

Minnesota Income Tax Credit for Past Military Service

What is the income tax credit for past military service?

The credit for past military service equals \$750 for qualifying individuals. It is nonrefundable and is subject to an income limitation. The credit took effect in tax year 2009 and was first claimed on tax year 2009 returns filed in 2010. Eligible individuals use form M-1C to claim the credit as part of their income tax return.

Who qualifies for the credit for past military service?

To qualify for the credit, a veteran must:

- 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.

What is a nonrefundable credit?

A nonrefundable credit may be used only to offset Minnesota income tax liability. A veteran must have at least \$750 of income tax liability to receive the full credit amount. A qualified veteran with less than \$750 of state income tax liability benefits from the credit only up to the amount of tax. A qualified veteran with no state income tax liability does not benefit from the credit.

In tax year 2016, a single veteran with no dependents who claims the standard deduction would need to have \$24,369 of federal adjusted gross income (FAGI) to receive the full \$750 credit.

How does a nonrefundable credit compare with an income tax subtraction?

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, 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.

How is the military service credit income limited?

The military service credit is phased out for individuals with 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 any portion of the credit.

FAGI is calculated on the federal tax forms (Form 1040, 1040A, or 1040EZ). It includes most kinds of income, such as:

- wages, salaries, and tips;
- taxable interest;
- dividends and capital gains or losses;
- business income or loss, including income from partnerships and S corporations;
- taxable IRA, pension, and annuity distributions;
- farm income or loss;
- unemployment compensation; and
- taxable Social Security benefits (the amount of Social Security benefits that are taxable depends on the individual's income level; at most, 85 percent of benefits are included in FAGI).

Some of the major items excluded from FAGI are:

- deductible retirement plan contributions;
- nontaxable employee fringe benefits;
- certain student loan interest payments;
- one-half of self-employment tax;
- health insurance premiums (for self-employed taxpayers only);
- tax-exempt bond interest; and
- veterans disability payments.

What are some examples of individuals who will and will not receive the military service credit?

A qualifying veteran with less than \$30,000 in taxable military retirement income and no other income other than Social Security would qualify for part or all of the credit, depending on the individual's tax liability. Since Social Security benefits are not included in FAGI for low-income filers, receipt of Social Security will not subject an individual to the income-based phaseout.

Qualifying veterans who are 100 percent totally and permanently disabled may or may not receive the credit, depending on their amount of taxable income (military disability compensation itself is nontaxable). With no taxable income or with more than \$37,500 of adjusted gross income, such disabled veterans do not receive the credit. Conversely, with any amount of taxable income greater than zero and less than \$37,500, the disabled veteran would receive a credit.

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.

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