

SMART POLICY 3-POINTER

PROTECT AND EXPAND IOWA'S EARNED INCOME TAX CREDIT

The state EITC helps keep Iowa families out of poverty. It not only rewards work and offers a ramp to better opportunities, but it fills in where the wage market — including the minimum wage — falls short. While Iowa lawmakers have focused most of the benefits of income-tax changes of the last two decades on the rich, this provision contributes to tax fairness.

An expansion of the EITC is overdue

It's been a decade since lawmakers last raised the state EITC, which was established in 1990 at 5% of the federal EITC. They raised it to 6.5% in 1991 and to 7% in 2007, when they made it refundable. This change allowed all recipients to get the full benefit of the credit for which they were eligible, even if they owed less than that amount in state income tax. In 2013, lawmakers voted to raise the credit to 14% for 2014 and 15% starting in 2015.¹

1

EITC goes to Iowa working families who need help

The most recent Iowa Department of Revenue evaluation of the credit shows federal and state EITC claims boost a significant share of Iowa households from a poverty-level income.² **Children benefit:** In 2019, 30% of households with dependents received the EITC.

2

EITC rewards work

Unlike corporate tax credits that may not display a clear public benefit to taxpayers or show they have met their intent, the EITC is structured to reward work and promote opportunity while reducing poverty. **The EITC is based on earned income** and family size, rising with higher earnings for a working household and then phasing out.

3

EITC boosts tax fairness while recent tax changes favor the wealthy

The EITC partially offsets provisions in the larger state and local tax system that for decades have been skewed to the wealthy.³ **Iowa's EITC could do more if paired with a state Child Tax Credit**, which some states also have implemented to foster economic stability in low- and moderate-income households.⁴

Policy Recommendation: Expand the Iowa EITC

Recently passed reductions in state income taxes — skewed to the wealthiest Iowans — alone justify an expansion, on grounds of both need and fairness. Department of Revenue analysis⁵ found **nearly three-fourths of EITC claimants were below 150% of the poverty guideline** (now less than \$39,000 for a family of three) far below what most families need to meet a bare-bones household budget.⁶ In addition, **any sales-tax increase⁷ should include an EITC expansion** to offset the regressive effects of sales taxes. The extra cost of doubling Iowa's EITC to 30 percent of the federal EITC, estimated at \$71.4 million in FY 2024, is little more than 1/8 of a full penny sales-tax increase. Finally, any proposal to reduce refundability of the EITC or to reduce the credit itself should be dismissed out of hand. Eligible recipients deserve the full value of the credit.

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- ¹ Legislative Services Agency, “Tax Credit: Earned Income Tax Credit,” Fiscal Topics, Oct. 13, 2023. <https://www.legis.iowa.gov/docs/publications/FTNO/1386549.pdf>
 - ² Iowa Department of Revenue, “Iowa’s Earned Income Tax Credit,” Tax Credit Program Evaluation Study, December 2021. <https://revenue.iowa.gov/media/3284/download?inline>. See pages 5-6. In tax year 2019, 61.7% of households claiming the EITC had Iowa adjusted gross income less than \$25,000, representing about 27% of household filers, and those claimants claimed 63% of the total amount of the EITC. In addition, nearly half of EITC claimants were below the federal poverty guideline and another quarter were below 150%. “After adding federal and Iowa EITC claims to AGI (adjusted gross income), the share of EITC claimants below the federal poverty guideline falls to 39.4%, and the share of claimants between 100 and 150% of the guideline rises to 29.1%.”
 - ³ Institute on Taxation and Economic Policy, “Iowa: Who Pays? 7th Edition.” Jan. 9, 2024. <https://itep.org/whopays/iowa-who-pays-7th-edition/>
 - ⁴ Samantha Waxman and Iris Hinh, “States Can Enact or Expand Child Tax Credits and Earned Income Tax Credits to Build Equitable, Inclusive Communities and Economies,” Center on Budget and Policy Priorities, updated March 3, 2023. <https://www.cbpp.org/research/state-budget-and-tax/states-can-enact-or-expand-child-tax-credits-and-earned-income-tax>
 - ⁵ Ibid, Iowa Department of Revenue, “Iowa’s Earned Income Tax Credit,” Tax Credit Program Evaluation Study, December 2021. <https://revenue.iowa.gov/media/3284/download?inline>
 - ⁶ Sean Finn and Samantha Tamborski, “The Cost of Living in Iowa,” Common Good Iowa. <https://www.commongoodiowa.org/data/cost-of-living-in-iowa>
 - ⁷ For example, if the Legislature funds the Natural Resources and Outdoor Recreation Trust Fund with a 3/8-cent sales-tax increase as voters demanded in 2010 by statewide referendum, it would be likely that lawmakers would raise the tax a full penny, using the remaining 5/8 for other purposes.

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