DEPARTMENT OF REVENUE

INDIVIDUAL INCOME TAX
Dependent Care Credit

March 1, 2023

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of S.F. 9 (Hauschild), As Proposed to be Amended (SCS0009A-2)

	Fund Impact			
	F.Y. 2024	**F.Y. 2025**	**F.Y. 2026**	**F.Y. 2027**
	(000's)			
Dependent Care Credit	($249,200)	($251,200)	($253,200)	($255,200)
Addition for Dependent Care Expenses	$15,300	$15,400	$15,600	$15,700
General Fund	($233,900)	($235,800)	($237,600)	($239,500)

Effective beginning tax year 2023.

EXPLANATION OF THE BILL

Current Law:

Exclusion for Dependent Care Expenses. Employer-provided dependent care assistance is excluded from an employee's income if the assistance is provided through a formal, written plan. The amount excluded from an employee's income cannot exceed $5,000 during a tax year.

Federal Dependent Care Credit. The federal dependent care credit is a nonrefundable credit equal to a percentage of unreimbursed employment-related expenses related to child or dependent care, up to $3,000 for one qualifying dependent and $6,000 for two or more qualifying dependents. The credit rate depends on income and ranges from 35% for families with incomes of $15,000 or less to 20% for families with incomes over $43,000. The maximum federal credit is equal to $1,050 for one dependent and $2,100 for two or more dependents. The maximum qualifying expenses are reduced by the amount of the exclusion. Married separate filers are not eligible for the federal credit unless the couple has lived apart for the last half of the year and other conditions apply.

Minnesota Dependent Care Credit. The Minnesota dependent care credit is equal to the federal credit except that it is refundable and the maximum credit is phased out by 5% of adjusted gross income over a threshold ($59,210 in 2023). The threshold is indexed annually for inflation. The credit is not available for individuals filing a married separate return. A newborn credit is allowed for a child born in the tax year even if there are no qualifying expenses. The newborn credit is only available to married taxpayers.

Proposed Law:

The proposal substantially revises the Minnesota credit. The credit is equal to a percentage of eligible employment-related dependent care expenses. Maximum eligible expenses are $3,000 for one qualifying dependent and $6,000 for two or more qualifying dependents.

EXPLANATION OF THE BILL (Cont.)

The maximum eligible expenses are increased for a “young child”, defined as a qualifying dependent under the age of five. The maximum is increased by $7,000 for one young child, by $14,000 for two young children, and by $19,000 for three or more young children.

The credit equals 50% of eligible expenses, reduced by one percentage point for each $2,000 of adjusted gross income over $125,000 ($1000 of adjusted gross income of $62,500 for married separate filers) until the percentage equals 20%. For taxpayers with FAGI over $400,000, the credit rate is 20%, reduced by two percentage point for each $2,000 of adjusted gross income over $400,000 ($1,000 of adjusted gross income of $200,000 for married separate filers) until the percentage equals zero. The thresholds are adjusted for inflation beginning in tax year 2024.

Taxpayers who care for their own child under the age of six at a licensed family day care home are deemed to have paid an amount equal to what they would charge to care for the child.

A married couple with a newborn child is deemed to have the maximum allowed expenses for that child, but not more than the combined earned income reported on the return. To qualify, the couple cannot participate in a federal employer-provided dependent care assistance program.

A taxpayer who claims the credit or the spouse of a taxpayer filing a separate return who claims the credit must add back the amount of any federal exclusion for employer-provided dependent care assistance.

For a married couple filing separate returns, only one spouse may claim the credit.

REVENUE ANALYSIS DETAIL

- The dependent care credit totaled about $25.3 million on 48,900 returns in 2019.
- Information from the Minnesota dependent care credit and the federal dependent care credit was used to estimate the proposed credit.
- For taxpayers who claimed the Minnesota credit, dependent age was determined based on information reported on the M1CD.
- Dependent age information was not available for taxpayers who did not file an M1CD. For those returns, ages were randomly assigned.
- The rate was calculated based on federal adjusted gross income. The thresholds were adjusted to 2019 levels based on the change in the chained consumer price index from 2019 to 2023.
- For taxpayers who did not claim the federal credit or the Minnesota credit, expenses were estimated based on the amount of dependent care benefits reported on the W-2. Taxpayers with the maximum exclusion were assumed to have the maximum allowed benefits for the credit.
- It is assumed that returns with a credit rate less than their marginal tax rate would not claim the credit, since they would get a greater benefit from the federal exclusion.

REVENUE ANALYSIS DETAIL (Cont.)

- Returns with excluded federal dependent care benefits would have to add the excluded amount to their taxable income to claim the credit. The amount of the credit was compared to the increase in tax due to the addition. Taxpayers are assumed to claim the credit only if they have a net reduction in tax.
- About 59,700 returns would have an addition for federally excluded dependent care benefits. The average addition would be $3,668.
- A marginal rate of 7.1% is used to estimate the impact of the addition.
- Growth is based on the projected growth for the current credit in the February 2023 forecast.
- Tax year impacts are allocated to the following fiscal year.

Number of Taxpayers: About 174,500 taxpayers would be affected in tax year 2023. The average decrease in tax is $1,341.

Minnesota Department of Revenue
Tax Research Division
https://www.revenue.state.mn.us/revenue-analyses