MINNESOTA · REVENUE

INDIVIDUAL INCOME TAX
K-12 Education Credit

April 15, 2004

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

Department of Revenue
Analysis of H.F. 2772 (Knoblach), Delete-All Amendment (DE1)

	Revenue Gain or (Loss)			
	F.Y. 2004	F.Y. 2005	F.Y. 2006	F.Y. 2007
	(000's)			
General Fund	$0	($630)	($665)	($700)

Effective beginning with tax year 2004.

EXPLANATION OF THE BILL

Current Law: The Minnesota income tax statute allows taxpayers to take a refundable credit 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 current 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. Tuition expenses are eligible for the subtraction, but expenses for religious materials and instruction are not eligible for the credit or for the subtraction.

The credit is equal to 75% of eligible expenses. The maximum credit is $1,000 per child and $2,000 per family. The maximum credit is phased out for household income between $33,500 and $37,500, so that no credit is available for taxpayers with income over $37,500.

Proposed Law: Under the proposed amendment, the maximum credits of $1,000 per child and $2,000 per family are replaced by a maximum credit per family of $1,000 multiplied by the number of qualifying children in the family in grades kindergarten through 12th grade. For all families, the phase-out of the maximum credit still begins at $33,500 of household income, but for families with more than two qualifying children, the end of the phase-out range increases by $2,000 for each qualifying child greater than two qualifying children. Thus, if the family has three qualifying children, the phase-out ends at a household income of $39,500, and if the family has four qualifying children, the phase-out ends at a household income of $41,500, etc.

REVENUE ANALYSIS DETAIL

- 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 with more than two qualifying children that would become eligible under the proposal, the model was rerun using the parameters of the proposed law. For tax year 2002, the estimate of the additional credit that could be taken as a result of the lengthening of the phase-out range for families with three or more qualifying children was $240,000.
- Tax return information from the 2002 income tax master file was analyzed to see how many returns were filed claiming the maximum credits of $1,000 (maximum credit for one qualifying child) or $2,000 (maximum credit for two or more qualifying children). The file was also analyzed to see how many returns were filed claiming a credit less than 1,000 and also to see how many returns were filed claiming a credit between $1,000 and $2,000. For families claiming a credit greater than or equal to $1,000, estimates of additional credits to be taken under the proposal were made. For tax year 2002, the estimate of the additional credit that could be taken as a result of the change in the maximum credit formulation was $365,000.
- The expenses that would no longer be taken for the subtraction were estimated based on the estimate of the extra expenses eligible for the credit due to the change in the maximum credit allowed. Five percent of those expenses were used as the estimate of the tax savings on the subtraction.
- For tax year 2002 the following costs for the provisions of the bill would be as follows:

o Credit	$605,000
o Subtraction	(30,000)
Net	$575,000

- 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: About 60,000 filers currently claim the education credit.

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

hf2772(sf2702)_4.doc/cc cej