



Pennsylvania provides guidance on New Jersey's termination of the reciprocal income tax agreement

As we previously reported, this year New Jersey Governor Chris Christie gave Pennsylvania the requisite 120-day notice that the reciprocal income tax agreement between the two states is terminated effective on and after January 1, 2017. Under that agreement, Pennsylvania residents working in New Jersey are subject only to Pennsylvania resident income tax and New Jersey residents working in Pennsylvania are subject only to New Jersey resident income tax. It is projected that nearly 250,000 employees will be affected by the ending of this 39-year tax pact. (*EY Payroll NewsFlash*, Vol. 17, #145, 9-26-2016.)

Pennsylvania has recently issued a notice of guidance concerning this change; however, New Jersey Division of Taxation officials tell us that it has not as yet finalized taxpayer guidance concerning the procedures that will apply for 2017 and future tax years. (*Telephone Conversation, New Jersey Division of Taxation, October 25, 2016.*)

Pennsylvania provides guidance to employers and employees

The Pennsylvania Department of Revenue posted a [notice](#) to its website advising employees and employers that its reciprocal agreement with New Jersey is ending. The notice also lays out the steps affected taxpayers will need to take as a result of this change.

- **Employees.** The notice explains that starting with tax year 2017 (filed in 2018), Pennsylvania residents working in New Jersey will be required to file an individual income return for both Pennsylvania and New Jersey. Pennsylvania residents will get a credit toward their Pennsylvania income tax obligation for income tax paid to New Jersey. This "resident credit" is the lesser of income tax paid to New Jersey or the income subject to tax in both states times 3.07%.

New Jersey residents working in Pennsylvania will likewise be required to file an individual income tax return in both states and will be subject to Pennsylvania income tax on their nonresident wages.

- **Employers.** Persons or organizations conducting business in Pennsylvania are required to withhold Pennsylvania income tax from all wages paid to Pennsylvania residents whether earned within Pennsylvania or New Jersey.

Also starting January 1, 2017, employers are required to withhold Pennsylvania income tax from wages earned within the state by New Jersey residents. New Jersey residents will also owe New Jersey income tax on wages earned within New Jersey; therefore, if an employer is not required to withhold New Jersey income tax from wages paid to New Jersey residents, they should consider if they will voluntarily withhold New Jersey income tax.

**New Jersey and Pennsylvania income tax requirements effective January 1, 2017
(Assuming the reciprocal income tax agreement is not reinstated)**

Requirement	Pennsylvania	New Jersey
Income tax withholding requirements	<p>Resident: All employers subject to the Pennsylvania income tax withholding requirement must withhold Pennsylvania income tax from the total compensation paid to residents from sources within and outside of Pennsylvania.</p> <p>Nonresident. Those wages paid to a New Jersey resident for work performed within Pennsylvania are subject to Pennsylvania income tax withholding.</p> <p>Local tax note: The Pennsylvania local income taxes are unaffected by the termination of the Pennsylvania-New Jersey reciprocal agreement and will continue to apply to Pennsylvania residents and nonresidents.</p>	<p>Resident: All compensation paid to a resident of New Jersey is subject to New Jersey income tax withholding even though some or all of the services may have been rendered outside New Jersey.</p> <p>However, in the event a New Jersey resident is employed totally outside New Jersey and subject to the Pennsylvania income tax, the employer is not obligated to withhold New Jersey gross income tax provided that Pennsylvania income tax withholding equals or exceeds the New Jersey income tax withholding that would have been required had the employee worked within New Jersey. Where the required New Jersey income tax withholding is greater than Pennsylvania income tax withholding, the employer must calculate New Jersey Income tax withholding as the difference between the amount required of New Jersey and the amount required of Pennsylvania.</p> <p>Nonresident: Those wages paid to a Pennsylvania resident for work performed within New Jersey are subject to New Jersey income tax withholding.</p>
Income tax withholding rate (for 2016)	3.07% (Note that an unemployment insurance tax of 0.07% is also required to be withheld for workers covered by the Pennsylvania unemployment insurance.)	1.5% to 9.9% depending on earnings
Withholding allowance certificate used by employees	Pennsylvania has no equivalent to the federal Form W-4. Personal exemptions, standard deductions or dependent credits are not allowed.	NJ-W-4
Source	Pennsylvania Rev. 415 ; Notice of termination of New Jersey Reciprocal Agreement	NJ-WT, New Jersey Gross Income Tax Instruction Booklet

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Ernst & Young LLP insights

Employers that will begin withholding New Jersey income tax for the first time next year will need to register with the New Jersey Division of Taxation.

Likewise, employers that will begin withholding Pennsylvania income tax for the first time will need to register with the Pennsylvania Department of Revenue.

Employees subject to New Jersey income tax withholding for the first time in 2017 will need to complete the NJ-W4, *Employee's Withholding Allowance Certificate*.

Employers should keep in mind that the New Jersey personal income tax can be substantially higher than the Pennsylvania rate; Pennsylvania has one income tax rate of 3.07% while the New Jersey income tax rate is graduated and ranges from 1.5% to 9.9% for tax year 2016.

If businesses have employees who work across New Jersey and Pennsylvania borders, they should consider providing them a notice explaining the state income tax changes that will apply effective January 1, 2017.

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