

AN ALERT FROM THE BDO STATE AND LOCAL TAX PRACTICE

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SUBJECT

NEW JERSEY TERMINATES PERSONAL INCOME TAX RECIPROCITY AGREEMENT WITH PENNSYLVANIA

SUMMARY

On September 2, 2016, New Jersey Governor Chris Christie (R) notified Pennsylvania that New Jersey terminated the reciprocity agreement between the two states. The reciprocity agreement requires each state to limit personal income tax reporting, payment, and withholding to the state of residency with respect to a resident individual that works in the other state. As a result of the termination, effective January 1, 2017, a Pennsylvania employer will be required to pay New Jersey withholding tax on the wages of a Pennsylvania resident employee attributed to work performed in New Jersey, and a New Jersey employer will be required to pay Pennsylvania withholding tax on the wages of a New Jersey resident employee attributed to work performed in Pennsylvania.

DETAILS

Very generally, an individual is required to report and pay income tax to the state of residency on wages wherever earned and, if different, to the state of work to the extent his or her wages are attributed to work performed in that state. The state of residency typically provides a credit to the extent of taxes paid to the state of work. An employer is required to withhold and pay income tax to the state where work is performed.

The reciprocity agreement between New Jersey and Pennsylvania, which had been in effect since December 31, 1977, allowed an employee who resided in one of these states and worked in the other to limit income tax reporting and payment to his or her state of residence. This removed the burden on such an employee to report and pay income tax to the state of work, too. The agreement similarly limited an employer's income tax withholding responsibility with respect to such an employee to the state of residency and,

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thus, eliminated the burden on such an employer to pay withholding tax to the employee's state of work.

By its terms, the agreement terminates as of the beginning of a calendar year upon 120 days written notice by either state. As a result of the September 2, 2016, notice given by New Jersey, the New Jersey-Pennsylvania reciprocity agreement terminates effective January 1, 2017.

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- ▶ Beginning January 1, 2017, a New Jersey employer with a New Jersey resident employee working in Pennsylvania may be required to register with Pennsylvania (or update its Pennsylvania registration) and pay withholding tax on wages attributed to the employee's work performed in Pennsylvania. These wages would no longer be subject to New Jersey withholding as they presently are. The New Jersey resident may have a personal income tax reporting and payment obligation in Pennsylvania where he or she did not have one before. The reverse would apply to a Pennsylvania employer with a Pennsylvania resident employee working in New Jersey.
- ▶ Highly compensated Pennsylvania residents working in New Jersey should be mindful of the potential to pay considerably more in personal income tax as a result of the termination of the reciprocity agreement. Pennsylvania imposes a flat 3.07 percent tax, but New Jersey applies a graduated rate structure with a top 8.97 percent rate.

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