

Subject Student loan tax credit marriage penalty

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Overview

The 2017 legislature established a nonrefundable individual income tax credit for payments of student loan principal and interest. The structure of the credit includes a marriage penalty for taxpayers who file joint returns—H.F. 503 reduces this penalty.

The amount of a taxpayer's student credit depends on the taxpayer's adjusted gross income (AGI) in excess of \$10,000. For married couples filing joint returns, the Department of Revenue calculates the credit for each spouse separately, but uses the couple's combined adjusted gross income for the calculation. As a result, there are cases where a married couple that files a joint return may see their credit reduced or eliminated as a result of filing jointly. The table below shows an example of how this might happen.

	Couple Files Separately		Couple Files Joint Return	
	Individual 1	Individual 2	Individual 1	Individual 2
AGI	\$40,000	\$40,000	\$80,000	\$80,000
Loan payments	\$3,500	\$3,500	\$3,500	\$3,500
Phaseout	\$3,000	\$3,000	\$7,000	\$7,000
Credit	\$500	\$500	\$0	\$0

Under H.F. 503, if the married couple in the example chose to file a joint return, the couple would allocate their combined AGI to each spouse based on their share of the couple's earned income. Assuming that all of the couple's income was earned income, under H.F. 503 the couple would receive the same credit amount regardless of whether they filed their taxes jointly or separately.

Summary

Section	Description
1	<p>Definitions.</p> <p>Amends the definition of “earned income” for the purposes of the student loan credit to reference the definition of “earned income” in the marriage penalty credit. Under current law, “earned income” includes wages, salaries, tips, and self-employment income. The bill adds Social Security benefits and some retirement income to the definition.</p> <p>This change has two effects:</p> <ol style="list-style-type: none">1) Section 2 of the bill allocates the couple’s adjusted gross income to each spouse based on their pro rata share of the couple’s earned income. Social Security and some retirement income would be used for the purposes of that calculation.2) A small number of taxpayers were previously not allowed a student loan credit due to the earned income limitation may become newly eligible for the credit. This would only happen for taxpayers who had Social Security or retirement income but did not earn significant wages or self-employment income.
2	<p>Credit Allowed.</p> <p>Requires the Department of Revenue to allocate the couple’s combined adjusted gross income to each individual spouse based on the spouse’s percentage share of the couple’s earned income. This has the effect of reducing the marriage penalty in the credit.</p>



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