MN HOUSE RESEARCH

# Minnesota's K-12 Education Subtraction and Credit

October 2022

## K-12 education subtraction

Minnesota allows a state income tax subtraction (deduction) for K-12 education-related expenses. The subtraction allows up to $2,500 to be subtracted for each dependent in grades 7-12 and up to $1,625 for each dependent in grades K-6.

In tax year 2019 approximately 189,000 returns claimed the subtraction. The Department of Revenue (DOR) estimates that the subtraction will reduce income tax revenues by $16.8 million in tax year 2023.

### Expenses eligible for the subtraction

Qualifying expenses for the subtraction are listed on the DOR website, and include payments for:

- tuition, including nonpublic school, after-school enrichment, academic summer camps, music lessons taught by qualifying instructors, and tutoring;
- textbooks and instructional materials;
- transportation costs (paid to others for transporting children to school); and
- school supplies, musical instrument rental and purchase, and up to $200 of computer hardware and educational software.

## K-12 education credit

A state income tax credit is allowed for 75 percent of K-12 education-related expenses. The credit is for up to $1,000 for each child in grades K-12. For taxpayers with two or more qualifying children, the $1,000 per child maximum is a family limit; credits may be claimed up to the maximum without regard to the qualifying child or children for whom the expenses were paid.

In tax year 2019, 32,220 Minnesota returns claimed a total of $8.0 million in K-12 education credits. The average credit was $249. In tax year 2023, the Department of Revenue estimates that Minnesotans will claim $6.3 million in K-12 education credits.

The credit begins to phase out when income exceeds $33,500 at a 25-percent rate for families with one child and at 50 percent for families with two or more children. For families claiming the credit for one or two children, it is fully phased out when income reaches $37,500. The phaseout extends for an additional $2,000 of income for each additional child claimed.

The measure of income used to phase out the credit is called "household income." Household income is a broad measure that includes many categories of nontaxable income, including nontaxable Social Security income, certain elective retirement account contributions, nontaxable scholarships and grants, some Medicaid waiver program payments, workers compensation benefits, and veterans benefits. The K-12 credit is the only state income tax credit that uses household income for eligibility, though the property tax refund programs use a similar measure, which is also called "household income."

### Expenses eligible for the credit

The same expenses qualify for the credit as for the deduction, except payment of nonpublic school tuition does not qualify for the credit.

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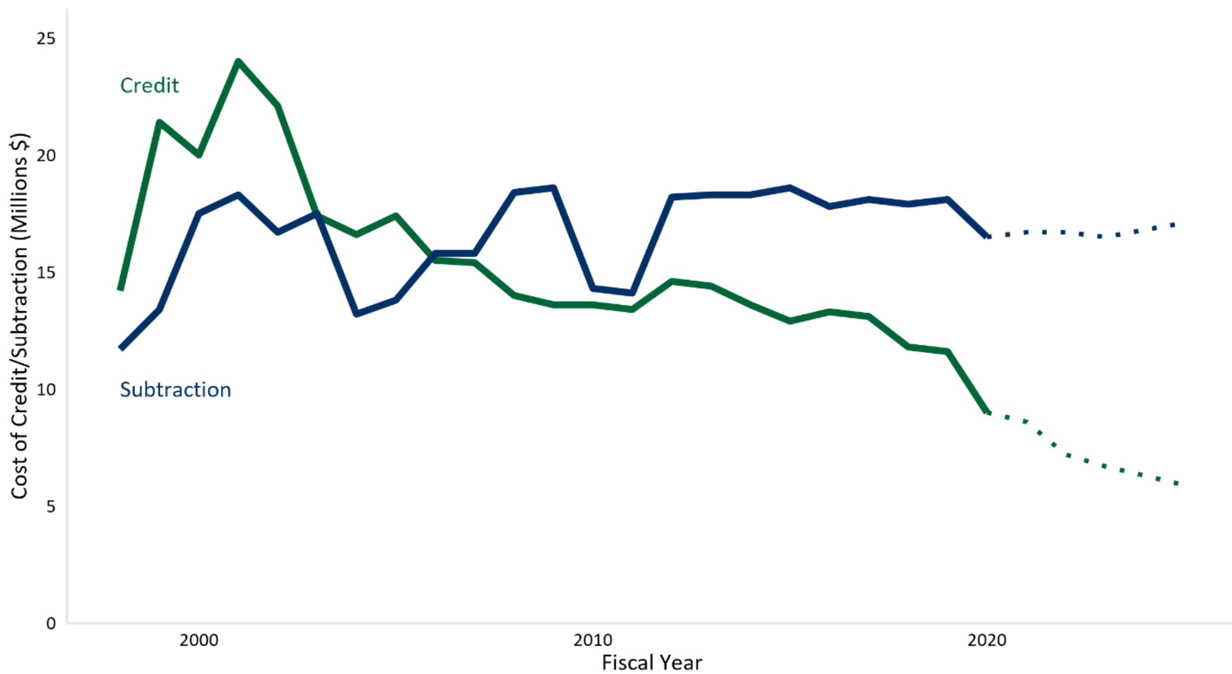
## Credits claimed have fallen; subtraction amounts have been steady

The credit and subtraction parameters are not indexed for inflation. As a result, the credit amount has fallen over time due to the growth in taxpayer incomes. DOR estimates that the cost of the credit will fall to $5.9 million in FY 2025, while the subtraction's cost will grow to $17.1 million in the same year.

**Cost of K-12 Credit and Subtraction, FY 1998 to FY 2023 (Projected)**




House Research Department. Data compiled from historical DOR Tax Expenditure Budgets. Dotted lines are DOR forecasts.

### Tax benefits of the subtraction and credit

The subtraction reduces an individual's taxable income. The tax benefit of the subtraction depends on the taxpayer's marginal tax rate and the total amount deducted. A taxpayer with a marginal rate of 5.35% who claims a $2,500 subtraction will pay $133.75 less in state income taxes (5.35% x $2,500). A taxpayer in the 9.85 percent bracket with the same deduction will pay $246.25 less in taxes. A taxpayer with too little income to have tax liability will not benefit from the deduction. The credit, in contrast, directly reduces tax liability and is fully refundable. If an individual's credit exceeds his or her liability, the excess is paid as a refund.

### Loans for educational services that qualify for the credit

Parents may assign payment of the credit to participating financial institutions and tax-exempt foundations. In exchange, parents receive a loan that is paid directly to a third-party provider of educational services and programs. This allows very low-income families to purchase educational products and services in anticipation of receiving a credit when they file their tax return the following year, with the credit paid directly to the financial institution or foundation that accepted the assignment.

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