Is the Child-Care Credit Parent Friendly?

By David Cay Johnston

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Johnston writes that Alan D. Viard's argument in support of the child-care tax credit favors complexity, is anti-family, and overlooks or ignores the fact that the real beneficiary of the credit may not be the working parents who apply for it.

What ever became of the idea that we should broaden the tax base, lower rates, and make the tax code simpler? How about designing a tax code so simple most people need only a postcard and a few minutes to file their return? How about going beyond that and getting rid of filing altogether for most people, the vast majority with little in taxable investments and who work to feed themselves?

Oh, I forgot. Lots of people, including me, make money off the tax code's faults. The annual misery and expense of filling out tax returns has become a big business. And while we have the technical capacity to end return filing for most people, this lucrative business expands with each new complexity in how we tax the many — especially complicated tax credits for parents.

Now that the midterm elections are over and all sorts of deferred tax business is back on the table, maybe we can have a serious debate about how much to levy efficiently and how to take the profit motive out of tax compliance. I hope, more than I expect, that we can.

This issue is on my mind after reading Alan D. Viard's detailed defense of the child-care tax credit. Over the past six weeks, I have come to realize that his piece is a textbook example of incompletely thought-through tax theory. (For the article, see Alan D. Viard, ''The Child Care Tax Credit: Not Just Another Middle-Income Tax Break,'' *Tax Notes*, Sept. 27, 2010, p. 1397, *Doc 2010-20075*, or *2010 TNT 189-14*.)

Reviewing Viard's footnotes is revealing. They show that he looks at tax policy through a lens focused on the needs and concerns of business, not people. Indeed, one footnote is from a *Tax Notes* article by Curtis S. Dubay and Chuck Donovan, two Heritage Foundation researchers whose views attacking the child-care tax credit Viard calls ''clearly incorrect.'' (For the Heritage report, see *Doc 2010-2861* or *2010 TNT 25-86*.)

Viard actually argues for complexity in the tax code. For someone who espouses conservatism, that is an extraordinary position.

Then there is the implicit anti-family position in Viard's argument, which in tax policy makes paid labor equal, if not superior, to parental child-rearing.

Somehow Viard missed noticing that the data in his footnotes show that the child-care tax credit is not worth the bother to a growing number of working parents or that they are not eligible to collect it. Since 1990 the population has grown 24 percent, but the number of people claiming this credit declined by 7 percent to less than 6.6 million in 2008. More revealing, the inflation-adjusted amount of the credit dropped by half from almost $4.3 billion in 1990 to $2.1 billion in 2008.

Ignoring these numbers makes sense only if you did not think the issues through or if you favor slowly vanishing tax benefits.

The most troubling part of Viard's defense of the child-care tax credit is his failure to address who benefits from it. As with the corporate income tax, incidence does not necessarily follow tax revenues.

Viard wants us to think the child-care tax credit is adequate to offset the work-related expenses that he wants to subsidize. He wrote:

> The assertion that there is no tax relief for the opportunity cost of producing child care within the home is completely mistaken. On the contrary, the opportunity cost receives *full tax relief* under both the income and payroll taxes. When a parent gives up wages to provide child care at home, she avoids the taxes that would have been imposed on those wages; stated differently, *only after-tax wages are given up by staying at home.* [Emphasis added.]

Even if we ignore the sexist assumption that only work outside the home by mothers is at issue, it is bizarre to think that the child-care tax credit provides ''full relief'' to working parents. (If anyone completes the arduous task of conducting a child-care tax credit contour I promise to write a column about your findings.)

Then Viard wrote:

> The most common objections to the child care tax credit revolve around its alleged non-neutrality. These objections miss the mark because they fail to recognize that the income tax is biased against work and work-related goods such as child care and fail to understand the appropriate tax treatment of such goods.
>
> One objection is that tax relief for child care costs artificially encourages work or unfairly favors parents who work over those who stay at home. This is clearly incorrect. Because the income tax imposes a penalty on work, *the allowance of tax relief for work-related costs does not create a net subsidy to work.* [Emphasis added.]

One could extend Viard's logic here on work-related costs. His points can be used to argue for a commuter tax credit, especially for people who drive long distances and thus must bear those costs only to be penalized on the income they earn because their houses and their jobs are far apart and they choose not to switch jobs or move. And what about an offsetting tax credit for the work-related expense of parking? Or what of the work-related cost of riding the bus or rails to work?

In fact, we have such subsidies. We have rules that provide some workers, most of them highly paid, with tax subsidies for the company cars they drive to work. We subsidize parking in myriad ways, as the Reason Foundation loves to document, adding to congestion and distorting land values. And we have a $230-a-month tax break for people who take public transit to work.

Self-employed workers like me, who commute from one room of their home to another, get no subsidy unless you consider the home office deduction, which is seldom worth the bother.

What of the thousands of workers who commute to work by commercial airline, as I did for 15 years? If neutrality and a penalty for work are real, then why discriminate against those workers by denying them tax credits for work-related expenses? And why that pesky 2 percent limitation on Schedule A work-related expenses like uniforms and union dues, together with clawbacks for higher-paid workers and total denial of these expenses for those subject to the alternative minimum tax?

Oh what a tangled web we weave when with tax credits we seek to deceive!

One can make an argument for mass transit subsidies because they discourage inefficient roads and reduce carbon burning and time wasted in traffic. Still, a much more direct, efficient, and effective way to achieve that would be through lower transit fares, greater frequency of service, building more miles of light rail, and making stations more hospitable, more like those in tax-eating Washington than in our greatest tax-revenue-producing locale, Manhattan.

Work-related subsidies, be they for child care or commuting, narrow the tax base, implicitly creating pressure for higher rates (or more deficit spending). Focused tax credits are generally a bad idea, lacking in principle and wasteful of taxpayer time. Then there is the crucial issue of who benefits from the child-care tax credit that Viard favors. Who really benefits?

Viard tells us it is the working parent. Really? We can easily track the official flow of dollars, but as with the corporate income tax, the incidence of the child-care tax credit is neither obvious nor indisputable.

It is widely believed that the burden of the corporate income tax is simply passed on to customers. That cannot be true in a competitive economy. However, it tends to be true in an economy with subtly rigged markets, which is the growing trend in America as political donations buy big businesses relief from the rigors of the competitive market.

In a competitive economy, the burden of a corporate income tax may fall on the business owners through a lowered rate of return on their capital, on the employees through reduced compensation, on vendors through lower prices, or on customers through higher prices. It can also fall on a shifting combination of any of those four.

The bulk of the economic evidence is that owners tend to bear this burden. If they did not, why would any owner object to the corporate income tax? After all, if the corporate income tax just gets passed forward to customers, what's the worry?

Of course the corporate income tax can actually boost profits, as I have documented exhaustively in this column and elsewhere.

To understand the incidence of the child-care tax credit, imagine a society with workers all of whom are willing to sell their time for amount A per hour and employers that will hire all available labor at that price. Assume that the cost of child care equals 10 percent of A.

Now introduce a tax credit C equal to 10 percent of A. By Viard's reasoning, we have now eliminated the work-related cost of child care.

But with the child-care tax credit, do wages remain at A? Are markets static? Economic theory teaches us that in an economy with even slightly more labor for sale than businesses are willing to buy, the result will be reduced wages. Wages may fall very slowly over time, because they tend to be sticky, and thus the trend may be subtle. The question is will they fall all the way to A-C? Or do they fall to some point between A and A-C?

To the degree that wages fall, or are below A, the child-care tax benefit actually helps businesses, not workers. The mere existence of the tax credit adds to downward pressure on wages. To the extent that the credit attracts more workers into the labor market, it adds even more downward pressure on wages.

The median wage was lower in 2009 than in 2000, as a previous column of mine showed (''Scary New Wage Date,'' *Tax Notes*, Oct. 25, 2010, p. 481, *Doc 2010-22689*, *2010 TNT 205-9*). By the narrowest measure, nearly 15 million people are out of work, and by the broadest, and unofficial, 34 million are under- or unemployed, an indication of significant downward pressure on wages.

Now, what happens if tax credit C has existed for so long that it is built into the market price of labor — and is then repealed? Will this cause wages to rise, as parents are unwilling to work unless they capture more of A, their hourly wage? Will parents accept net pay of A-C, which amounts to a 10 percent reduction in their income net of taxes and this work-related expense, assuming Viard's ''full relief'' claim has any validity? Might wages rise to a level equal to A+C, or some point in between, as some parents withdraw from the labor force, causing wages to trend upward?

There is an inherent bias in favor of labor supply expanding. Most people need to work to eat, but capital can sit idle awaiting better opportunities, as nearly $2 trillion of cash held by corporations is doing right now.

If the credit provides ''full relief'' to work-related costs for parents, as Viard claims, how does this government intrusion into the market affect the supply and price of labor as well as the price paid for it?

Viard's entire analysis presents a materialistic perspective, as does the Heritage analysis. But the purpose of our tax laws is not to create more material wealth; it is to raise the revenue necessary to sustain government. Everything is not about money and profits, although commercial values have so infused American culture that it is easy to forget other values and even the reasons we created this nation.

Instead of mucking up the tax code with credits of dubious value and uncertain beneficiaries, how about taking the road to simplicity and human values. Let's junk the child-care tax credit Viard endorses and the other complex child tax provisions and replace them with a significant, universal, and refundable per-child tax credit for all dependent children. Let's reduce government intrusion in the market, not encourage it as Viard proposes.

Let's get back to broadening the base, simplifying taxes for the vast majority, and sustaining that ancient — and therefore profoundly conservative — moral and practical principle that the greater your economic gain, the greater the tax burden you must bear so that the society that made your gains possible will endure. Those are simple and sound principles that actually will benefit children.

SSA Corrects Wage Data

The Social Security Administration revised its 2009 wage data on November 1, resulting in new data showing smaller total compensation, a smaller average, and a dramatic decline in wages paid to those whose salary and bonus totaled more than $50 million.

The agency originally reported October 15 that the 74 highest paid workers earned an average of $518.8 million 2009, compared to 131 making $91.2 million in 2008.

My October 25 column, and coverage of it by others, prompted internal questions about the reasons the average pay of the highest paid workers quintupled, said Mark Lassiter, an SSA spokesman. He said the inquiry established that two individuals filed multiple Forms W-2 reporting $32.3 billion of pay for work, forms the agency determined after examination were phony.

Removing those bogus reports showed that the 72 remaining high-wage earners averaged $84.1 million each, down $7 million or 7.7 percent from the 2008 average in nominal dollars.

Lassiter said he did not know if the filings were part of a scam or a malicious prank. The matter has been referred to the agency's inspector general, he said.

It was the first time the agency has ever found an error in its data, Lassiter said. There is no indication anyone at SSA was involved in the phony Form W-2 filings, he said. The revised numbers were first reported by Ryan J. Donmoyer of Bloomberg.

The phony Form W-2 filings also resulted in revised total income and average income.

Removing the phony Forms W-2 reduced total compensation by $32.3 billion or 0.55 percent of all the wages, salaries, and bonuses earned by Americans. The total number of people with any work was reduced by two to 150,917,733.

As a result of the revisions, the data show that the average wage in 2009 dollars declined by $457 (not $243), a 1.2 percent decline from 2008. The revision shows that since 2000 the average wage, in 2009 dollars, barely changed in real terms, increasing only $347 or 0.9 percent after nine years.

The median wage — half make more, half less — was unchanged at $26,261. The median is $37 lower than in 2000 and $253 lower than in 2008.

Your thoughts? E-mail me at JohnstonsTake@tax.org.