Congress enacted Section 188 in 1971 in an attempt to give employers a tax incentive to provide child care facilities for the children of their employees. The author discusses the proposed regulations issued August 1978, which, he believes, add a degree of certainty to the law although they are restrictive and tend to make Section 188 even less attractive than it seemed to be in the absence of regulations.

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Code Section 188, as originally enacted in the Revenue Act of 1971, provided an election to amortize the capital cost of certain on-the-job training and child care facilities over a 60-month period, regardless of the facilities' estimated lives. The provision was limited to expenditures made after 1971 and before 1977. The Tax Reduction and Simplification Act of 1977 extended the time limit for child care facility expenditures to the end of 1981, but allowed the provision relating to on-the-job training facility expenditures to expire.

Although Congress specifically provided that various important aspects of this law would be determined by regulations, it is only just recently that the Treasury issued proposed regulations to this section. These proposed regulations discuss the tax treatment of expenditures for both on-the-job training and child care facilities, even though post-1976 expenditures for on-the-job training facilities cannot qualify for Section 188 treatment. This article will address the special tax rules available to child care facility expenditures since this area alone has been extended beyond 1976.

**Legislative Intent**


1 Revenue Act of 1971, P. L. 92-178, Sec. 303.
2 Tax Reduction and Simplification Act, P. L. 95-30, Sec. 402.
Simplification Act of 1977 indicates that Congress enacted and extended Section 188 with an intent to "encourage private businesses to furnish child care facilities for their employees." Underlying this desire was a recognition of a "need to make child care facilities available for working parents." At this point in time it is questionable whether or not Section 188 is accomplishing its purpose. Senator Alan Cranston, Chairman of the Senate Subcommittee on Child and Human Development, recently stated that the lack of affordable child care has become critical and few employers have even considered the tax benefits of providing qualified child care facilities. The proposed regulations add a degree of certainty to the law, but they are restrictive in nature and tend to make Section 188 even less attractive than it seemed to be in the absence of regulations.

**How It Works**

Basically, Section 188 provides that a taxpayer may elect to amortize ratably over a period of 60 months capital expenditures made in acquiring, constructing, reconstructing or rehabilitating Section 188 property. Section 188 property is limited to depreciable, tangible property that, according to regulations, qualifies as a child care facility primarily for the children of the taxpayer's employees. Additionally, only property located within the United States can qualify as Section 188 property. Obviously, the "carrot" is the opportunity to shorten the period over which these expenditures may be deducted.

**Tax Costs of Electing Section 188**

A taxpayer who qualifies for Section 188 treatment may nevertheless decide not to elect its application for one or more of the following reasons: (1) Property subject to a Section 188 election cannot be depreciated under Section 167 or 179. (2) Any property with respect to which a Section 188 election applies will not qualify for an investment tax credit. (3) Gain on the sale or exchange of Section 188 property will be subject to recapture as ordinary income to the extent of amortization deductions taken pursuant to Section 188. (4) The amount by which the annual Section 188 amortization deduction exceeds the depreciation deduction that would otherwise be allowable under Section 167 constitutes an item of tax preference.

As a result of these adverse factors, taxpayers who acquire or construct personal property that qualifies as Section 188 property will generally not find it to their advantage to elect Section 188 treatment. On the other hand, depreciable real property, which generally has an estimated life far in excess of five years and which would generally not qualify for an investment tax credit anyway, will typically constitute an excellent candidate for Section 188 treatment. The proposed regulations make it clear that a taxpayer can make a piecemeal election—that is, he can refrain from making the election for personal property where the adverse effects probably outweigh the tax benefits, if any, under Section 188, while making the election for depreciable real property.

However, even with depreciable real property, certain potential problems should be noted. First of all, the item of tax preference, which almost always results from a Section 188 election, may be significant in amount. Since this item of tax preference is spread over only 60 months rather than the life of the property, a minimum tax liability can be a real concern. Second, unlike the recapture of most items of depreciable real property, any recapture upon disposition of Section 188 property (real or personal) will be limited only by the amount of gain and total amortization taken. There is no downward adjustment for what would have been deductible using the straight-line depreciation method.
Section 188 Property

In order to qualify as Section 188 property, tangible depreciable property must qualify "under regulations prescribed by the Secretary as a child care center facility primarily for the children of employees of the taxpayer."16 The proposed regulations define a qualified child care facility as a "facility which is (i) particularly suited to provide child care services and specifically used by an employer to provide such services primarily for his employee's children; (ii) operated as a licensed or approved facility under applicable local law, if any, relating to the day care of children; and, (iii) if directly or indirectly funded to an extent by the United States, established and operated in compliance with the requirements contained in Part 71 of Title 45 of the Code of Federal Regulations, relating to Federal Interagency Day Care Requirements." "Facility" is defined broadly to include "buildings, or portions or structural components thereof, in which children receive such personal care, protection, and supervision in the absence of their parents as may be required to meet their needs and the equipment or other personal property necessary to render such services."17 In giving examples of property that would not qualify as a qualified child care facility, the regulations mention a general purpose room used as an employee recreation center during the evening and a room that is "simply screened off for use by children during the day."18

The regulations imply that an existing building or room might qualify as Section 188 property if it is "adapted" for proper use as a child care facility.19 Neither the proposed regulations nor the Code section speaks directly to the question of whether or not the adjusted basis in the converted room or building can now be amortized under Section 188. The Code section limits the benefits of Section 188 to expenditures made to acquire, construct, reconstruct or rehabilitate Section 188 property. Does this mean that expenditures made to acquire or construct non-Section 188 property, which later becomes Section 188 property, do not qualify under Section 188? A strict reading of the statute would suggest an affirmative answer.20 However, since the legislative intent would be furthered just as much by converting an old room or building to use as a child care facility as it would by building or buying a new structure, and since Congress granted the Treasury a great deal of discretionary latitude in writing regulations for Section 188, the regulations for Section 188 could permit such a broad reading of the statute. Unfortunately, the proposed regulations are silent in this regard.

Termination of Election

Once it is made, an election under Section 188 cannot be revoked by the taxpayer.21 However, it will be terminated as soon as the property in question ceases to be used as a qualified child care facility.22 Upon termination of a Section 188 election, any remaining basis in the property can be deducted to the extent allowable under Section 167.23

In what seems to be a particularly harsh position, the proposed regulations state that a facility will cease to qualify as Section 188 property if, for any month, more than 20% of the average daily enrolled or attending children for that month are other than children of the taxpayer's employees.24 Many factors (e.g., economies of scale or the taxpayer's desire to improve his image in the community) might cause a center to admit children of nonemployees, in addition to employees' children. If the children of nonemployees number anywhere near 20% of the total, the availability of Section 188 is constantly in jeopardy. Any month where children of employees are disproportionately sick, or on vacation, or whatever, can mark the end of Section 188 amortization.

There are several important areas of concern that were not addressed in the proposed regulations. For example, must the facility be on the business premises of the employer? Silence would seem to imply a lack of any restriction as to location. Can two or more employers join together,
construct a facility and elect Section 188 amortization for their respective expenditures? The proposed regulations do not directly address this possibility. However, the 20% test discussed above would almost certainly serve to effectively prevent any of the sponsoring employers from qualifying for Section 188 treatment; yet there would seem to be no reason for excluding such arrangements. Also, it is not uncommon for unions to operate child care facilities in cooperation with employers. Although the 20% test may not constitute a barrier here, the proposed regulations do not discuss other important issues inherent in this sort of joint effort.

**Conclusion**

The proposed regulations have added some meat to the skeleton provided by the legislature in 1971. However, because of the negative ramifications of electing Section 188 treatment and the restrictive approach of the proposed regulations, it is doubtful that Section 188 will provide a significant incentive for employers to provide child care facilities for their employees as was the expressed intent of Congress in 1971 and again in 1977.

"See footnote 6.

**Tax Meetings**


Further details may be obtained from Public Affairs Department, One World Trade Center—68W, New York, New York 10048.

**Panel Publishers.**—International Tax Journal is sponsoring three seminars as follows: Section 367: The Tax Aspects of International Reorganizations, February 12-14, 1979, at the Four Ambassadors Inter Continental in Miami, Florida, and March 5-7, 1979, at the MGM Grand Hotel in Reno, Nevada; The International Aspects of Earnings and Profits, February 15-16, 1979, in Miami, Florida, and March 8-9, 1979 in Reno, Nevada; and Maximizing Foreign Tax Credit Benefits, February 12-14, in Miami, Florida, and March 5-7, 1979, in Reno, Nevada.

Further information may be obtained from Barbara Halper, Seminar Registrar, International Tax Journal, 14 Plaza Road, Greenvale, New York 11548.

**Fordham University School of Law.**—Co-sponsored by Legal Times of Washington, a seminar on “What Lawyers and Accountants Need to Know About the 1978 Tax Law” will be held on February 5-6, 1979, in Key Biscayne at the Sonesta Beach Hotel.

Each session will stress the new substantial changes made by the 1978 Act, what they mean and how planning concepts must be modified, altered, or revised to take maximum advantage of the Act’s provisos.

Among the specific subjects on which advice will be offered are: capital gains—minimum and maximum taxes, tax shelters, corporate changes, deferred compensation and retirement, T&E and other perks, carryover basis—estate and gift, and tax procedure.

To register or obtain additional information, contact Legal Times of Washington, 1601 Connecticut Avenue, NW, Washington, D. C. 20009.

**Organization Management, Inc.**—The 15th Annual Washington Non-Profit Tax Conference will be held March 7-8, 1979, at the Washington Hilton Hotel in Washington, D. C.

Further information may be obtained from Mrs. Alice F. Corcoran, Washington Non-Profit Tax Conference, 13234 Pleasantview Lane, Fairfax, Virginia 22030.

**Employee Stock Ownership Council of America.**—The 2nd Annual Meeting of the Employee Stock Ownership (ESOP) Council of America will be held May 7-8, 1979, in Washington, D. C.

For more information, contact Robert W. Smiley, Jr., Employee Stock Ownership Council of America, 11661 San Vicente Boulevard, Suite 901, Los Angeles, California 90049.