

The Minnesota and Federal Dependent Care Tax Credits: An Overview

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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 is the federal credit 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).

How is the state credit calculated?

The state credit equals the federal credit for which the claimant is eligible, subject to an income-based phaseout. While all filers with tax liability and qualifying expenses may claim the federal credit, the state credit is fully phased out for filers with higher incomes. In tax year 2019, the phaseout begins when adjusted gross income exceeds \$52,160 and the credit is fully phased out when income reaches \$64,160 for claimants with one dependent, and \$76,160 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 2016, 154,410 Minnesotans claimed the federal dependent care credit—these claims represent 5.6 percent of all federal returns filed by Minnesotans.

In tax year 2016, 29,561 Minnesotans claimed the state credit—these claims represent 1.1 percent of all state returns filed by Minnesotans.

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.

How does Minnesota compare with other states?

Nationwide, 4.3 percent of all 2016 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 2.3 percent.

The average federal dependent care credit in 2016 was \$560 nationwide and \$506 in Minnesota. Alaska had the highest average credit at \$603, and Montana had the lowest at \$490. 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: See the House Research publication *The Minnesota and Federal Dependent Care Tax Credits*, November 2017.



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