

March 25, 2019

	<b>Yes</b>	<b>No</b>
<b>DOR Administrative Costs/Savings</b>	<b>X</b>	

Department of Revenue  
Analysis of S.F. 560 (Eichorn), As Proposed to be Amended (SCS0560A-1)

	<b>Fund Impact</b>			
	<b>F.Y. 2020</b>	<b>F.Y. 2021</b>	<b>F.Y. 2022</b>	<b>F.Y. 2023</b>
	(000's)			
K-12 Education Credit	(\$26,400)	(\$26,900)	(\$27,300)	(\$27,700)
Reduced K-12 Subtractions	\$1,400	\$1,400	\$1,500	\$1,500
General Fund Total	(\$25,000)	(\$25,500)	(\$25,800)	(\$26,200)

Effective beginning tax year 2019.

**EXPLANATION OF THE BILL**

**Current Law:**

*K-12 Education Credit*

A taxpayer is allowed a refundable income tax credit equal to 75% of eligible education expenses for a qualifying child in kindergarten through 12<sup>th</sup> grade. The maximum credit is \$1,000 for each child. Eligible expenses include fees for instruction outside the regular school day or school year, expenses for textbooks or instructional materials, and transportation costs paid to others. Tuition is not an eligible expense.

The maximum credit is phased out beginning at household income of \$33,500. For taxpayers with one child, the maximum credit is reduced by one dollar for every four dollars of household income over \$33,500. For taxpayers with two or more children, the maximum credit is reduced by two dollars for every four dollars of household income over \$33,500. The phase-out range is increased by \$2,000 for each additional child. The income thresholds are not indexed for inflation. Household income includes income from all sources, both taxable and nontaxable.

*K-12 Education Subtraction*

A taxpayer may claim a subtraction for certain education expenses of up to \$1,625 per qualifying child in kindergarten through sixth grade and \$2,500 per child in 7<sup>th</sup> through 12<sup>th</sup> grade. Qualifying expenses include amounts paid to others for tuition, transportation, nonreligious textbooks, and instructional equipment for regular school classes. Fees or tuition for instruction outside the regular school day and school year also qualifies, such as tutoring and educational summer camps. The same expenses cannot be used to claim the credit and subtraction.

## EXPLANATION OF THE BILL (Cont.)

**Proposed Law:** The bill would phase out the credit based on the income eligibility guidelines for the federal reduced school lunch program as of July 1 of the tax year. Those guidelines are equal to 185% of the federal poverty guidelines and vary with the size of the household. For taxpayers with one eligible child, the credit would be reduced by one dollar for every four dollars of household income over the reduced lunch income limit. For taxpayers with two or more children, the maximum credit would be reduced by two dollars for every four dollars of household income over the reduced lunch income limit. The following table shows the most recent reduced lunch eligibility guidelines.

Reduced Lunch Income  
Eligibility Guidelines  
July 1, 2018 to June 30, 2019

Household Size	Annual Income
2	\$30,451
3	\$38,443
4	\$46,435
5	\$54,427
6	\$62,419
7	\$70,411
8	\$78,403

The income thresholds are increased by \$7,992 for each additional household member. All amounts are indexed annually for inflation.

## REVENUE ANALYSIS DETAIL

- The proposed credit was estimated separately for: 1) those claimants that currently take the existing credit and 2) new taxpayers that can now claim the proposed credit. These simulations use a stratified sample of 2016 individual income tax returns compiled by the Minnesota Department of Revenue.
- Any expenses used to claim the K-12 education credit reduce the amount that can be claimed as a subtraction. The estimate includes the tax benefit of the reduced education subtraction for those claimants that are better off with the proposed K-12 credit and no longer take the subtraction. However, about 2% of claimants claim both the credit and the subtraction. It is assumed that they would continue to claim both. Further, an adjustment was made to account for those claimants that can report expenses for the subtraction for private school tuition and claim the new credit.

### REVENUE ANALYSIS DETAIL (Cont.)

- Because the proposed phase-out threshold is less than the current threshold for taxpayers with a household size of two (\$30,451 vs. \$33,500), it is estimated that approximately 5,000 claimants will be worse off with the proposed credit compared to the current law credit. These claimants are generally head-of-household with one dependent and in the phase-out range.
- That number will shrink over time because the proposed thresholds are indexed for inflation, while the current thresholds are not. By tax year 2023, the projected phase-out threshold for a two-member household would be \$33,300, just less than the current threshold of \$33,500.
- Consumer Price Index projections were applied to income and expenses for tax years after 2019.
- Tax year impacts were allocated to the following fiscal year.

**Number of Taxpayers:** Approximately 59,400 returns will benefit from the proposed credit, of which 16,100 are new claimants. The average credit would be \$420 compared to \$253 per claimant under current law. About 5,000 head-of-household filers with one dependent would be worse off under this proposal in tax year 2019.

Minnesota Department of Revenue  
Tax Research Division  
[www.revenue.state.mn.us/research/stats/Pages/Revenue-Analyses.aspx](http://www.revenue.state.mn.us/research/stats/Pages/Revenue-Analyses.aspx)