

REVENUE DEPARTMENT[701]

Adopted and Filed

**Rule making related to income limit for child and dependent care
or early childhood development tax credit**

The Revenue Department hereby amends Chapter 42, “Adjustments to Computed Tax and Tax Credits,” Iowa Administrative Code.

Legal Authority for Rule Making

This rule making is adopted under the authority provided in Iowa Code section 422.68.

State or Federal Law Implemented

This rule making implements, in whole or in part, Iowa Code section 422.12C and 2021 Iowa Acts, Senate File 619, sections 2 through 4.

Purpose and Summary

This rule making is intended to implement statutory changes to the income limit for a taxpayer to qualify for the Child and Dependent Care Credit or the Early Childhood Development Credit. 2021 Iowa Acts, Senate File 619, increases the income limit to qualify for the credits from \$45,000 to \$90,000 for tax years beginning on or after January 1, 2021.

The rule making clarifies that a taxpayer who claims the Child and Dependent Care Credit cannot also claim the Early Childhood Development Credit. The rule making also clarifies that the percentage of the federal Child and Dependent Care Credit the taxpayer can claim is based on the taxpayer’s all-source net income. The rule making also explains how nonresidents and part-year residents should calculate the amount of the Early Childhood Development Credit available to them.

Public Comment and Changes to Rule Making

Notice of Intended Action for this rule making was published in the Iowa Administrative Bulletin on November 17, 2021, as **ARC 6032C**. No public comments were received. Two references to 2021 Iowa Acts, Senate File 619, have been removed since the legislation has been codified in the 2022 Iowa Code.

Adoption of Rule Making

This rule making was adopted by the Department on December 22, 2021.

Fiscal Impact

This rule making has no fiscal impact to the State of Iowa beyond that of the legislation it is intended to implement.

Jobs Impact

After analysis and review of this rule making, no impact on jobs has been found.

Waivers

Any person who believes that the application of the discretionary provisions of this rule making would result in hardship or injustice to that person may petition the Department for a waiver of the discretionary provisions, if any, pursuant to rule 701—7.28(17A).

Review by Administrative Rules Review Committee

The Administrative Rules Review Committee, a bipartisan legislative committee which oversees rule making by executive branch agencies, may, on its own motion or on written request by any individual or group, review this rule making at its [regular monthly meeting](#) or at a special meeting. The Committee's meetings are open to the public, and interested persons may be heard as provided in Iowa Code section 17A.8(6).

Effective Date

This rule making will become effective on February 16, 2022.

The following rule-making actions are adopted:

ITEM 1. Amend rule 701—42.15(422) as follows:

701—42.15(422) Child and dependent care credit. ~~Effective for tax years beginning on or after January 1, 1990, there~~ There is a child and dependent care credit which is refundable to the extent the amount of the credit exceeds the taxpayer's income tax liability less other applicable income tax credits. If a taxpayer claims the child and dependent care credit, the taxpayer cannot claim the early childhood development credit described in rule 701—42.31(422).

42.15(1) Computation of the Iowa child and dependent care credit. The Iowa child and dependent care credit is computed as a percentage of the child and dependent care credit which is allowed for federal income tax purposes under Section 21 of the Internal Revenue Code. ~~For taxpayers whose federal child and dependent care credit is limited to their federal tax liability, the Iowa credit shall be computed based on the lesser amount for tax years beginning on or after January 1, 2012, but before January 1, 2015. For tax years beginning on or after January 1, 2015, the Iowa credit is computed without regard to whether or not the federal credit was limited to the taxpayer's federal tax liability. In addition, for tax years beginning on or after January 1, 2015, the Iowa credit will be allowed even if the taxpayer's federal adjusted gross income is below \$0. The credit is computed so that taxpayers with lower adjusted gross incomes (net incomes in tax years beginning on or after January 1, 1991) net incomes are allowed higher percentages of their federal child care credit than taxpayers with higher adjusted gross incomes (net incomes) net incomes. The following is a schedule showing the percentages of federal child and dependent care credits allowed on the taxpayers' Iowa returns on the basis of the federal adjusted gross incomes (or net incomes) net incomes of the taxpayers for tax years beginning on or after January 1, 1993.~~

<u>*Federal Adjusted Gross Income (Net Income for Tax Years Beginning on or after January 1, 1993) Net income</u>	<u>Percentage of Federal Child and Dependent Care Credit Allowed for 1993 through 2005 Iowa Returns federal credit allowed for tax years beginning on or after January 1, 2006, and before January 1, 2021</u>	<u>Percentage of Federal Credit Allowed for 2006 and Later Tax Years federal credit allowed for tax years beginning on or after January 1, 2021</u>
Less than \$10,000	75%	75%
\$10,000 or more but less than \$20,000	65%	65%
\$20,000 or more but less than \$25,000	55%	55%
\$25,000 or more but less than \$35,000	50%	50%
\$35,000 or more but less than \$40,000	40%	40%
\$40,000 or more but less than \$45,000	No Credit 30%	30%
\$45,000 or more but less than \$90,000	No Credit	No Credit 30%
\$90,000 or more	No Credit	No Credit

*Note that in the case of married taxpayers who have filed joint federal returns and elect to file separate returns or to file separately on the combined return form for Iowa purposes, the taxpayers must determine the child and dependent care credit by the schedule provided in this rule on the basis of the their combined federal adjusted gross income of the taxpayers or their combined net income for tax years beginning on or after January 1, 1991 net incomes. The credit determined from the schedule must be allocated between the married taxpayers in the proportion that each spouse's federal adjusted gross income relates to the combined federal adjusted gross income of the taxpayers or in the proportion that each spouse's net income relates to the combined net income of the taxpayers in the case of tax years beginning on or after January 1, 1991.

42.15(2) Examples of computation of the Iowa child and dependent care credit. The following are examples of computation of the child and dependent care credit and the allocation of the credit between spouses in situations where married taxpayers have filed joint federal returns and are filing separate Iowa returns or are filing separately on the combined Iowa return form. ~~For tax years beginning on or after January 1, 1991, the taxpayers' net incomes are used to compute the Iowa child and dependent care credit and allocate the credit between spouses in situations where the taxpayers file separate Iowa returns or separately on the combined return form.~~

EXAMPLE A: A married couple has filed a joint federal return on which they showed a federal adjusted gross income of \$40,000 or a combined net income of \$40,000 on their state return for the tax year beginning January 1, 2007. Both spouses were employed. They had a federal child and dependent care credit of \$600 which related to expenses incurred for care of their two small children. One of the spouses had a federal adjusted gross income of \$30,000 or a net income of \$30,000 and the second spouse had a federal adjusted gross income of \$10,000 or a net income of \$10,000.

The taxpayers' Iowa child and dependent care credit was \$180 since they were entitled to an Iowa child and dependent care credit of 30 percent of their federal credit of \$600. If the taxpayers elect to file separate Iowa returns, the \$180 credit would be allocated between the spouses on the basis of each spouse's net income as it relates to the combined net income of both spouses as shown below:

$$\$180 \times \frac{\$30,000}{\$40,000} = \$135 \quad \text{child and dependent care credit for spouse with } \$30,000 \text{ net income for } 2007$$

$$\$180 \times \frac{\$10,000}{\$40,000} = \$45 \quad \text{child and dependent care credit for spouse with } \$10,000 \text{ net income for } 2007$$

EXAMPLE B: A married couple filed a joint federal return for 2007 and filed their 2007 Iowa return using the married filing separately on the combined return form filing status separately on a combined

return. Both spouses were employed. They had a federal child and dependent care credit of \$800 which related to expenses incurred for care of their children. One spouse had a net income of \$25,000 and the other spouse had a net income of \$12,500, so their combined net income was \$37,500.

The taxpayers' Iowa child and dependent care credit was \$320, since they were entitled to an Iowa credit of 40 percent of their federal credit of \$800. The \$320 credit is allocated between the spouses on the basis of each spouse's Iowa net income as it relates to the combined Iowa net income of both spouses as shown below:

$$\begin{aligned} \$320 \times \frac{\$25,000}{\$37,500} &= \$213 \quad \text{child and dependent care credit for spouse} \\ &\quad \text{with } \$25,000 \text{ Iowa net income for } 2007 \\ \\ \$320 \times \frac{\$12,500}{\$37,500} &= \$107 \quad \text{child and dependent care credit for spouse} \\ &\quad \text{with } \$12,500 \text{ Iowa net income for } 2007 \end{aligned}$$

42.15(3) Computation of the Iowa child and dependent care credit for nonresidents and part-year residents. Nonresidents and part-year residents who have ~~incomes~~ income from Iowa sources in the tax year may claim child and dependent care credits on their Iowa returns. The percentage of the federal credit allowed is determined based on the nonresident or part-year resident's all-source net income. If the nonresident or part-year resident's all-source net income is \$90,000 or higher, the taxpayer will not qualify for the Iowa child and dependent care credit regardless of the amount of the taxpayer's Iowa-source income. To compute the amount of child and dependent care credit that can be claimed on the Iowa return by a nonresident or part-year resident, the following formula shall be used:

Federal child and dependent care credit	×	Percentage of federal child and dependent credit allowed on Iowa return from table in subrule 42.15(1) <u>based on all-source net income</u>	×	*Iowa net income <hr style="width: 100%; border: 0.5px solid black; margin: 0;"/> Federal adjusted gross income or all-source All-source net income
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*Iowa net income for purposes of determining the child care credit that can be claimed on the Iowa return by a nonresident or part-year resident taxpayer is the total of ~~the Iowa source incomes~~ Iowa-source income less the Iowa-source Iowa-source adjustments to income as computed on line 26 of the Form Schedule IA 126.

In cases where married taxpayers are nonresidents or part-year residents of Iowa and are filing separate Iowa returns or are filing separately on the combined Iowa return form, the child and dependent care credit allowable on the Iowa return should be allocated between the spouses in the ratio of the Iowa net income of each spouse to the combined Iowa net income of the taxpayers.

42.15(4) Example of computation of the Iowa child and dependent care credit for nonresidents and part-year residents. The following is an example of the computation of the Iowa child and dependent care credit for nonresidents and part-year residents.

A married couple lives in Omaha, Nebraska. One of the spouses worked in Iowa and had ~~wages and other income from Iowa sources or an Iowa~~ Iowa-source net income of \$15,000. That spouse had an ~~all-source~~ all-source net income of ~~\$18,000~~ \$20,000. The second spouse had an ~~Iowa~~ Iowa-source net income of \$10,000 and an ~~all-source~~ all-source net income of ~~\$12,000~~ \$15,000. The couple had a combined Iowa-source net income of \$25,000 and a combined all-source net income of \$35,000. The taxpayers had a federal child and dependent care credit of \$800 which related to expenses incurred for the care of their two young children. The taxpayers' Iowa child and dependent care credit is calculated below ~~for the 2007 tax year:~~

Federal child and dependent care credit	Percentage of federal child and dependent credit allowed on Iowa return	Iowa Iowa-source net income
		<u>All-source All-source</u> net income
\$800	× $\frac{50\%}{40\%} = \frac{\$400}{\$320}$	× $\frac{\$25,000}{\$30,000} = \frac{\$333}{\$229}$

The ~~\$333~~ \$229 credit is allocated between the spouses as shown below for the 2007 tax year:

<u>\$333</u>	×	$\frac{\$10,000}{\$15,000}$	=	<u>\$133</u>	\$137 for spouse with Iowa source Iowa-source net income of \$10,000 \$15,000
<u>\$229</u>		$\frac{\$25,000}{\$25,000}$			
<u>\$333</u>	×	$\frac{\$15,000}{\$10,000}$	=	<u>\$200</u>	\$92 for spouse with Iowa source Iowa-source net income of \$15,000 \$10,000
		<u>\$229</u>			
		\$25,000			

This rule is intended to implement Iowa Code section 422.12C as amended by 2014 Iowa Acts, Senate File 2337.

ITEM 2. Amend rule 701—42.31(422) as follows:

701—42.31(422) Early childhood development tax credit. ~~Effective for tax years beginning on or after January 1, 2006, taxpayers~~ Taxpayers may claim a tax credit equal to 25 percent of the first \$1,000 of expenses paid to others for early childhood development for each dependent three to five years of age. The credit is available only to taxpayers whose net income is less than ~~\$45,000~~ \$90,000. If a taxpayer claims the early childhood development tax credit, the taxpayer cannot claim the child and dependent care credit described in rule 701—42.15(422). The early childhood development tax credit is refundable to the extent that the credit exceeds the taxpayer’s income tax liability. ~~For the tax year beginning in the 2006 calendar year only, amounts paid for early childhood development expenses in November and December of 2005 shall be considered paid in 2006 for purposes of computing the credit.~~

For married taxpayers who elect to file separately on a combined form or elect to file separate returns for Iowa tax purposes, the combined net income of the taxpayers must be less than ~~\$45,000~~ \$90,000 to be eligible for the credit. If the combined net income is less than ~~\$45,000~~ \$90,000, the early childhood development tax credit shall be prorated to each spouse in the proportion that each spouse’s respective net income bears to the total combined net income.

Nonresidents and part-year residents who have income from Iowa sources in the tax year may claim the early childhood development tax credit on their Iowa returns. If the taxpayer’s all-source net income is \$90,000 or higher, the taxpayer will not qualify for the credit. Nonresidents or part-year residents of Iowa must determine the early childhood development tax credit in the ratio of their Iowa-source net income to their all-source net income. In addition, if nonresidents or part-year residents of Iowa are married and elect to file separate returns or to file separately on a combined Iowa return, the early childhood development tax credit must be allocated between the spouses in the ratio of each spouse’s Iowa-source net income to their combined Iowa-source net income.

42.31(1) Expenses eligible for the credit. The following expenses qualify for the early childhood development tax credit, to the extent they are paid during the time period that a dependent is either three, four, or five years of age:

a. Expenses for services provided by a preschool, as defined in Iowa Code section 237A.1. The preschool may only provide services for periods of time not exceeding three hours per day.

b. Books that improve child development, including textbooks, music books, art books, teacher editions, and reading books.

c. Expenses paid for instructional materials required to be used in a child development or educational lesson activity. These materials include, but are not limited to, paper, notebooks, pencils, and art supplies. In addition, software and toys which are directly and primarily used for educational or learning purposes are considered instructional materials.

d. Expenses paid for lesson plans and curricula.

e. Expenses paid for child development and educational activities outside the home. These activities include, but are not limited to, drama, art, music, and museum activities, including the entrance fees for such activities.

42.31(2) *Expenses not eligible for the credit.* The following expenses do not qualify for the early childhood development tax credit:

a. Any expenses, including expenses paid to a preschool, once a dependent reaches the age of six.

b. Expenses relating to food, lodging, membership fees, or other nonacademic expenses relating to child development and educational activities outside the home.

c. Expenses related to services, materials, or activities for the teaching of religious tenets, doctrines, or worship, in cases where the purpose of the teaching is to inculcate the religious tenets, doctrines, or worship.

This rule is intended to implement Iowa Code section 422.12C.

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