

April 3, 2019

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H.F. 578 (Lien), 1st Engrossment, As Proposed to be Amended (H0578A2)

	Fund Impact			
	F.Y. 2020	F.Y. 2021	F.Y. 2022	F.Y. 2023
	(000's)			
K-12 Education Credit	(\$27,100)	(\$27,400)	(\$27,600)	(\$27,900)
Reduced K-12 Subtractions	\$1,300	\$1,400	\$1,400	\$1,400
General Fund Total	(\$25,800)	(\$26,000)	(\$26,200)	(\$26,500)

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 12th 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 7th through 12th 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 adjusted gross income over: 1) The current thresholds or 2) the income eligibility guidelines for the federal reduced school lunch program as of July 1 of the tax year, whichever is greater. The reduced lunch guidelines are equal to 185% of the federal poverty guidelines and vary with the size of the household. In determining the credit, a household would include the taxpayer (and spouse for married joint returns) plus any dependents, as defined in the Internal Revenue Code.

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.

Proposed Phase-Out Thresholds

Tax Year 2019

Household Size	Annual Income
2	\$33,500
3	\$39,461
4	\$47,638
5	\$55,815
6	\$63,992
7	\$72,169
8	\$80,346

The thresholds are increased by \$8,177 for each additional household member. The 2019 reduced lunch guidelines are greater than the current K-12 credit phase-out threshold for all but two-member households. The thresholds 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.

REVENUE ANALYSIS DETAIL (Cont.)

- About 2% of claimants claim both the credit and the subtraction. It is assumed that they would continue to claim both.
- An adjustment was also made to account for those claimants that can report expenses for the subtraction for private school tuition and claim the new credit. Since tuition is not eligible for the credit, they are assumed to continue to claim the subtraction for tuition expenses.
- 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 62,300 returns will benefit from the proposed credit, of which 19,000 are new claimants. The average increased credit would be \$435.

Minnesota Department of Revenue
Tax Research Division
www.revenue.state.mn.us/research/stats/Pages/Revenue-Analyses.aspx