INDIVIDUAL INCOME TAX
Marriage Penalty Reduction:
Working Family Credit; Dependent Care Credit; K-12 Credit; AMT; Elderly/Disabled Subtraction

April 5, 2001

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

Department of Revenue
Analysis of H.F.1848 (Knoblach)/ S.F. 2062 (Kierlin) **As Proposed to be Amended (H1848A1).**

	Revenue Gain or (Loss)			
	F.Y. 2002	**F.Y. 2003**	**F.Y. 2004**	**FY2005**
		(000's)		
Working Family Credit	($8,900)	($9,400)	($10,000)	($10,300)
Dependent Care Credit	($4,100)	($4,100)	($4,100)	($4,100)
K-12 Credit	($15,900)	($16,700)	($17,600)	($18,400)
Elderly/Disabled Subtraction	($1,100)	($1,200)	($1,100)	($900)
Alternative Minimum Tax	($15,000)	($17,500)	($20,600)	($24,200)
General Fund Total	($45,000)	($48,900)	($53,400)	($57,900)

Effective for tax years beginning after December 31, 2000.

EXPLANATION OF THE BILL

Working Family Credit

Current Law: The Minnesota working family credit is a refundable credit against the individual income tax allowed to taxpayers who are eligible for the federal earned income credit. To qualify, the taxpayer (or spouse) must have income from wages or self employment, and total earned income or (modified adjusted gross income, whichever is larger) cannot exceed a maximum amount.

Proposed Law: The proposal allows a subtraction of the earned income of the lesser-earning spouse from total earned income or (modified adjusted gross income, whichever is larger) in computing the phase-out of the credit over a threshold amount. "Earned income of the lesser-earning spouse" is defined as wages, earnings, and taxable pension and retirement income. As proposed to be amended, eligibility for the credit is extended to those not eligible for the federal earned income credit.

Dependent Care Credit

Current Law: A Minnesota taxpayer may claim a refundable credit for a portion of dependent care expenses 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 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 state credit allowed for married couples is based on the couple's total income. For tax year 2001 the maximum amounts were reduced for taxpayers with total household incomes over $18,610, so that a taxpayer with total household income over $32,260 received no credit.

Proposed Law: The maximum credit allowed for married couples is based on the couple's total income minus the earned income of the lesser-earning spouse. The proposal also allows the subtraction of the earned income of the lesser-earning spouse from total earned income in computing the phase-out of the credit over a threshold amount of $18,610. "Earned income of the lesser-earning spouse" is defined as wages, earnings, and taxable pension and retirement income.

K-12 Credit

Current Law: The maximum credit allowed for married couples is based on the couple's total income. The maximum amounts are phased out for household incomes between $33,500 and $37,500.

Proposed Law: The credit calculation for married couples would be based on their total household income minus the earned income of the lesser-earning spouse. "Earned income of the lesser-earning spouse" is defined as wages, earnings, and taxable pension and retirement income.

Elderly/Disabled Subtraction

Current Law: A subtraction from federal taxable income is allowed for persons who are age 65 or over or totally disabled. The subtraction is computed as follows for a married couple who both qualify and file a joint return: $12,000 base amount minus nontaxable retirement and nontaxable social security and disability benefits minus one-half of federal adjusted gross income over $18,000. Low income taxpayers who have more of their income from taxable sources such as pensions and interest benefit more than taxpayers who have nontaxable sources such as social security.

Proposed Law: The new subtraction for married couples would be computed as follows: $12,000 base amount minus nontaxable retirement and nontaxable social security benefits (excluding nontaxable retirement and disability income of the spouse with the lower amount of nontaxable retirement and disability benefits) minus one-half of federal adjusted gross income (excluding earned income of the lesser-earning spouse) over $18,000. "Earned income of the lesser-earning spouse" is defined as wages, earnings, and taxable pension and retirement income.

Alternative Minimum Tax (AMT) Exemption Amounts, AMT Income Level for Exemption Reduction

Current Law:

Current Law
Tax Year 2001 and After

		Phase-Out	
Filing Status	**Exemption**	**Begins at**	**Ends at**
Married Joint	$40,000	$150,000	$310,000
Married Separate	$20,000	$ 75,000	$155,000
Single	$30,000	$112,500	$232,500
Head of Household	$30,000	$112,500	$232,500

Proposed Law: The proposal would change the AMT exemption amounts and the income level for exemption reduction for married couples to be twice the amounts allowed for single filers. The married separate filers would be the same as the single filers.

Proposed Law
Tax Year 2001 and After

		Phase-Out	
Filing Status	**Exemption**	**Begins at**	**Ends at**
Married Joint	$60,000	$225,000	$465,000
Married Separate	$30,000	$112,500	$232,500
Single	$30,000	$112,500	$232,500
Head of Household	$30,000	$112,500	$232,500

REVENUE ANALYSIS DETAIL

- The House Income Tax Simulation (HITS) Model was used to estimate the tax year revenue impact of the reduction of the marriage penalties in the individual income tax for the working family credit, dependent care credit, elderly/disabled subtraction and the alternative minimum tax exemption amounts and the income level for the AMT exemption reduction.
- 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 the elderly/disabled subtraction, the earned income of the lesser-earning spouse includes taxable pensions and taxable social security. The estimate assumes that one-fourth of pension income and one-third of the social security income goes to the lesser-earning income spouse in computing the phase-out of the subtraction. The estimate also assumes that one-third of the nontaxable retirement income is attributed to the spouse with the lower retirement benefits and is excluded from the reduction of the subtraction base amount.
- Tax year impact would be reflected in the following fiscal year.
- An off-model estimate was made for the K-12 education credit by using the model-generated number of returns of married filers with dependents which move from over $37,500 to under $37,500 of household income. Applying the same proportion to these 65,210 newly eligible returns as current users of the credit are to currently eligible returns, 61%, yields the estimated number of new credit claimants of 39,800. Assuming a slightly higher than current average credit amount of $400, the revenue cost of allowing this adjustment to the income of married filers would be $15.9 million in the first year. Growth of five percent was used in subsequent years.

Number of Taxpayers Affected:

Working Family Credit: With the proposed change, an additional 4,150 claimants would receive the credit and 17,400 married working family claimants would receive an increase in credit for tax year 2001.

Dependent Care Credit: With the proposed change, an additional 12,100 claimants would receive the credit and 4,400 married working family claimants would receive an increase in credit for tax year 2001.

K-12 Credit: This proposal affects 40,000 taxpayers in 2001.

Elderly/Disabled Subtraction: With the proposed change, an additional 6,700 married taxpayers would receive the subtraction and 7,400 married taxpayers would receive an increase in the subtraction for tax year 2001.

Alternative Minimum Tax (AMT) Exemption Amounts, AMT Income Level for Exemption Reduction: The proposed AMT changes will eliminate the AMT for 23,800 taxpayers and will reduce the AMT for 3,000 taxpayers in tax year 2001 for an average tax reduction of $560 per taxpayer.

ADMINISTRATIVE/OPERATIONAL IMPACT

See fiscal note.

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

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