

March 3, 2021

	Yes	No
DOR Administrative Costs/Savings		X

 Department of Revenue
 Analysis of H.F. 1373 (Frazier) / S.F. 1251 (Rest)

	Fund Impact			
	<u>F.Y. 2022</u>	<u>F.Y. 2023</u>	<u>F.Y. 2024</u>	<u>F.Y. 2025</u>
	(000's)			
K-12 Education Credit				
Increased Phase-Out	(\$9,700)	(\$4,900)	(\$5,000)	(\$5,000)
Computer & Internet Expenses	(\$22,900)	(\$11,600)	(\$11,700)	(\$11,800)
K-12 Education Subtraction				
Shift to K-12 Credit	<u>\$800</u>	<u>\$400</u>	<u>\$400</u>	<u>\$400</u>
General Fund Total	(\$31,800)	(\$16,100)	(\$16,300)	(\$16,400)

Effective retroactively beginning with tax year 2020.

EXPLANATION OF THE BILL

Current Law: a taxpayer is allowed a refundable income tax credit equal to 75% of eligible education expenses for a qualifying child in kindergarten through 12th grade. The maximum credit is \$1,000 for each child. Eligible expenses include fees for instruction outside the regular school day or school year, expenses for textbooks or instructional materials, and transportation costs paid to others. Tuition is not an eligible expense. A maximum of \$200 per family for certain computer hardware and software is allowed.

The maximum credit is phased out beginning at household income of \$33,500. For taxpayers with one child, the maximum credit is reduced by one dollar for every four dollars of household income over \$33,500. For taxpayers with two or more children, the maximum credit is reduced by two dollars for every four dollars of household income over \$33,500. The phase-out range is increased by \$2,000 for each additional child. The income thresholds are not indexed for inflation. Household income includes income from all sources, both taxable and nontaxable.

Proposed Law: The bill expands the definition of qualified expenses to include monthly internet service charges and would increase the maximum computer expenses from \$200 to \$300.

The bill increases the phase out threshold from \$33,500 to \$45,000. The threshold would be adjusted annually for inflation beginning in tax year 2021.

The Commissioner of Revenue must prescribe the way for taxpayers to claim the tax refund for education related expenses incurred in tax year 2020.

REVENUE ANALYSIS DETAIL

- The estimate is based on a sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- About 12,600 returns would be newly eligible for the credit due to the higher phase-out threshold. Returns in the current phase-out range would qualify for a higher credit.
- Newly eligible taxpayers are assumed to be currently claiming the education expense subtraction. The subtraction was reduced by the amount of expenses used to claim the credit.
- A marginal rate of 6.5% was assumed to estimate the impact of the forgone subtractions.
- About 15,200 returns claimed the credit for computer expenses in 2018. Of those, 10,000 claimed the maximum of \$200. The remainder claimed an average of \$103. It is assumed that with the addition of internet expenses, they would claim the maximum of \$300.
- About 19,600 returns claimed the credit but did not report computer expenses. 57% of those returns are assumed to have internet service expenses, based on a survey by the Pew Research Center on home broadband access by income. They are expected to claim the maximum computer expenses of \$300.
- An additional 12,700 returns are expected to be eligible for the credit because of the expansion of the credit to include internet service expenses. Their expenses are assumed to be \$300.
- Under the current income phase-out thresholds, the credits for computer expenses will increase by \$6.9 million. With the expanded income phase-out threshold, the new credit would increase by an additional 62%, to \$11.2 million.
- Because the income phase-out threshold would be indexed for inflation, the credit is assumed to grow about 1% annually.
- The tax year 2020 impact was allocated to fiscal year 2022. For other years, tax year impacts were allocated to the following fiscal year.

Number of Taxpayers: The increased income phase-out would increase the number of credits by about 12,600 returns. About 39,100 returns would receive an increased credit or be newly eligible for a credit for computer and internet expenses.

Minnesota Department of Revenue
Tax Research Division
[https://www.revenue.state.mn.us/
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