New Jersey: Governor considers terminating reciprocal income tax agreement with Pennsylvania

David M. Kall | Thursday, August 4, 2016

Many states have executed reciprocal agreements with other jurisdictions that simplify taxes for employees who live in one state and work in another. These benefit residents of Iowa, Kentucky, Michigan, or Wisconsin who work in Illinois; residents of Kentucky, Michigan, Ohio, Pennsylvania, or Wisconsin who work in Indiana; and residents of Illinois, Indiana, Kentucky, Minnesota, Ohio, or Wisconsin who work in Michigan.

New Jersey and Pennsylvania also have such an arrangement, the PA/NJ Reciprocal Income Tax Agreement (Agreement). But in February of this year, Gov. Chris Christie issued Executive Order 209, ordering the state's Treasurer and Acting Attorney General to determine what it would take to withdraw from the Agreement.

Under its terms, Pennsylvania residents who receive compensation income from sources located in New Jersey are not subject to New Jersey's income tax on that income. In addition, a New Jersey employer is not required to withhold New Jersey income tax from compensation paid to its Pennsylvania resident employees that file and Employee's Certificate of Nonresidence in New Jersey.

Likewise, Pennsylvania employers need not withhold Pennsylvania income tax from their New Jersey domiciled employees. In a December 2015 op-ed for NJSpotlight, the former New Jersey Treasurer Andrew Sidamon-Eristoff explained that the Agreement provides that each state will tax compensation earned in the other state as if earned in the taxpayer's state of residence.

In his op-ed, Sidamon-Eristoff, who was New Jersey's Treasurer from 2010 to July 2015, opined that it was time to revisit the Agreement, the "mother of all South Jersey sacred cows." Many residents of cities in the southern part of the state commute into New York City. The crux of his reasoning was "[m]oney's tight," and withdrawing from the 1977 Agreement could give the Garden State $180 million a year. This solution offers one new source of revenue "that won't make New Jersey into even more a tax hell."

Expanding on this, he pointed to the need to fix the state's Transportation Trust Fund, shore up local governments in fiscal distress, fund the state's long-term pension and healthcare obligations, and provide "long-overdue tax relief." As we described earlier this month, the Transportation Trust Fund in and of itself is causing a budget crisis to which the Governor responded by declaring a State of Emergency, halting most work on the state's transportation system.

Sidamon-Eristoff noted that when New Jersey and Pennsylvania entered into their 1977 Agreement, the two states had comparable income tax structures, so the goal of simplifying tax compliance made sense. "But times change and so do taxes," he asserted. Now, nearly 40 years later, the tax structures are quite different: Pennsylvania maintains a flat income tax rate 3.07 percent and offers no credits for local income taxes paid, while New Jersey has a highly progressive rate structure that tops out at 8.97 percent and does provide a credit for local taxes paid. The result is a disproportionate revenue loss for New Jersey.

According to Sidamon-Eristoff, Pennsylvania is also a "net loser" because it "gains less from taxing the relatively small number of residents who commute to high-paying jobs in New Jersey than it loses from not taxing the larger number of New Jersey residents who commute to Pennsylvania." This amounts to $35 million annually.

Not everyone agrees that the Agreement should be repealed, especially those who commute into New Jersey, and the topic remains a hot one. In recent news coverage, an NJTVOnline article featured an employee of a Princeton, New Jersey pharmaceutical company who lives and pays income tax in Pennsylvania. He said he would "leave New Jersey completely" if he had to pay New Jersey tax rates.

The NJTVOnline piece noted that Gov. Christie can end the Reciprocity Agreement on his own, by way of an executive order; he does not need legislative approval.

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