New Jersey Tax Guide

Retiring in New Jersey

(Updated October, 2020)

Understanding Taxes in Retirement

New Jersey taxes retirement income differently than the federal government. If you are retired or planning to retire, this guide provides answers to common questions regarding retirement income and how to report it on your New Jersey Income Tax return. It also can help prepare you for future tax situations.

Social Security, Railroad Retirement, and Disability Benefits

Social Security and Railroad Retirement benefits are *not taxable* under the New Jersey Income Tax and should not be reported as income on your State return.

Payments from a public or private pension plan because of total and permanent disability also are *not taxable*. However, if you retired before age 65 on a permanent disability pension and continue to receive payments after 65, the disability pension is treated as an ordinary pension beginning at that age and is **taxable**.

Pensions and Annuities

Pension and annuity income are **taxable** and must be reported on your New Jersey Income Tax return. In some cases, the taxable pension or annuity amount that you report on your New Jersey return may differ from the amount reported on your federal return.

That is because you may have to use a different method to calculate the taxable amount for your New Jersey return than the method you use for federal income tax purposes. (See Retirement Income.)

Nonresidents

Pension and annuity income received by a nonresident for work performed in New Jersey are *not taxable*, even if you were a resident when you worked in New Jersey. However, you might have other income from New Jersey that is **taxable** to a nonresident (e.g., wages, business income, or a gain from selling real property in New Jersey).

If so, you are required to file a New Jersey Nonresident Income Tax Return (Form NJ-1040NR) and report any pension or annuity income in Column A along with your other taxable income.

Taxable vs. Nontaxable Distributions

Pensions and annuities fall into one of two categories: noncontributory or contributory. The taxable amount you report on your New Jersey Income Tax return will depend on whether the pension or annuity payment came from a contributory or a noncontributory retirement plan.

You have a *noncontributory plan* if you did not make contributions to that plan. Distributions from a noncontributory plan are taxable. Include the full amount on your tax return.

You have a *contributory plan* if you made contributions to that plan. In general, your contributions were already taxed since they were made through payroll deductions. Therefore, they are *not taxable* a second time.

When you receive a pension or annuity distribution from a contributory plan, you must determine the taxable and nontaxable portion so you are not taxed twice on your contributions.

Individual Retirement Account (IRA) Withdrawals

In general, IRA *contributions* were taxed when you made them and are not taxed by New Jersey when withdrawn. The remaining portion of your withdrawal is fully taxable, including:

- Interest;
- Dividends;
- Capital appreciation (an increase in the value of the investments you bought); and/or
- Amounts that were rolled over into an IRA from a tax-deferred pension plan.

You must calculate the taxable and excludable portions of the withdrawal for your New Jersey tax return. (See Retirement Income for information on how to calculate taxable and excludable portions.)

Roth IRAs

Roth IRA contributions were taxed when you made them. For more information on the taxability of Roth IRA distributions, see our Technical Bulletin Roth IRAs.

New Jersey Bonds

An IRA withdrawal is *not taxable* if the distribution you receive was derived entirely from New Jersey municipal, county, or State debt (bonds) that is exempt from New Jersey Income Tax. For more information, see Exempt Obligations.

401(k) Withdrawals

As of January 1, 1984, contributions that employees make to 401(k) plans from their wages are *not taxable*. Since the contributions were not taxed when made, they are fully taxable when you receive a distribution (withdrawal).

If you made contributions to a 401(k) plan before January 1, 1984, your distribution will be treated differently than if all the contributions were made after that date. (See Retirement Income for information about 401(k) plans.)

If you convert a 401(k) plan to an IRA – meaning the funds go from one financial institution to another, not to you – that is a rollover, which is *not taxable*. The same applies when you transfer funds from one IRA to another. However, the money is subject to Income Tax when you withdraw it.

Section 457 plans (Deferred Compensation)

Some retirement plans, such as the New Jersey Deferred Compensation Plan offered to government workers, are called Section 457 plans. Unlike a 401(k) or IRA, those plans are funded with after-tax earnings*, not* pre-tax earnings. Because you already paid tax on the earnings used to fund the plan, you will have to calculate how much of your annual distribution results from after-tax earnings and how much results from capital gains to figure out what you owe in taxes. Otherwise, you could be taxed twice on the same income.

You only pay New Jersey tax on the amount that exceeds what you contributed to the plan. New Jersey has two ways to calculate tax on a 457 plan distribution: The Three-Year Rule and the General Rule.

Use the Three-Year Rule if you will receive an amount that equals or exceeds your total contributions within three years of the date of your first distribution from the plan. The General Rule applies if it will take more than three years to recover all of your contributions. You can find more details in GIT-1&2, Retirement Income*.*

If you die before receiving all of the funds in the plan, your immediate family heirs (spouse and children) will pay no Inheritance Tax on the remaining distributions. However, if your beneficiaries are nieces and nephews, they are treated differently than immediate family and may have to pay Inheritance Tax on a 457 plan distribution.

Military Pensions

New Jersey does not tax U.S. military pensions or survivor's benefits, regardless of your age or disability status. Do not include such payments on your New Jersey return.

This exemption does not apply to civil service pensions or annuities, even if the pension or annuity is based on credit for military service. They are **taxable**. (See Military Personnel and Families.)

New Jersey Pension/Retirement Exclusion

Even if you have taxable income from a pension, annuity, or IRA, you may be able to exclude all or part of the amount you received during the year. To qualify for the exclusion, you must be:

- 62 years of age or older, or permanently disabled/blind; and
- Have gross income of $100,000 or less.

For **Tax Year 2020**, you can exclude up to the following amounts of retirement income:

- $100,000 (if married/CU couple or filing joint return);
- $75,000 (if single, head of household, or qualifying widow(er)/surviving CU partner); or
- $50,000 (if married/CU partner, filing separate return).

For **Tax Year 2019**, the three exclusions mentioned above were $80,000, $60,000, and $40,000, respectively.

You can be taxed on any income *over* the exclusion amounts stated above.

If filing jointly and both spouses received retirement income, but only one of you is 62 or older, you may *only* exclude retirement income of the eligible spouse.

If you are a part-year resident, you must prorate the pension exclusion amount by the number of months you spent as a New Jersey resident. (See Part-Year Residents.)

Qualified Domestic Relations Order (QDRO) Savings Plan

When couples divorce, a QDRO can be ordered by a Court to grant someone the right to a portion of his/her former spouse's retirement accounts. Funds from a QDRO savings plan must be properly disbursed per the Court Order.

If the spouses simply divide the savings under the QDRO, and neither party receives a distribution, you will not have to pay New Jersey Income Tax. You will have to pay tax when you receive a cash distribution from the savings plan/account.

If you are a member of a New Jersey State-administered pension plan (PERS or TPAF, for example), the Order must be deemed acceptable by the Division of Pensions and Benefits before you can determine the taxability of the disbursement.

The form of the payment determines how payments are reported for tax purposes. (See the Life Events tab on the Division of Pensions and Benefits website, and select "divorce/dissolution.")

Beneficiaries of a Pension, Annuity, or IRA

In general, pension and annuity income received by a survivor or beneficiary, whether in the form of periodic payments or in a lump sum, are **taxable** if they exceed the decedent's previously taxed contributions.

If the pension or annuity was subject to the New Jersey Transfer Inheritance Tax, the value of the pension or annuity represents the decedent's previously taxed contributions. Those contributions are deductible when determining the taxable pension, annuity, or IRA income received. (See Retirement Income or Estates and Trusts.)

Withholding Tax from a Pension

New Jersey residents who receive pension or annuity income should consider asking their fund manager to withhold New Jersey Income Tax from those payments. The **reason to withhold** some money to cover taxes is because if you owe us too much tax, we might require you to make estimated payments every three months the following tax year.

If you want New Jersey Income Tax withheld from a pension, complete Form NJ-W-4P, Certificate of Voluntary Withholding of New Jersey Gross Income Tax from Pension and Annuity Payments. Indicate the amount of tax to be withheld ($10 minimum) and give the certificate to the payer of the pension or annuity.

Withholding Tax from an IRA

If you have an IRA, you might want to consider withholding New Jersey Income Tax when you receive an annual distribution, **so you do not have to make estimated payments** every quarter in subsequent years.

Making Estimated Tax Payments

You **are required** to make quarterly estimated tax payments to New Jersey if you owe **more than $400** after taking all exemptions, deductions, withholdings, and other credits on your State return. Use Form NJ-1040-ES to file estimated tax payments when due. (See Estimating Income Taxes.)

Figuring out how much tax to withhold from a pension payment can be challenging. Consult our supplemental tax tables to get an idea of the withholding amount to indicate on your NJ-W-4P. For better accuracy, you will need to know:

- The frequency of payment – weekly, bi-weekly, etc.;
- How much your payments are;
- How many exemptions you expect to claim.

Post-Retirement Employment/Income

You may want to earn extra money from a part-time job, self-employment, or other sources after retirement. That extra income could increase your State tax obligation. To determine how much you could earn along with your retirement income, you must:

- Total your estimated income;
- Apply the retirement exclusion – if eligible;
- Total your gross income (the amount after taking the exclusion but before any deductions).

If your gross income for the year is more than $20,000 (or $10,000 if filing single or married/CU partner filing separately) **you will owe New Jersey Income Tax**.

For more information on gross income, consult the NJ-1040 instruction booklet.

Veteran Exemption

Many veterans qualify for an additional exemption of $3,000 on their New Jersey Income Tax for income earned in 2017 and beyond. This exemption does **not** apply to income earned in 2016 or earlier. If you are a military veteran, you are eligible for this exemption if you were honorably discharged.

The first time you claim the exemption, you must provide official documentation showing you were honorably discharged or released under honorable circumstances from active duty. (See Military Personnel and Families for more information.)

Life Insurance

Life insurance proceeds are exempt from New Jersey Income Tax *only* when received because of someone's death. A whole life or universal life insurance policy is **taxable** when cashed in for any other reason other than the insured's death. Here are some questions and answers that may help you:

I have a life insurance policy from my old company, but now I pay the premiums. Is the coverage taxable just as it was when I was an active employee?

No. It is considered an out-of-pocket expense, not a taxable benefit.

Property Tax Relief Programs

Many retirees live on a fixed income. New Jersey offers two property tax relief programs to help them remain in their New Jersey homes. You must apply annually for both programs maintain eligibility.

Senior Freeze

This program reimburses eligible senior citizens and disabled persons for property tax or mobile home park site fee increases on their principal residence (main home).

To qualify, you must meet eligibility requirements for each year – from the base year through the application year.

Senior Freeze eligibility depends on age and disability status, residency and income.

See our Property Tax Reimbursement page for more details.

Homestead Benefit

This program is not only for seniors and disabled persons. However, it does have different eligibility guidelines for those seniors who may qualify. For most, the approved benefit is credited to your local property taxes. You will see it reflected on a property tax bill sent by your municipality.

See our Homestead Benefit Program page for more details.

Maintain Good Records

Keep any statements that show your contributions to your pension, annuity, or IRA. You will need this information when you start to withdraw money from the plan. You may have to pay more tax if you do not know the amount of your contributions on which New Jersey Income Tax has already been paid.

If you do not have a record of your contributions, you may contact the payer of the pension or annuity to obtain that information. Keep all statements from your pension, annuity, or IRA payer, including Forms W-2P and 1099-R. We also recommend that you keep any worksheets used to calculate your taxable and excludable retirement income distributions each year.