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Keystone Monitoring New Jersey's Threat to End Income Tax Reciprocity with PA

New Jersey Governor Chris Christie is threatening to end New Jersey's 38-year old tax reciprocity agreement with Pennsylvania on January 1, 2017. Unilaterally ending this arrangement will subject PA residents who work in New Jersey to that state's income tax system, effectively reducing or eliminating their local tax obligation in Pennsylvania.

Keystone is carefully monitoring the issue and anticipates there may be a significant impact on revenues at the local level, even though the effect will vary by community.

Although reports indicate ending reciprocity is not a done deal, Moody's Bond Rating Service and PA Governor Tom Wolf expect PA to lose a net of $5 million a year at the state level. The State's net loss is based on projections that Pennsylvania will lose $204 million in taxes currently paid by PA residents working in New Jersey, but will pick up $199 million from New Jersey residents working in PA.

The effect of New Jersey's planned tax changes at the state level are not comparable to the expected impact at the local level. The statewide analyses project revenues based on average annual incomes of the entire region of PA, rather than the income levels of PA residents who work in New Jersey. Moreover, the state analyses are not broken down by municipality and thus do not measure the greater losses on PA communities bordering New Jersey. Most importantly there will be no additional offsets in local revenues from New Jersey residents currently working in PA. Unlike at the state level, New Jersey residents working in PA already pay the non-resident local earned income tax to their workplace jurisdictions.

There exist many obstacles to attempting to estimate the effect of New Jersey's planned action on local tax revenues by community. The major obstacles include:

- Some New Jersey employers withhold local EIT for their PA-resident employees, but not all do. Those without employer withholding must self-report and pay their EIT, without identifying an employer location. As a result, a self-reporter who works in New Jersey is indistinguishable from an individual who is self employed in PA.

- A New Jersey business address on the taxpayer's W-2 does not necessarily mean that the individual is employed in New Jersey, only that the payroll taxes are filed from a central payroll office location there. Act 32 does not require employers to provide workplace location addresses when filing their payroll withholding tax. As such, the actual workplace location could be anywhere inside or outside of PA.

- The DCED assigned the same PSD code to <u>all</u> out-of-state workplace locations, rather than separate PSD codes for each state. As such, New Jersey employers who withhold EIT are systematically indistinguishable from those workplaces in other reciprocal states (such as Indiana, Maryland, Ohio, Virginia and West Virginia).

- At the individual level, PA's uniform local earned income tax return form provides no place for the taxpayer to indicate that the income is earned in New Jersey.

- PA residents who work in non-reciprocal states (such as Delaware or New York) may claim out-of-state tax credits on Line 12 of the local tax return. As such, comparable data for New Jersey would not be available until 2018, after the 2017 tax returns are processed under new non-reciprocity rules, assuming New Jersey's plan goes into effect.

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