

Minnesota's 529 Tax Credit and Subtraction

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Federal and state tax advantages for section 529 college savings accounts

Investment income on 529 accounts is exempt from both federal and Minnesota income taxes, if the income is used for qualified higher education expenses. Investment income on the accounts that is used for nonqualified purposes is taxed as ordinary income, plus a 10 percent penalty. 529 plans also provide special estate and gift tax benefits.

Minnesota allows both a nonrefundable income tax credit and an income tax subtraction for contributions to any state's 529 plan. A taxpayer may claim either the credit or the subtraction, but not both. Any Minnesota resident who makes a contribution to a 529 plan or prepaid tuition plan may claim the credit or subtraction, as long as the individual is not claimed as a dependent. An individual does not need to be the account owner to be eligible to claim the credit or subtraction.

Minnesota's subtraction for 529 account contributions

Minnesota offers a subtraction of up to \$1,500 (\$3,000 for married joint filers) of contributions to any state's section 529 college savings plan or prepaid tuition plan. The amount of contributions eligible for the subtraction is net of any distributions and excludes any amounts that are rolled over from other college savings plans.

Minnesota's credit for 529 account contributions

Minnesota also allows a nonrefundable credit equal to 50 percent of contributions, up to a maximum of \$500. The maximum credit is phased out as income increases. The phaseout starts at \$93,610 of adjusted gross income for all filers—the phaseout rate for married taxpayers filing joint returns is 1 percent of income above the threshold, and the rate for unmarried filers is 2 percent.

Minnesota's 529 Credit Phaseouts, Tax Year 2024

| Adjusted Gross Income | Maximum Credit Married Joint | Maximum Credit Single/Head of Household |
|------------------------|---------------------------------|---|
| Less than \$93,610 | \$500 | \$500 |
| \$93,610 to \$121,610 | Phases down from \$500 to \$250 | Phases down from \$500 to \$0 |
| \$121,610 to \$168,500 | \$250 | \$0 |
| \$168,500 to \$193,500 | Phases down from \$250 to \$0 | \$0 |
| \$193,500 and above | \$0 | \$0 |

Comparison of the credit and subtraction

The credit and subtraction differ in three main ways. First, income limits apply to the credit, but not the subtraction. Second, for the same contribution amount, the credit will typically provide a larger tax benefit than the subtraction. A credit reduces tax liability dollar-for-dollar, while the value of a subtraction depends upon the taxpayer's marginal tax rate. Third, the credit can result in a marriage penalty or bonus, while the subtraction can only provide a bonus.

Income Distribution of 529 Credit and Subtraction Claimants, Tax Year 2021

| Adjusted Gross Income | 529 Credit | | | | 529 Subtraction | | | |
|-----------------------|--------------------|------------|--------------|---------------|--------------------|------------|--------------|---------------|
| | Reduction in Tax | % of Total | Average | Returns | Reduction in Tax | % of Total | Average | Returns |
| Less than \$50,000 | \$576,600 | 8.8% | \$379 | 3,200 | \$0 | 0.0% | \$0 | 0 |
| \$50,000 - \$75,000 | \$1,211,400 | 18.4% | \$394 | 3,500 | \$0 | 0.0% | \$0 | 0 |
| \$75,000 - \$100,000 | \$1,565,900 | 23.8% | \$349 | 4,600 | \$5,500 | 0.1% | \$54 | 100 |
| \$100,000 - \$150,000 | \$2,958,100 | 45.0% | \$244 | 12,100 | \$289,700 | 3.8% | \$96 | 3,000 |
| \$150,000 - \$200,000 | \$263,300 | 4.0% | \$139 | 1,900 | \$1,717,200 | 22.3% | \$152 | 11,300 |
| \$200,000 and more | \$0 | 0.0% | \$0 | 0 | \$5,702,800 | 73.9% | \$212 | 27,000 |
| Totals | \$6,575,200 | — | \$293 | 24,400 | \$7,715,200 | — | \$186 | 41,400 |

House Research estimates using the House Income Tax Simulation (HITS) model, version 7.4

Qualified higher education expenses

Minnesota mostly adopts the federal rules defining qualified higher education expenses (with the exception of K-12 tuition, described below). Those rules allow penalty-free distributions for tuition, fees, room and board, books, certain computer equipment and software, certain apprenticeship expenses, and other education expenses. Qualified higher education expenses also include up to \$10,000 in distributions used to make payments of principal or interest on the student loans of the beneficiary or the beneficiary's sibling. The \$10,000 limit is a lifetime limit per individual.

Minnesota does not conform to federal treatment of K-12 tuition

Since 2018, federal law has allowed distributions from 529 accounts to be used to pay for up to \$10,000 of tuition at an elementary or secondary public, private, or religious school. Minnesota has not adopted this rule, meaning taxpayers who use a 529 distribution to pay for school tuition are required to add back the portion of the distribution that represents investment earnings. In tax year 2021, House Research modeling estimates that about 400 returns were required to make this addition, resulting in a total increase in tax of about \$100,000 for all filers. The average increase was about \$243.

Other states' incentives for 529 plan contributions

States offer a wide variety of incentives for 529 plan contributions, including income tax deductions, tax credits, and matching grants. As of 2023:

- 33 states (including Minnesota) and the District of Columbia allowed **tax deductions**
- Five states (Indiana, Minnesota, Oregon, Utah, and Vermont) offer **tax credits**
- Four states with income taxes don't offer 529 plan deductions or credits
- Most states limit deductions to contributions to the state's own plan, but nine states (including Minnesota) provide deductions for contributions to any state plan
- 16 states offer **matching grants** of some kind; 11 offer matching grants and five offer onetime grants, either at the time of the child's birth or the opening of an account



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