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Minnesota Income Tax Benefits for Veterans

What tax benefits does Minnesota provide for past military service and military retirees?

Minnesota allows a nonrefundable credit for past military service and an income tax subtraction for military retirement pay. Individuals who are eligible for both the credit and the subtraction may claim one or the other, but not both.

The credit equals $750 for qualifying individuals and is subject to an income limitation. The credit took effect in tax year 2009.

The income tax subtraction applies to all retirement pay and is not income limited. The subtraction takes effect in tax year 2016.

Who qualifies for the credit for past military service?

To qualify for the credit, an individual must meet one of two criteria:

- have served in the military (including the National Guard and reserves) for at least 20 years; *or*
- have a service-connected disability rated by the U.S. Department of Veterans Affairs as being 100 percent total and permanent.

Individuals currently serving in the military do not qualify for the credit, nor do survivors of individuals who qualified. Individuals are not required to receive military retirement pay in order to claim the credit.

How is the military service credit income limited?

The military service credit is phased out for individuals with federal adjusted gross income (FAGI) of $30,000 or more. The credit is reduced by 10 percent of FAGI in excess of $30,000, so that individuals with FAGI over $37,500 are not eligible for the credit. FAGI is a broad income measure that includes most kinds of income; among the items excluded are tax-exempt bond interest, the nontaxable portion of Social Security benefits, and veterans disability payments.

Who qualifies for the military retirement pay subtraction?

Individuals who receive military retirement pay qualify for the subtraction. The subtraction applies to pay received by retirees from the full-time military, National Guard and reserves, and also Survivors Benefit Plan payments received by survivors of retirees. Disability pensions are excluded from federal and state taxable income and thus are not eligible for the subtraction.

How does the nonrefundable credit for past service compare with the income tax subtraction for retirement pay?

A nonrefundable credit and an income tax subtraction both reduce tax liability, but in different ways. A credit is a dollar-for-dollar reduction in tax liability, while a subtraction reduces taxable income, which reduces tax liability. The benefit from a subtraction depends upon the taxpayer’s tax bracket or rate. Because of the income limits for the credit, veterans who qualify for the credit will be in the bottom or lowest tax bracket with a rate of 5.35 percent. The $750 nonrefundable military service credit is equivalent to a $14,020 income tax subtraction ($14,020 times

5.35 percent, the state income tax rate for the first bracket of taxable income, equals $750).

Only individuals with tax liability will benefit from either a nonrefundable credit or a subtraction, and the amount of the benefit is limited to their tax liability.

Who will claim the credit and who will claim the subtraction?

Some individuals will be eligible for the credit but not the subtraction, chiefly lower-income individuals who have a service-connected disability rated as being 100 percent total and permanent. While these individuals may receive disability pensions, the disability pensions are exempt from federal and state tax, and they would not benefit from the subtraction. Most individuals who receive military retirement pay will obtain a greater tax benefit from the subtraction rather than the credit. Individuals who are eligible for both the credit and the subtraction must choose one or the other, and may not claim both.

How many returns claim the credit and how much do they claim?

In tax year 2014, 2,004 returns claimed about $1.4 million in credits, for an average of $677. Since the credit is nonrefundable, the reduction in liability in 2014 may have been less than $1.4 million. Individuals who are eligible for credits that exceed their tax liability use the credit to reduce their liability to zero, and do not benefit from the remaining credit amount that exceeds liability. For tax year 2016, the Department of Revenue projects that about 500 individuals who have previously claimed the credit will shift to the subtraction.

How many individuals are projected to claim the subtraction, and how much will they benefit?

The Department of Revenue estimates that 16,400 taxpayers will claim the subtraction in tax year 2016, including 500 taxpayers who in previous tax years claimed the credit, with a $22.6 million decrease in income tax revenues. The average tax benefit is estimated to be $1,378.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204. Also see the House Research publication *Military Pay under Minnesota's Individual Income Tax*, October 2016.