

The Minnesota and Federal Dependent Care Tax Credits: An Overview

- What are the credits?*** The Minnesota and federal dependent care credits partially offset the cost of child care for certain workers. The maximum Minnesota and federal credit is \$1,050 for one child and \$2,100 for two or more children.
- Are the credits refundable?*** The Minnesota credit is fully refundable. If an individual qualifies for a credit that is greater than his or her tax liability, the excess is paid as a refund. The federal credit is not refundable and may only be used to offset federal income tax liability.
- Who is eligible for the credits?*** Anyone who incurs expenses related to the care of a dependent and related household expenses may be eligible to claim the credits. The claimant must:
- maintain a household that includes the dependent;
 - pay for care for a dependent under age 13, or a disabled spouse or adult dependent; and
 - pay for care in order to work or look for work.
- What are qualifying expenses?*** Qualifying expenses are amounts paid for the care of a dependent under age 13, or a disabled spouse or adult dependent, but do not include amounts paid to the claimant's spouse or another dependent.
- Qualifying expenses may not exceed the claimant's earned income (for married couples filing joint returns, expenses may not exceed the earned income of the lesser earning spouse). Maximum allowable qualifying expenses are reduced by amounts paid through dependent care pre-tax accounts.
- How are the credits calculated?*** The *federal credit* equals 35 percent of up to \$3,000 of qualifying expenses for one dependent (\$6,000 of qualifying expenses for two or more dependents). The maximum federal credit is \$1,050 for one dependent and \$2,100 for two or more dependents. The federal credit percentage rate begins to phase down when income exceeds \$15,000, with the credit percentage decreasing as income increases. Claimants with incomes over \$43,000 qualify for the minimum federal credit rate of 20 percent of qualifying expenses, or up to \$600 for one dependent and \$1,200 for two or more dependents. For example, a claimant with \$50,000 of income and \$1,000 of expenses will qualify for a credit of \$200 (20 percent of \$1,000).
- The *state credit* equals the federal credit for which the claimant is eligible, subject to an income-based phaseout.
- (By contrast, the federal credit rate phases down to a minimum percentage but is never totally phased out.) In tax year 2017, the phaseout begins when adjusted gross income exceeds \$50,000 and the state credit is fully phased out when income reaches \$62,000 for claimants with one dependent, and \$74,000 for claimants with

two or more dependents. The income threshold for the phaseout is adjusted each year for inflation.

How do filers claim the credits?

Filers claim the credits when they file their federal and state income tax returns, by completing a separate schedule—Form 2441 for the federal credit and schedule M1CD for the state credit.

How many Minnesotans claim the credits?

In tax year 2014, 151,220 Minnesotans claimed the federal dependent care credit and 34,135 claimed the state credit. These claims represent 5.6 percent of all federal returns filed by Minnesotans and 1.2 percent of all state returns filed.

How much is paid out in credits?

In tax year 2014, Minnesotans claimed \$72.8 million of federal dependent care credits. The average federal dependent care credit was \$482.

In tax year 2014, Minnesotans claimed \$14.1 million of state dependent care credits. The average state dependent care credit was \$414.

What are recent changes to the state credit?

The 2017 Legislature:

- ▶ tied the state credit directly to the federal credit;
- ▶ changed the income measure used for the credit phaseout from household income to adjusted gross income; and
- ▶ increased the phaseout floor to \$50,000, with the credit extending to \$62,000 for those with one dependent and \$74,000 for those with two or more dependents.

The Department of Revenue estimates that the changes will increase credits by \$16.9 million in tax year 2017, and that 42,800 individuals will receive larger credits of \$342 on average. Additionally, 16,900 individuals who were not previously eligible for the credit would become eligible.

How does Minnesota compare with other states?

Nationwide, 4.3 percent of all income tax returns claimed the federal dependent care credit, compared to 5.6 percent in Minnesota. South Dakota had the highest percentage of returns claiming the federal credit at 6.3 percent, and West Virginia had the lowest at 2.2 percent.

The average federal dependent care credit in 2014 was \$546 nationwide and \$482 in Minnesota. New York had the highest average credit at \$595, and Montana had the lowest at \$470. Minnesota's average credit amount may be lower than the national averages because state residents have above-average incomes, or because Minnesotans are more likely to receive child care assistance or use pre-tax dependent care accounts, reducing the amount of qualifying expenses.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research information brief *The Minnesota and Federal Dependent Care Tax Credits*, February 2014.

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