

Why Reform Plan Means Tax Cuts for Most

Selected Representative Iowa Tax Filers Under Current Law, Proposal

The following are tax scenarios for different representative Iowa tax filers that show their federal and Iowa income-tax liabilities today and under the proposed income-tax changes. The first three compare different types of moderate income-tax filers — a working married couple with children, a single working person, and a retired individual. The next three examples show married working families with increasing incomes (\$60,000, \$90,000 and \$180,000, respectively).

As these examples show, most of the proposed changes in Iowa taxes are relatively modest, but moderate-income families with children receive more substantial reductions.

Scenario One

Married couple family with two children – income of **\$30,000** from a \$20,000 per year full-time job and a \$10,000 per year part-time job. Couple pays \$2,000 for child care expenses. Claims standard deduction.

Federal income-tax liability — None (receives a refund from EITC)

Current Iowa income-tax liability — \$352

Iowa income-tax liability under proposed tax reform — \$80

Change — **\$272 reduction in Iowa income tax**, -77.2 percent (effective tax rate: 0.27 percent of income)

Scenario Two

Single individual with income of **\$30,000** from full-time job. Claims standard deduction.

Federal income-tax liability — \$2,753

Current Iowa income-tax liability — \$1,166

Iowa income-tax liability under proposed tax reform — \$1,097

Change — **\$69 reduction in Iowa income tax**, -5.9 percent (effective tax rate: 3.66 percent of income)

Scenario Three

Single retired person with income of **\$30,000**, \$10,000 from Social Security, \$10,000 from private pension, \$5,000 from treasury notes, and \$5,000 from interest income. Claims standard deduction

Federal income tax-liability — \$1,030

Current Iowa income-tax liability — none

Iowa income-tax liability under proposed tax reform — none

Change — **none** (effective tax rate: 0 percent of income)

Scenarios 4-6 on page 2 show a comparison of working married couples.

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Scenario Four

Married couple with two children, income of **\$60,000** from one \$40,000 and one \$20,000 job. Couple has itemized federal deductions of \$15,000, which includes state income taxes paid.

Federal income-tax liability — \$3,844

Current Iowa income-tax liability — \$1,785

Iowa income-tax liability under proposed tax reform — \$1,704

Change — **\$81 reduction in Iowa income tax**, -4.5 percent (effective tax rate: 2.84 percent of income), \$20 increase in federal income tax, **net \$61 reduction in taxes paid**

Scenario Five

Married couple with grown children, income of **\$90,000** from one \$28,000 job, one \$56,000 job and \$6,000 in interest income. Couple has itemized federal deductions of \$20,000, which includes state income-taxes paid.

Federal income-tax liability — \$8,647

Current Iowa income-tax liability — \$3,429

Iowa income-tax liability under proposed tax reform — \$3,369

Change — **\$60 reduction in Iowa income tax**, -1.7 percent (effective tax rate: 3.74 percent of income), \$15 increase in federal income tax, **net \$45 reduction in taxes paid**

Scenario Six

Married couple family with income of **\$180,000** from one \$100,000 job and one \$50,000 job and \$30,000 in interest income. Couple has itemized federal deductions of \$36,000, which includes state income taxes.

Federal income-tax liability — \$27,104

Current Iowa income-tax liability — \$8,136

Iowa income-tax liability under proposed tax reform — \$8,333

Change — **\$197 increase in Iowa income tax**, 2.4 percent increase (effective tax rate: 4.63 percent of income), \$55 reduction in federal income tax, **net \$142 increase in taxes paid**

The final scenario points to the fact that some Iowa income is sheltered from any tax liability. This particular example is for Iowa's total exclusion from income of certain types of capital gains. Many very high-income individuals have substantial preferential tax items (including municipal bonds and other tax exempt income) that shelters income from taxes. The examples above were designed for simplicity; in fact, most tax filers with incomes of \$180,000 will have some income that is taxed at preferential rates at the federal and state levels. This will lower their overall tax liability and mean their effective tax rate is lower than that shown in the examples above.

Scenario Seven

Entrepreneur whose income is from \$3 million sale of business in which entrepreneur materially participated and secured a capital gains of **\$600,000**.

Current Iowa income tax liability — \$0

Iowa income tax liability under proposed tax reform — \$0

Change — **none**, (tax rate of 0 percent of income)

*For more information about this issue, see the **Iowa Fiscal Partnership** policy brief, "More Tax Cuts in Latest Reform Plan," at <http://www.iowafiscal.org/2009docs/090407-taxplan.pdf>*

*The **Iowa Fiscal Partnership** is a joint fiscal policy initiative of two nonprofit, nonpartisan Iowa-based organizations, the **Child & Family Policy Center** in Des Moines, and the **Iowa Policy Project** in Iowa City. IFP reports are available at www.iowafiscal.org.*