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**SF 119** – Early Childhood and Child and Dependent Care Tax Credits (LSB1171XS)  
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Fiscal Note Version – New

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**Description**

[Senate File 119](#) increases the maximum net income amount used in determining eligibility for the Early Childhood Development (ECD) and Child and Dependent Care (CDC) Tax Credits. The maximum is increased from the current \$45,000 to \$90,000. The change is retroactive to tax years beginning on or after January 1, 2021.

**Background**

The federal CDC Tax Credit is equal to up to 35.0% of eligible child care expenses for qualified children and dependents. The Iowa CDC Tax Credit is calculated as a percentage of the federal CDC Tax Credit. The Iowa CDC Tax Credit ranges from 75.0% of the federal credit for taxpayers with net income of less than \$10,000, to 30.0% for taxpayers with net income of \$40,000 to \$44,999. The Iowa CDC Tax Credit is not available to taxpayers with net income of \$45,000 or more. The Iowa credit is refundable.

The Iowa ECD Tax Credit equals 25.0% of up to \$1,000 (a maximum tax credit of \$250) in eligible early childhood expenses incurred by households with children aged 3 to 5 and net income under \$45,000. The Iowa ECD Tax Credit is also refundable.

Under this proposal, the top income eligibility limit for the Iowa CDC Tax Credit would be increased such that taxpayers with net income above \$39,999 but less than \$90,000 would be eligible to claim an Iowa CDC Tax Credit equal to 30.0% of their federal CDC Tax Credit. Taxpayers with eligible early childhood expenses and net income below \$90,000 would be eligible to claim a tax credit of up to \$250. Under current law and under the Bill, households may only claim one of the two tax credits (ECD or CDC) in each tax year (TY).

**Assumptions**

The number of taxpayers benefiting from the increase in the maximum net income amount for the CDC and ECD Tax Credits, as well as the tax credit value, was estimated by the Department of Revenue using the Department's computer model of Iowa income tax returns. That model utilizes actual State and federal tax return data from TY 2019 to simulate tax returns filed for future tax years. The model gives the Department the ability to change tax parameters and determine the estimated fiscal impact of those changes on tax liability and State General Fund revenue.

The model results, by tax year, are shown in **Table 1**. The model simulation assumes that the contingent income tax system established in [SF 2417](#) (2018 Tax Modifications Act) will be put in place the second tax year possible (TY 2024) under existing law. The contingent tax system redefines Iowa net income, and that redefinition results in the TY 2024 increase in the number of taxpayers benefiting from the changes contained in this Bill.

**Table 1**  
**CDC and ECD Tax Credit Net Income Maximum Increase**  
**Estimated Taxpayer Benefit by Tax Year**

	Resident Taxpayers			Nonresident Taxpayers			All Taxpayers Average		
	Number of Taxpayers	Average Tax Credit	Tax Credit Total	Number of Taxpayers	Average Tax Credit	Tax Credit Total	Number of Taxpayers	Tax Credit	Tax Credit Total
TY 2021	24,530	\$ 171	\$ 4,194,672	1,555	\$ 68	\$ 105,746	26,085	\$ 165	\$ 4,300,418
TY 2022	24,082	171	4,117,953	1,488	69	102,674	25,570	165	4,220,627
TY 2023	23,511	171	4,020,366	1,410	71	100,132	24,921	165	4,120,498
TY 2024	25,710	180	4,627,775	1,765	70	123,562	27,475	173	4,751,337
TY 2025	25,955	186	4,827,594	1,682	70	117,760	27,637	179	4,945,354
TY 2026	26,947	190	5,120,000	1,806	72	130,000	28,753	183	5,250,000

To convert tax year impacts to fiscal year impacts, the following timing assumptions are made:

- Fiscal year 2021 ends June 30, 2021. Given the retroactive application to TY 2021, 15.0% of the TY 2021 impact is assumed to fall in FY 2021 and 85.0% in FY 2022.
- Impacts for tax year 2022 and after are assumed to fall 65.0% in the first fiscal year and 35.0% in the second fiscal year.

**Fiscal Impact**

The changes to the Iowa CDC and ECD Tax Credits contained in the Bill are projected to reduce net General Fund revenue by the following amounts:

- FY 2021 = \$0.6 million
- FY 2022 = \$6.4 million
- FY 2023 = \$4.2 million
- FY 2024 = \$4.5 million
- FY 2025 = \$4.9 million
- FY 2026 and after = \$5.1 million

As refundable tax credits, the changes do not impact the calculation of the local option income surtax for schools. Expected implementation costs for the Department of Revenue are assumed to be minimal. Given the expanded number of taxpayers projected to claim the credits, enforcement costs for the Department will increase.

**Additional Potential Fiscal Impact**

Existing Iowa law provides for a significant change to Iowa’s individual income tax system once two General Fund revenue triggers are met. The first year that the triggers may be met is at the conclusion of FY 2022. Once implemented, this contingent income tax system is projected to reduce Iowa individual income tax by roughly \$300.0 million per tax year. Since this Bill is projected to reduce General Fund revenue in FY 2022 and after, the Bill’s changes will modestly reduce the possibility of achieving both revenue triggers; as a consequence, the Bill could result in delayed implementation of the income tax reduction.

**Source**

Department of Revenue

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/s/ Holly M. Lyons

January 26, 2021

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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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