

## Minnesota revenue notice # 03-05

### Revenue Notice # 03-05: Individual Income Tax - K-12 Education Credit

#### 1. In order to qualify for the K-12 Education Credit, there are specific requirements that must be followed if the vendor offers a package of educational services and products.

When a taxpayer purchases a package of goods and/or service for one price and some of the items qualify for the education credit under Minnesota Statutes, section 290.0674 and some of the items do not qualify for the credit or are computer hardware or educational software, the department will allow the education tax credit to the extent the vendor allocates the purchase price on the sales receipt to the various items in the package. The allocation must be based on the fair market value of each item received by the taxpayer over the total fair market value of all items received by the taxpayer times the purchase price paid by the taxpayer. The total purchase price must be allocated to all items received including "gift" items given by the vendor, which are conditioned on the purchase of the other items. Individual goods and services with a fair market value of less than 2% of the total purchase price need not be allocated.

#### Example

A vendor sells 20 hours of math and reading tutoring by qualified instructors, textbooks and workbooks used in this tutoring, a personal computer, access to the internet, and 10 hours of music lessons for a total purchase price of \$2,000. The amount of qualifying expense would need to be computed as reflected in the following table. An itemized account of the items in the educational bundle is required to be given to the buyer of the goods and services. In this example, the taxpayer would receive the education credit for 75% of that \$1,291 qualifying amount, or \$968. Even if the taxpayer had only one child, the entire \$968 would qualify since the credit amount would be under the \$1,000 maximum per child.

Educational Materials or Services	Fair Market Value (FMV) if Purchased Separately	(FMV/Total FMV) times Total Price of Bundled Package	Educational Expense of Each Piece of Bundled Package	Educational Expense Allowed
Math and Reading Instruction	\$800	$(800/2200)$ times 2000	\$727	\$727
Tutoring Materials	\$300	$(300/2200)$ times 2000	\$273	Does not qualify
Music Lessons	\$400	$(400/2200)$ times 2000	\$364	\$364
Computer	\$600	$(600/2200)$ times 2000	\$545	\$200 (limited)
Internet	\$100	$(100/2200)$	\$91	Does not

Access		times 2000		qualify
Total	\$2,200		\$2,000	\$1,291

**2. K-12 Education Credit is allowed only if payment is made for education-related expenses in the tax year.**

A. The vendors must receive payment for their educational goods and/or services during the tax year for which the credit is claimed. Vendors must be paid with cash, check or credit cards. Only amounts actually paid to the vendor during the tax year are included in the qualifying expenses.

B. If the taxpayer borrows money from the vendor for the purchase of the vendor's product, the expenses are only considered paid to the extent the taxpayer repays the loan.

C. Taxpayers may borrow the money for the cash payment from any third-party lender other than the vendor of the educational product being purchased. The vendor of the educational services/products will be considered to be paid only when the loan proceeds are given to the vendor. The lender must accept the full risk of lending the money to pay for the educational expense. However, if the lender is a bank or a 501(c)(3) non-profit organization, the risk that the loan might not be repaid can, in some cases, be mitigated by assignment of income tax refunds to repay a portion of the loan. (See assignment guidelines below.)

**3. If the taxpayers borrow the money for the purchase of a qualified educational product from a 501(c)(3) charitable organization or a financial institution such as a bank, savings association, or credit union, the taxpayers can use their Minnesota income tax refunds to repay the loan by assigning the right to their refund to the lender.**

A. These lenders may ask customers to provide information (grades and number of children, household income, parents' tax filing status) that will help the lenders determine whether the customer will qualify for the education credit.

B. Lenders may ask taxpayers to complete a release form (REV186) that will authorize the Department of Revenue to provide information about each taxpayer's tax debts, child support debts, hospital debts, restitution amounts, and other claims that might take precedence over the lender's claim to the income tax refund.

C. Taxpayers may assign their Minnesota income tax refunds (the refund may be more or less than the amount of credit depending upon the taxpayer's tax and other credits) to repay a qualifying loan.

- Taxpayers must be told in clear and understandable language that they have entered into a loan agreement. The loan agreement must be written.
- Taxpayers must be told in clear and understandable language that they have given up their right to receive their Minnesota income tax refund to the extent of the assignment. That is, that they are giving their income tax refund to pay for that loan. If the entire purchase price is financed, the education credit, at most, will only generate a refund of 75% of the loan. The remaining 25% of the loan must be repaid by the taxpayers directly or indirectly from their own funds. The amount of the refund that can be assigned is limited to \$1,000 for a single qualifying child and \$2,000 for two or more qualifying children.
- Lenders must tell the taxpayers in clear and understandable written language that, as the result of the assignment process, their refunds will be paid to the lender up to the assigned amount. Only the amount of their refund over the assigned amount will be sent to them.

- If the educational product or service does not qualify for the credit, the assignment is invalid, and the department will not honor the assignment.
- If the educational product or service qualifies for the credit, but the taxpayer does not qualify because of income thresholds, the assignment will still be honored.
- Assignment forms (M300s) will only be accepted until December 31, 2003 unless the legislature extends the effective date.

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