

March 15, 2021

	<b>Yes</b>	<b>No</b>
<b>DOR Administrative Costs/Savings</b>	<b>X</b>	

Department of Revenue  
Analysis of H.F. 1373 (Frazier), as Proposed to be Amended (H1373A-1)

	<b>Fund Impact</b>			
	<b><u>F.Y. 2022</u></b>	<b><u>F.Y. 2023</u></b>	<b><u>F.Y. 2024</u></b>	<b><u>F.Y. 2025</u></b>
	(000's)			
K-12 Education Credit				
Increased Phase-Out	(\$8,900)	(\$9,200)	(\$9,600)	(\$9,800)
Computer & Internet Expenses	(\$19,600)	(\$12,700)	(\$12,800)	(\$13,000)
K-12 Education Subtraction				
Shift to K-12 Credit	<u>\$700</u>	<u>\$700</u>	<u>\$800</u>	<u>\$800</u>
General Fund Total	(\$27,800)	(\$21,200)	(\$21,600)	(\$22,000)

The increased credit for computer and internet expenses is effective retroactively beginning with tax year 2020. The increased phase-out threshold is effective beginning with tax year 2021.

**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 12<sup>th</sup> 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 would expand the definition of qualified expenses to include monthly internet service charges and increase the maximum computer expenses from \$200 to \$300.

As proposed to be amended, the bill would phase out the credit based on adjusted gross income over the income eligibility guidelines for the federal reduced school lunch program as of July 1 of the tax year. The income guideline for reduced-price lunches is 185 percent of the federal poverty guidelines, which are based on family size and adjusted annually for inflation. For the 2020-21 school year, the income eligibility guideline for a family of four is \$56,758. It is increased by \$8,288 for each additional family member.

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

### *Increased Income Thresholds*

- The estimate is based on a sample of tax year 2018 individual income tax returns compiled by the Minnesota Department of Revenue.
- If in effect in tax year 2018, the bill would increase total K-12 education credits by about \$8.0 million. The average credit would increase from \$284 to about \$376.
- About 12,400 returns would newly qualify for the credit, and 2,800 returns would receive an increased credit.
- For single parents with one child, the proposed phase-out threshold is lower than the current threshold, reducing the credit for about 2,800 returns. The phase-out threshold will increase each year as it is adjusted for inflation. By tax year 2023, the income threshold for a two-member family is expected to be higher than the current phase-out threshold of \$33,500.
- The education subtraction was reduced by the amount of expenses which would now qualify for the K-12 education credit.
- A marginal rate of 6% was applied to the reduced subtractions.

### *Computer and Internet Expenses*

- 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 \$7.0 million in 2020. With the expanded income phase-out threshold in tax year 2021, the new credit would increase by an additional 77.4% to \$12.6 million.
- Because the income phase-out thresholds are 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:** Around 15,200 returns would be newly eligible or receive an increased credit due to the phase-out thresholds. About 2,800 return would receive a reduced credit. About 39,100 returns would receive an increased credit or be newly eligible for a credit for computer and internet expenses.