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**HF 227** – Child and Dependent Care Expense Deduction (LSB1996YH)  
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Fiscal Note Version – New

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**Description**

**House File 227** creates a new individual income tax deduction for qualified amounts paid to a child or dependent care provider. Under the Bill, a qualified child is under the age of 13 and a qualified dependent is a person who resides with the taxpayer and is unable to physically or mentally care for themselves.

Expenses are limited to those that are “reasonable and customary” for the services provided. Payments to a care provider who is the taxpayer’s spouse, partner, or dependent child cannot be included as expenses for the deduction. The annual eligible expense amount is not limited.

The new tax deduction is not transferable or refundable. The change applies to tax years beginning on or after January 1, 2020.

**Background**

The federal tax code provides for a **Child and Dependent Care Credit** equal to 20.0% to 35.0% of qualified expenditures paid to care providers for a child under the age of 13 and for certain other dependents of the taxpayer. Qualified expenditures are limited to \$3,000 per year for one qualified dependent or \$6,000 for two or more qualified dependents. The federal tax credit does not have an upper income limit.

Iowa provides its own tax credit based on the amount of the federal credit. The Iowa tax credit is allowed on a sliding scale, based on the taxpayer’s net income. The Iowa tax credit amount ranges from 75.0% of the federal credit for net income of less than \$10,000, to 30.0% for taxpayers with net income of \$44,000 to \$44,999. No State tax credit is available for net income of \$45,000 or higher.

Taxpayers will be allowed to claim both the new child/dependent care income deduction and the existing Iowa **Child and Dependent Care Credit** for the same expenditures.

**Assumptions**

The Department of Revenue utilized federal tax return data from federal form **2441** to calculate the total child/dependent care expenditures for Iowa taxpayers. The Department used the amounts reported on the federal form as the amounts each taxpayer will claim for the new Iowa deduction, and the tax impact for each Iowa tax return is estimated using the Department’s income tax micro model. The tax year impact is the total tax reduction for all taxpayers assumed to benefit from the new tax deduction.

Iowa tax liability is met as the tax year progresses through income tax withholding and estimate payments with an adjustment in the form of a tax refund or a tax return payment when the return is filed. The tax year impacts of law changes are usually spread across these four items and across two fiscal years. For the TY 2020 estimate, 15.0% is assumed to be due to lower withholding and estimate payment revenue and 85.0% to increased refunds and lower payments with tax returns. For future fiscal years, the spread is assumed to be as follows:

- Tax year 2021 = 25.0%/75.0%
- Tax year 2022 = 40.0%/60.0%
- Tax year 2023 and after = 100.0%/0.0%

[Senate File 2417](#) (2018 Tax Modifications Act) created a contingent individual income tax system to be activated once two General Fund revenue thresholds are met. This estimate assumes the contingent system will be initiated the first year allowed under the law, which is tax year 2023.

Tax deductions impact the calculation of the local option income surtax for schools by lowering the amount of income subject to the surtax. That surtax averages 2.9% of Iowa income tax liability.

### **Fiscal Impact**

The new tax deduction for child/dependent care expenses is estimated to reduce net General Fund revenue by the following amounts:

- FY 2020 = \$1.2 million
- FY 2021 = \$17.1 million
- FY 2022 = \$18.2 million
- FY 2023 = \$21.2 million
- FY 2024 = \$14.8 million

In future fiscal years, the tax deduction is projected to increase at the rate of inflation.

The deduction is also estimated to reduce the revenue raised by the annual local option income surtax for schools by \$500,000.

### **Sources**

Department of Revenue  
Federal tax form 2441

/s/ Holly M. Lyons

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The fiscal note for this Bill was prepared pursuant to Joint Rule 17 and the Iowa Code. Data used in developing this fiscal note is available from the Fiscal Services Division of the Legislative Services Agency upon request.

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