MN HOUSE RESEARCH

Minnesota Taxable Income

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Calculating Minnesota Taxable Income

Minnesota taxable income is the tax base used to calculate Minnesota individual income tax liability. Income tax rates and brackets are applied to a taxpayer's Minnesota Taxable Income (MTI). Beginning with tax year 2019, Minnesota will use Federal Adjusted Gross Income (FAGI) as the starting point for calculating MTI. The state used Federal Taxable Income (FTI) as the starting point for calculating MTI from tax year 1987 to tax year 2018. After calculating FAGI on the federal return, a taxpayer must add to FAGI the amount of the taxpayer's Minnesota additions and subtract the amount of the taxpayer's Minnesota dependent exemptions, standard or itemized deductions, and other Minnesota subtractions.

	Federal Adjusted Gross Income (FAGI)
+	Minnesota Additions
-	Minnesota Dependent Exemption
-	Standard or Itemized Deductions
-	Other Minnesota Subtractions
=	Minnesota Taxable Income (MTI)

The following sections of this publication will discuss each component of this calculation.

Federal Adjusted Gross Income

FAGI is a broad federal definition of income. It includes most of a taxpayer's gross income, including wages, interests, dividends, capital gains, retirement income, and part of a taxpayer's Social Security benefits. FAGI includes deductions for certain "adjustments to income." In tax year 2018, there were 11 adjustments to income, including educator expenses, health savings account contributions, deductible self-employment taxes, alimony paid, IRA deductions, and student loan interest.

	Gross Income
-	Adjustments to Income
=	Federal Adjusted Gross Income (FAGI)

Minnesota Additions

Most Minnesota additions fall into two categories—additions for income that is exempt from federal tax but subject to Minnesota tax, and additions related to Minnesota's nonconformity to federal law.

- **Example nonconformity additions:** section 179 and bonus depreciation additions; suspended losses; and fines, fees, and penalties deducted as a business expense.
- **Examples of income not taxed federally:** interest from municipal bonds of another state or local government, capital gains portions of a lump-sum distribution.

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Minnesota Dependent Exemption

The federal and Minnesota tax codes adjust a taxpayer's liability to account for family size. Minnesota allows a dependent exemption, modeled on the personal exemptions that existed in federal law prior to tax year 2018. A taxpayer with dependents is allowed to subtract $4,250 for each dependent. This amount is adjusted for inflation each tax year. For taxpayers without dependents, the exemption is $0.

Minnesota Standard or Itemized Deductions

A Minnesota individual income taxpayer may either claim the Minnesota standard deduction or deduct the amount of taxpayer's Minnesota itemized deductions. Minnesota's standard and itemized deductions are similar—but not identical—to those allowed federally.

Minnesota's standard deduction amounts are set in state law; the Minnesota amounts are the same as the federal amounts for tax years 2019 to 2025. In tax year 2019, the Minnesota standard deduction is $24,400 for married taxpayers filing a joint return, $12,200 for single taxpayers, and $18,350 for taxpayers filing as a head of household. Taxpayers who are older than 65 or blind are allowed a larger standard deduction. The standard deduction amounts are adjusted for inflation each tax year.

Minnesota allows a similar list of itemized deductions to the deductions allowed federally, except the state allows a deduction for unreimbursed employee expenses and a broader deduction for losses.

- **Taxes paid:** Up to $10,000 of property and certain foreign taxes paid.
- **Charitable contributions:** Allowed under federal law, up to 60 percent of FAGI.
- **Interest:** Mortgage interest and investment interest allowed as a federal deduction.
- **Medical expenses:** In excess of 10 percent of the taxpayer's FAGI.
- **Unreimbursed employee expenses:** In excess of 2 percent of the taxpayer's FAGI.
- **Losses:** Personal casualty and theft losses in excess of 10 percent of the taxpayer's FAGI.
- **Miscellaneous deductions:** Miscellaneous deductions allowed federally.

Minnesota's itemized and standard deduction are subject to an income-based limitation. For most taxpayers, the limit begins with FAGI above $194,650 in tax year 2019 (for married couples filing separately, the threshold is half that amount). State law reduces the itemized and standard deductions of taxpayers by 3 percent of FAGI above the threshold, up to 80 percent of the deduction amount

Other Minnesota Subtractions

In addition to itemized deductions, Minnesota allows a number of other subtractions from FAGI. Taxpayers are allowed to claim these subtractions even if they do not itemize their deductions. Many state subtractions relate to income the state cannot constitutionally tax. Others are tax expenditures the legislature enacted to achieve certain policy goals. Others are required due to nonconformity.

- **Examples of income that cannot be taxed:** interest on U.S. government bonds, railroad retirement benefits, and reservation-source income of an American Indian tribe member.
- **Example tax expenditures:** education expenses, charitable contributions of nonitemizers, organ donation expenses, 529 contributions, Social Security benefits, elderly exclusion.
- **Example nonconformity subtractions:** Bonus depreciation and section 179 subtractions.

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