

INFORMATION BRIEF

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The Minnesota and Federal Dependent Care Tax Credits

Minnesota offers a refundable dependent care income tax credit that is limited to people under certain income levels. Minnesota's dependent care credit is linked to the federal dependent care credit, which is not refundable and not tied to income. This information brief explains the purposes for each of the credits, how they work, how people can claim the credits, and how the benefits have been distributed. It also explains how federal legislation enacted in 2003, extended in 2010, and made permanent in 2012 expanded the federal credit.

Contents

Overview.....	2
Purpose of the Minnesota and Federal Dependent Care Credits	3
How the Minnesota and Federal Dependent Care Credits Work.....	4
How People Claim the Dependent Care Credit	10
Distribution of the Benefits of the Dependent Care Credit.....	11

Readers interested in other federal and state tax credits may wish to see House Research information brief *The Federal Earned Income Tax Credit and The Minnesota Working Family Credit*, March 2013.

Overview

Minnesota and the federal government provide income tax credits for dependent care expenses.

The federal dependent care credit equals 35 percent of qualifying dependent care expenses for families with incomes of \$15,000 or less. The credit percentage phases down to 20 percent for families with incomes over \$43,000, but all families qualify, regardless of income. The maximum credit is \$1,050 for one dependent and \$2,100 for two or more. The federal credit is nonrefundable; that is, it can only be used to offset federal income tax liability. Many low-income families do not receive the full credit because it exceeds their income tax liability.

The Minnesota credit is linked to the federal credit, but has a lower maximum, different income limits, and is subject to a complete phaseout. The maximum Minnesota credit is \$720 for one dependent and \$1,440 for two or more. In tax year 2014, the Minnesota credit begins to phase out when income reaches \$25,350, and it is not available to families with incomes over \$39,000. Unlike the federal credit, the Minnesota credit is refundable. Thus, a low-income family can receive the maximum credit even if the family has little or no income tax liability.

In tax year 2011, 36,469 Minnesota income tax returns claimed the dependent care credit, for total credits of \$14.6 million. This represented 1.4 percent of all state returns in 2011. Most claimants were single parents: about 80 percent of 2011 claimants were head of household filers.¹

Under half of the total amount of credits paid—\$5.2 million—went to offset liability, with the balance of \$9.4 million paid as refunds. About 38 percent of recipients had no liability and received the full credit amount as a refund; 35 percent had liability that exceeded the credit amount for which they qualified. The remaining claimants had some liability but qualified for a credit that resulted in a refund.

¹ Distribution between married and head of household filers are estimated from the 2011 sample of income tax returns prepared by the Minnesota Department of Revenue.

Purpose of the Minnesota and Federal Dependent Care Credits

The Minnesota dependent care credit is targeted to low- and moderate-income families, making it easier for them to work.

Many low- and moderate-income taxpayers pay a significant portion of their incomes for dependent care. By directing the dependent care credit to taxpayers with incomes below a certain amount (\$39,000 in 2014), Minnesota reduces these families' cost of working.

The authorizing statute does not assign an explicit purpose or goal to the Minnesota dependent care credit. However, the credit may be assumed to have at least two goals:

- To recognize dependent care costs as a necessary expense of working
- To encourage low- and moderate-income individuals to work

The federal dependent care credit is available to all taxpayers, regardless of income. This approach recognizes dependent care expenses as a necessary expense of working. Because the federal credit is nonrefundable (i.e., it can only be used to offset income tax liability and does not benefit those without liability), it does not provide any special assistance for low- and moderate-income individuals to enter the workforce. Most of these individuals have little or no federal income tax liability.

The federal and state income taxes allow taxpayers to deduct most business expenses from taxable income. For example, a taxpayer who runs a business and has employees may deduct the employees' salaries. Personal or living expenses, by contrast, are not deductible. Rather, individuals may deduct exemption amounts for the taxpayer, spouse, and dependents, reflecting basic living expenses.² The Minnesota income tax has traditionally classified child care expenses as nondeductible personal or living expenses.³ However, in many cases, taxpayers with young children must pay for their care in order to work. To allow some recognition of these "business expenses," taxpayers may claim both federal and state dependent care credits that partially offset the cost of dependent care.⁴

² In addition, a standard deduction or itemized deductions for certain expenses (mortgage interest, charitable contributions, etc.) are allowed.

³ Between 1954 and 1976, the federal income tax allowed an itemized deduction for dependent care expenses. As with any itemized deduction, taxpayers claiming the standard deduction were not allowed the dependent care credit deduction. Minnesota also allowed a deduction for this purpose from 1969 to 1976. The federal and Minnesota dependent care credits replaced these deductions.

⁴ This "business expense" rationale apparently was the primary justification for enactment of the federal dependant care credit. For example, the Senate Committee Report that accompanied the legislation enacting the dependent care credit cited this as a main reason for the credit and as the justification for eliminating features of the itemized deduction that it replaced, such as denying the deduction to those claiming the standard deduction and limiting it to lower income individuals.

"Treating child care expenses as itemized deductions denies any beneficial tax recognition of such expenses to taxpayers who elect the standard deduction. The committee believes such expenses should be viewed as a cost of earning income for which all working taxpayers may make a claim . . . The committee views qualified child care

How the Minnesota and Federal Dependent Care Credits Work

The Minnesota dependent care credit is tied to the federal dependent care credit. Both of these credits allow taxpayers to claim a percentage of qualifying dependent care expenses as a credit against income tax liability. The box to the right summarizes the history of the federal and state credits. The state credit is limited to families with incomes less than \$39,000, while the federal credit is available to all filers, regardless of income level.

To qualify for the dependent care credit, an individual must incur expenses related to the care of a dependent to have employment.

Under federal law, four basic tests must be satisfied to qualify for the dependent care credit. By using the federal credit amount in calculating its credit, Minnesota also follows these rules.

- **The taxpayer must maintain a household that includes a qualified individual.**

In order to maintain a home, more than half of the cost must be

furnished by the individual or married couple. For example, an individual who lives with a parent and does not pay one-half or more of the costs of the home may not claim the dependent care credit for the care of his or her children.

- **Qualified individuals are dependent children under age 13 or disabled spouses or dependents.**⁵ To qualify, an adult dependent must be physically or mentally unable to

History of Federal and State Credits

1954	Federal itemized deduction for dependent care expenses of up to \$4,800 annually
1969	Minnesota itemized deduction for dependent care expenses of up to \$900
1977	Federal deduction replaced by nonrefundable credit of up to \$480 Minnesota deduction replaced by refundable credit of up to \$300 available to filers with incomes under \$18,000
1981	Federal credit increased to maximum of \$1,440, phased down for those with incomes between \$10,000 and \$28,000 Minnesota credit increased to maximum of \$800 available to filers with incomes under \$31,000
1983	Minnesota credit increased to \$960; maximum income eligible lowered to \$24,000 of income
1984	Minnesota credit increased to match federal maximum of \$1,440
1989	Minnesota extends phaseout to \$27,000 of income
1991	Minnesota indexes phaseout floor; phaseout starts at \$13,990 and ends at \$27,640
2003	Federal credit increased to maximum of \$2,100, phases down for those with incomes between \$15,000 and \$43,000; increase in effect for tax years 2003 to 2010
2010	2003 federal credit expansion extended through 2012
2012	2003 federal credit expansion made permanent

Note: Credit and deduction maximums shown are for expenses for care of two or more dependents; lower maximums apply for one dependent.

expenses as a cost of earning income and believes that an income ceiling on those entitled to the allowance has minimal revenue impact, if the allowance is in the form of credit.” (Senate Rep. No. 94-938, 94th Cong., 2d Sess., reprinted in 1976 USCCAN 3565-66. The House Report contained essentially identical language.)

⁵ A nondependent child may qualify if the parent is divorced or separated, has custody, and has agreed not to claim the child as a dependent or the noncustodial parent can claim the child as a dependent.

perform self-care. Dependents must satisfy five conditions specified in federal law;⁶ one of these requires the taxpayer to provide at least one-half of the person's support. The Minnesota credit differs from federal law in disregarding payments under the Temporary Assistance to Needy Families (TANF) program in determining whether the dependency support test is met.

- **The expenses must be incurred to enable the taxpayer to be gainfully employed.** Expenses must be paid to allow the taxpayer to work or look for work. For a married couple, both spouses generally must work. However, a parent who is a full-time student is considered to be working.
- **The expenses must relate to the care of the qualified individual.** In general, two types of expenses qualify—(1) direct care expenses, such as day care or a nanny for a qualified individual, or (2) household expenses, such as a maid or cleaning service, when performed in conjunction with dependent care. Expenses may not exceed the earned income of the lower earning spouse.⁷ Generally, payments to a day care center (those taking care of six or more children) qualify only if the center meets the requirements of state law. The taxpayer also must report the caregiver's taxpayer identification number (generally a Social Security number) on the federal dependent care credit form. Credits cannot be claimed for payments made to a spouse, parent of the child, dependents, or a child of the taxpayer under age 19.

The maximum federal credit equals 35 percent of the first \$3,000 of qualifying expenses (\$6,000 for two or more dependents) or \$1,050 for one dependent (\$2,100 for two or more dependents). The maximum state credit is \$720 for one dependent and \$1,440 for two or more dependents.

The federal dependent care credit allows maximum qualifying expenses of \$3,000 for one dependent and \$6,000 for two or more dependents, and a maximum credit rate of 35 percent. Taxpayers with adjusted gross income under \$15,000 qualify for the maximum federal credit of \$1,050 for one dependent or \$2,100 for two or more dependents. Before tax year 2003, the maximum federal qualifying expenses were \$2,400 for one dependent and \$4,800 for two or more dependents, and the maximum credit rate was 30 percent. The federal Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 increased the maximum federal credit from \$720 to \$1,050 for one dependent and from \$1,400 to \$2,100 for two or more dependents, increased the maximum credit rate from 30 percent to 35 percent, and increased the income level

⁶ Five conditions must be satisfied to claim a person (other than a child under age 13) as a dependent:

- the person must be a member of the taxpayer's household
- the person must be a U.S. citizen or resident, or a resident of Canada or Mexico
- the person may not file a married joint return
- the person may not have gross income over the personal exemption amount—\$3,950 in tax year 2014—unless the person is the taxpayer's child and is under age 19 or age 24 and is a student
- the taxpayer must provide over half of the person's support during the calendar year

⁷ A full-time student with one dependent is deemed to have \$250/month in earned income (\$500/month for two or more dependents).

at which the credit begins to phase down from \$10,000 to \$15,000. The American Taxpayer Relief Act (ATRA) of 2012 made the EGTRRA changes permanent.

The state dependent care credit does not explicitly set maximum qualifying expenses or a credit rate, but rather allows families to claim a credit equal to the federal credit, but subject to a state maximum of \$720 for one dependent and \$1,440 for two or more dependents. The state credit maximum amounts are specified in statute and equal the maximum federal credits in effect prior to enactment of EGTRRA.

The maximum qualifying expenses for the federal credit have not kept pace with inflation, even with the increases under EGTRRA. Qualifying expenses were set at \$2,400 for one dependent and \$4,800 for two or more dependents in 1982. If they had been adjusted for inflation, the maximum would be about \$5,900 for one dependent and \$11,800 for two or more dependents in 2012. An annual survey of dependent care expenses in family day care homes showed a range in 2012 from about \$9,600 for infants in the metro area to about \$6,500 for preschoolers in the nonmetro, both above the maximum allowable qualifying expense of \$3,000 for one child.⁸

Dependent care expenses paid out of pretax accounts do not qualify for the credit, but do count against the credit maximums. Many employers allow their employees to participate in pretax accounts for dependent care expenses. Employees may set aside up to \$5,000 of pretax income in these accounts to pay dependent care expenses. People who use these accounts, however, may only claim the dependent care credit if the amount paid through the pretax account is less than the maximum qualifying expense allowed under the credit. For example, a taxpayer who sets aside \$2,000 in a pretax account and has actual dependent care costs of \$4,000 for one child may claim a dependent care credit for \$1,000 of qualifying expenses—the difference between the \$3,000 maximum allowed under the credit and the \$2,000 set-aside in the pretax account. Because annual dependent care expenses may exceed the maximum allowed under the credit, many taxpayers will either use a pretax account or claim the credit, but not qualify for both programs.

Dependent care expenses paid through the state's Basic Sliding Fee child care program or through Minnesota Family Investment Program (MFIP) child care do not qualify for either the federal or state dependent care tax credit. However, any amounts families are required to contribute as "copayments" do qualify for both credits.

The federal credit rate phases down to a minimum 20 percent of qualifying expenses.

The federal credit percentage begins to phase down from 35 percent when income exceeds \$15,000. The credit phases down at the rate of one percentage point for each \$2,000 of income over \$15,000 to a minimum credit percentage of 20 percent. Claimants with incomes of \$43,000 or more are eligible for a minimum credit equal to 20 percent of qualifying expenses—\$600 for one child (20 percent of the \$3,000 maximum qualifying expenses) and \$1,200 for two or more children.

⁸ Minnesota Department of Human Services, *Results of the 2012 Child Care Market Rate Survey: Minnesota Child Care Provider Business Update*. Rates cited are the averages of 75th percentile rates for family child care in metro and nonmetro Minnesota, as of 2012.

Prior to 2003, the maximum federal credit percentage was 30 percent, maximum qualifying expenses were \$2,400 per child, and the phasedown began when income exceeded \$10,000. The credit was phased down to the minimum of \$480 for one child and \$960 for two or more children when income exceeded \$28,000.

Minnesota conformed to federal changes through tax year 2012, to the extent they affect the calculation of the state credit, but has not conformed for tax year 2013 and following years.⁹

Since the Minnesota credit equals the federal credit (subject to the state maximum and phaseout), beginning in tax year 2013, taxpayers will calculate the state credit in reference to a maximum federal credit of \$2,400 for one child, and \$4,800 for two or more children. This will result in some taxpayers being eligible for a smaller state credit than they would be allowed if Minnesota had conformed to the increased federal credit. For example, a single parent with one dependent, \$2,000 of expenses, and \$13,000 of income will qualify for a state credit of \$560 in 2013. The \$560 equals the pre-2003 federal credit rate for filers with \$13,000 of income—28 percent—multiplied by the \$2,000 of expenses. If Minnesota had conformed to the increased federal credit parameters, the credit rate at \$13,000 of income would have been 35 percent rather than 28 percent, and that single parent would have qualified for a state credit of \$700.

The Minnesota credit fully phases out; in 2014 taxpayers with incomes above about \$39,000 may not claim the credit.

The Minnesota phaseout begins at a higher income level than does the federal credit and uses a broader definition of income.¹⁰ When Minnesota adopted the full amount of the federal credit as the starting point for the state credit, the legislation started the phaseout at the same income level—\$10,000—as the federal credit. In later sessions, the Minnesota Legislature increased the phaseout floor and indexed it for inflation, while the federal phaseout floor remained unchanged. In tax year 2014, the Minnesota credit begins to phase out for those with incomes over \$25,350. The Minnesota credit decreases by \$18 (\$36 if the filer claims the credit for two dependents) for each \$350 over the income threshold, with the credit fully phased out at \$39,000.

Figure 1 shows the maximum credit amounts for married couples with two dependents and head of household filers with one dependent by income level. The figure takes into account that one must have tax liability to qualify for the federal credit, since it is not refundable. The figure assumes that taxpayers claim the standard deduction, the nonrefundable federal child credit,¹¹ and

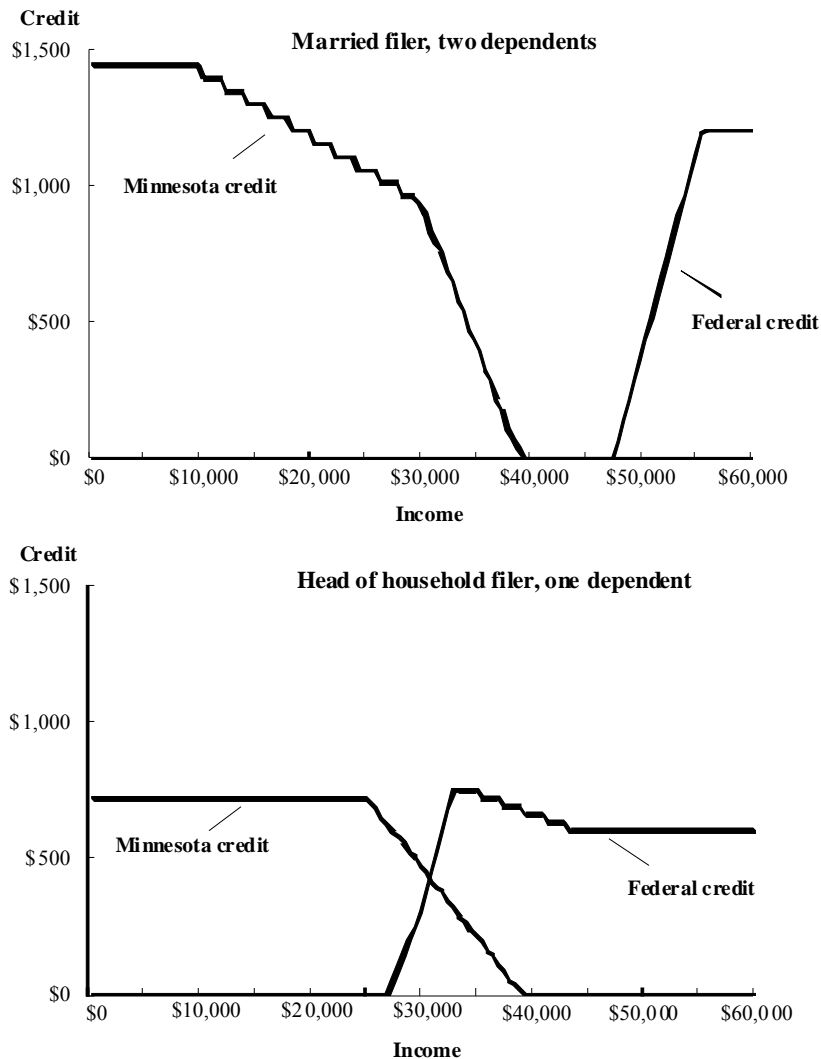
⁹ [Laws 2001, 1st spec. sess., ch. 5, art. 10, § 6](#); [Laws 2011, 1st spec. sess., ch. 7, art. 2, § 5](#).

¹⁰ The Minnesota dependent care credit uses a broad measure of income that includes all income subject to the income tax plus most nontaxable cash income, such as welfare benefits, tax-exempt bond interest, workers' compensation benefits, and so forth. The measure does not include noncash income that is not subject to tax, such as employee fringe benefits, Medical Assistance, and food stamps.

¹¹ The federal child credit was initially implemented at \$400 in the Tax Reform Act (TRA) of 1997, effective in 1998, with the credit amount increased to \$500 in 1999. EGTRRA set in motion a phase-up of the credit to \$1,000 in tax year 2010. The Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) of 2003 accelerated the EGTRRA 2001 phase-up by increasing the credit to \$1,000 in 2003 and 2004 only. The Working Families Tax Relief Act (WFTRA) of 2004 kept the credit at the \$1,000 level through 2010. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act (TRUIRCA) of 2010 maintained the child credit at \$1,000 through 2012. ATRA made the \$1,000 amount permanent.

report the maximum allowable qualifying expenses. The figure shows that the two credits serve distinct populations that have little overlap.

Figure 1
Federal and Minnesota Dependent Care Credits Available to Filers with Maximum Qualifying Expenses, Tax Year 2014



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Low-income filers may claim the maximum state credit, because it is refundable. But because the federal credit is only available to offset net tax liability after subtracting the \$1,000 child credit, the married couple in the example does not receive any federal credit until their income reaches \$47,584; the head of household filer, until income reaches \$27,000. In effect, the figure shows that it is impossible for a head of household or married joint filer to qualify for

the maximum federal credit, since the phasedown of the maximum credit begins at \$15,000.¹² The figure also shows the Minnesota credit fully phasing out at \$39,000 of income, while the federal credit is available to all taxpayers regardless of income.

The Minnesota credit is refundable; the federal credit is not. If a filer is eligible for a Minnesota dependent care credit that exceeds his or her tax liability, that filer receives any “leftover” credit as a refund. However, filers eligible for a federal dependent care credit that exceeds tax liability may only use the credit to offset liability; any remaining “unused” credit is forfeited.

Many credit recipients are low income and have little or no tax liability. In 2014, the standard deduction and exemption amounts ensure that a married couple with two dependents had no federal liability until gross income exceeds \$28,200. Their next \$2,000 of federal liability is offset by the nonrefundable \$1,000 per-child tax credit, which, unlike the dependent care credit, is not tied to any particular type of expenditure. As a result, the typical married couple with two dependents will not receive any benefits under the federal dependent care credit until their income reaches \$47,584. A head of household filer with one dependent owes no tax until gross income exceeds \$17,000. This filer will have the next \$1,000 of liability offset by the child credit and will not benefit from the dependent care credit until income reaches \$27,000. Both of these example filers will receive a state credit, however, since the state credit is refundable.

Since tax year 1992, Minnesota has allowed parents who operate licensed family day care homes to claim the dependent care credit for their own children. Parents who operate licensed family day care homes and care for their own children may claim the dependent care credit without regard to their actual out-of-pocket expenses. They may claim \$2,400 of qualifying expenses for their own children under 16 months of age. For children from 16 months to six years of age, they may claim the amount they charge to care for children of the same age. They may not claim the credit for their own children age six or older under this provision.

Since tax year 1994 the Minnesota dependent care credit has included a special young-child credit. The young-child credit allows married joint filers with a child under age one to claim a credit, regardless of whether they incurred dependent care expenses. These couples will be deemed to have paid the maximum qualifying expenses of \$2,400 for the child under one and will calculate their credit for that child as though they had actually paid \$2,400 in expenses. This will provide a credit to families in which one parent stays at home and to those in which both parents work but incur no out-of-pocket child care expenses. Families may not claim this credit and the regular credit for the same child. They also may not claim more than one young-child credit in any year, regardless of the number of children they have under age one.

¹² The income at which the federal credit begins to phase down increased from \$10,000 to \$15,000 in 2003 under EGTRRA. However, EGTRRA also implemented a new 10 percent rate bracket and increased the nonrefundable child credit, which is calculated before the dependent care credit. Combining these changes with the annual adjustment for inflation of the standard deduction and the personal exemption results in a steady increase over time in the tax threshold or income level at which a filer has liability. Increasing the income threshold for the dependent care credit phasedown to \$15,000 was not enough to catch up to the income at which most parents begin to have liability after the child credit—\$47,584 for a married family of four in 2014, and \$27,000 for single parent of one.

The dependent care credit is an entitlement; no limit is imposed on its funding. Unlike some direct spending programs for dependent-related expenses, such as the Basic Sliding Fee child care program, no fixed dollar appropriation or spending limit applies to either the federal or state dependent care credits. Filers receive the full credits to which they are entitled under the credit formula.

How People Claim the Dependent Care Credit

People claim both the federal and state credits by filing the appropriate tax forms.

At the federal level, taxpayers must file either form 1040 (“the long form”) or form 1040A (“the short form”) and Schedule 2441 to claim the dependent care credit. They may not file form 1040EZ if they wish to claim the credit. Taxpayers enter qualifying expenses on Schedule 2441 and then look up the credit rate in a table keyed to income. Finally, the taxpayer calculates the credit amount by multiplying the credit rate by the qualifying expenses.

At the state level, taxpayers must file form M-1 and also complete Schedule M-1CD to claim the Minnesota dependent care credit. They also must file a copy of federal Schedule 2441 with their state tax return. Schedule M-1CD requires taxpayers to fill in the various income items used in calculating the state credit phaseout. The state credit phaseout is based on a broad income measure that includes federal adjusted gross income, nontaxable Social Security benefits, deductible payments to retirement accounts, and welfare benefits. After adding up these income items, the taxpayer looks up the credit amount in a table keyed to income. Taxpayers then compare their state credit with the federal credit computed on Schedule 2441, limited to the old maximum federal credit amounts of \$2,400 and \$4,800, and claim the smaller of the two as a state credit. Special instructions are provided for taxpayers who claim the young-child credit or who operate a licensed family day care home and are claiming the credit for their own children.

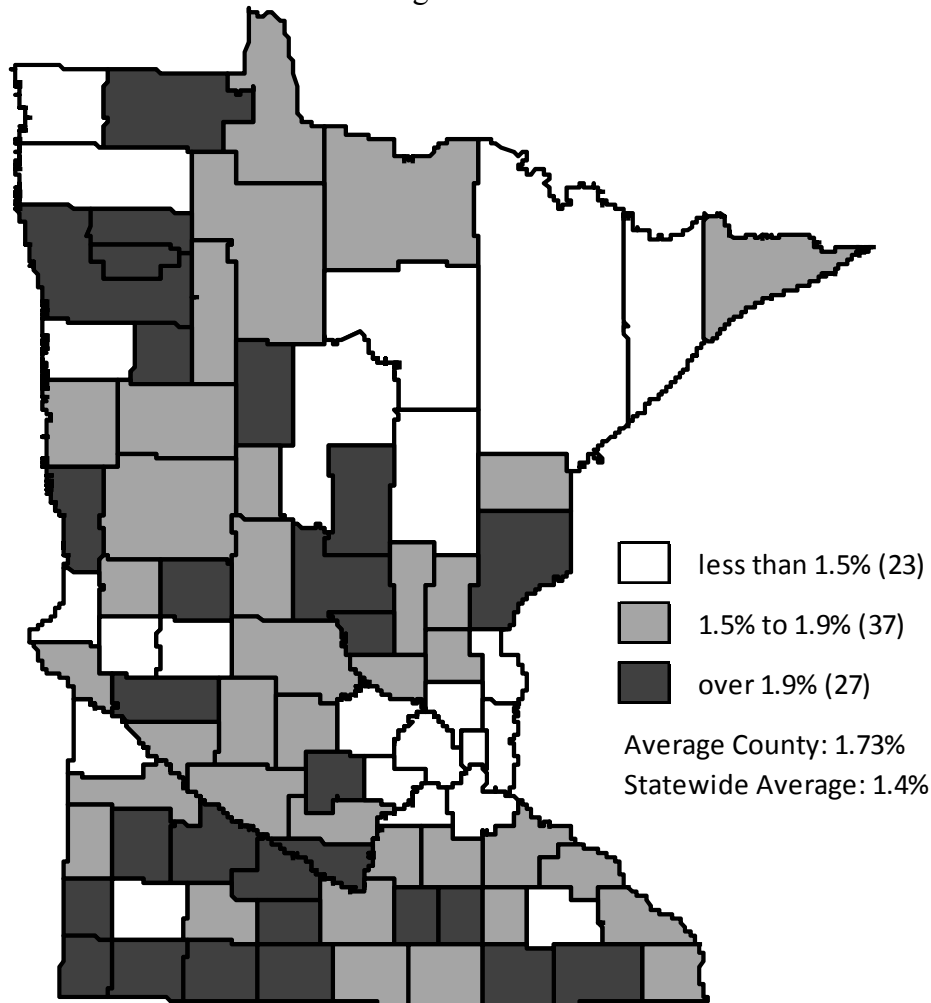
Taxpayers must keep records on the amount paid for dependent care expenses and provide information about the caregiver. Both the federal and state tax forms require taxpayers to report the name and taxpayer identification number of the caregiver. The federal forms also require the caregiver’s address. Also, taxpayers should maintain records, such as receipts or canceled checks, of how much they paid for dependent care expenses throughout the year.

People who have no state income tax liability must file a tax return to claim the dependent care credit as a refund. Individuals with incomes below the filing thresholds generally do not need to file tax returns. However, if they have qualifying dependent care expenses, they must file to claim the refundable credit. Claimants must complete a Minnesota tax return and a federal Schedule 2441, which is referenced in calculating the state credit amount.

Distribution of the Benefits of the Dependent Care Credit

Over 36,000 filers received \$14.6 million in Minnesota dependent care credits in tax year 2011. Figure 2 shows the percentage of returns in each county that claimed the credit in 2011.

Figure 2



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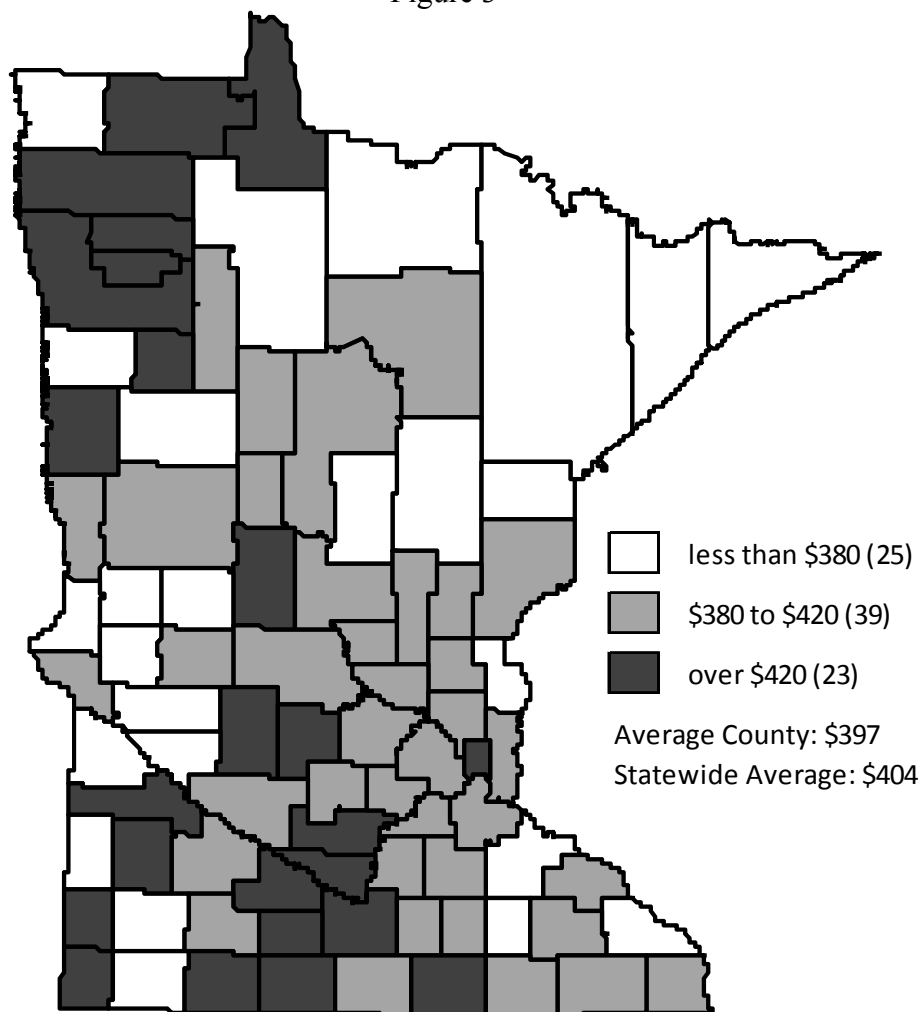
Statewide, 1.4 percent of all returns claimed the dependent care credit in 2011. Pennington County filers were most likely to claim the credit (3.2 percent of returns), and the credit was least likely to be claimed in Carver County (0.8 percent of returns). Residents of the seven-county metro area were somewhat less likely to claim the credit (1.2 percent of returns) than were taxpayers in the rest of the state (1.9 percent of returns), perhaps because personal income tends to be higher in the metro area.

The availability of pretax dependent care accounts may affect the percentage of taxpayers who claim dependent care credits, since taxpayers may either use a pretax account to pay dependent care expenses or claim the credit, but not both. Employers are not required to offer pretax accounts, and they are not available to the self-employed. Past employer surveys have shown that

relatively few employers offer pretax accounts, and that larger companies are more likely than smaller companies to offer the accounts.¹³ Larger companies are more likely to be located in cities than in rural areas, which may explain in part the larger share of returns claiming the credit as shown in Figure 2.

The average dependent care credit claimed by Minnesotans in 2011 was for \$404. Figure 3 shows the average dependent care credit by county.

Figure 3



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Credit recipients throughout the state claimed about the same amount on average—\$410 in the metro compared to \$407 in the remaining 80 counties. The highest average credit claimed in 2011 was \$511 in Lake of the Woods County; the lowest was \$294 in Traverse County. The gap between the average credit in the metro area and in the rest of Minnesota has narrowed

¹³ *Employee Benefits Survey*, Minnesota Department of Employment and Economic Development (DEED) and State Society of Human Resource Managers, Spring 2005. As of early 2014, DEED did not anticipate updating the survey.

considerably since 1994, when the average was \$355 in the metro, compared to \$255 in the rest of the state. The difference between the two has gotten smaller, mostly due to an increase in the average for nonmetro Minnesota. The difference in the past may have reflected higher child care costs in the Twin Cities. The narrowing of the gap reflects increased child care costs combined with the failure to increase the maximum allowable expenses.

Single parents claim more dependent care credits than do married parents and are more likely to claim the credit as a refund.

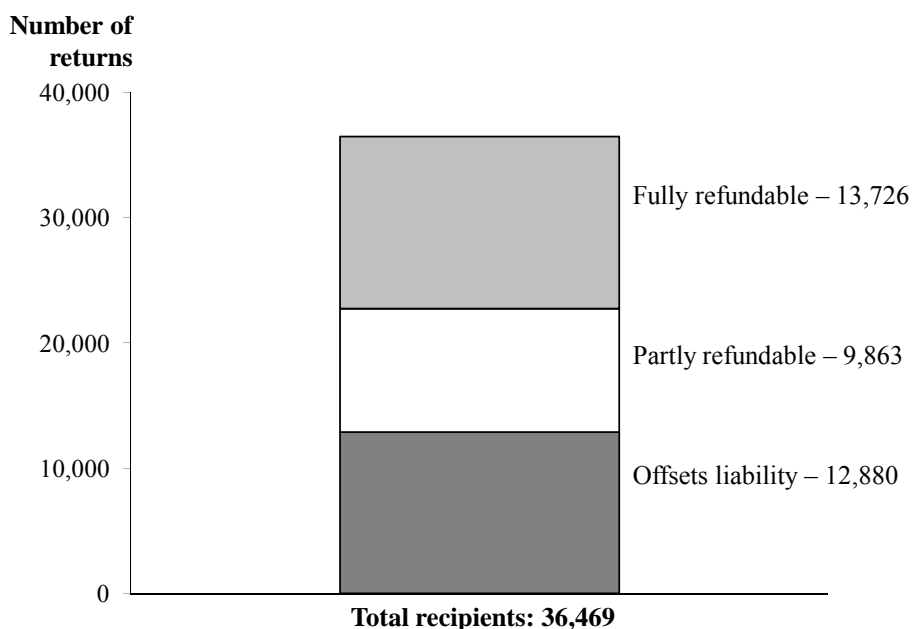
An estimated 29,300 head of household filers claimed the dependent care credit in 2011, compared to about 5,800 married couples.¹⁴ Some married couples may choose to have one spouse work outside the home while the other cares for their children, making them ineligible for the credit. Two-earner married couples may pay for dependent care, but are also more likely to be income-ineligible than are single parents simply by having two paychecks rather than one. Because of this, married couples are more likely to receive the credit as an offset to tax liability rather than a refund, while head of household filers are more likely to receive the credit as a refund.

Just over one-third of the \$14.6 million in dependent care credits paid in 2011 went to offset tax liability—\$5.2 million—with the remaining \$9.4 million paid as refunds.

Figure 4 shows that of the 36,469 credits claimed in 2011, less than half were taken as full or partial refunds of liability. About 38 percent of recipients had no liability at all and received the full credit amounts as a refund, 27 percent had some liability but qualified for a credit that resulted in a refund, and the remaining 35 percent had tax liability that exceeded the credit amount for which they qualified.

¹⁴ Distribution between married and head of household filers are estimated from the 2011 sample of income tax returns prepared by the Minnesota Department of Revenue and then applied to the actual tax year 2011 count of returns that claimed the credit.

Figure 4
**Minnesota Dependent Care Credit
Recipients by Refundability of Credit, 2011**



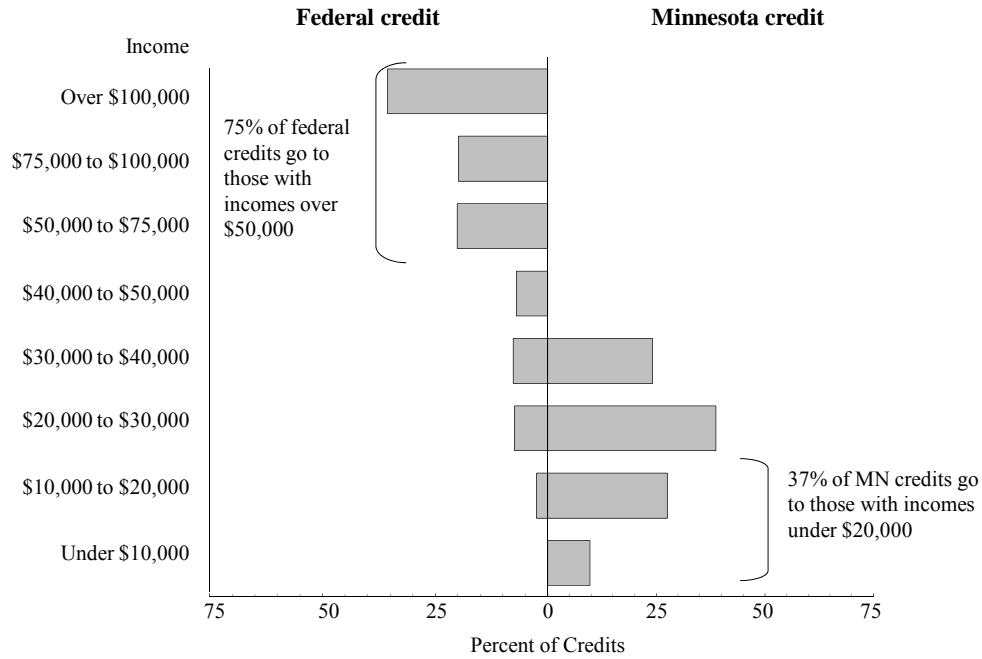
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The Minnesota dependent care credit targets its benefits to low- and moderate-income families.

Figure 5 shows that over a third of all Minnesota dependent care credits go to taxpayers with adjusted gross incomes of less than \$20,000, and over a third go to those with incomes between \$30,000 and \$40,000.¹⁵ In contrast, federal credits tend to go to higher income families (e.g., about 75 percent of all federal credits go to those with incomes over \$50,000, with over 20 percent going to those with incomes between \$50,000 and \$75,000). Two factors explain this divergence. First, the federal credit is not refundable. Families whose incomes are too low for them to owe income tax do not receive the credit. Nonrefundability explains why almost no one with gross income under \$10,000 can claim a federal credit. In contrast, about 10 percent of the refundable Minnesota credits go to families with incomes less than \$10,000. Second, the federal credit phases down to a minimum amount, while the Minnesota credit phases out entirely. This explains why no one with gross income above \$40,000 receives a Minnesota dependent care credit, while over 80 percent of all federal credits go to filers in this moderate-to-high income range. Of the estimated 163,000 federal credit recipients in Minnesota, over 134,000, or about 82 percent, are income-ineligible for the state credit.

¹⁵ Distribution of federal and state credits by income are estimated using the 2011 sample of income tax returns prepared by the Minnesota Department of Revenue.

Figure 5
Distribution of Federal and Minnesota Dependent Care Credits by Income, 2011



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For more information about tax credits, visit the income tax area of our website, www.house.mn/hrd/