welch v. Helvering, 290 U.S. 111 (1933), "ordinary" means "not a capital expense" and "necessary" means "appropriate and helpful." The latter requirement is a fairly easy one to satisfy.
21. Bodzin v. Commissioner, 60 T.C. 820 (1973), rev'd, 509 F.2d 679 (4th Cir.), cert. denied, 423 U.S. 825 (1975). In Bodzin, a government attorney who worked two or three evenings a week in his study, wherein he also kept his stamp collection and some other non-business activities, was allowed by the Tax Court to deduct the cost of his home office as an ordinary and necessary business expense under section 62 of the 1954 I.R.C. However, in reversing the Tax Court's opinion, the Fourth Circuit found the "appropriate and helpful" standard set forth in Welch to be too subjective a criteria and denied the taxpayer's deduction as being a nondeductible personal expense. See Bodzin v. Commissioner, 509 F.2d 679, 681 (4th Cir.), cert. denied, 423 U.S. 825 (1975). Congress made it clear that it was reacting to this specific decision in creating the new section. See H.R. REP. No. 658, 94th Cong., 1st Sess. 160 (1975) [hereinafter 1975 H.R. REP.]; S. REP. No. 938, 94th Cong., 2d Sess., pt. 1, at 147 (1976) [hereinafter 1976 S. REP.]; JOINT COMM. ON TAX'N, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 139 (1976), reprinted in 1976-3 C.B. 1, 151 [hereinafter 1976 JOINT COMM. EXPLANATION].
in the Tax Code that added further requirements for the deductibility of these expenses. The new section required that the taxpayer use his home office, exclusively and on a regular basis, either: (1) as his principal place of business, (2) as a place where he meets or deals with patients, clients or customers in the ordinary course of his business, or (3) in connection with his business, where the office is a separate structure unattached to his home. If the taxpayer is an employee, the exclusive use of the home office must be for the convenience of his employer.\textsuperscript{23} Congress' reaction to this particular case provided some consistency among the positions of the courts and the Service in this area.\textsuperscript{24} Congress enacted these stricter rules in order to prevent taxpayers from converting personal expenses into deductible business expenses,\textsuperscript{25} particularly where there were little or no additional expenses incurred by the taxpayer.\textsuperscript{26} During subsequent years, Congress has amended

\begin{itemize}
  \item \textsuperscript{23} I.R.C. § 280A(c) (1988).
  \item \textsuperscript{25} 1976 Joint Comm. Explanation, supra note 21, at 151. The example consistently given in the legislative history referencing this section is that of a professor who is given office space at his school but uses his den to grade papers and prepare for his classes. Congress intended that this taxpayer be denied a home office deduction. \textit{Id.}
  \item \textsuperscript{26} \textit{Id.}
\end{itemize}
this section in certain ways\textsuperscript{27} without changing its basic original requirements or purposes.\textsuperscript{28}


The Black Lung Benefits Revenue Act of 1981, Pub. L. No. 97-119, 95 Stat. 1635 (1981), changed the language of this section to read “the principal place of business of any trade or business of the taxpayer.” Sec. 113(c), 95 Stat. at 1642. Originally, it read “the taxpayer's principal place of business.” Congress enacted this amendment to conform with the Tax Court's interpretation of Curphey v. Commissioner, 73 T.C. 766 (1980). In Curphey, the court recognized that a taxpayer could have more than one trade or business and ruled, therefore, that this section should be applied separately to each of the taxpayer's trades or businesses. See Joint Comm. on Tax’n, Summary of Black Lung Benefits Revenue Act of 1981 11 (1981) [hereinafter BLBRA Summary].


The Tax Reform Act of 1986, Pub. L. No. 99-514, sec. 143(b) (c), 100 Stat. 2085, which added I.R.C. § 280A(b), (c)(5), (c)(6), tightened two abuses relating to two contemporary Tax Court decisions: Feldman v. Commissioner, 84 T.C. 1 (1985), aff’d, 791 F.2d 781 (9th Cir. 1986), and Scott v. Commissioner, 84 T.C. 683 (1985). See H.R. REP. No. 426, 99th Cong., 1st Sess., 133-134 (1985) [hereinafter 1985 H.R. REP.;] 1986 S. REP., supra note 3, at 81-82; Joint Comm. on Tax’n, General Explanation of the Tax Reform Act of 1986, 100th Cong., 1st Sess. 84, reprinted in 1986-3 C.B. (1987) [hereinafter 1986 JOINT COMM. EXPLANATION]. The Act disallows a home office deduction where a taxpayer leases part of his home to his employer and limits the deduction to a taxpayer’s gross income from his business activity as reduced by all other deductible expenses attributable to the activity, including those allocable to the use of the unit itself. Thus, the deduction may not be used to create or expand a loss. The Act allows for a carry-forward to future years where such excess losses may absorb a succeeding year’s income from the home office business activity. For example, if a taxpayer has gross income of $1,000 from his business activity and has $1,500 of related expenses (e.g., rent and depreciation) and $1,000 of expenses which do not relate to the use of the home (e.g., expenses for secretaries and supplies), he is not entitled to a home office deduction since it would create a loss. Under the Scott decision, he would have been able to deduct the $1,500 costs relating to the unit as well. In the above example, the taxpayer could carry over the unused home office expenses of $1,500 to the next year to offset his home office income. See 1986 Joint Comm. Explanation, supra, at 84.

The 1986 Tax Act also placed a 2% floor on an employee’s unreimbursed business expenses which would include his home office deduction. See sec. 132(a), 100 Stat. at 2113-16 (adding I.R.C. § 67). The 2% floor applies to an employee’s home office deduction because it is not a deduction used to compute AGI, see I.R.C. § 62 (1988 & Supp. 1990), and is not one of the itemized deductions excepted under I.R.C. § 67(b) (1988).

Finally, the 1990 Act reduces the amount deductible for a higher income employee’s home office, because the home office deduction is one subject to the phase-out of itemized deductions imposed by I.R.C. § 68 (Supp. 1990). See Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388-400.

28. The statute was enacted to prevent taxpayers from converting essentially personal expenses into deductible business expenses, and to disallow a deduction where there are no incremental costs. See 1986 S. REP., supra note 3, at 83. Further, the provision was “enacted
B. The Courts and the Principal Place of Business Exception

The Tax Reform Act of 1976 allowed a home office deduction for a taxpayer’s home office structurally within his home, but only where the office was either a place wherein the taxpayer met or dealt with his clients or customers, or was his principal place of business. Although there has been some litigation over the first exception and over the “exclusive use” requirement of the overall provision, most of the controversy with regard to this section has centered around the meaning of a taxpayer's “principal place of business.”

In a 1980 case, the Tax Court adopted the “focal point” test to determine the location of a taxpayer’s principal place of business. In that case, the taxpayer operated a hot dog (and other food) stand but used her home for cooking, freezer storage, and administrative tasks. Since it was the sales at her stand that generated taxable income, the court reasoned that the location of the stand was the “focal point” of her operation, and therefore was her principal place of business. It adopted this test in light of the restrictive purpose of the 1976 home office deduction legislation. The Tax Court continued to apply the “focal point” test throughout the 1980s.

The Courts of Appeals for the Second and Seventh Circuits, however, expressly rejected the “focal point” test. The Second Circuit reversed two Tax Court opinions, holding that a concert violinist’s home, where he practiced, was his principal place of business rather than the Metropolitan Opera House, where he performed, and that a professor’s study, where he prepared classes and worked on his publications, was his principal place of business.

29. See supra notes 22-23. It is even more significant, perhaps, that when part of a taxpayer's home is defined as a home office, he is entitled not only to deduct expenses related to that home office, but also to deduct expenses relating to his commute to and from that home office to his other business locations. See infra notes 41, 62 and accompanying text.
30. See, e.g., Green v. Commissioner, 707 F.2d 404 (9th Cir. 1983) (holding that “meeting or dealing” requires the physical presence of the taxpayer, and that talking on the phone is insufficient).
31. See, e.g., Hamacher v. Commissioner, 94 T.C. 348 (1990) (stating that where taxpayers use their home office for two different businesses, both uses must be exclusive in order to qualify for the deduction).
32. See supra note 27 (discussing the change Congress made to this language in the Black Lung Benefits Revenue Act of 1981). For a discussion of this controversy, see infra notes 33-43.
34. Id. at 109.
36. See supra note 35.
ness rather than his university classroom, where he delivered his lectures.  

Likewise, the Seventh Circuit criticized the Tax Court's test. The court admonished that the "focal point" test merely emphasized the place where the taxpayer's work was more visible, instead of the location where he accomplished more of his business.

Responding to these criticisms, the Tax Court decided to abandon its "focal point" test in Soliman v. Commissioner, and adopted a facts and circumstances approach in which many factors, such as the time spent by the taxpayer in his home office, the business exigencies inherent in maintaining a home office, the functions performed at the home office and the suitability of the office for these duties, and the appropriateness of the furnishings, would all be examined. The relative time a taxpayer spent in

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39. See Meiers v. Commissioner, 782 F.2d 75 (7th Cir. 1986) (discussing a taxpayer who, along with her husband, owned and operated a laundromat, worked one hour per day at the laundromat and two hours per day at her home office, where she drafted work schedules and did bookkeeping and other administrative work); see also Cadwallader v. Commissioner, 919 F.2d 1273 (7th Cir. 1990). The taxpayer in Cadwallader, a psychology professor, was denied a deduction for his home office because his employer had given him two and one-half offices at his university, but the court nevertheless rejected the "vagaries" of a "focal point" test. Although Cadwallader was decided by the circuit court after the Tax Court's opinion in Soliman v. Commissioner, 94 T.C. 20 (1990), aff'd, 935 F.2d 52 (4th Cir. 1991), cert. granted, 112 S. Ct. 1472 (1992), the Seventh Circuit berated the Tax Court's new test as creating a "laundry list." Cadwallader, 919 F.2d at 1275.
40. 94 T.C. 20 (1990) (finding that an anesthesiologist who worked at three hospitals in the Washington, D.C. area, but who maintained a home office wherein he did his billing and administrative work, had his principal place of business in his home), aff'd, 935 F.2d 52 (4th Cir. 1991), cert. granted, 112 S. Ct. 1472 (1992).
41. Id. at 28. Since the Soliman decision, this test has been applied by the Tax Court and a home office deduction has been allowed in such cases as Kahaku v. Commissioner, 58 T.C.M. (CCH) 1247 (1990), which held that a guitarist who practiced at his in-laws' home and received home office designation at that location could deduct all commuting expenses from that office to his various performance locations, and Hoye v. Commissioner, T.C.M. (CCH) 1338 (1990), where a surgeon who had a cytology biopsy lab in his home was held to have a home office for the separate business, since billing was done at his medical office outside his home. The Soliman test was applied and home office deductions were disallowed in McDonal d v. Commissioner, 61 T.C.M. (CCH) 1876 (1991). There, a taxpayer-wife did bookkeeping part-time at home for her husband's electronics repair business and worked Saturdays in the shop; the court held that her home office was secondary and incidental to her business location at the electronics shop. In Mathes v. Commissioner, 60 T.C.M. (CCH) 704 (1990), a history professor with a university-provided office was denied a home office deduction, and although the office was not large enough to house his extensive research materials, the home office was held not to be maintained for the convenience of his employer. Similarly, in Shore v. Commissioner, 59 T.C.M. (CCH) 762 (1990), aff'd, 1991 U.S. App. LEXIS 26835 (6th Cir. 1991), the Tax Court denied the taxpayer a home office deduction where his blueprints were stored in an unfinished part of his basement when he failed to prove that the unfinished area was essential to his business, that he actually spent substantial time there, and that he had no other location available for this purpose. Finally, in Starrett v. Commissioner, 59 T.C.M. (CCH) 334 (1990),
each of his offices was held to be relevant, but not determinative, in establishing whether a home office would qualify as a principal place of business.\footnote{42}

\section*{C. A Proposal}

Though recent, this new test has also been criticized as expanding the deduction from its 1976 Tax Act limitations.\footnote{43} The Tax Court's move away from a "bright line" approach has created much confusion in this area\footnote{44} and more opportunities for abuse.\footnote{45} Moreover, it is questionable whether these "home offices" create anything more than incidental costs to those taxpayers who merely keep records and do bookkeeping there.\footnote{46} Unlike the home office that must be fixed up to accommodate clients or customers, it is not clear whether taxpayers in cases dealing with the "principal place of business" exception really expend more money than they otherwise would if they did not have a home office.\footnote{47}

This Article proposes that Congress amend the home office deduction statute to delete the principal place of business exception and insert in its place "the taxpayer's sole place of business."\footnote{48} Not only would this substitu-

\footnote{42. \textit{Soliman}, 94 T.C. at 26.}

\footnote{43. See, e.g., Robert Kelly, Jr., \textit{Tax Court's New Test for Home Offices Expands Availability of the Deduction}, 19 TAX'N FOR LAW 48 (1990) (suggesting that health care professionals, accountants, realtors, and entertainers may now take advantage of the home office deduction); James A. Fellows, \textit{Current Status of Home Office Deductions Needs Clarification}, 72 J. TAX'N 332 (1990); see also Cadwallader, 919 F.2d at 1275.}

\footnote{44. By contrast, as part of its enactment of the 1976 disallowance provisions, Congress amended a related part of this section dealing with vacation home rentals, stating that it wanted to move away from a vague, facts and circumstances approach towards a more objective standard, so that taxpayers would be prevented from converting personal nondeductible expenses into deductible expenses. See 1976 S. REP., \textit{ supra} note 21, at 152; 1975 H.R. REP., \textit{ supra} note 21, at 165; 1976 JOINT COMM. EXPLANATION, \textit{ supra} note 21, at 143.}

\footnote{45. See \textit{ supra} note 43.}

\footnote{46. See \textit{ supra} note 26 and accompanying text and \textit{ supra} note 28.}

\footnote{47. Dr. Soliman would probably still have a desk in his study, Professor Weissman would probably still use a part of his home to grade papers or prepare lectures, and Mr. Drucker would undoubtedly have a violin in his house. See \textit{ supra} notes 37, 38, 40 and accompanying text. Obviously, however, expenses for such items as business file cabinets, business phone calls and so forth would continue to be deductible within the guidelines of I.R.C. §§ 162, 167, and 168.}

\footnote{48. A similar requirement is found in the part of this statute dealing with the "storage use exception," which is applicable to salespersons. Specifically, the taxpayer may deduct expenses "allocable to space within the dwelling unit which is used on a regular basis as a storage unit for the inventory of the taxpayer held for use in the taxpayer's trade or business of selling products at retail or wholesale, but only if the dwelling unit is the sole fixed location of such trade or business." I.R.C. sec. 280A(c)(2) (1988) (emphasis added). This is an exception to the exclusive-use test of the statute and it relates to separately identifiable as suitable for storage. See 1975 H.R. REP., \textit{ supra} note 21, at 161; 1976 S. REP., \textit{ supra} note 21, at 148; 1976 JOINT
tion obviate the controversies that have occurred with the "principal place of business" exception, but also it would be more consistent with the original, more restrictive, legislative intent. This change would eliminate the deduction for those taxpayers who appear to be converting personal nondeductible expenses into deductible business ones. Additionally, the alternative would mean that such taxpayers would be unable to derive further tax gain from the ability to deduct what amounts to commuting expenses once they have a statutorily accepted home office. Finally, this change would deny, in ambiguous areas, the home office deduction to taxpayers who are generally in higher tax brackets. Since most employees have been unable to take this deduction due to the more recent tax legislation, it is often the self-employed professional who is likely to benefit from the expanded interpretation of the "principal place of business" exception established by the Tax Court and the two circuit courts.

II. DEDUCTIBLE TRAVEL BETWEEN HOME AND WORK

Although most travel between a taxpayer's home and work is a nondeductible personal expense, there are some exceptions to this rule. The Service and the courts have allowed deductions for travel to a temporary job.

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Although most travel between a taxpayer's home and work is a non-deductible personal expense, there are some exceptions to this rule. The Service and the courts have allowed deductions for travel to a temporary job.
for travel between two places of employment, for the increased costs of expenses. See Rev. Rul. 83-82, 1983-1 C.B. 45, amplifying Rev. Rul. 60-189, 1960-1 C.B. 60, where the Service ruled that employment lasting one year or more would not be considered “temporary.” By contrast, the courts have consistently rejected the Service’s rules of thumb, see, e.g., Norwood v. Commissioner, 66 T.C. 467, 470 (1976), and have adopted a facts and circumstances approach. For example, in Albert v. Commissioner, 13 T.C. 129 (1949), the Tax Court established a test for determining what is a “temporary” job by examining whether “termination within a short period could be foreseen.” Id. at 131. In Albert, the taxpayer, a junior textile inspector, worked at her job in Lowell, Massachusetts, for two years until a reduction-in-force caused her dismissal. The Court held that since such reduction-in-force was not foreseeable, her job was not “temporary.” Therefore, she could not deduct commuting expenses from her home in Gloucester to Lowell. See also Tucker v. Commissioner, 55 T.C. 783 (1971).

The criteria the Tax Court has fashioned to ascertain what is or is not “temporary” employment includes: (1) the expected duration of the employment, (2) the size of the project, (3) the availability of a local labor supply, and (4) the actual duration of the employment. In McCallister v. Commissioner, 70 T.C. 505 (1978), for instance, the court held that the taxpayer’s employment as an electrician was not temporary because there was no real evidence that the expected duration was temporary. In addition, the work was a large construction project, the jobsite was not near a large city, such that the local labor supply had to continually be supplemented by workers from outside the area, and the taxpayer left work after twenty and one-half months without giving an explanation for leaving. Id. The Eighth Circuit has also held that employment which lasted for three years was “temporary” since there was a substantial risk that the taxpayer would be laid off during that three-year interval. See Frederick v. United States, 603 F.2d 1292 (8th Cir. 1979).

Interestingly, the Supreme Court has not actually accepted this exception for commuting expenses. In fact, at one time, the Tax Court itself questioned the legitimacy of making any temporary commuting expenses deductible. In Turner v. Commissioner, 56 T.C. 27 (1971), the Tax Court distinguished between business transportation expenses, which are deductible, and personal commuting expenses which are nondeductible. The court stated that the “temporary” versus “indefinite” analysis is only relevant to I.R.C. § 162(a)(2) travel expenses and not to § 162(a) transportation business expenses. The court gave an example of the illogic that flows from the confusion of these concepts. Assuming that two neighbors each work at the same job location but one is a permanent employee while the other is only temporary, and they alternate driving days, the court asked whether it was reasonable that one should be allowed a deduction while the other was denied one. Turner, 56 T.C. at 32 n.1. In response to the Turner decision, the Service ruled that there was no distinction between “temporary” and “indefinite” employment and that commuting expenses are nondeductible. See Rev. Rul. 1976-453, 1976-2 C.B. 86. Nevertheless, it suspended the application of its ruling. See Announcement 77-147, 1977-42 I.R.B. 45 (relying upon News Release IR-1884 (Sept. 23, 1977)); see also McCallister, 70 T.C. at 508 n.5. Yet, as courts have later noted, the exception for temporary employment derives both from an analysis of whether the taxpayer’s choice of residence is motivated by business or personal considerations, see Frederick, 603 F.2d at 1294-95, and, by parallel consideration to I.R.C. § 162(a)(2), from a desire to alleviate the burden of a taxpayer who must incur additional living expenses, because it would be unreasonable to expect him to move his residence, when employment is only temporary. See id. at 1295; see also Rev. Rul. 83-82, 1983-1 C.B. 45.

55. See Rev. Rul. 55-109, 1955 C.B. 261 (ruling that where a reservist drives to required drills at one location in a city and on the same day works at another business location, he may deduct the transportation expenses in getting from one place of business to another).
travel to transport tools to a job,\textsuperscript{56} for travel to and from a home office,\textsuperscript{57} and for travel which is integral to a job.\textsuperscript{58} Because travel to a temporary job involves unavoidable additional or duplicative costs,\textsuperscript{59} as does the transportation of tools to a job,\textsuperscript{60} and since travel between two places of business is not commuting at all but is clearly motivated primarily by business exigencies,\textsuperscript{61} only the latter two exceptions require some modification to prevent taxpayer abuse. Moreover, Congress has enacted legislation to exclude from personal income the costs of employer-provided parking\textsuperscript{62} and has exempted this commuting fringe benefit from any nondiscrimination requirements.\textsuperscript{63} This exclusion should also be changed.

\textbf{A. Travel Between One's Home Office and Other Work Locations}

Because a deduction is allowed for travel between two business locations, it follows that when a taxpayer travels from his home office to another busi-

\textsuperscript{56} See Fausner v. Commissioner, 413 U.S. 838 (1973). In Fausner, the taxpayer, an airline pilot, could not deduct any part of his automobile expenses driving to or from the airport since the Court said it could neither find nor allocate any extra expense incurred by his carrying his overnight and flight bags. Although the Service ruled that it was now emphasizing the Fausner "additional cost" test as the sole test to deduct expenses relating to the transportation of tools, see Rev. Rul. 75-380, 1975-2 C.B. 59, the Service and the courts have at times continued to use a "but for" test. See, e.g., Grayson v. Commissioner, 36 T.C.M. (CCH) 1201 (1977) (permitting a transportation expense deduction for a taxpayer who otherwise would have hitchhiked or taken the bus except for his need to transport his tools by car). But see Pool v. Commissioner, 36 T.C.M. (CCH) 93 (1977) (allowing a taxpayer to deduct the extra cost of a pickup truck as opposed to a car); Myers v. Commissioner, 43 T.C.M. (CCH) 220 (1981) (denying the taxpayer a deduction because he had incurred no additional expenses).

\textsuperscript{57} See infra notes 64-66 and accompanying text.

\textsuperscript{58} See infra notes 67-70 and accompanying text.

\textsuperscript{59} See supra note 54.

\textsuperscript{60} See supra note 56.

\textsuperscript{61} See supra note 55; see also Flowers v. Commissioner, 326 U.S. 465, 474 (1946) ("The exigencies of business rather than the personal conveniences and necessities of the traveler must be the motivating factors"). The Flowers decision set forth three requirements for the deductibility of travel expenses under I.R.C. § 162(a)(2): (1) the expense must be reasonable and necessary, (2) it must be incurred "away from home," and (3) it must be incurred in pursuit of business. \textit{Id.} at 470.


\textsuperscript{63} According to I.R.C. § 132(h)(4) (1988), parking is defined as a "working condition fringe" benefit, and as such (i.e., as a I.R.C. § 132(a)(3) category benefit) it is not subject to the nondiscrimination rules of I.R.C. § 132(b)(1) (Supp. 1990). Those rules provide that the fringe benefit, in order to be excluded for highly compensated employees, must be available on essentially the same conditions to a reasonable classification of employees without discrimination.
ness location he may also deduct these costs. However, when he travels from his home office to his other business locations, he is often duplicating the commuting expenses that other taxpayers may not deduct. Limiting the home office designation as suggested would stop this abuse.

B. Commuting Defined as Business

Recently, the Tenth Circuit created a new exception to the rule of nondeductibility of commuting expenses. In *Pollei v. Commissioner*, the court held that police officers who were on call during the drive between their homes and police headquarters were allowed to deduct their commuting costs because they were on duty from the moment they left home. By engrafting a new exception for commuting that is integral to a taxpayer's job, the decision, if followed, will open the possibility for more taxpayers to convert their nondeductible commuting expenses into deductible business expenses.

64. See Wisconsin Psychiatric Servs., Ltd. v. Commissioner, 76 T.C. 839, 849 (1981) (allowing a psychiatrist to deduct the cost of travel to and from his home office, which was his principal place of business).

65. See supra note 53.

66. See supra notes 29-52 and accompanying text. Again, because it is the higher income professional who is likely to benefit from the liberalized interpretation of "home office," it is he or she who also benefits from the commuting expense deduction.

67. 877 F.2d 838 (10th Cir. 1989), rev'g 87 T.C. 869 (1986). In *Pollei*, the police officers were required to notify their department when leaving or arriving home, and had to drive specially equipped, though privately owned, unmarked cars so that they would be in contact with police headquarters by radio. Id. at 838-39. The circuit court relied on *Christey v. United States*, 841 F.2d 809 (8th Cir. 1988) (permitting highway patrol officers who were required to eat at restaurants adjacent to the highway "to promote public safety and obedience" to deduct their meal costs as ordinary and necessary business expenses), cert. denied, 489 U.S. 1016 (1989), and on *Sibla v. Commissioner*, 611 F.2d 1260 (9th Cir. 1980) (allowing firefighters who were required to contribute money to a meal plan to deduct those amounts as ordinary and necessary business expenses or to exclude these amounts under I.R.C. § 119). This Article declines to follow the *Christey* decision, as it again represents a conversion of personal expenses into deductible business allowances. The *Sibla* decision, while literally contrary to the Supreme Court's decision in *Commissioner v. Kowalski*, 434 U.S. 77 (1977), may be interpreted to be outside the purview of the definition of "income" established in *Commissioner v. Glenshaw Glass*, 348 U.S. 426 (1955), since the firefighters may not have had sufficient dominion and control over their funds, which had to be contributed to the meal plan regardless of whether they ate or not.

The Tenth Circuit emphasized the uniqueness and the public service found in these particular facts that it believed would avoid a floodgate of litigation on this issue. But see infra note 69. By contrast, the Tax Court found that the taxpayers' expenses were essentially like any other commuting expenses, reasoning that the officers were not engaged in any business activity during the travel time. The expenses were therefore nondeductible. See *Pollei v. Commissioner*, 87 T.C. 869 (1986).

68. The Service has stated that it will not ask the Supreme Court to review the *Pollei* decision, but rather will continue to litigate the issue. See *Service Will Continue to Litigate Police Officers' Deductions for Commuting Expenses*, 50 TAX NOTES 33 (1991).
expenses.\textsuperscript{69} Hopefully, other circuits will reject this expansion of the deductibility of commuting expenses, as there seems to be no convincing reason to except these commuting expenses from the general rule.\textsuperscript{70}

\textbf{C. The Exclusion for Employer-Provided Parking Costs}

While enacting comprehensive fringe benefit legislation,\textsuperscript{71} Congress decided to exclude all employer-provided parking without limitation or qualification\textsuperscript{72} by classifying such parking as a “working condition fringe” benefit.\textsuperscript{73} Yet, the actual definition of a “working condition fringe” benefit is any employer-provided property or services which would otherwise be deductible under sections 162 or 167 of the Internal Revenue Code (I.R.C.) if the employee paid for such expenses.\textsuperscript{74} Clearly, parking without a special exception is a nondeductible personal commuting expense and would not satisfy the statutory definition.\textsuperscript{75} The “working condition fringe” benefit exclusion is explained as a means of simplifying the administration of the tax laws by eliminating the need for an income inclusion coupled with a matching deduction.\textsuperscript{76} That rationale seems inapplicable here, because commuting expenses are normally not deductible. Moreover, parking, which may be provided by a business solely to its officers or highly-compensated employees, will nevertheless be excluded from these wealthy taxpayers’ income tax bases.\textsuperscript{77}

\textsuperscript{69} See Scott N. Cairns, et al., \textit{Scope of Commuting Expenses Broadened as a Result of Recent Developments}, 44 \textit{TAX’N FOR ACCT.} 340, 341 (1990), in which the authors suggest that other taxpayers “such as emergency personnel, brokers, and executive assistants” attempt to deduct the full amount of their commuting costs.

\textsuperscript{70} Although this new exception currently affects primarily middle class taxpayers, allowance of this deduction distorts horizontal equity since other taxpayers of equal income will have to pay more in taxes than taxpayers who can fit their commuting within this exception.

\textsuperscript{71} See supra note 62; see also infra notes 102-12 and accompanying text.

\textsuperscript{72} See supra note 63.

\textsuperscript{73} I.R.C. § 132(h)(4) (1988).

\textsuperscript{74} Id. § 132(d).


There is no justification for the parking exclusion, because parking merely constitutes another typical commuting expense.\textsuperscript{78} If the exclusion is permitted, however, at a minimum, it should be subject to nondiscrimination requirements.\textsuperscript{79}

III. THE MOVING EXPENSE DEDUCTION

A. Legislative Background

Before the Revenue Act of 1964,\textsuperscript{80} there existed an exclusion for reimbursed moving expenses only if made by a taxpayer's current employer.\textsuperscript{81} Legislation enacted in 1964\textsuperscript{82} attempted to equalize the treatment between reimbursed and unreimbursed taxpayers and between those who received payments from new as well as from current employers.\textsuperscript{83} The 1964 enactment covered certain direct moving expenses\textsuperscript{84} although it imposed certain distance and continued duration of employment limitations.\textsuperscript{85} Later,
although the Tax Reform Act of 1969\textsuperscript{86} liberalized the scope of the moving expense deduction by covering both direct and indirect moving expenses\textsuperscript{87}, it still placed dollar limitations on their deductibility.\textsuperscript{88} Furthermore, the statute extended the distance requirements of the 1964 Act.\textsuperscript{89} To truly equalize the treatment between reimbursed and unreimbursed expenses, the 1969 legislation required that a taxpayer first include his reimbursements in his gross income and then, to the extent that the expenses qualified, take a deduction.\textsuperscript{90} With several modifications,\textsuperscript{91} the 1969 Act represents the law as it


\textsuperscript{87} With the 1969 Tax Reform Act, costs for househunting, for temporary living expenses, and for selling one's former home were included in the category of deductible moving expenses. See id. (adding I.R.C. § 217(b)(1)(C)-(E)).

\textsuperscript{88} The 1969 Act placed a $1,000 limitation on indirect costs of pre-move househunting trips and temporary living expenses and a total limitation of $2,500 on those expenses plus the expense of selling the taxpayer's former residence. See id. at 577-78 (adding I.R.C. § 217(b)(3)).

\textsuperscript{89} The Act extended the distance for the taxpayer's move from twenty to fifty miles. See id. at 578 (amending I.R.C. § 217(c)(1)).


The Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, increased the limits from $1,000 to $1,500 and from $2,500 to $3,000, sec. 506(b), 90 Stat. at 1568 (amending I.R.C. § 217(b)(3)), while reducing the distance requirements from 50 miles to 35 miles, sec. 506(a), 90 Stat. at 1568 (amending I.R.C. § 217(c)(1)). The increased dollar limitations were intended to reflect increased costs due to inflation, and the decreased distance requirements reflected the need to conserve oil because of the Mid-East Oil Embargo. See 1975 H.R. REP., supra note 21, at 155; 1976 S. REP., supra note 21, at 141; 1976 JOINT COMMITTEE EXPLANATION, supra note 21, at 133. In addition, the 1976 Act excepted the military from many of the moving expense deduction requirements (i.e., mileage and the 39-week rule as well as the requirement to first include reimbursements in income) because Congress felt that the administrative difficulties were too great for the military as it had no way of valuing in-kind reimbursements. Sec. 506(c), 90 Stat. at 1568-69 (adding new I.R.C. § 217(g)), see 1975 H.R. REP., supra note 21, at 156; 1976 S. REP., supra note 21, at 141-42; 1976 JOINT COMMITTEE EXPLANATION, supra note 21, at 134.

In 1978 the moving expense deduction was amended to provide higher dollar limitations of $4,500 (up from $1,500) and $6,000 (up from $3,000). See Tax Treatment Extension Act of 1977, Pub. L. No. 95-615, sec. 204(a), 92 Stat. 3097, 3106-07 (1978) (adding new I.R.C. § 217(h) for foreign moves to make U.S. workers more competitive with foreign workers and to reflect the greater costs of such moves); H.R. REP. NO. 1798, 95th Cong., 2d Sess. (1978); see also S. REP. NO. 940, 96th Cong., 2d Sess. 112-13 (1981) (referring to this liberalization in seeking even higher limitations). The 1978 Act also increased limits for deducting temporary
exists today, except that now the reimbursement allowance is a personal itemized deduction.92

B. A Proposal

Essentially, the moving expense deduction is a mixed personal93 and business94 cost. To the extent that it reflects business motivation, it is justified. Yet job-related moves also resemble commuting, which is considered a personal nondeductible expense.95 Although there has been virtually no controversy in interpreting the language of the statute,96 and there has been little criticism of the provision itself,97 this Article proposes that the benefits of living expenses from 30 to 90 days and allowed deductions for certain storage fees. Sec. 204(a), 92 Stat. at 3106.


93. There are “strong personal elements” in the moving expense deduction, emphasizing the dual nature of this deduction. Tax Reform, 1969: Hearings Before the House Comm. on Ways and Means, 91st Cong., 1st Sess. 5499 (statement of Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy) [hereinafter 1969 Hearings].

94. American labor is most efficient if it can move to where the jobs are. Thus, the moving expense deduction is seen as a means of reducing unemployment and increasing productivity. See 1969 S. REP., supra note 90, at 108; H.R. REP. No. 413, 91st Cong., 1st Sess., pt. 1, at 75 (1969); 1970 JOINT COMM. EXPLANATION, supra note 90, at 101-02; 1969 Hearings, supra note 93, at 4; see also 2 1984 TREASURY PLAN, supra note 1, at 123. Because of this rationale, the Treasury Department proposed to increase dollar limitations on moving costs to allow a deduction of $10,000 (up from $3,000) and of $3,000 (up from $1,500) for domestic moves, and of $10,000 (up from $6,000) and of $6,000 (up from $4,500) for foreign moves. These higher limitations would also reflect the increased costs of such moves. Id. The moving expense deduction is viewed as a cost of earning income. 1970 JOINT COMM. EXPLANATION, supra note 90, at 102.

95. See supra note 53.

96. See, e.g., Fogg v. Commissioner, 89 T.C. 310 (1987) (finding the moving of a taxpayer’s sailboat to be a deductible expense of moving his “personal effects”); Aksomitas v. Commissioner, 50 T.C. 679 (1968) (holding the moving of a taxpayer’s yacht to be a nondeductible moving cost).

97. The section has, however, been criticized for its unfairness to married working couples who are limited to a single set of dollar amounts even where each spouse formerly lived in widely different locations. See Toni Robinson & Mary M. Wenig, Marry in Haste, Repent at Tax Time: Marital Status as a Tax Determinant, 8 VA. TAX REV. 773, 840 (1989).

The low dollar limitations have also been attacked as not being reflective of contemporary moving costs. See supra note 94; see also Lee Objects to Change in Threshold for Moving
this provision need to be refocused upon those for whom these costs create the greatest burden. To effectuate this proposal, the following changes should be made: (1) the deduction should again be made an adjustment to income, under I.R.C. section 62, so that nonitemizers (generally lower or middle income taxpayers) may receive this benefit;98 (2) the moving expense dollar limitations should be adjusted to reflect contemporary costs of an average-income taxpayer’s move;99 and (3) the deduction should be phased out for upper income taxpayers. Just as the original dollar limitations were placed on indirect moving expenses in order to prevent a windfall to the wealthy,100 the moving expense deduction should be re-directed to avoid the abuse of converting personal nondeductible expenses into allowable deductions and to add more progressivity into the tax system.


98. By 1988, about half of those who could have benefitted from this provision were denied its aid because they did not itemize. See Brown, supra note 97; see also supra note 92.

99. Indirect moving expense dollar limitations, apart from foreign moves, have remained constant since 1976. Their increased costs have been estimated at $7,500 (converted to 1991 dollars) and at $10,000 (based upon a review of a typical taxpayer’s indirect moving costs), see 2 1984 Treasury Plan, supra note 1, at 123. However, guidelines should not be tied to either standard, but rather should depend upon a review of a middle income taxpayers’ typical moving costs. Including upper income taxpayers’ typical expenses would merely reflect a greater portion of costs dictated by personal considerations. See infra note 100.

100. The $1,500 limitation on indirect expenses will provide the needed relief from the financial burden of moving for the great majority of employees; that is employees with average earnings and average moving expenses. Total expenses for these indirect costs may exceed the limitation in cases of high-income employees. Their added costs are attributable to their higher standard of living which their increased earning power makes possible and should therefore properly be considered as personal rather than business related. For example, a corporate executive who is transferred is likely to have above-average temporary living expenses by staying in a more expensive hotel and above average real estate costs from selling a more expensive home. The taxpaying public should not be required to defray . . . these more-than-average expenses. In addition, the $1,500 limitation reduces the possibility of abuse, or extravagant expenditures, at the expense of the general public.

IV. FRINGE BENEFITS

A. Background

In 1984, after an absence of consistent guidelines, Congress enacted comprehensive fringe benefit legislation, which has been modified only slightly since that date. This legislation produced major reform by pro-

101. This Article will address only those fringe benefits that have been excluded on quasi-business justifications (i.e., I.R.C. §§ 132, 117(d) (1988 & Supp. 1990)).

Clearly, in terms of revenue lost, the major fringe benefits are the exclusions for pensions, health care, and life insurance. See I.R.C. §§ 79, 101(b), & 106 (1988 & Supp. 1990). Specifically, in 1992, $91 billion in revenue is estimated to have been lost because of the exclusion of these fringe benefits. See GAO Report Cites Effects of Changing Tax Treatment of Fringe Benefits, 92 TAX Notes TODAY 76-16 (Apr. 9, 1992) [hereinafter 1992 GAO Report Summary] (summarizing GAO/GGD-92-43, released Apr. 7, 1992). These expenses are clearly personal costs which are not within the scope of this Article. However, because of the immense dollar impact and the inequities involved between those who provide these benefits tax free and those who would need to purchase them with after-tax dollars, and because of the disproportionate value of these benefits for higher bracket taxpayers (vertical inequity), potential changes to these provisions should be highlighted. The GAO Report, although containing no specific recommendations, suggests that alternatively these benefits could be fully taxed or capped in terms of the dollar amounts excluded. Additionally, the report suggests that to ease the inequities while allowing lower income taxpayers to retain their coverage without incurring a tax, a credit could be allowed to offset some or all of these expenses (depending on the taxpayer's income bracket) which would first be included in the taxpayer's income. Id.

This Article suggests that these benefits could also be phased out and eliminated for upper income levels. There would be less erosion of the tax base and more tax equity, and it is unlikely that such action would affect coverage for these individuals. According to the GAO Report, taxpayers in the upper brackets would continue to contribute to their pensions and to purchase health and life insurance even without a tax break. Id.


Note, however, that if another section expressly provides for a particular fringe benefit, except for an I.R.C. § 132(e) "de minimis fringe" benefit, that other section controls. I.R.C. § 132(j) (1988).

104. The Tax Reform Act of 1986 contained comprehensive non-discrimination rules which would have applied to these provisions. Pub. L. No. 99-514, secs. 1151(a), 100 Stat.
viding that fringe benefits not explicitly excluded by statute are includable in gross income. These “new” rules are essentially historical inequities which only benefit employees in certain industries. Essentially, “no additional cost service fringe” benefits (aiding those in the airline, other transportation, and hotel industries), “qualified employee discounts” (benefitting those in the retail industries),

2085, 2494 (codified at I.R.C. § 89 (1988) (repealed 1989)). However, the Debt Limit Extension Act, Pub. L. No. 101-140, secs. 201-04, 103 Stat. 830, 830-33 (1989), retroactively repealed § 89 and left §§ 117(d) and 132 with their individual nondiscrimination rules.

The 1986 Act also included, mostly for clarification, some technical amendments to the 1984 fringe benefit legislation. In defining an employee discount in I.R.C. § 132(c)(3)(A), Congress substituted “are provided by the employer to an employee for use by such employee” for “are provided to the employee by the employer.” 1986 Tax Reform Act, sec. 1853(a)(2), 100 Stat. at 2870. In defining a dependent child who qualifies as an individual treated as an employee for purposes of the “no-additional-cost” and “qualified employee discount fringe” benefits, Congress added an age restriction to I.R.C. § 132(f)(2)(B)(ii) so that the section would read, “both of whose parents are deceased and who has not attained age 25.” Id. at sec. 1853(a)(1), I.R.C. § 132(f)(2)(B)(ii) (1988).


The Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, sec. 6066, 102 Stat. 3342, 3702-03 (adding I.R.C. § 132(h)(8)), equated the services of air cargo transport with air passenger transportation for the purposes of the “no-additional-cost fringe” benefit.

105. 1984 Tax Reform Act, sec. 531(c) (amending I.R.C. § 61(a)(1)). Congress stated that one of its main purposes in enacting the fringe benefit legislation was to provide clear boundaries for these benefits without substantially eroding the tax base. 1984 H.R. REP., supra note 77, at 1591-92; 1984 JOINT EXPLANATION, supra note 75, at 840-41. When the value of a fringe benefit is included in a taxpayer’s income, it is included at its fair market value less the money the taxpayer-recipient paid for it. Id. at 842.


107. See Shaller, The New Fringe Benefit Legislation, supra note 76; see also 1984 JOINT EXPLANATION, supra note 75, at 843.

108. A “no additional cost service fringe” benefit is defined as an employer-provided service which is offered for sale to customers in the ordinary course of the employer’s line of business in which the employee is performing services, and for which the employer incurs no additional cost, including forgone revenue. I.R.C. § 132(b) (1988). It is subject to the nondiscrimination rule of I.R.C. § 132(b)(1) (1988 & Supp. 1990), see supra note 63, and is available to current, retired and/or disabled employees, their spouses or surviving spouses, their dependent children, and, in a special perk for air transportation employees, their parents. I.R.C. § 132(f) (1988 & Supp. 1990).

109. A “qualified employee discount” is defined as an employee discount with respect to any property, except real or investment property, which does not exceed the employer’s gross profit percentage or, in the case of services, twenty percent of the sales price. I.R.C. § 132(c) (1988 & Supp. 1990). It is subject to the nondiscrimination requirements of I.R.C. § 132(b)(1) (1988 & Supp. 1990), see supra note 63, and is available to current, retired and/or disabled employees, their spouses or surviving spouses, and their dependent children. I.R.C. § 132(f) (1988 & Supp. 1990).
and "qualified tuition reductions" (providing perks to those in the education field) are exempt from income ostensibly because of their business purpose and because of valuation and administrative difficulties. However, their business purpose is questionable and certainly intertwined with a significant personal motivation and use. Moreover, since the 1984 legislation, there has been much guidance on valuation, in the form of regulations which has been made available to assist employers with the taxing of these benefits.

**B. A Proposal**

In order to prevent the erosion of the tax base and to restore equity, the exclusions for "no additional cost services," "qualified employee discounts," and "qualified tuition reductions" should be repealed. Alternatively, as a more moderate change consistent with the other proposals in this Article, the exclusion should be phased out and eliminated for upper income taxpayers in order to broaden the tax base and reinstitute more progressivity and fairness into the tax system.

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110. A "qualified tuition reduction" is defined as a reduction in tuition given to current, retired and/or disabled employees of an educational institution at the undergraduate level their spouses, or surviving spouses, and their dependent children. I.R.C. § 117(d)(2) (1988). The "qualified tuition reduction fringe" is subject to nondiscrimination requirements. I.R.C. § 117(d)(3) (1988); see supra note 63.

111. See 1984 H.R. REP., supra note 77, at 1591 ("Although employees may receive an economic benefit from the availability of these free or discounted goods or services, employers often have valid business reasons, other than simply providing compensation, for encouraging employees to avail themselves of the products which they sell to the public."); 1984 JOINT EXPLANATION, supra note 75, at 840.

112. See 1984 JOINT EXPLANATION, supra note 75, at 842. Note, however, that there are recordkeeping requirements that must be satisfied to qualify for the exclusion. I.R.C. § 6039D (1988 & Supp. 1990); see also I.R.S. Announcement 86-20, 1986-7 I.R.B. 34.

113. A fringe benefit that reflects a true business expense is excludible as a "working condition fringe" benefit under I.R.C. § 132(d) (1988 & Supp. 1990). A "working condition fringe" benefit is defined as an employer-provided benefit, which if paid for by the employee, would be deductible as a business expense under I.R.C. §§ 162 or 167. *Id.* For example, the money a county pays its police officers for their uniforms or for dog food for their police dogs is excludible as a "working condition fringe" benefit since both are deductible business expenses under I.R.C. § 162. *Priv. Ltr. Rul. 91-09-041* (Dec. 3, 1990).

While a current employee may be sampling and/or displaying his employer's wares and thus demonstrate some business purpose, it is more difficult to understand how this same rationale applies to current retired and/or disabled employees and their families. See supra notes 106-09.


V. BUSINESS MEALS AND ENTERTAINMENT

A. Historical Context

In 1961, President Kennedy recommended disallowing all business entertainment deductions, including those expenses relating to entertainment facilities, and curtailing deductions for business travel and business gifts. He also suggested a maximum deduction (between four and seven dollars per day) for business meals, but only if the meals were part of an activity that was directly related to the taxpayer's business and was not merely productive of goodwill. These proposals were intended to prevent personal and extravagant expenses from being borne by the federal government (i.e., by other taxpayers). However, Congress did not adopt President Kennedy's plan. Instead, Congress enacted legislation on business meals and entertainment similar to that which exists today. Congress enacted a disallowance provision under which such expenses, in addition to qualifying as business expenses under I.R.C. section 162, had to be either "directly related" or "associated with" the taxpayer's trade or business. Business meals merely had to be furnished in surroundings conducive to business discussion. Mixed business and personal foreign travel were limited to either

116. An entertainment facility is an "item of personal or real property owned, rented, or used by a taxpayer during the taxable year for, or in connection with, an activity normally considered to be of an entertainment nature." S. REP. No. 1036, 96th Cong., 2d Sess. 24 n.1 (1980). An example of an entertainment facility is a yacht or hunting lodge. See 2 1984 TREASURY PLAN, supra note 1, at 81. The term also includes, inter alia, fishing camps, swimming pools, tennis courts, bowling alleys, ski lodges, and beach cottages. H.R. CONF. REP. No. 1800, 95th Cong., 2d Sess. 248 (1978).

117. See Detailed Explanation of the President's Recommendations Contained in His Message on Taxation, President's 1961 Tax Recommendations: Hearings Before the House Comm. on Ways and Means, 87th Cong., 1st Sess. 253, 283 (1961) [hereinafter 1961 Hearings]. The exact figure of the deduction had not been determined, but it was expected to fall within the four to seven dollar range. Id. This reform was estimated to produce an additional $250,000,000 per year in revenue. Id. at 44 (Statement of Honorable C. Douglas Dillon, Secretary of the Treasury).

118. Id.

119. Congress reacted to anticipated hardships in the entertainment industry and emphasized that valid business purposes were also being served, especially for salespersons. S. REP. No. 1881, 87th Cong., 2d Sess. 24, 25 (1962); H.R. REP. NO. 2508, 87th Cong., 2d Sess. 19-26 (1962).


one week or a maximum of twenty-five percent of personal time in relation to the total amount of time spent abroad in order to be deductible.\footnote{Revenue Act of 1962, sec. 217 (codified at I.R.C. § 274(c)(1988)).}

Finally, travel, meals, and entertainment were made subject to more specific substantiation requirements.\footnote{Id. at sec. 4 (codified at I.R.C. § 274(d) (1988)); see Treas. Reg. § 1.274-5 (as amended in 1985). Congress enacted the substantiation requirements to insure that taxpayers were not deducting purely personal expenses as business costs. See H.R. REP. NO. 1447, 87th Cong., 2d Sess. 19 (1962). The Tax Reform Act of 1984, Pub. L. No. 98-369, sec. 179(b)(1), 98 Stat. 494, 877 (codified at I.R.C. § 274(d)(4) (1988)), added “listed property,” (as defined by § 280F(d)(4)), to those items requiring this substantiation. In addition, the 1984 Act further restricted the substantiation rules; however, the “contemporaneous” recordkeeping requirement was later repealed by the Act of May 24, 1985, Pub. L. No. 99-44, sec. 1(a), 99 Stat. 77, 77 (1985).}

In 1978, President Carter proposed the disallowance of all business entertainment deductions and only half deductions for business meal expenses.\footnote{See Message from the President of the United States Transmitting Proposals for Tax Reduction and Reform in the President's 1978 Tax Reduction and Reform Proposals, 1978: Hearings Before the House Comm. on Ways and Means, 95th Cong., 2d Sess. 3, 11, 341 (1978). President Carter also urged the disallowance of first class air travel (over coach) and of costs for attending foreign conventions. Id. at 341.}

Like the Kennedy plan, it was not enacted.\footnote{In 1982, the Senate passed a proposal like the Carter plan, but it was eliminated in conference. S. REP. NO. 760, 97th Cong., 2d Sess. 556 (1982).} Instead, Congress merely curtailed the deductibility of most entertainment facilities.\footnote{Revenue Act of 1978, Pub. L. No. 95-600, sec. 361, 92 Stat. 2763, 2847 (codified at I.R.C. § 274(a)(1)(B),2(C) (1988)); Technical Corrections Act of 1979, Pub. L. No. 96-222, sec. 103(a)(10), 94 Stat. 194, 212 (1980), (amending I.R.C. § 274(a)(2)(C)). If costs relating to the use of a facility are disallowed under this section, the facility itself is considered to be a personal, rather than a business asset. Revenue Act of 1962 sec. 4 (codified at I.R.C. § 274(g) (1988)). Dues for clubs, such as sporting or social clubs, continue to be deductible if they are primarily for the taxpayer’s business and if the item is directly related to the active conduct of that business. Revenue Act of 1978 sec. 361(b) (codified at 274(a)(2)(C) (1988)). Also, in 1978, restrictions were made on deductions for foreign conventions, see id. sec. 701(g), later modified by the 1980 Tax Act. That Act disallowed expenses for attending a foreign convention unless, on a facts and circumstances basis, it was “as reasonable” for the meeting to be held outside, as within North America, Act of Dec. 28, 1980, Pub. L. No. 96-608, sec. 4(a), 94 Stat. 3550, 3552; see S. REP. NO. 1031, 96th Cong., 2d Sess. 11-13 (1980).}

In 1984, the Treasury Department issued its plan, which would have generally denied all deductions for entertainment expenses. Business meals, however, would be excepted and would be required to be furnished in a “clear business setting” and have a dollar cap on the amounts deductible.\footnote{2 1984 TREASURY PLAN, supra note 1, at 83. The deduction for business meals would be restricted to ten dollars for breakfast, fifteen dollars for lunch, and twenty-five dollars for}
gress made more modest reforms, disallowing twenty percent of the cost of business entertainment and meals, and requiring a closer business connection for deductible business meals.

B. A Proposal

Like others in the past and present, this Article proposes that the entertainment deduction should be eliminated and that the deduction for business meals should be limited to dollar amounts like those proposed in dinner (including tax and gratuity). Id. Arguing that its proposal was based on ideas of fairness, the Treasury Report stated:

The current treatment of business entertainment expenses encourages taxpayers to indulge personal entertainment desires while at work or in the company of business associates. The majority of taxpayers, however, do not benefit from this incentive. Most hold jobs that do not permit business entertainment . . . .

Current law thus creates a preference for the limited class of taxpayers willing and able to satisfy personal entertainment desires in a setting with at least some business trappings. Lunches are deductible for a business person who eats with clients at an elegant restaurant, but not for a plumber who eats with other workers at the construction site. A party for friends of a business person is deductible if they are business associates, but a party for friends of a secretary, sales clerk, or nurse is not deductible.

Id.

In a second proposal, President Reagan offered an alternative recommendation that no entertainment expense be deductible, but that expenses for business meals be deductible up to twenty-five dollars, then fifty percent beyond that dollar limit. U.S. DEPT. OF THE TREASURY, THE PRESIDENT'S PROPOSALS TO THE CONGRESS FOR FAIRNESS, GROWTH, AND SIMPLICITY (May 1985) (sometimes referred to as TREASURY II).


131. 1986 Tax Reform Act, sec. 142(b). Section 142(b) repealed I.R.C. § 274(e)(1), thereby requiring that business meals be subject to the "directly related" or "associated with" limitations of I.R.C. § 274(a). See supra notes 121, 122.

The 1986 legislation also subjects business meals to the requirements that they not be lavish or extravagant under the circumstances, although such terms are left undefined, and that they be eaten while the taxpayer is present. 1986 Tax Reform Act, sec. 142(a) (codified at I.R.C. § 274(k) (1988)). In addition, the 1986 Act limited the amount allowable as a deduction for an entertainment ticket to the ticket's face value, thus disallowing any additional amounts paid to "scalpers;" similar amount limitations were applied to skyboxes. Id. sec. 142(b) (codified at I.R.C. sec. 274(l) (1988 & Supp. 1990)). Small additional limitations, with many exceptions, were applied to luxury water travel. Id. sec. 142(b) (codified as amended at 274(m) (1988)).

132. See, e.g., supra notes 116, 126, 127 and 129.

the 1984 Treasury Department plan. Alternatively, since it is the wealthy who disproportionately benefit from these provisions and who can better absorb the personal element of the cost due to their greater discretionary income, these deductions should be phased out and eliminated for upper bracket taxpayers. In this way, more progressivity would be reinjected into the Tax Code.

VI. THE DEPENDENT CARE CREDIT AND THE DEPENDENT CARE PROGRAM EXCLUSION

A. Legislative Background of the Dependent Care Credit

The 1954 Tax Code introduced a deduction for dependent or childcare expenses, of up to $600, that enabled a woman or widowed taxpayer to work. The deduction was phased out for married taxpayers earning an adjusted gross income beginning at $4,500 and was unavailable to taxpayers with a combined income of $5,100 or more. During the 1960s and the first half of the 1970s, adjustments were made to the coverage of this program.

134. See supra note 129. Further, the deduction should be restricted to meals with non-business associates, except to the extent that meals with associates qualify for the de minimis exclusion under I.R.C. § 132(e). See Wendy G. Shaller, Reforming the Business Meal Deduction: Matching Statutory Limitations with General Tax Policy, 24 DUQ. L. REV. 1129, 1149 (1986).
135. See supra notes 126, 129.
136. See 1990 CONF. REP., supra note 8, at 361.
137. This deduction applied to dependents who were physically or mentally incapacitated. See S. REP. No. 1622, 83d Cong., 2d Sess. 35 (1954) [hereinafter 1954 S. REP.].
138. I.R.C. § 214 (1954). The provision allowed an itemized deduction for the costs of caring for children under age twelve. No deduction was allowed for payments to the taxpayer's dependents, and married taxpayers had to file a joint return to avail themselves of these benefits. See 1954 S. REP., supra note 137, at 36; H.R. REP. No. 1337, 83d Cong., 2d Sess. 30 (1954) [hereinafter 1954 H.R. REP.]. The woman had to be working or seeking employment, and, if the caretaker also did household chores, such costs had to be prorated; however, if the caretaker watched two children but only one was of eligible age for the deduction, no allocation was required. The $600 limit was applied regardless of how many eligible children the taxpayer had. See 1954 S. REP., supra note 137, at 220.
139. For example, if the taxpayer's AGI was $4,700, which is $200 over the AGI limit of $4,500, the taxpayer's deduction was limited to $400 ($600 − $200). 1954 S. REP., supra note 137, at 220.
140. In 1963, Congress made the deduction available to women who were deserted by their husbands so long as their husbands' whereabouts were unknown and they had sought court-ordered child support. These women were no longer subject to the requirements of filing joint returns or to the upper income limitations. Act of April 2, 1963, Pub. L. No. 88-4, 77 Stat. 4 (amending I.R.C. § 214(c)(3) (repealed 1976)); see S. REP. NO. 69, 88th Cong., 1st Sess. 1 (1963).
vision, the dollar amounts\(^{141}\) of deductible expenses, and the income level,\(^{142}\) indicating for which taxpayers this deduction was available.


In 1971, Congress amended this section to apply to all individuals who maintain a household for one or more “qualifying individuals.” A “qualifying individual” was defined as the taxpayer’s dependent under the age of fifteen or an incapacitated dependent or spouse. Revenue Act of 1971, Pub. L. No. 92-178, sec. 210(a), 85 Stat. 497, 518 (amending and renumbering I.R.C. § 214(b)(1)). Moreover, the 1971 Act expanded coverage to include “substantially full-time employees” (i.e., those working an average of at least three-fourth’s time). See S. Rep. No. 437, 92d Cong., 1st Sess. 62 (1971) [hereinafter 1971 S. REP.].

The Revenue Act of 1964, sec. 212(a), raised the dollar limit for expenses from $600 to $900 where the taxpayer had two or more dependents. There had been a Senate proposal that the top level be raised to $1,000 where there were three or more dependents, but this change was not adopted. See 1964 S. REP., supra note 83, at 3.

With the 1971 Act, the maximum deductible expenses increased to $200 per month for one dependent, $300 for two dependents and $400 for three or more dependents. Revenue Act of 1971, sec. 210(a) (adding I.R.C. § 214(c)(2)(B) (repealed 1976)).

In addition, taxpayers were no longer required to allocate between household and childcare expenses. See supra note 138. Rather, both types of expenses qualified under the definition of “employment related expenses.” 1971 Revenue Act, sec. 210(a) (adding I.R.C. § 214(b)(2) (repealed 1976)). Besides reflecting a cost increase for actual childcare expenses, the increased deduction was designed, in part, to cover these new expenses. See 1971 S. REP., supra note 140, at 60.

142. The 1964 Revenue Act, sec. 212(a), raised the AGI limit for the phase-out and elimination of the deduction to an AGI of $6,000. Initially, it had been proposed that the AGI limit begin at $7,000 since, according to the U.S. Labor Department’s statistics, the median income of married couples where the wife worked outside the home was $7,050 in 1961. See 1964 S. REP., supra note 83, at 68. The $6,000 upper income limitation was applied to married taxpayers and to husbands whose wives were incapacitated. Also, it applied to husbands whose wives were institutionalized for the first ninety consecutive days. 1964 Revenue Act, sec. 212(a) (amending I.R.C. § 214(b)(2) (repealed 1976)).

Further increases were made in 1971 by legislation raising the limit to an $18,000 AGI. Revenue Act of 1971, sec. 210(a) (adding I.R.C. § 214(d) (repealed 1976)). For those taxpayers with incomes above $18,000, the deduction was reduced fifty cents for each dollar the taxpayer’s AGI exceeded that amount. See H.R. Conf. Rep. No. 708, 92d Cong., 1st Sess. 42 (1971) [hereinafter 1971 CONF. REP.]. For example, if the taxpayer’s AGI is $24,000, subtract $18,000 from $24,000 and divide the result by twenty-four (i.e., 2 × 12 months); the result is $400, the amount by which the taxpayer’s deduction had to be reduced because of this income limitation. See Prop. Treas. Reg. § 1.214A-2(c), 40 Fed. Reg. 20633-40 (1975). Congress desired that the phase-out of the childcare deduction be less abrupt so that denial of the deduction, by a gradual elimination, would be made over a wider span of income levels. See 1971 S. REP., supra note 140, at 60.

By 1971, all taxpayers were subject to the maximum income limitations. Previously, those restrictions applied only to married taxpayers or to husbands with incapacitated wives. Id. However, owing to the low level of income earned by women in those years, it is likely that there were few single mothers whose income exceeded the maximum levels.
With the Tax Reform Act of 1976,\textsuperscript{143} the deduction became a credit,\textsuperscript{144} in order to extend this tax benefit, previously limited to itemizers, to those taxpayers using the standard deduction.\textsuperscript{145} At this time, Congress also eliminated the income ceiling, because as a credit, its allowance had "minimal revenue impact."\textsuperscript{146} Four years later, the 1981 tax legislation imposed a sliding scale of applicable percentages based on income\textsuperscript{147} in order to relieve the burdens of the lower and middle class taxpayers,\textsuperscript{148} but again failed to


\textsuperscript{144} The credit was equal to twenty percent of employment-related expenses. Those expenses were subject to a dollar limitation of $2,000 for one qualifying individual and $4,000 for two or more qualifying individuals, as well as an earned income limitation, which in the case of spouses, was equal to the lower of their respective incomes. I.R.C. § 44A(a), (c)(1), (c)(2), (d), (e) (1976). Married taxpayers had to file jointly to receive the credit. I.R.C. § 44A(f)(2) (1976).

The 1978 tax legislation amended I.R.C. § 44A(f)(6) and allowed childcare payments to related individuals, with the exception of either a dependent of the taxpayer or the taxpayer's child under age nineteen. See Revenue Act of 1978, Pub. L. No. 95-600, sec. 121(a), 92 Stat. 2767, 2779.

\textsuperscript{145} See 1976 S. Rep., supra note 21, at 132. The credit also broadened the scope of the benefit to include part-time workers. Id. at 133.

\textsuperscript{146} Id. at 132. Congress also reiterated that the childcare credit was "a cost of earning income." Id.

\textsuperscript{147} The percentages applied against employment-related expenses vary from 20% to 30%, depending upon the taxpayer's income. The percentage is reduced by one percentage point for every $1,000 by which the taxpayer's AGI exceeds $10,000. Recovery Economic Tax Act of 1981, Pub. L. No. 97-34, sec. 124(a), 95 Stat. 172, 197-98 (codified and renumbered at I.R.C. § 21 (1988)). For example, if a taxpayer's AGI is $11,000, the applicable percentage would be 29%, which would be multiplied by the taxpayer's employment-related expenses. See H.R. Rep. No. 201, 97th Cong., 1st Sess. 57 (1981) [hereinafter 1981 H.R. Rep.] The example given in the House Report provided that a 40% maximum be reduced in such a case to 39%, since as originally proposed, the sliding scale was to run between 30% and 40%. Id. The dollar limitations on deductible employment-related expenses were raised to $2,400 for one qualifying individual, and to $4,800 for two or more qualifying individuals. Economic Recovery Tax Act, Pub. L. No. 97-34, sec. 124(b)(1)(A), (B), 95 Stat. 172, 198 (1981) (amending I.R.C. § 44A(d)). To constitute employment-related expenses, daycare centers have to meet state law requirements. Id. sec. 124(d) (adding I.R.C. § 44A(c)(2)(C)).

recreate an income limit. Since 1981, only minor changes have been made to this section.

B. Legislative History of the Dependent Care Program Exclusion

In 1981, the Economic Recovery Tax Act (ERTA) created a new exclusion for employer-provided childcare which was administered under a written, nondiscriminatory plan. Because Congress was concerned that the exclusion was more valuable than the credit, particularly to higher income taxpayers, in 1986 it imposed a $5,000 limit on this tax benefit and, in 1988, it offset the allowable credit by the amount of exclusion taken.

149. Although the sliding scale has some relationship to income, it has little impact upon taxpayers with incomes above $30,000, since a taxpayer with an income of $30,000 has the same percentage limitation as a taxpayer with an income of $30,000,000. Because of the lack of any real upper income limitation, there was also some objection to the fact that those taxpayers with marginal incomes would have to pay for the childcare of the wealthy. 127 Cong. Rec. S8448 (daily ed. May 5, 1981) (statement of Sen. Biden).

150. This section was renumbered as I.R.C. § 21 and listed under the category of "Nonrefundable Personal Credits." Tax Reform Act of 1984, Pub. L. No. 98-369, sec. 471(c)(1), 98 stat. 494, 826.


In 1988, Congress revised the definition of a "qualifying individual" to be a dependent under the age of thirteen rather than fifteen. Family Support Act of 1988, Pub. L. No. 100-485, sec. 703(a), 102 Stat. 2343, 2426-27. Congress also required that the amount of credit available to taxpayers first be reduced by the amounts excluded under I.R.C. § 129, the Dependent Assistance Program Exclusion. Id. sec. 703(b); see infra notes 152-54 and explanation of the accompanying text.


154. See supra note 150.
C. Unsuccessful Attempts to Phase Out Childcare Benefits

Until the childcare benefits deduction became a credit, an upper income limitation on the availability of this tax benefit existed. Reasoning that there would be only a small impact on revenue, however, Congress eliminated this cap. Since that time there have been several unsuccessful attempts to reimpose a ceiling upon the childcare benefits credit in order to redirect the tax credit to the lower and middle classes and, ironically, to provide a source of revenue. Opponents of income limits argue that the

155. See supra notes 139-42 and accompanying text.
156. See supra note 148. Evidently, this “minimal revenue impact” has become more appreciable since 1976. When the childcare phase-out legislation was introduced in 1989, the ceiling was intended to produce approximately $1.5 billion in new revenue over a five year period. See infra note 157.
157. See, e.g., H.R. REP. NO. 4021, 102d Cong., 1st Sess. (1991); 137 CONG. REC. H11885, H11888 (daily ed. Nov. 26, 1991). Representative Thomas Petri (R-Wisc.) introduced a bill to replace the childcare credit, among others, with a single earned income tax credit. Benefits would be phased out at higher income levels and eliminated for taxpayers with AGIs of more than $61,000. The goal of the legislation was to aid middle-income families. See Daily Tax Rep. (BNA) No. 241, at H-1 (Dec. 16, 1991). Representative Mickey Edwards (R-Okla.) introduced a bill to phase out both the dependent care credit and the dependent care assistance program exclusion for taxpayers with incomes greater than $70,000, with a total elimination of these benefits at incomes of $89,000 or more. See Edwards Amendment to H.R. 3, 101st Cong., 2d Sess., 135 CONG. REC. H6662, H6665 (daily ed. Oct. 5, 1989). This measure was expected to raise more than $1.5 billion for taxable years 1991-1995. See Joint Comm. on Tax’n, Staff Estimates of Budget Effects of Title III of H.R. 3, Childhood Education and Development Act (JCX-9-90) (1990), reprinted in Daily Tax Rep. (BNA) No. 64, at L-54 (Apr. 3, 1990); see also House Passes Childcare Bill, 89 Tax Notes Today 204-4 (Oct. 6, 1989). The Edwards Amendment was passed by the House on March 29, 1990, but this provision was deleted by the Senate. See Senate Finance Comm., Response to House Offer on H.R. 3 28 (Aug. 3, 1990), reprinted in Daily Tax Rep. (BNA) No. d152, at L-37 (Aug. 7, 1990). Representative Clyde C. Holloway (R-La.), introduced the Toddler Tax Credit for families with children under the age of five, which, if enacted, would be more generous than the current childcare credit for families with incomes of between $10,000 and $30,000. Families with incomes between $30,000 and $50,000 would retain the current tax credit, and those with incomes between $50,000 and $78,000 would have their credit phased out, until it was completely eliminated for taxpayers with incomes over $78,000. Holloway-Schulze Tax Credit Amendment to H.R. 3, 101st Cong., 1st Sess., 135 CONG. REC. H3582 (daily ed. July 12, 1989). Senator Pete Wilson (R-Cal.) introduced the Kids in Day-Care Services Act of 1988, which intended to limit the childcare benefits to “American families who are in the most need” by imposing a phase-out for AGIs of more than $65,000, with the elimination of benefits for families with an AGI of more than $93,000. 134 CONG. REC. S11464, S11465 (daily ed. Aug. 10, 1988). Senator Bill Bradley (D-N.J.) in 1988 made a counterproposal to phase out business meals and entertainment expenses for upper income taxpayers in order to finance the rest of the childcare legislation. See 134 CONG. REC. S7933, S7958 (daily ed. June 16, 1988). The Senate accepted the substitute. See 88 Tax Notes Today 160-2 (Aug. 4, 1988). Both proposals, however, were dropped by the Senate. See 88 Tax Notes Today 163-H (Aug. 9, 1988).
childcare industry would be hurt;\textsuperscript{158} that employers would eliminate their dependent care assistance programs, resulting in adverse effects upon lower and middle class families;\textsuperscript{159} that childcare is a cost of earning income for all families regardless of income;\textsuperscript{160} that the credit alleviates some of the penalties associated with two-income married couples;\textsuperscript{161} that no other employment-related expenses are subject to a phase-out;\textsuperscript{162} and that imposing a ceiling would create administrative problems for employers.\textsuperscript{163} Proponents of a ceiling, on the other hand, consider the income limitations as fostering greater tax equity and providing additional revenue to serve lower income taxpayers' childcare needs.\textsuperscript{164}

\begin{footnotes}
\item 158. See Daily Tax Rep. (BNA) No. 188, at G1 (Sept. 27, 1990) (statement of Mark Wincek, an attorney with the D.C. law firm of Kilpatrick and Cody, on behalf of Employers Coalition on Childcare) [hereinafter Wincek].
\item 159. Because participation would fall, there would be little justification for administering a Dependent Care Assistance Program. See Wincek, supra note 158. The ceiling would eliminate the "carrot" to stimulate employers to administer such programs, since the bill would eliminate the exclusion for corporate executives. See Daily Tax Rep. (BNA) No. 95, at G-7 (May 16, 1990) (statement of Ken Feltman, Employers' Council on Flexible Compensation). According to a survey of ninety-three employers who were contacted by the Employers' Council on Flexible Compensation, approximately one-half of the companies said they would cancel their exclusion program if H.R. 3 passed. Id. According to a survey of workers conducted by the Voucher Corporation, fifty-six percent of employees currently using flexible spending accounts would be affected by the bill. See Daily Tax Rep. (BNA) No. 188, at G-1 (Sep. 27, 1990) (statement of Ken Feltman, Employers' Council on Flexible Compensation). The phase-out would detract from the appeal of flexible benefit programs. Id. (statement of Helena Peterson, Minnesota Mining and Manufacturing Company).
\item 160. See 2 1984 TREASURY PLAN, supra note 1, at 18.
\item 163. Employers would be uncertain as to an employee's eligibility based on family income. See Wincek, supra note 158.
\item 164. See, e.g., Daily Tax Rep. (BNA) No. 95, at G-7 (May 16, 1990) (statement of Rebecca Tice, Legislative Director for Rep. Stenholm, D-Tex.).
\end{footnotes}
D. A Proposal

This Article suggests replacing the current dependent care statute with a refundable credit\textsuperscript{165} that is indexed for inflation\textsuperscript{166} and has a gradual phase-out\textsuperscript{167} and elimination at upper income levels. In addition, the current exclusion for Dependent Care Assistance Programs should be repealed, since the exclusion mainly benefits the higher income brackets.\textsuperscript{168} Returning to an income ceiling would complement the statute's original function of enabling average-income taxpayers to work.\textsuperscript{169} In addition, it would finance those additional changes that would increase childcare benefits for those who truly need these costs subsidized.\textsuperscript{170}

\begin{itemize}
  \item \textsuperscript{165} Many legislators and commentators have urged the benefit of making the childcare credit refundable in an effort to aid lower income working parents. See, e.g., S. REP. NO. 196, 101st Cong., 1st Sess. 404 (1989) [hereinafter 1989 S. REP.]. The Senate more recently approved an amendment to legislation which was dropped from the Conference agreement, proposing to make the credit 90\% refundable for taxpayers with an AGI less than $28,000. 1990 CONF. REP., supra note 8, at 21. The purpose of such refundable credit is to "remove an important barrier to the economic advancement of low-income families in that adequate childcare while parents work will now be more affordable." 1989 S. REP., supra, at 404; see ABA Task Force, reprinted in 89 TAX NOTES TODAY 205-07 (Oct. 10, 1989) [hereinafter ABA Report]; Campbell, supra note 162.
  \item The refundable feature should allow for advance payments to be made throughout the year so that the taxpayer will not have to wait to receive a refund until after he has filed for the taxable year. See ABA Report, supra, at 205-07; Campbell, supra note 162; President Bush's Proposed Child Care TC Legislation 1989, reprinted in Daily Tax Rep. (BNA) No. 50, at L-1 (Mar. 16, 1989) (submitted to Congress March 15, 1989).
  \item See Campbell, supra note 162; ABA Report, supra note 165, at 205-07. Further adjustments could be made to reflect the added costs for larger families. See ABA Report, supra note 165, at 205-07 (recommending an additional tier of employment-related dollar expense limitations for three or more eligible children).
  \item The need for a less abrupt denial of this tax benefit led to some of the revisions made in the 1971 Act. See supra note 142. Certainly, with inflation, such a gradual phase-out is even more necessary in the 1990s. The phase-out should resemble the recent phase-outs in personal exemptions and itemized deductions. See supra notes 8, 9; infra part VII.
  \item A further reason to eliminate the exclusion is that it is likely that since executives have been eliminated as beneficiaries, fewer employers will want to administer these programs. See supra note 159. It should be noted, however, that currently only 3-7\% of employees participate in these exclusion plans, as opposed to 18-22\% participation in health benefit exclusion plans. By contrast, the average contribution is between $2,000 and $2,696 per employee (compared to between $488 to $608 for such health plans). See 1992 GAO Report Summary, supra note 101, at 76-16. Moreover, without an exclusion there would be no administrative problems such as those outlined, supra note 162.
  \item The I.R.C. \S 129 exclusion benefits those taxpayers at income brackets higher than the credit equivalent, currently 20\%. The childcare credit saves more in taxes than the exclusion for lower bracket taxpayers; therefore, it is untrue that eliminating this provision would greatly hurt the lower and middle classes. See supra note 159.
  \item See supra notes 138-42 and accompanying text.
  \item See supra 164-66 and accompanying text. The $100,000 threshold amount set forth in I.R.C. \S 68 is a politically acceptable level to begin the phase-out, yet even at this amount over $100 million could be restored to the government or used to fund other features of a childcare
\end{itemize}
While childcare expenses reflect a cost of earning taxable income, they are also personal and family expenses.\textsuperscript{171} To those critics who foresee irreparable harm to the childcare industry,\textsuperscript{172} it is unclear whether the childcare industry, and which part therein, would be hurt by an income ceiling, because wealthier taxpayers are more likely to use in-home childcare and housekeeping than outside-the-home daycare facilities and are also more likely to continue to work without this tax benefit.\textsuperscript{173} For those who view the childcare credit as compensation for the marriage penalty, it should be understood that the childcare credit only aids those two-income married couples with children under the age of thirteen and thus cannot adequately address the problems associated with the marriage penalty.\textsuperscript{174} By contrast, because of the lack of an income ceiling, low and moderate income families are subsidizing the childcare of 280,000 families earning over $100,000 a year, according to 1990 data.\textsuperscript{175} In fact, the lower and middle classes effectively pay for the childcare expenses of millionaires,\textsuperscript{176} and therefore the rationale of the provision, to enable taxpayers to work, has been lost. Because the phase-out would apply to many mixed personal/business deductions,\textsuperscript{177} it would not be the only quasi business-motivated expense eliminated for the wealthy.\textsuperscript{178} Finally, since this phase-out would parallel the phase-outs for personal exemptions and itemized deductions enacted by the credit that would benefit lower and middle class families. \textit{See Joint Comm. on Tax'n, Distribut} \textit{ional Effects of Certain Tax Provisions of H.R. 3 as Passed by the House, (JCX-14-90) (May 18, 1990), repr} \textit{ented in 90 Tax Notes Today (May 21, 1990) [hereinafter Distributional Effects]; see also infra note 183.}

\textsuperscript{171} Thus, although these expenses can be considered a cost of earning income at all income levels, childcare may well be restricted like all other personal costs because it represents personal and family choices. While to some degree the dollar limitations which are placed on "employment-related expenses" address these concerns, \textit{see 2 1984 Treasury Plan, supra note 1, at 18, they do not go far enough to explain the purpose of having lower and middle income taxpayers subsidizing the childcare expenses of the wealthy.  

\textsuperscript{172} \textit{See supra note 158.}

\textsuperscript{173} \textit{See supra note 161.}

\textsuperscript{174} \textit{See Distributional Effects, supra note 170.}

\textsuperscript{175} \textit{See supra note 161.}

\textsuperscript{176} \textit{See supra note 158.}

\textsuperscript{177} In-home childcare is usually more expensive than outside-the-home care. \textit{See Robert J. Klein, Finding Live-In Help for Your Child That is Loving, Loyal and Also Legal, Money, Sept. 1989, at 155.}

\textsuperscript{178} \textit{See supra note 162.}
1990 legislation, it is a consistent way to restore progressivity into the tax system.

VII. PHASE-OUT AT UPPER INCOME LEVELS

As Congressman Dan Rostenkowski remarked, "I am on record endorsing a higher top tax rate. The principle of simplicity is severely compromised by the deduction limits and exemption phaseouts concocted to maintain the fiction of the 31 percent top tax rate." This Article likewise suggests imposing progressivity through higher tax brackets for the wealthy. In addition, many of these mixed personal/business deductions should be eliminated entirely, regardless of whether brackets are added to the rate structure, since the abuse inherent in deducting the personal element of these items creates gross inequities in the tax system. As long as the public prefers the "fiction of the 31 percent top tax rate," the phase-out of personal and mixed personal/business deductions seems necessary.

This Article therefore recommends that the moving expense deduction, the exclusions for no-additional-cost services, qualified employee discounts, and qualified tuition reductions, the deductions for business meals and entertainment, and the childcare credit be phased out and eliminated at upper income levels. Paralleling the phase-outs for personal deductions, the diminution of mixed personal/business expense benefits should: (1) begin at adjusted gross incomes of $100,000, the applicable amount for imposition of the I.R.C. section 68 floor on personal itemized deductions, (2) be eliminated at $150,000, the threshold amount for the phase-out of personal exemptions under I.R.C. section 151(d), and (3) be indexed for inflation.

Clearly, imposing such phase-outs will produce much needed tax revenue to support measures for the lower and middle classes. In 1991, for example, an estimated $146,000,000 in revenue were lost because taxpayers with incomes over $100,000 were able to claim the childcare credit. Similarly, and even more remarkably, in 1988, the proposed phase-out and elimination of the entertainment and meal deduction for taxpayers with adjusted gross

179. See supra notes 8, 9; infra part VII.
181. See supra note 8 and accompanying text.
182. See supra note 9 and accompanying text. Obviously, a phase-out could begin at higher income levels, similar to the I.R.C. § 151(d) phase-out which begins at $150,000 and has a very gradual phase-out, but such a phase-out would produce less revenue. Since the overall objectives of restoring some progressivity into the tax system and eliminating some of the abuses associated with mixed personal/business deductions would still be served, these alternatives, perhaps more politically acceptable, should be considered.
incomes over $360,000 was expected to raise $800,000,000 in new revenue.\textsuperscript{184}

VIII. CONCLUSION

In light of the fact that mixed personal/business deductions produce inequities, that the current tax system sorely needs more progressivity, and that the budget deficit has reached astronomical levels, reforms are necessary. Congress should amend the home office deduction statute to provide that only expenses from a home office in which the taxpayer actually meets or deals with his clients or customers, or which is the taxpayer's sole office, be deductible.\textsuperscript{185} By limiting the home office deduction in this manner, Congress would consequently restrict the deduction allowed for certain commuting expenses. Congress should further eliminate the parking exclusion, or, at the very least, subject that exclusion to nondiscrimination requirements so that tax-free parking must be available to a broad spectrum of employees, instead of allowing the exclusion to apply to only higher paid executives as is the current law. Moreover, Congress should re-focus the moving expense deduction to aid those taxpayers for whom moving to take a new job at a new job location would create the greatest burden. The new deduction should be an “above the line” adjustment to income, adjusted in limits to reflect current costs and phased out for upper bracket taxpayers. Congress should move away from the inequities among employees of certain industries created by the 1984 fringe benefit legislation by imposing income limits on their excludibility. In addition, a great deal of revenue could be raised by imposing income caps on deductible meal and entertainment expenses, thereby increasing the public’s confidence in the fairness of the tax system. There has been resistance to the phase-out of the childcare credit for high income taxpayers. If such a phase-out is coordinated with income phase-outs of other mixed personal/business expenses, it may be more politically acceptable. Regardless of whether Congress ultimately is successful in enacting additional tax brackets, it is clear that many mixed personal/business deductions need to be curtailed or eliminated.

\textsuperscript{184} 134 CONG. REC. S7933, S7962 (daily ed. June 16, 1988) (statement of Sen. Bradley). The huge figure led Senator Bradley to remark, “[s]urprising is it not, that people who earn over $440,000 a year have that many lunches?” \textit{Id.} Although the deduction is phased out beginning at an AGI of $360,000, it is not eliminated until an AGI of over $440,000. \textit{Id.} at S7959.

\textsuperscript{185} The third exception, relating to a separate structure which is not attached to the dwelling unit, should also be retained since it is more likely to be based on business exigencies and less often on an area of abuse.