

MINNESOTA • REVENUE

INDIVIDUAL INCOME TAX K-12 Education Credit & Subtraction

March 9, 2004

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

Department of Revenue
Analysis of H.F. 2772 (Knoblach)

	<u>Revenue Gain or (Loss)</u>			
	<u>F.Y. 2004</u>	<u>F.Y. 2005</u>	<u>F.Y. 2006</u>	<u>F.Y. 2007</u>
		(000's)		
Credit	\$0	(\$35,400)	(\$37,200)	(\$39,000)
Subtraction	<u>\$0</u>	<u>(\$2,200)</u>	<u>(\$2,300)</u>	<u>(\$2,400)</u>
General Fund Total	\$0	(\$37,600)	(\$39,500)	(\$41,400)

Assumed effective beginning with tax year 2004.

EXPLANATION OF THE BILL

The Minnesota income tax statute allows taxpayers to take credits on their income tax returns for some school expenses for students in kindergarten through 12th grade. If an expense is not used for the credit, then the expense might possibly be used as a subtraction on the return. The statute imposes income limits, expense limits, and limits on the types of expenses that can be used for the credit or the subtraction. The following five types of expenses are authorized under both current law and the proposed law for both the credit and the subtraction: fees for enrichment programs, fees for individual instruction, cost of required school materials, some transportation expenses, and hardware and educational software for personal computers (PC). Under both current law and the proposal, expenses for religious materials and instruction are not eligible for the credit or for the subtraction. The proposed law authorizes additional expenses for the credit and the subtraction and increases or eliminates some of the limits that are in current law.

The following list is a summary of the changes that would occur under the proposed law:

	<u>Current Law</u>	<u>Proposed Law</u>
Tuition expense eligibility	Subtraction only	Credit and subtraction
Extracurricular fees and materials	Neither	Credit and subtraction
PC expense limit per family	\$200	\$500
Credit amount	75% of expense	100% of expense
Maximum credit per child	\$1,000	\$1,200
Maximum credit per family	\$2,000	None
Beginning credit phase out income	\$33,500	\$40,000
Maximum income for credit	\$37,500	\$44,800
K-6 maximum subtraction per child	\$1,625	\$2,000
7-12 maximum subtraction per child	\$2,500	\$3,000

REVENUE ANALYSIS DETAIL

- For the expense types that are currently eligible for the credit, tax return information summarized for the 2002 income tax sample provided eligible education expenses by type of expense for each child. A model was developed to use the average expense information, and the model was calibrated for actual experience under current law. Then, with an appropriate expense assumption for the higher-income families that would become eligible under the proposal, the model was rerun using the parameters of the proposed law. In running the model, it was assumed that computer expenses claimed under the proposal would increase by 50%.
- Census data for 2000 provided information about the number of students enrolled in private schools by income level in Minnesota. Using this data along with tuition information obtained from the Minnesota Independent School Forum, the likely distribution of tuition by income level was approximated by assuming participation rates and averages. This tuition expense information was input into the K-12 credit model using the parameters of the proposed law. The resulting credit was reduced by 10% to account for the likelihood that some of the families that would claim the tuition credit under the proposal are already claiming the credit for currently-authorized expenses.
- For the subtraction, information is not available by type of expense or for each child. Using the 2002 income tax sample, information for current subtraction claimants was distributed by gross income, and separate tables were produced for those at and below the current maximums. For those with income of \$45,000 and above and claiming a subtraction of \$1,625 or more, it was assumed that the subtraction claimed would increase by 15% because most, but not all, taxpayers would have enough expenses to claim the increased maximums. The increase was multiplied by the appropriate marginal tax rate for each income range.
- The total amount of extracurricular fees for public schools was obtained from the Department of Education. The likely distribution of the fees by income level was approximated by assuming participation rates and averages. For income levels eligible for the credit, it was assumed that 60% of the fees would be claimed. For the subtraction, it was assumed that 90% of the fees would be claimed.
- For the increase in the computer limit, it was assumed that 20% of the taxpayers with income of \$45,000 and above and claiming a subtraction of less than \$1,625 would have an average increase in eligible expenses of \$200.
- For taxpayers with income under \$45,000 and currently claiming a subtraction of \$1,000 or more, it was assumed that most of the expenses are for tuition and would be switched to the credit under the proposal. The estimate of this portion was consistent with the independent method used to estimate the increase in the credit due to tuition.
- It was assumed that most of the increase in the credit due to the increase in maximum income (independent of tuition) would result in a decrease in the subtraction for those now claiming \$1,000 or less.

REVENUE ANALYSIS DETAIL (Continued)

- For tax year 2002 the following costs for the provisions of the bill would be as follows:
 - Credit
 - Tuition eligibility \$18,300,000
 - Raising credit amount to 100%, increasing income ranges, increase in maximum and computer expense limit 13,000,000
 - Fees and materials for extracurricular activities 800,000
 - Credit total \$32,100,000
 - Subtraction
 - Increased maximums \$1,800,000
 - Fees and materials for extracurricular activities 700,000
 - Increased computer limit 400,000
 - Reduction for credit changes - income limits (200,000)
 - Reduction for credit changes – tuition (700,000)
 - Subtraction total \$2,000,000
- A 5% annual growth rate over the base year was assumed.
- The costs for a particular tax year are reflected in the following fiscal year.

Number of Taxpayers:

Credit: A total of 60,400 returns claimed the K-12 education for tax year 2002. All current credit claimants would receive an increased credit under the proposal. An estimated 12,000 additional returns would claim the credit due to the higher income limits. An estimated 12,000 returns would claim the credit for tuition expenses. An estimated 13,000 would claim the credit for extracurricular fees and materials. An estimated 17,500 would claim the credit for personal computer expenses.

Subtraction: A total of 224,000 returns claimed the K-12 subtraction for tax year 2002. An estimated 52,000 returns would benefit from the higher maximum subtraction amounts. An estimated 33,000 returns would benefit from the increase in computer expenses allowed, and an estimated 74,000 returns would claim the subtraction for extracurricular fees and materials.

Source: Minnesota Department of Revenue
Tax Research Division
http://www.taxes.state.mn.us/taxes/legal_policy