

March 3, 2021

	Yes	No
DOR Administrative Costs/Savings		X

 Department of Revenue
 Analysis of S.F. 1153 (Eichorn) /H.F. 153 (Robbins)

	Fund Impact			
	<u>F.Y. 2022</u>	<u>F.Y. 2023</u>	<u>F.Y. 2024</u>	<u>F.Y. 2025</u>
	(000's)			
K-12 Education Credit				
Increase Maximum Credit;				
Raise Phase-out Threshold	(\$7,400)	(\$7,400)	(\$7,500)	(\$7,600)
Credit for Tuition	(\$9,900)	(\$10,000)	(\$10,100)	(\$10,200)
K-12 Subtraction				
Shift to K-12 Credit	\$1,500	\$1,500	\$1,500	\$1,500
Increased Maximum Subtraction	(\$7,100)	(\$7,200)	(\$7,200)	(\$7,300)
General Fund Total	(\$22,900)	(\$23,100)	(\$23,300)	(\$23,600)

Effective beginning tax year 2021.

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. A maximum of \$200 per family for certain computer hardware and software is allowed.

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 educational 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 qualify, such as tutoring and educational summer camps. Amounts paid for computer hardware and educational software can be subtracted, subject to a limit of \$200 per family. The amount that can be subtracted is reduced by any expenses used to claim the K-12 education credit. The maximum subtraction, and income thresholds are not indexed for inflation.

EXPLANATION OF THE BILL (Cont.)

Proposed Law:

K-12 Credit

The bill would extend to include tuition as eligible expense to claim the credit. The bill would increase the maximum credit to \$1,500 for each child. The income threshold at which the maximum credit begins to phase out would increase from \$33,500 to \$50,000.

For taxpayers with one child, the maximum credit would be reduced by one dollar for every six dollars of household income over \$50,000. For taxpayers with more than one child, the maximum credit would be reduced by one dollar for every three dollars of household income over \$50,000. Those amounts would be indexed for inflation beginning in tax year 2021.

K-12 Subtraction

The maximum subtraction would be \$2,600 for each qualifying child in kindergarten through grade 6, and \$3,900 for each qualifying child in grades 7 through 12. The maximum credit amounts, the maximum subtraction amounts, and the income thresholds would be adjusted for inflation starting tax year 2021.

Currently, eligible expenses are defined separately for the K-12 education subtraction and the credit. The principal difference is that tuition is eligible for the subtraction but not the credit. Under the bill, eligible expenses would be the same for both the subtraction and the credit.

REVENUE ANALYSIS DETAIL

K-12 Education Credit

- For tax year 2019, the total K-12 education credit was \$8.3 million on 33,000 returns.
- This analysis is based on Department of Revenue data from 2018 income tax returns.
- It is estimated that 18% of taxpayers with children that have incomes between \$50,000 and \$56,000 would claim the expanded credit, based on the percentage of taxpayers taking the K-12 education credits in 2018. For taxpayers not currently claiming the credit, federal adjusted gross income was used as a proxy for household income.
- The average credit for newly eligible taxpayers is estimated to be \$327.
- The bill would also increase the maximum credit to \$1,500 per qualifying child.
- About 200 taxpayers claimed the maximum credit in 2018. Their total credits were \$234 million. It is assumed that their credits would increase by 50%.
- The bill also would expand the credit to include school tuition.
- There were about 66,000 students enrolled in nonpublic schools in school year 2020-21, according to data from the Minnesota Department of Education.
- It is estimated that 12% of those (8,000) are in households that would qualify for the expanded K-12 credit, based on the income distributions of taxpayers currently taking the subtraction for tuition expenses.
- They would be eligible for a maximum credit of \$1,500 per child.

REVENUE ANALYSIS DETAIL (Cont.)

- The national average annual tuition for nonpublic schools is \$11,173 in 2020-21, according to a Private School Review survey. Most eligible taxpayers would qualify for the maximum credit. However, those taxpayers would likely have other eligible expenses besides tuition. After excluding those expenses, the additional credit due to tuition is estimated at \$1,200.
- The total increase in credits due to tuition would be about \$9.6 million in tax year 2018.
- The income phase-out threshold would be indexed for inflation. It is assumed that the credit would grow about 1% annually.

K-12 Education Subtraction

- About 30,020 taxpayers would shift from taking the subtraction to claiming the credit, reducing the total subtractions. Those who are ineligible for the credit or have leftover expenses would continue to take the subtraction. An average marginal tax rate of 6.5% was used to estimate the foregone subtractions.
- The bill increases the maximum subtraction amounts. In tax year 2018, an estimated 51,700 returns took the maximum subtraction, with an average of 2.3 qualifying children per return. Of those, about 8,700 are assumed to be taxpayers with tuition or others newly eligible for the credit because of the increased income thresholds. The remaining 43,000 returns are expected to receive a higher subtraction.
- The amount of education expenses for those taxpayers is unknown, but if the high subtractions are due to tuition, most of those would qualify for the maximum subtraction. The average increase is assumed to be \$875 for elementary students and \$1,250 for secondary students.
- Increased subtractions are estimated at \$105.9 million in tax year 2018. An average marginal tax rate of 6.5% was used to estimate the impact of the increased subtraction limits.
- The maximum subtraction amounts would be indexed for inflation. The estimate was increased by 1% annually based on current consumer price index projections.
- Tax year impact was allocated to the following fiscal year.

Number of Taxpayers: About 30,000 taxpayers would shift from claiming the subtraction to claiming the credit, due to the increased phase-out threshold and the credit for tuition. Some taxpayers would also receive an increased credit. About 43,000 taxpayers would receive an increased subtraction.

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