

The K-12 Education Deduction and Credit: An Overview

What is the K-12 deduction?

A state income tax deduction is allowed for K-12 education-related expenses. The deduction allows up to \$2,500 to be deducted for each dependent in grades 7-12 and up to \$1,625 for each dependent in grades K-6.

In tax year 2015 (fiscal year 2016) an estimated 207,000 returns claimed the deduction. The Department of Revenue estimates that the deduction will reduce income tax revenues by \$18.4 million in tax year 2017 (fiscal year 2018).

What expenses qualify for the deduction?

Qualifying expenses for the deduction include payments for:

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

What is the 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. 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. In other words, each \$4 dollar of income over the limit reduces the maximum credit by \$1 for a family with one child or by \$2 for a family 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 (i.e., to \$39,500 for three children, \$41,500 for four children, etc.).

In tax year 2014, 51,317 Minnesota returns claimed a total of \$13.3 million in K-12 education credits. The average credit was \$259. In tax year 2017 (fiscal year 2018), the Department of Revenue estimates that Minnesota will claim \$13.1 million in K-12 education credits.

What expenses qualify 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.

What are the tax benefits of the deduction and credit?

The deduction reduces an individual's taxable income. The tax benefit of the deduction depends on the taxpayer's marginal tax rate and the total amount deducted. Minnesota has four marginal tax rates: 5.35, 7.05, 7.85, and 9.85 percent. A taxpayer in the 5.35 percent bracket who claims a \$2,500 deduction

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. In tax year 2017, a typical married couple with two dependents would need to have \$28,900 of gross income before owing any state income tax.

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.

Can parents obtain loans to pay 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.

How do taxpayers claim the deduction and credit?

Taxpayers claim the deduction on form M-1M, income additions and subtractions. Taxpayers claiming the credit must complete form M1ED and attach it to their state tax return.

Has the constitutionality of Minnesota's credit and deduction been challenged in court?

The constitutionality of state income tax benefits for education expenses have regularly been challenged in court under the First Amendment and the education clauses of state constitutions.

The Minnesota dependent education deduction was upheld by the U.S. Supreme Court in a 1983 decision, *Mueller v. Allen*. An earlier Minnesota tax credit that applied to private school tuition was invalidated by the Minnesota Supreme Court in 1974.

Minnesota's current K-12 education credit has not been subject to legal challenge.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at joel.michael@house.mn. Also see the House Research publication *Income Tax Deductions and Credits for Public and Nonpublic Education in Minnesota*, September 2011.

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