

February 1, 2023

	Yes	No
DOR Administrative Costs/Savings	X	

Department of Revenue
Analysis of H. F. 915 (Norris) / S. F. 860 (Kunesh)

	Fund Impact			
	<u>F.Y. 2024</u>	<u>F.Y. 2025</u>	<u>F.Y. 2026</u>	<u>F.Y. 2027</u>
	(000's)			
K-12 Education Credit	(\$12,100)	(\$12,700)	(\$13,000)	(\$13,300)
K-12 Subtraction	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$1,000</u>	<u>\$1,100</u>
General Fund Total	(\$11,100)	(\$11,700)	(\$12,000)	(\$12,200)

Effective beginning tax year 2023.

EXPLANATION OF THE BILL

Current Law: Under current law, 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.

Proposed Law: The bill makes the following changes:

- Uses federal adjusted gross income rather than total household income for credit phase-out threshold. The new threshold is \$70,000 for tax year 2023. The income threshold will be indexed for inflation starting tax year 2024.
- Increases the maximum credit from \$1,000 to \$1,500 starting tax year 2023.

The phase-out rate starts at the new, higher maximum income but is otherwise unchanged. The bill makes some technical changes in how qualifying expenses are defined.

REVENUE ANALYSIS DETAIL

- The estimate is based on a sample of 2019 individual income tax returns.
- In tax year 2019, K-12 education credits totaled \$7.2 million on 28,700 returns. Maximum credits claimed account for about 5.5% of total credits.

REVENUE ANALYSIS DETAIL (Cont.)

- The credit has declined over the past several years, including a decline of about 20% in tax years 2020 and 2021. The November budget forecast assumes that the credit will return to 2019 levels by 2022.
- An additional 31,200 returns are expected to qualify for the proposed credit. About 5,100 returns in the current phase-out range could also receive an increased credit.
- The credit is assumed to grow at the rate of the chained consumer price index.
- Taxpayers who claim the credit cannot claim the subtraction for the same expense. A marginal rate of 6% is used to calculate the impact of reduced subtractions under the proposal.
- The changes in the definition of qualifying expenses could affect which expenses are eligible for the credit. The impact of the definitional changes is unknown.
- Tax year impacts are allocated to the following fiscal year.

Number of Taxpayers: About 36,300 returns are affected, including 31,200 newly eligible returns and 5,100 returns that could receive an increased credit. The average reduction in tax is \$305 in tax year 2023.

Minnesota Department of Revenue
Tax Research Division
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