INDIVIDUAL INCOME TAX
Dependent Care Credit

April 3, 2001

	Yes	No
Separate Official Fiscal Note Requested		X
Fiscal Impact		
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 1335 (Slawik)/ S.F. 1489 (Rest)

	Revenue Gain or (Loss)			
	F.Y. 2002	**F.Y. 2003**	**F.Y. 2004**	**FY2005**
		(000's)		
Appropriation		---------- Unspecified ----------		
Dependent Care Credit	($18,300)	($18,500)	($18,900)	($19,300)
General Fund Total	($18,300)	($18,500)	($18,900)	($19,300)

Effective for tax years beginning after December 31, 2001.

EXPLANATION OF THE BILL

Current Law:

Minnesota taxpayer may claim a refundable credit for a portion of dependent care expenses depending on income, provided that those expenses were necessary in order to hold or look for a job. A dependent is defined as a child under age 13 or a dependent or spouse of any age who is disabled. The determination of the credit amount starts with the federal child and dependent care credit, which is equal to eligible expenses up to $2,400 for one dependent and $4,800 for two or more dependents multiplied by a percentage ranging from 30% to 20%, with the percentage decreasing as income increases. The maximum credit is limited to $720 for one child and $1,440 for two or more children.

For the Minnesota dependent care credit, these maximum credit amounts are reduced for a taxpayer whose household income exceeds an income threshold of $18,610 for tax year 2001. Above that threshold, the maximum credit is reduced by $18 for every $350 of income for households with one dependent, and by $36 for every $350 of income for households with two or more dependents. Therefore, taxpayers whose total household income exceeds $32,260 receive no credit in 2001. The threshold income is indexed each year for inflation.

For married joint filers who have a dependent under the age of one and do not participate in a dependent care assistance program, the current law allows the lesser of the combined earned income for the couple or $2,400 as the deemed employment related expenses paid for that child.

Proposed Law:

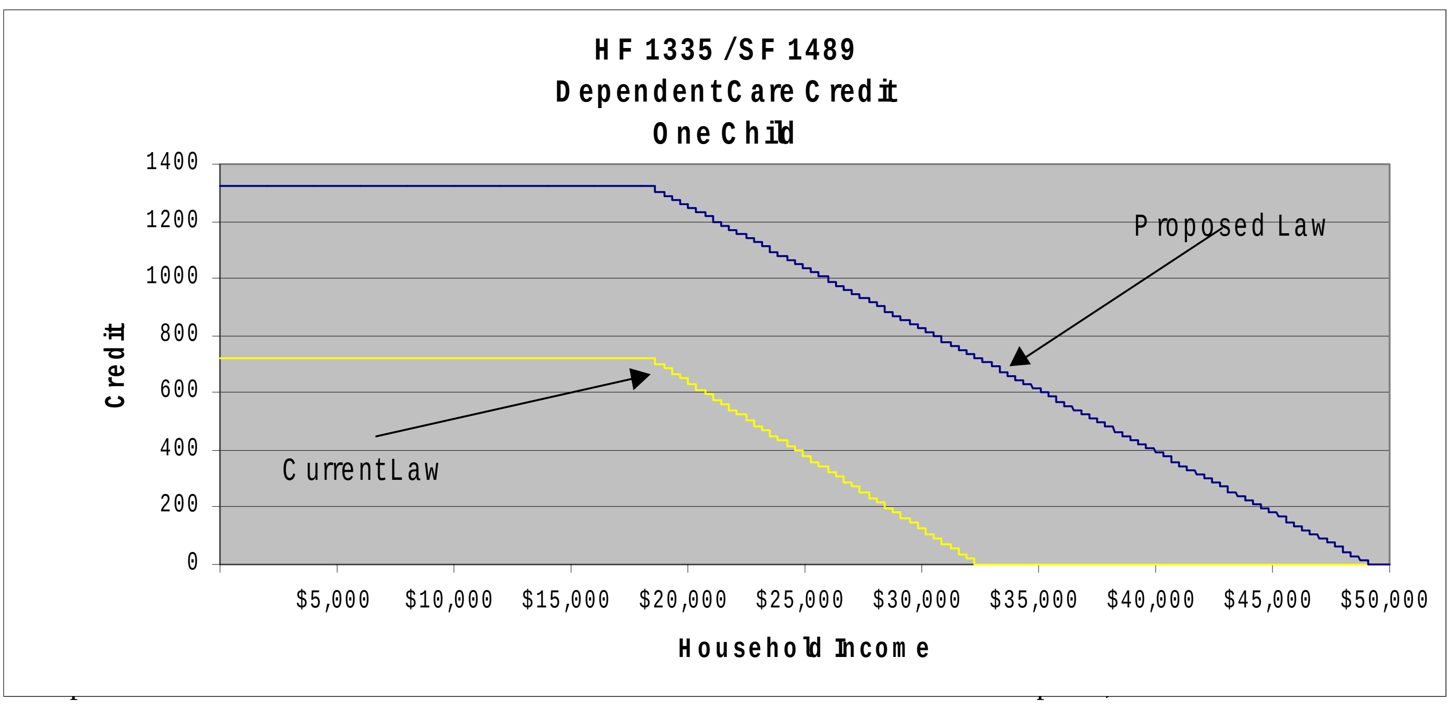
The proposal allows an increase in eligible employment related expenses up to $4,400 for one dependent and $8,800 for two or more dependents multiplied by a percentage rate of 30%. The maximum credit amount allowed for one child increases to $1,320 and for two or more children the credit increases to $2,640.

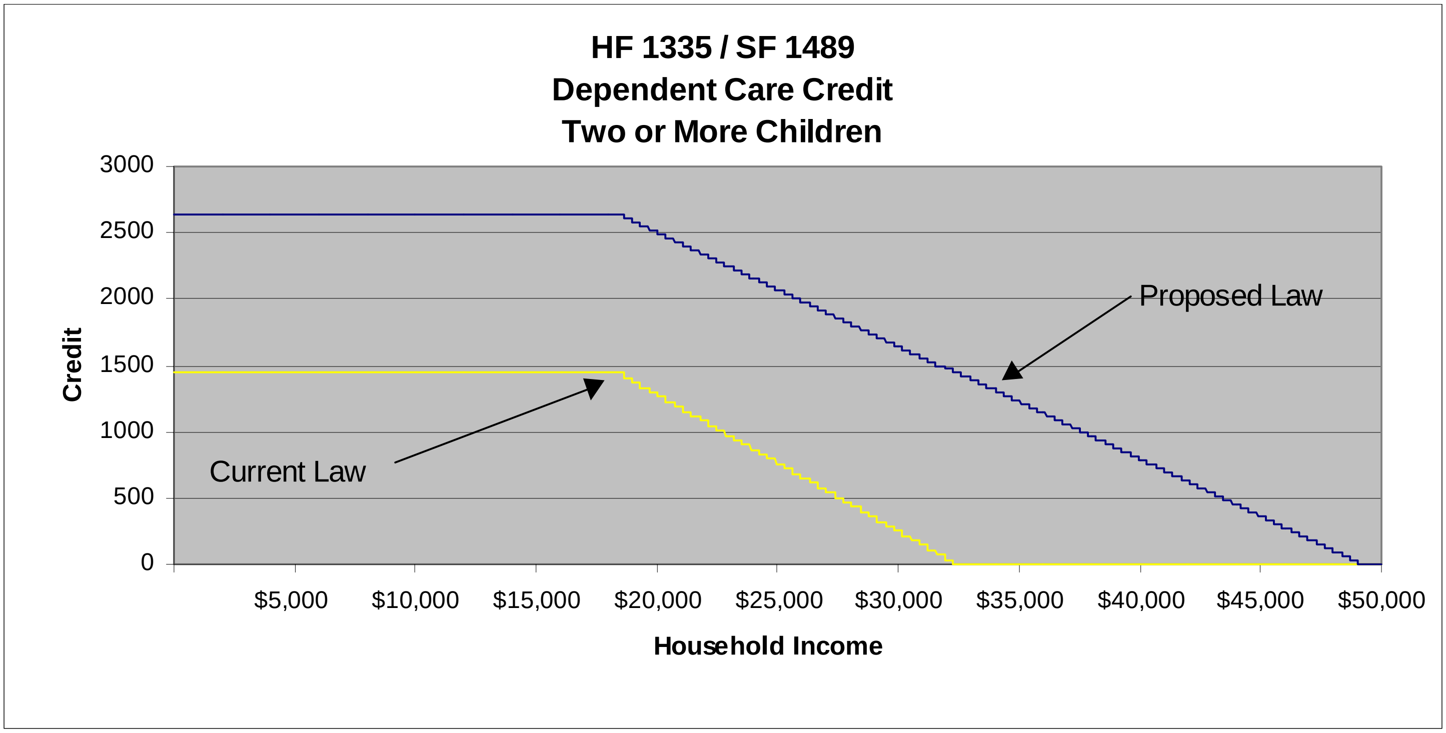
As under current law, the credit decreases over a threshold income of $18,610, however, the proposal changes the rate of decrease in the credit over the threshold income. The rate of decrease changes from $18 to $15 of credit for every $350 of income for one dependent and from $36 to $30 of credit for every $350 of income for two or more dependents. Therefore, the maximum credit amounts are reduced for a taxpayer with household income over $18,610 so that a taxpayer with total household income over $49,060 will receive no credit in 2001. The threshold amount of $18,610 in tax year 2001 is indexed for inflation in the following years.

For married joint filers who have a dependent under the age of one and do not participate in a dependent care assistance program, the proposal allows the lesser of the combined earned income for the couple or $4,400 as the deemed employment related expenses paid for that child.

The bill also contains an unspecified direct appropriation for fiscal year 2002 to provide information to employers on the administration and benefits of dependent care pre-tax accounts.

The proposal can be depicted graphically as follows:





REVENUE ANALYSIS DETAIL

- The House Income Tax Simulation (HITS) Model was used to estimate the tax year revenue impact of the change in the maximum credit amount and the rate of decrease from the phase-out threshold of the dependent care credit.
- These simulations assume the same economic conditions used by the Minnesota Department of Finance for the forecast published in February 2001. The model uses a stratified sample of 1998 individual income tax returns compiled by the Minnesota Department of Revenue.
- For those taxpayers in the sample that have reported the maximum amount of eligible employment related expenses under current law, one half the difference between the maximum amount of eligible expenses under the proposed law and under current law was added to the taxpayers' total eligible expenses.
- An adjustment was made to account for newly-eligible households with newborns who do not claim a federal child care credit (because they have no eligible expenses or expenses less than $2,400) but would be deemed to have $4,400 of eligible expenses under Minnesota law. The estimate was increased by 25% of the dependent care credit amount for newly-eligible joint returns as indicated by HITS model runs.
- Tax year impact would be reflected in the following fiscal year.

Number of Taxpayers Affected: The proposal affects 66,600 returns with an average tax reduction of $275 per return in tax year 2001. An additional 26,000 taxpayers would be eligible for the credit.

ADMINISTRATIVE/OPERATIONAL IMPACT

Because the department is currently formalizing a reengineered process for the income tax, the operational impact of this provision cannot be precisely estimated. However, there will be significant additional costs associated with this expansion of a current credit which nearly doubles the projected numbers of taxpayers using it.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/polic.html#analyses

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