MINNESOTA · REVENUE

Additional Nontaxable Income

The list below details what types of income you must include on line 5 (Additional nontaxable Income) when applying for the following Minnesota tax credits and refunds:

- Child and Dependent Care Credit (Schedule M1CD)
- K-12 Education Credit (Schedule M1ED)
- Credit for New Participants in a Section 125 Employer Health Plan (Schedule M1H)
- Property Tax Refund for renters and homeowners (Form M1PR)

However, the list may not be complete, so be sure to include any other nontaxable income you receive, except as noted in the sections "What Not to Include on Line 5" and "Retirement Distributions."

What to Include on Line 5

Include any other nontaxable income that wasn't part of FAGI, such as:

- Adoption assistance or subsidy payments
- Contributions to pre-tax employee benefit plans for dependent care, medical or health expenses, transit or parking, and other expenses (also known as a "flexible spending account" or "FSA," "cafeteria plan," "pre-tax plan," or "section 125 plan")
- Compensated Work Therapy (CWT) payments from the Department of Veterans Affairs
- Deferred compensation plans (also known as "employee elective deferred plans") – include voluntary employee contributions to a 401(k), 457, 403(b) or SEP/SIMPLE plan (codes D, E, F, G, or S in box 12 of Form W-2)
- Disability benefits (but not funds used to pay medical expenses)*
- Employer-paid education or adoption expenses
- Excluded gain on the sale of your home
- Excluded unemployment compensation up to $2,400 per recipient (for 2009 only)
- Federal adjustments to income for:
    - Contributions to IRA, Keogh, SEP or SIMPLE plan (under M.S. 290A.03, subd. 3(1)(b)(xi))
    - Contributions to a Health Savings Account (HSA), or Archer Medical Savings Account (MSA)
    - Educator expenses (beginning with tax year 2008)
    - Domestic production activities deducted on your federal return
    - Tuition and fees deducted on your federal return (for 2008 and 2009 only).
- Interest and mutual fund dividends that aren't taxable on your federal return
- Foreign-earned income that's excluded from FAGI
- Forgiveness of debt income, usually due to bankruptcy, that's not taxable on your federal return (but not any that is taxable and included in FAGI
- Foster care payments for children you claim as dependents, including adult foster care
- Housing or parsonage allowance for members of the military or clergy
- Income that's excluded from FAGI under tax treaties with other countries
- Income of people living with the homeowner other than a spouse, dependents or renters (but only when completing form M1PR, Property Tax Refund. Do not include when determining the M1CD, M1ED or M1H credits.)
- IRA distributions that are made directly to a charity (see Excluded IRA Distributions under Retirement Distributions, below)
- Military nontaxable earned income (e.g., combat zone pay, hazardous duty pay, basic housing, and subsistence allowances)
- Pension and annuity payments (nontaxable portion) , including lump-sum distributions and disability payments that aren't used to pay medical expenses (under M.S. 290A.03, subd. 3(1)(b)(v) and subd. 3(2)(b)) – see Retirement Distributions, below
- Personal injury or other nontaxable settlement income; this includes insurance payments for lost wages and lawsuit income (but not funds used to pay medical expenses, or Holocaust settlement payments)
- Reduction in rent for caretaking duties (difference between the actual rent and what rent would have been if filer wasn't the caretaker)
- Scholarships, fellowships and nontaxable grants, including Pell grants, tuition reimbursements and tuition waivers (from domestic and foreign sources)
- Sick pay (but not funds used to pay medical expenses)
- Strike benefits
- Veterans benefits (including education benefits and Agent Orange payments)
- Workers compensation and other nontaxable disability benefits (but not funds used to pay medical expenses); starting with tax year 2008, this includes wage-based periodic death benefits paid to a surviving spouse or other beneficiary

- Gains reported on federal Form 1099-A, Acquisition or Abandonment of Property (but not any amounts that were included in FAGI)

Note: For income from legal settlements, you may not reduce the amount you report on line 5 for legal fees, even if those fees were paid out of the settlement.

You must also include the following losses and deductions on line 5 if they reduced FAGI:

- Capital loss carryforward (but not the current year's allowable federal capital loss) – see Adding Back Capital Loss Carryforward in Household Income worksheet.
- Net operating loss carryforward or carryback (but not the current year's allowable federal NOL)
- Current-year passive activity losses (including rental losses) that exceed current-year passive activity income
- Prior year passive activity loss carryforward claimed on your federal return for the current year

What Not to Include on Line 5

Don't include the following types of income:

- Bonus depreciation addition or subtraction on your Minnesota tax return
- Car insurance settlement payments (or other insurance proceeds) used to pay medical bills
- Child care assistance or subsidy payments made to the provider or any other "vendored" government assistance (where you can't receive cash instead of the benefit)
- Child support payments required under the terms of any divorce decree or legal separation
- Dependent's income (including Social Security) or the income of parents living with the filer
- Dependent's indemnity compensation (if designated for children)
- Distributions from a Roth IRA (under M.S. 290A.03, subd. 3 (2)(b))
- Employer's contributions to filer's deferred compensation or pension plan, such as 401(k), etc.
- Employee's mandatory contributions to a retirement plan (including PERA, TRA or MSRS) or other mandatory contributions
- Federal adjustments to income, such as:
    - Tuition and fees deducted on your federal return (starting in 2010)
    - Student loan interest
    - Moving expenses
    - Penalty on early withdrawal from a retirement account
    - Self-employment tax (half the amount paid)
    - Self-employment health insurance
    - Alimony or "separate maintenance" paid by the filer
- FEMA emergency grants for disaster victims
- Foster care payments (if not claimed as a dependent) or adoption bonus
- Fuel assistance payments
- Gifts and inheritances (under M.S. 290A.03, subd. 3 (2)(a))
- Gulf War bonus
- Holocaust settlement payments
- IRA, pension and annuity rollovers, or 1035 annuity exchange
- Life insurance and/or survivor benefits, including those paid for the deaths of dependent children and workers compensation death benefits for burial costs (under M.S. 290A.03, subd. 3 (2)(a))
- Long-term care benefits used to pay medical expenses
- Medicare, Medicaid or Government Assistance Medical Care (GAMC)
- Payments that someone else made to a care provider for the filer (such as direct payments to a nurse, nursing home or hospital)
- Refunds, such as:
    - Property Tax Refund (under M.S. 290A.03, subd. 3 (2))
    - Nontaxable portion of federal and state income tax refunds, refundable credits or rebates
    - Stimulus rebate
    - First-time Homebuyers Credit
    - Cash for Clunkers
    - Making Work Pay Credit
- Reimbursements by your employer for work-related expenses (such as gas, meals and lodging)
- Return of capital investment (not a taxable distribution under Internal Revenue Code)
- Reverse-mortgage proceeds (considered a loan under IRC)
- Special-needs welfare benefits (welfare statement)
- Spouse's Social Security income if filing separately (i.e., when one spouse is in a nursing home)
- Value of meals and lodging furnished only for an employer's convenience
- Value of noncash government benefits such as food or food stamps, clothing, and medical care or supplies (under M.S. 290A.03, subd. 3 (2)(c))

>Retirement Distributions
Do not include nontaxable retirement distributions if you funded the retirement account by yourself with only after-tax dollars.

"After-tax" dollars are funds on which the taxpayer paid federal income tax.

"Pretax" dollars are funds on which the taxpayer did not pay federal income tax, because either:
- the contribution was deductible on the federal return, (for example, IRA contributions) or
- the funds were not subject to federal income tax when the income was earned (for example, contributions to deferred compensation plans).

Nontaxable Distributions You Don't Report on Line 5:

Roth IRAs
Contributions to a Roth IRA are made with after-tax dollars, so they aren't tax deductible (unlike contributions to a traditional IRA). As a result, all distributions from a Roth IRA – including earnings on the account – are nontaxable on your federal return. Do not include any part of these distributions when determining household income. for the Property Tax Refund (Form M1PR).

Example: Walt took a distribution from his Roth IRA last year of $5,000. None of the distribution was taxable on his federal return. When determining household income, Walt doesn't have to report any part of the distribution as nontaxable income on line 5.

Annuities
Taxpayers may purchase annuities directly from life insurance companies or other financial institutions with after-tax dollars. When you receive distributions from the policy, your contributions aren't taxable but the earnings are. Since the plan was fully funded with after-tax dollars, you don't have to add back the nontaxable portion on line 5.

Example: Ruth and Stanley took an $8,000 distribution from their annuity. Their Form 1099-R shows that $2,000 of the distribution was taxable (representing their earnings on the account). Ruth and Stanley didn't file a federal return because their other income was $12,000 of nontaxable Social Security benefits. When determining household income, they report:

Line 1 – FAGI (taxable annuity)	$2,000
Line 3 – Social Security Benefits	$12,000
Line 5 – Additional Nontaxable Income	$0
Household Income	$14,000

Since they fully funded the annuity with after-tax dollars, Ruth and Stanley don't have to add back the $6,000 nontaxable part of the distribution on line 5.

Nontaxable Distributions You Must Report on Line 5:

Employer-Sponsored Retirement Plans
Contributions to a retirement (pension) plan are usually made with pre-tax dollars. This includes both public-sector plans (such as the MSRS, PERA and FERS) and private plans (such as 3M, General Mills and Honeywell).

You may have to include the nontaxable part of distributions from these plans on line 5. It depends how the plan was funded and if the employer contributed to the plan, as outlined below:
- If the plan was funded with pre-tax dollars, or a mix of pretax and after-tax dollars, you must include any nontaxable part of the distribution on line 5 when determining household income.
- If the plan was funded with after-tax dollars, and with no employer contributions, do not include the nontaxable part of the distribution on line 5.
- If you don't know whether the employer contributed to the plan, find out how benefits are determined. If distributions are based on salary, age and/or length of service – instead of strictly on the employee's contributions – then the employer almost certainly contributed to the plan.

Example: Marie received a Form 1099-R from her employer's pension plan showing gross distributions of $18,000, of which $16,000 was taxable. She made contributions to the plan with both pre-tax dollars (in the 1990s and later) and after-tax dollars (before 1990).

The $16,000 taxable distribution is reported as part of Marie's FAGI, which flows to line 1. Since Marie didn't fully fund the plan with her own after-tax dollars, she must include the $2,000 nontaxable distribution on line 5.

Elective Deferral or Deferred Compensation Plans
Contributions to 401(k), 403(b), or 457 deferred compensation plans, or to SIMPLE/SEP plans, are usually made with pre-tax dollars.

Generally, distributions from these plans are fully taxable on the federal return. However, you must include any nontaxable distributions on line 5 (even if the employer didn't contribute to the plan).

Example: Richard took a $10,000 distribution from his 401(k), which was funded entirely by his pre-tax contributions. He received a Form 1099-R showing the whole distribution was taxable. Richard reported this $10,000 as part of FAGI on his federal return, which flows to line 1. He doesn't have any nontaxable income to include on line 5.

Traditional IRAs
Taxpayers can generally take a deduction on their federal return for contributions to traditional IRAs, which means they are funded with pre-tax dollars. As a result, distributions are usually taxable on the federal return.

However, part of your distribution from a traditional IRA may be nontaxable if you contributed in a year when you couldn't take the federal deduction (such as before Roth IRAs were available). If that happens, you must include the nontaxable portion on line 5.

Example: Brooke took a $12,000 from her traditional IRA. Since it was her only retirement account, Brooke made non-deductible contributions to the IRA in some years (before Roth IRAs were available). As a result, $1,000 of her distribution is nontaxable. Brooke reports the $11,000 taxable portion as part of FAGI on her federal return, which flows to line 1. She must also include the $1,000 nontaxable portion on line 5.

Excluded IRA Distributions Made to a Charity
Taxpayers who are at least 70½ years of age may direct their IRA distribution to a charitable organization tax-free. This type of distribution is excluded from FAGI on the federal return. But you must include this amount on line 5.

Excluded IRA Distributions Paid for Health Care
Retired public safety officers can exclude up to $3,000 of eligible retirement plan distributions from FAGI on their federal return. The money must be transferred directly to an insurer to pay premiums for accident, health or long-term care insurance. You must include this amount on line 5.