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The Minnesota Student Loan Tax Credit

What is the student loan tax credit?

The Minnesota Student Loan Tax Credit is a nonrefundable credit for payments of principal and interest on eligible higher education loans. Individuals with one or more qualified education loans may claim the credit to reduce their Minnesota income tax liability by up to $500. The credit was enacted by the 2017 Legislature, and takes effect beginning in tax year 2017.

What is a nonrefundable credit?

A nonrefundable credit may be used only to offset Minnesota income tax liability; it cannot reduce tax liability to less than zero. An individual with no state income tax liability does not benefit from the credit.

Who is eligible for the credit?

An individual with one or more qualified education loans may claim the credit. For married couples, each spouse is eligible for the credit. Individuals who are not full- or part-year residents of Minnesota may not claim the credit.

There is no limit on the number of years in which a taxpayer may claim the credit; the taxpayer may claim the credit any year the taxpayer made qualified education loan payments.

Which higher education loan payments are counted toward the credit?

"Eligible loan payments" are payments of principal and interest on "qualified education loans" incurred on behalf of the eligible individual. The loan payments must be related to an undergraduate or graduate degree program at a public or nonprofit postsecondary institution. If the institution is located in Minnesota, it must be eligible for the Minnesota State Grant program; if the institution is in another state, it must participate in the federal Pell Grant program.

"Qualified education loan" is defined by reference to the Internal Revenue Code. Although the federal definition includes both parent loans and the loans of a taxpayer's spouse, the Minnesota Student Loan Credit specifically excludes those loans from eligibility for the credit, so that only loans an individual takes out for his or her own education are eligible.

How is the credit calculated?

The initial credit amount depends on the amount of the individual's eligible loan payments and federal adjusted gross income (FAGI), subject to three limits. FAGI is a federal definition of income that includes most kinds of cash income, including wages, salaries, tips, taxable interest, dividends, capital gains, and business income.

Loan payments are reduced by 10 percent of FAGI in excess of $10,000. This means that, as income increases, the initial credit amount decreases. The formula for the initial credit is as follows:

$$Student\ Loan\ Credit = Eligible\ Loan\ Payments - .1 * (FAGI\ in\ excess\ of\ \$10{,}000)$$

How is the credit limited?

An individual's credit amount is subject to three limits. The credit cannot be more than:

1. **The Maximum Credit:** $500;
2. **The Individual's Earned Income:** wages, salaries, tips, and net earnings from self-employment; or
3. **10% of the Individual's Original Balance, plus Interest paid in the tax year.**

Since the credit is **nonrefundable**, the credit is also implicitly limited to the individual's income tax liability.

How could a credit vary by income and loan payment amounts?

Estimated Credit by FAGI and Eligible Loan Payments

(Assumes taxpayer is not limited by earned income, or the original loan balance)

Income (FAGI)	$2,750 in Loan Payments	$7,500 in Loan Payments
$15,000	$500	$500
$35,000	$250	$500
$55,000	$0	$500
$75,000	$0	$500
$95,000	$0	$0

Example Calculation

Example Taxpayer Situation:

- Eligible Loan Payments: $4,700 ($1,800 interest, $2,900 principal)
- Income: $55,000 in FAGI and $45,000 in Earned Income
- Original Loan Value: $38,000

The initial credit equals $200—eligible loan payments, reduced by 10 percent of FAGI in excess of $10,000.

- Federal adjusted gross income minus $10,000 = $45,000
- 10 percent of $45,000 = $4,500
- $4,700 in payments minus $4,500 = $200

The initial credit is subject to three limits, none of which apply to the example:

- **Maximum Credit:** $500
- **The Individual's Earned Income:** $45,000
- **10 percent of the Individual's Original Balance, plus Interest paid in the tax year:** $5,600 ($3,800 plus $1,800 in interest paid)

How much is the credit estimated to cost?

The Minnesota Department of Revenue (DOR) estimated that 65,000 returns will claim the credit in tax year 2017, with an average credit of $414. DOR estimated the credit would result in the following revenue reductions per fiscal year:

- Fiscal Year 2018: $26.9 million
- Fiscal Year 2019: $27.8 million
- Fiscal Year 2020: $28.8 million
- Fiscal Year 2021: $29.8 million

For more information: Contact legislative analyst Sean Williams at 651-296-5053. Also see the House Research web page *Income Tax Benefits for Higher Education Costs*, http://www.house.leg.state.mn.us/hrd/issinfo/hetaxben.aspx?src=20.