

## Federal Taxable Income, the starting point for calculating Minnesota income tax

### *What is federal taxable income (FTI)?*

Federal taxable income is the tax base used to calculate federal income tax liability. It is also the starting point for calculating Minnesota taxable income, the tax base used to calculate Minnesota income tax liability. Federal taxable income equals federal adjusted gross income (FAGI) after deductions and exemptions.

$$\begin{array}{|c|} \hline \text{Federal} \\ \text{adjusted} \\ \text{gross income} \\ \text{(FAGI)} \\ \hline \end{array} - \begin{array}{|c|} \hline \text{Standard} \\ \text{or} \\ \text{Itemized} \\ \text{deductions} \\ \hline \end{array} - \begin{array}{|c|} \hline \text{Personal} \\ \text{and} \\ \text{Dependent} \\ \text{exemptions} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Federal} \\ \text{taxable} \\ \text{income} \\ \text{(FTI)} \\ \hline \end{array}$$

### *What kinds of income are included in FAGI?*

FAGI includes most kinds of cash income: wages, salaries, and tips; taxable interest; dividends; alimony received by the taxpayer; business income or loss; capital gains or losses; other gains or losses; taxable IRA distributions; taxable pension and annuity distributions (the taxable portion excludes recovery of amounts that were included in FAGI when the contributions were made); income from rental real estate, royalties, partnerships, S corporations, and trusts; farm income or loss; unemployment compensation; and taxable Social Security benefits (the amount taxable depends on the individual's income level; at most, 85 percent of benefits are included in FAGI). FAGI does not include child support received by the taxpayer.

### *What kinds of income are excluded from FAGI?*

FAGI excludes: deductible IRA, SEP, SIMPLE, and other retirement contributions; nontaxable employee fringe benefits; deductible student loan interest payments; Health Savings Account contributions and investment income; moving expenses; one-half of self-employment tax; health insurance premiums (for self-employed taxpayers only); penalty on early withdrawal of savings; alimony paid by the taxpayer; and \$250 of teacher classroom expenses. FAGI does not exclude child support paid by the taxpayer.

### *What deductions are allowed from FTI?*

Taxpayers may claim either the standard deduction or itemized deductions. In tax year 2014, the most recent year for which data is available, 64 percent of Minnesotans claimed the standard deduction and 36 percent itemized.

### *How much is the standard deduction?*

In tax year 2017, the standard deduction is as follows:

- \$12,700 for married couples filing joint returns
- \$6,350 for married couples filing separate returns
- \$9,350 for head of household filers
- \$6,350 for single filers

***What itemized deductions are allowed?***

In tax year 2017 itemized deductions are allowed for the following:

- Payments of state and local property taxes and either income or sales taxes
- Mortgage interest
- Charitable contributions
- Medical expenses and health insurance premiums in excess of 10 percent of FAGI
- Casualty and theft losses in excess of 10 percent of income
- Job expenses and miscellaneous expenses (most only allowed in excess of 2 percent of income)

***What personal and dependent exemptions are allowed?***

Taxpayers may claim one personal exemption each and one dependent exemption for each dependent claimed. For tax year 2017, the personal and dependent exemptions are \$4,050 each. A family of four qualifies for four exemptions, totaling \$16,200.

***Are there limits on deductions and exemptions?***

The federal American Taxpayer Relief Act of 2012 (ATRA) revived and made permanent the limitation on itemized deductions and phaseout of personal and dependent exemptions for taxpayers with incomes over a threshold.

The limit takes away some of the benefit of the deduction for higher income taxpayers. Taxpayers subject to the limit have their deductions reduced by 3 percent of their FAGI over the applicable thresholds. But they are always guaranteed 20 percent of the deductions, no matter how high their FAGIs are.

ATRA also provides for personal and dependent exemptions to be phased out for taxpayers with incomes over a threshold. Affected taxpayers lose 2 percent of their total exemption amount for each \$2,500 of income over the threshold.

The table shows the income thresholds for the itemized deduction limitation and the personal and dependent exemption phaseout in effect in tax year 2017. The income thresholds are adjusted annually for inflation.

<b>Tax year 2017</b>	<b>Itemized deduction limit and personal and dependent exemption phaseout begins at</b>
Married joint filers	\$313,800
Married separate filers	\$156,900
Single filers	\$261,500
Head of household filers	\$287,650

**For more information:** Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publication *Income Tax Terms: Deductions and Credits*, July 2015.