

HF4830 - 3A - Direct Free Filing of Individual Returns

Chief Author: **Aisha Gomez**  
 Committee: **Taxes**  
 Date Completed: **4/10/2024 2:49:33 PM**  
 Agency: **Revenue Dept**

State Fiscal Impact	Yes	No
Expenditures	X	
Fee/Departmental Earnings		X
Tax Revenue		X
Information Technology	X	
Local Fiscal Impact		X

This table shows direct impact to state government only. Local government impact, if any, is discussed in the narrative. Reductions shown in the parentheses.

State Cost (Savings)	Biennium			Biennium		
	Dollars in Thousands	FY2023	FY2024	FY2025	FY2026	FY2027
General Fund	-	-	2,026	2,656	2,692	
<b>Total</b>	-	-	<b>2,026</b>	<b>2,656</b>	<b>2,692</b>	
<b>Biennial Total</b>			<b>2,026</b>		<b>5,348</b>	

Full Time Equivalent Positions (FTE)	Biennium			Biennium	
	FY2023	FY2024	FY2025	FY2026	FY2027
General Fund	-	-	7.52	18.03	17.67
<b>Total</b>	-	-	<b>7.52</b>	<b>18.03</b>	<b>17.67</b>

**LBO Analyst's Comment**

I have reviewed this fiscal note for reasonableness of content and consistency with the LBO's Uniform Standards and Procedures.

**LBO Signature:** Joel Enders      **Date:** 4/10/2024 2:49:33 PM  
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**State Cost (Savings) Calculation Details**

This table shows direct impact to state government only. Local government impact, if any, is discussed in the narrative. Reductions are shown in parentheses.

\*Transfers In/Out and Absorbed Costs are only displayed when reported.

<b>State Cost (Savings) = 1-2</b>		<b>Biennium</b>			<b>Biennium</b>	
Dollars in Thousands		FY2023	FY2024	FY2025	FY2026	FY2027
General Fund	-	-	2,026	2,656	2,692	
<b>Total</b>		-	-	<b>2,026</b>	<b>2,656</b>	<b>2,692</b>
<b>Biennial Total</b>				<b>2,026</b>		<b>5,348</b>
<b>1 - Expenditures, Absorbed Costs*, Transfers Out*</b>						
General Fund	-	-	2,026	2,656	2,692	
<b>Total</b>		-	-	<b>2,026</b>	<b>2,656</b>	<b>2,692</b>
<b>Biennial Total</b>				<b>2,026</b>		<b>5,348</b>
<b>2 - Revenues, Transfers In*</b>						
General Fund	-	-	-	-	-	
<b>Total</b>		-	-	-	-	-
<b>Biennial Total</b>				-		-

**Bill Description**

This description is for HF 4830 with the A3 amendment. This bill requires the commissioner of revenue to establish a direct free filing system for individual income tax returns.

Section 1 (a) requires the commissioner to establish an electronic direct free filing of individual income tax returns. It allows Revenue to contract with a vendor to build the system, but the vendor must not offer paid tax preparation services in Minnesota while the system is active. The filing system must be made available on the Department of Revenue website.

Section 1 (b) requires the commissioner to coordinate the state filing system with federal direct file options, to the extent feasible.

The A3 amendment requires the filing system to include the ability to file a sufficient number of tax forms that the commissioner estimates at least 70 percent of resident individual income taxpayers could file their returns using the system.

Section 2 allows transfer of funds for this effort from the general fund to the tax filing modernization account in the special revenue fund in FY25.

**Assumptions**

The Department of Revenue (Revenue) assumes that, in collaboration with MN.IT, it will do an in-house build that utilizes our current e-Services environment to develop a direct free file system for Minnesota individual income tax returns. It is assumed that Revenue will be able to participate in the IRS Direct File (Pilot) program. Based on this assumption, Revenue would need to develop all Minnesota state forms and schedules, but would not be required to develop any federal forms or schedules. It is assumed that by participating in the IRS Direct File (Pilot) program, Revenue would be able to receive a copy of a filer's federal individual income tax return at the same time the Minnesota Individual Income Tax return is filed, and the federal return will not be considered federal tax information (FTI).

It is assumed that this system would be developed with a limited pilot program that initially would only be available to certain filers. IRS Direct File is for individuals with simple tax filing needs and who report certain types of income, credits, and deductions. IRS Direct File requires individuals to have a social security number or an individual taxpayer identification number (ITIN), if applicable an adoption taxpayer identification number (ATIN) for any dependents that are claimed, and a current driver's license, state identification, passport, or passport card. IRS Direct File can only be used by individuals who have the following types of income and not other types of income:

- Income from an employer (Form W-2)
- Unemployment compensation (Form 1099-G)
- Social security benefits (Form SSA-1099)
- \$1,500 or less in interest income or US savings bonds or Treasury obligations

You cannot use IRS Direct File if your wages are more than \$200,000 (\$160,200 if you had more than one employer) or if you are using the filing status Married Filing Separately and your wages are more than \$125,000. You also cannot use IRS Direct File if you file a joint federal tax return and either your spouse's wages are more than \$200,000 (\$160,200 if your spouse had more than one employer) or you and your spouse's total wages are more than \$250,000.

IRS Direct File only supports individuals who use the standard deduction, those who take itemized deductions cannot use Direct File. Individuals who purchase health insurance through MNsure or who withdrew money from a health savings account (HSA) are not eligible for IRS Direct File. You can only use IRS Direct File if you want to claim the federal Child Tax Credit, Earned Income Tax Credit, and Credit for Other Dependents. Individuals who claim any other credits or who claim tax benefits for a child as their non-custodial parent are not eligible for IRS Direct File.

It is assumed the Minnesota Direct File will only support individuals who use the standard deduction, are residents of Minnesota for the full year, have wages less than \$250,000 for filers filing a joint return, or less than \$125,000 for all other filers, and will be limited to the following credits:

- Marriage Credit
- K-12 Education Credit
- Child and Working Family Credit
- Renter's Credit

It is assumed that of the 3 million income tax returns filed in Minnesota, approximately 2.1 million returns (70 percent) would be eligible to be filed using the Minnesota Direct File program. This estimate is based on the total number of 2022 returns filed and excludes filers who have income reported on Form 1099-K, Form 1099-NEC, Form 1099-MISC, and Form 1099-R. It also excludes those with the Married Filing Separately filing status with wages over \$125,000 and those with the Married Filing Jointly filing status with combined wages over \$250,000. It also excludes those who itemize deductions on their federal return and those who claim a federal credit other than the Child Tax Credit, Earned Income Tax Credit, and the Credit for Other Dependents. It is assumed that the credit for renters that is currently claimed on Form M1PR would be included in this population as, by the time this system is available, the renter's credit will have moved to the M1 Individual Income Tax Return.

Revenue cannot guarantee that the filing system, in the commissioner's estimation, will be able to serve at least 70 percent of resident individual income taxpayers as required in the A3 amendment. While Revenue estimates that approximately 2.1 out of 3 million tax returns filed in 2022 would be eligible for a Minnesota Direct File Program, this estimation is based on tax returns filed and not actual taxpayers. Additionally, Revenue cannot control changes made by the legislature or the IRS that could ultimately impact who may be eligible for such a program. For example, the one-time advanced refundable tax credit passed by the legislature in the 2023 Tax Bill requires Minnesotans who received refunds to submit Form 1099 with their tax return, which would make them ineligible for a Minnesota Direct File Program.

MN.IT assumes system development costs of \$808,000 for FY25 and system support costs of \$103,800 beginning in FY26 and ongoing based on the following assumptions. This includes 6,460 hours of systems development work in FY25 and 1,006 hours of systems support beginning in FY26 and ongoing. MNIT will not be creating the IRS's forms and schedules as it assumes Revenue will become a part of the IRS's Direct File pilot. The new system will be created within the existing Integrated Tax System (GenTax) e-Services system. Individuals will be able to log into e-Services. The time and effort to achieve individual log-in to e-Services are not included in this estimate as this is an in-progress effort at Revenue.

The new system will support taxpayers that are eligible to use the IRS Direct File pilot by allowing them to complete, submit, and pay their Minnesota Individual Income Tax form (M1) and supporting schedules. System development costs are based on the breakdown of forms and schedules that Revenue is assuming will need to be developed.

The estimate is based on currently available tax preparation and filing systems which are step-by-step based; meaning,

taxpayers are led through the system by answering a series of sequential questions and providing data. This is done through a series of data capture screens that are developed and displayed to the user. The screen estimates are based on the logic that each line entry for all and any forms required to complete an individual income tax return require a decision tree scenario along with a taxpayer entry.

Revenue does not currently have any returns that are filed in e-Services of this magnitude, and anticipates this will be a complex build. Revenue assume that it will need two system architects to assist the business and the development staff with the design and system architecture. It also assumes it will need to work with FAST Enterprises (currently under contract with MNIT @Revenue) during design discussions and to implement core GenTax functionality. Additional costs are included for standard virtual servers, storage, backups configuration and storage, network set up and configuration, and disaster recovery site configuration and infrastructure.

The Tax Operations Division assumes a standard rate of 3 hours of system development work and ongoing maintenance for every 1 hour of development completed by MN.IT. Based on this Tax Operations assumes it will need 6.99 FTEs (14,535 hours) for FY25. For FY25 only, Tax Operations is reporting hours below the 3 to 1 ratio of MN.IT hours to accommodate hiring times. Tax Operations assumes that 1.45 FTE (3,018 hours) will be required starting in FY26 and ongoing for continued ongoing testing and system maintenance.

Work to be completed by Tax Operations in the initial development in FY25 includes system testing, identifying and developing system requirements including but not limited to return mock-ups and specific line details, e-Services testing, GenTax return mapping and testing, testing interfaces to ensure receipt of accurate data, completing user experience review, and updating and monitoring security. Work for FY26 and ongoing includes continued system testing, review of form and schedule updates based on relevant law changes, system improvements, and general system and security maintenance.

The Income Tax and Withholding (ITW) Division assumes it will provide support with the development of the 14 Minnesota forms at a rate of 8 hours per form or schedule, totaling 112 hours or .05 FTE in FY25. For FY26 and beyond, updating the aspects of the system related to Minnesota forms will be part of the agency's existing annual changes process.

ITW assumes 5% of the 2,100,000 eligible filers (105,000) will call or email for assistance at an average rate of 15 minutes per call or email, requiring approximately 26,250 hours to respond. ITW assumes a new contact center unit will be created in FY26 and will be needed on an ongoing basis to address these new customer contacts. This unit will consist of 1 supervisor at the MMA level, 1 lead worker at the MAPE level to handle complex customer escalations, 2 resource representatives at the MAPE level to handle moderately complex customer escalations, and 12 customer contact agents at the AFSCME level to handle the majority of customer contacts.

The Appeals, Legal Services, and Disclosure Division assumes that its legal unit will provide legal advice and support, attend meetings, and review documents related to the direct free filing system. The disclosure unit assumes it will have a representative on the team that develops the filing service to ensure that any possible disclosure issues are identified in advance and mitigated. Disclosure will also draft Tennessee language to pair with the filing service.

The Communication Division assumes it will provide initial and ongoing forms, communication, marketing, usability, and user experience support for the electronic direct filing system. New and ongoing products of this scope require appropriate marketing to inform, remind, and support the existing and potential customer base each year. With 2.1 million potential users, it's necessary to promote the system through both earned media and targeted social media as well as digital spots to raise general awareness of the system and to reach potential users. Communications assumes the following one-time and ongoing staff hours and costs.

### **Communication Division One-time Impacts**

#### Usability and User Experience Testing and support

Communications will support/provide usability testing and user experience consulting, collaborating with MNIT, FAST Enterprises, and Tax Ops during development and in follow-up testing/feedback gathering.

FY25 and FY26: 120 total hours (60 hours each year) for usability testing and user experience support during system development. We assume this would begin in FY25 and extend into FY26.

FY27: 30 hours (25% of initial time), assuming the basic design of the system is not redone each year.

#### Review and Consult on GenTax Messaging and Screens

Communications will review and collaborate with MNIT, FAST Enterprises, and Tax Ops during and after development to create and maintain the onscreen messaging/questions in GenTax for the new system:

FY25 and FY26: 80 total hours (40 hours each year). We assume this would begin in FY25 and extend into FY26.  
FY27: 20 hours (25% of initial time), assuming the basic design and flow of the system is not redone each year.

#### Outreach Materials

Communications will design a large banner for use at the Revenue booth for the Minnesota State Fair (can also be used for other events), as well as 3 handouts in different sizes and formats along with translated versions in Spanish, Hmong, and Somali. These materials will be updated each year based on response and goals to fine-tune and improve our messaging over time to reach the appropriate audiences.

Banner FY25, 26, and 27: 40 hours each year design time for banner and \$1,100 costs for outside printing

Handouts FY25, FY26, and FY27: 20 hours each year design time and \$2,340 translation costs (3 pieces x 3 language x \$260 per page/piece)

#### Conference call scripts

Communications will provide scripts and staffing to support 2 conference calls for partners and the media and public.

FY26: 30 hours (15 hours editorial and audio/video assistance per call x 2 calls)

FY27: 30 hours for additional calls with updated information and messaging each year

#### Press Releases

Communications will create, review, and publish three press releases each year to secure earned media promotion of the system.

FY26: 24 hours (3 press releases x 8 hours per release)

FY27: 24 hours (same number of releases with updated messaging each year)

#### Press Conference

Communications will support one press conference each year around filing season opening to promote the system.

FY26, FY27: Design + Editorial + A/V Staffing = 36 hours/year

- Design for displays at press conference: 16 hours
- Write/Review/Edit script for event: 12 hours
- Video/Audio setup, staffing, and post-production: 8 hours

#### Promotional Videos

Communications will work with Tax Operations Division and the Individual Income Tax and Withholding Division to produce two short-length and two medium-length videos to promote and remind customers about the system.

FY26: 120 total hours (2 short videos x 20 hours per video = 40 hours; 2 medium videos x 40 hours per video = 80 hours)

FY27: 120 hours (same number of videos with updated messaging and visuals each year)

### **Communication Division Ongoing Impacts**

#### Forms

Each year, Communications would need to recreate special-use versions of 14 Minnesota forms to support the creation and annual updates of the system. These re-creations require that final versions of designed forms be reformatted for use with the system each year, making this a repeating cost.

FY25: 112 total hours (14 state forms x 8 hours per form)

FY26 and FY27: 112 hours (same as FY25) in all, but re-creation of state forms would be part of annual updates process.

#### Website

Communications will review, edit, create, and publish website pages that inform customers of the system and provide complementary support information for those using the system. This is similar to what we do for other e-Services functions and content. We assume 24 hours of work will be needed beginning in FY25 and each year ongoing.

#### GovDelivery email bulletins

Communications will review, edit, and send email bulletins for five audiences (three bulletins per year ahead of filing season kickoff and twice during the season).

FY26: 22.5 hours (3 bulletins x 5 audiences/lists x 1.5 hours per bulletin)

FY27: 22.5 hours (same number of bulletins w/updated messaging each year)

Social Media

Communications will promote the system on all platforms (Twitter, Facebook, and Instagram) ahead of and during the filing season each year.

FY26: 22.5 hours (5 postings x 3 channels x 1.5 hours/post)

FY27: 22.5 hours (same number of posts with updated messaging each year)

Social Media and Digital Marketing

Communications will purchase paid and targeted social media ad placements linking back to our website and videos each year to promote the system to potential and existing customers. These placements would be in addition to our standard social media posts. We will handle the creative design of these in-house. Paid social and digital placement costs vary based on goals, channel, and day. We assume \$200,000 will be needed in FY26 and \$300,000 in FY27, with placements optimized within these amounts. We assume Revenue would undertake a comprehensive review of its costs and the results for these paid placements after the first two years the system is in operation. Based on the results and goals at that time, costs could increase in the future.

IRS and Other Partner Promotions

Revenue assumes it would partner with the IRS’s Direct File marketing with cross-linking promotions between our websites, and would collaborate in a similar way with community and partner groups such as Prepare + Prosper, Minnesota Budget Project, etc. No cost is assumed for these activities.

**FTE Impact**

FTEs	FY 2024	FY 2025	FY 2026	FY 2027
Appeals, Legal, and Disclosure staff		.35	.35	
Attorney		.1	.1	
MAPE		.25	.25	
Communications staff (MAPE)		.13	.24	.22
Income Tax and Withholding staff		.05	16	16
AFSCME			12	12
MAPE		.05	3	3
MMA			1	1
Tax Operations/Processing staff (MAPE)		6.99	1.45	1.45
Total FTE Impact		7.52	18.03	17.67

Note: Totals may vary slightly due to rounding.

Expenditure and/or Revenue Formula

**Administrative Impact**

Administrative Costs (Savings)	FY 2024	FY 2025	FY 2026	FY 2027
Employee Compensation		1,214,801	2,348,466	2,284,568

Paid Social Media/Digital Placements			200,000	300,000
Translations/Banner Display		3,440	3,440	3,440
Systems Development		808,000		
Systems Support			103,800	103,800
Total Administrative Costs (Savings)		2,026,241	2,655,706	2,691,808

Note: This table uses whole numbers. Totals may vary slightly due to rounding.

**Long-Term Fiscal Considerations**

The system developed will require ongoing updates on an annual basis. These updates include any changes made to Minnesota individual income tax forms and schedules based on new law changes, annual testing of the system, and ongoing maintenance. There are also ongoing staff costs.

**Local Fiscal Impact**

N/A

**References/Sources**

IRS Direct File Pilot: <https://directfile.irs.gov/> and <https://www.irs.gov/about-irs/strategic-plan/irs-direct-file-pilot>

Tips for success using Direct File:

<https://www.irs.gov/newsroom/tips-for-success-using-direct-file#:~:text=Direct%20File%20allows%20you%20to%20claim%20the%20following,Child%20Tax%20Credit%203%20Credit%20for%20Other%20Dependents>

Agency staff provided information for this fiscal note.

If information technology costs are included, my agency’s Chief Business Technology Officer has reviewed the estimate.

I have reviewed the content of this fiscal note and believe it is a reasonable estimate of the expenditures and revenues associated with this proposed legislation.

**Agency Contact:**

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