



## **Working Families with Children and Iowa's Income Tax: The Importance of State Income Tax Reform**

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*Jerry Rasmussen cleared \$43,600 in income from his small business in home carpentry. Nancy Rasmussen is a dental technician by trade but is staying at home to care for their twin three-year-old daughters. The Rasmussens decided it simply didn't make economic sense for her to continue working and the family to pay child care expenses, and she wanted to be with her daughters when they were young. The Rasmussens owe no federal income taxes, but they have a \$1,987 Iowa income tax bill they must pay.*

*Connie Johnson is an office manager for a nonprofit agency and loves her job. She has two teenage sons she has raised by herself since her husband died. She pinches pennies to make ends meet and works hard to protect the proceeds from her husband's life insurance policy that she has put aside as money for her sons' higher education. Like the Rasmussens, Connie Johnson owes no federal income taxes, but she has a \$1,575 Iowa income tax bill she must pay.*

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Both these stories are fictional, but they are representative of tens of thousands of working Iowa families with children that owe Iowa income taxes, although they do not owe any federal income taxes. The current tax legislation before the General Assembly, House File 807, would begin to change this.

Tax experts generally agree that the income tax should begin taxing income only after a family's basic needs have been met. At the federal level, the standard deduction, personal exemptions, and the child tax credit all work to exempt a significant amount of income, based upon family size, from any taxation in order to address this tax principle. The federal earned income tax credit provides further assistance for lower-income families with income derived from work. As a result, a family of four with an income up to \$43,600 owes no federal income tax and a family of three with an income up to \$37,400 owes no federal income tax. These figures are very consistent with both national and Iowa public opinion polls on what level of income it takes for families of these sizes simply to make ends meet.

Iowa's income tax code, however, provides very little recognition of the costs of raising a family: Iowa's standard deductions are much smaller than federal standard deductions; Iowa has no personal exemptions; and Iowa's child credit of \$40 pales in comparison with the federal government's \$1,000 credit.

As a result, working families with children in Iowa with incomes starting at about \$20,000 begin paying state income taxes, although their income would need to double before they would owe federal income taxes.

House File 807, with amendment 1484, makes significant changes to the Iowa income tax that provides improved treatment for these families. Specifically, it:

- Lowers the rates at which income is taxed;
- Increases the Iowa standard deduction;
- Increases the Iowa earned income tax credit; and
- Raises the child and dependent care tax credit, which would help working families who have child care expenses and taxable incomes below \$50,000.

The major reason that House File 807 can make these changes is that it also ends the ability of Iowa taxpayers to deduct the federal income taxes they pay from their state income tax liability. This “federal deductibility” provision, however, has an impact on the tens of thousands of families like the Rasmussens and Johnsons who owe state income taxes but no federal income taxes. All these families will benefit from the legislation.

If enacted, House File 807 will reduce these two families’ Iowa income taxes by over 18%. In the Rasmussen’s case, the Iowa income tax would decline by \$361. In the Johnson’s case, the Iowa income tax would decline by \$290. This reduction certainly will help these families better meet their basic and immediate needs. It also will be a help to their communities, as families like the Rasmussens and Johnsons are very likely to spend this money in their local economies.

In the long-term, Iowa’s income tax needs further review and reform to fully reflect the cost of raising a family – through much expanded credits or personal exemptions. During this legislative session, House File 807 makes a significant step forward.

*Every Child Counts is the advocacy division of the Child and Family Policy Center. Every Child Counts has three 2009 legislative priority policy areas: (1) quality early care and education; (2) child well-being and development; and (3) child and family economic success. House File 807 takes significant steps to improving child and family economic success.*

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