



Taxation of Retirement Benefits

Information for:
All Funds

This fact sheet contains general information about federal and New Jersey State income taxes, and your retirement benefits from the New Jersey Division of Pensions & Benefits (NJDPB). The NJDPB cannot provide tax advice. Consult the Internal Revenue Service (IRS)(1-800-TAX-1040), or the N.J. Division of Taxation (609) 292-6400, or your tax advisor for assistance.

HOW ARE MY RETIREMENT BENEFITS TAXED FOR FEDERAL PURPOSES?

Retirement benefits (except for Accidental Disability Retirement and Accidental Death benefits) are subject to federal income tax. However, if you paid tax on any of your contributions to the retirement system in the past, the portion of your monthly retirement benefits representing a return of your previously taxed contributions is not taxable.

Currently, contributions made to the retirement system are tax-exempt; however, contributions made prior to January 1, 1987, were taxed, as were any purchases of optional pension service credit made before 2002. After January 1, 2002, some purchases of service credit may have been made with previously taxed money. Therefore, if you began contributing to the retirement system prior to January 1, 1987, or if you purchased service credit since then, all or a portion of your total contributions may have been previously subject to federal tax.

The rate at which you can recover your previously taxed contributions is determined, in part, by your retirement date:

If you retired before August 1, 1986 — you were able to fully recover your contributions before having to pay tax on your benefits. Once you recovered your contributions, your benefits became fully taxable. The exception is if you did not fully recover your contributions within the first three years of retirement; in that case, you had to recover your contributions under the IRS expected return rule explained below.

If you retired on or after August 1, 1986 — you must recover your contributions under the expected return rule. Under this rule, you recover your contributions evenly over your expected lifetime or the combined lifetime of you and your pension beneficiary. This means that only a small portion of each monthly benefit is considered a return of your previously taxed contributions and is tax-free.

CALCULATING THE NON-TAXABLE AMOUNT UNDER THE EXPECTED RETURN RULE

If you retired after July 1, 1986, and before November 1, 1996 — your monthly non-taxable amount is determined using life expectancy tables found in IRS *Publication 939*.

If you retired on or after November 1, 1996 — the following tables found in IRS *Publication 575 (Simplified Method)* are used to determine your monthly non-taxable amount:

| TABLE A | |
|-----------------------------------|--------------------|
| Benefits Payable to Retiree Only* | |
| Age of Retiree (at Retirement) | Number of Payments |
| 55 or less | 360 |
| 56–60 | 310 |
| 61–65 | 260 |
| 66–70 | 210 |
| 71 or more | 160 |

* For those retired on or after November 1, 1996, and before December 1, 1997, Table A is used even if benefits are payable to the retiree and the retiree's survivor.

| TABLE B | |
|---|--------------------|
| Benefits Payable to Retiree and Beneficiary | |
| Combined Age of Retiree (at Retirement) and Beneficiary | Number of Payments |
| 110 or less | 410 |
| 111–120 | 360 |
| 121–130 | 310 |
| 131–140 | 260 |
| 141 or more | 210 |

The following examples illustrate how the monthly non-taxable amount is computed using Tables A and B:

Example 1 — A PERS member, whose previously taxed contributions equaled \$12,000, retires at age 62 and chooses to receive the Maximum Allowance (designating no monthly pension to a surviving beneficiary). Table A is used because benefits are payable to the retiree only. The \$12,000 is divided by 260, which produces a monthly tax-free amount of \$46.15. The balance of the monthly pension is subject to federal income tax.

Example 2 — A TPAF member, whose previously taxed contributions equaled \$15,000, retires at age 60 and chooses to receive benefits under Option 2 (designating the same monthly pension to the surviving beneficiary). Table B is used because benefits are payable to the retiree and the retiree's beneficiary. The designated beneficiary is the same age as the retiree. The \$15,000 is divided by 360, which produces a monthly tax-free amount of \$41.67. The balance of the monthly pension is subject to federal income tax.

HOW LONG WILL THE NON-TAXABLE PORTION CONTINUE?

For those who retired after December 31, 1986, the monthly non-taxable amount remains in effect until all of your previously taxed contributions are fully recovered. At that point your benefits become fully taxable.

For those who retired before December 31, 1986, the monthly non-taxable amount is effective for as long as you or your survivor receive benefits.

If benefits cease before your previously taxed contributions are fully recovered, the remaining balance can be claimed as a deduction on the income tax return of the last recipient, provided you retired on or after July 1, 1986. If you retired before July 1, 1986, no deduction is allowed for unrecovered contributions.

WITHHOLDING FEDERAL INCOME TAX FROM YOUR PENSION CHECK

The NJDPB is required by federal law to automatically withhold federal income tax from your pension check, based on a default status of Single with no adjustments. Refer to IRS Form W-4P for instructions regarding federal tax withholding. In order to change your federal withholding status, you must log in to your Member Benefits Online System (MBOS) account to complete a federal W-4P. You will have access to this application after you receive your first retirement check. This online application allows you to elect no withholding, or, if you want withholding, to inform us of your tax filing status so that we can withhold the proper amount. If you need assistance completing Form W-4P, please contact your tax preparer or call the Internal Revenue Service at 800-829-1040. **Note:** Use Form W-4R for non-periodic payments and eligible rollover distributions. This form can be found on the IRS website at www.irs.gov

WITHHOLDING N.J. STATE INCOME TAX FROM YOUR PENSION CHECK

Most retirees will not be subject to New Jersey income tax until they recover, in pension checks, the amount of contributions they made to the retirement system while working. If you will not recover your total contributions within three years of retirement, refer to the instructions for the Form NJ-1040 to determine how your pension is taxed. You can find information on both the three-year rule and the general rule methods in the instructions for the Form NJ-1040.

If you are at least 62 or considered disabled by Social Security, you may exclude the following amounts of retirement income from New Jersey income tax for the tax year indicated in the following chart:

RETIREMENT INCOME EXCLUSIONS

| Tax Year | Married Filing Jointly | Single | Married Filing Separately |
|----------------|---|--|---|
| 2003–2016 | \$20,000 | \$15,000 | \$10,000 |
| 2017 | \$40,000 | \$30,000 | \$20,000 |
| 2018 | \$60,000 | \$45,000 | \$30,000 |
| 2019 | \$80,000 | \$60,000 | \$40,000 |
| 2020 and after | \$100,000 | \$75,000 | \$50,000 |
| 2021 and After | 50 percent of retirement income if gross income is over \$100,000 up to \$125,000 | 37.5 percent of retirement income if gross income is over \$100,000 up to \$125,000 | 25 percent of retirement income if gross income is over \$100,000 up to \$125,000 |
| | 25 percent of retirement income if gross income is over \$125,000 up to \$150,000 | 18.75 percent of retirement income if gross income is over \$125,000 up to \$150,000 | 12.5 percent of retirement income if gross income is over \$125,000 up to \$150,000 |

Note: Please see the instructions for the Form NJ-1040, or contact the New Jersey Division of Taxation or a professional tax advisor for further information.

Unlike federal income tax, withholding for New Jersey income tax is completely voluntary. No New Jersey income tax will be withheld unless you authorize it through your MBOS account by completing a New Jersey W-4P. The amount withheld must be at least \$10 per month in even dollar amounts (no cents). If you need help deciding whether or not to have New Jersey income tax withheld or how much tax to have withheld, you can contact the New Jersey Division of Taxation at (609) 292-6400.

If you live outside New Jersey, you are not required to pay New Jersey income tax on the pension you re-

ceive from the retirement system. The NJDPB does not withhold income tax for other states. Check with your home state's tax office to determine if your pension is taxable in your state of residence.

QUESTIONS COMMONLY ASKED AFTER RETIREMENT

Will I receive a statement of pension income for tax purposes?

Yes. Retirees receive *Form 1099-R* at the end of January each year, covering the previous tax year. This shows the gross retirement allowance; how much is subject to federal income tax; and the amounts, if any, that were withheld for federal and New Jersey income tax. If you are a non-resident alien or foreign estate, you will receive a *Form 1042-S Foreign Person's U.S Source Income Subject to Withholding*.

Am I taxed on the reimbursement of Medicare premiums?

No. If you receive a reimbursement for the Medicare Part B premiums you pay to Social Security, the gross amount of your pension checks will be greater than the gross amount shown on your *Form 1099-R* because the Medicare reimbursement is not taxable. The Medicare premium reimbursement is subtracted from your total gross income to determine the gross pension reported to the IRS.

Is my Disability Retirement taxable?

If you are receiving a Disability Retirement, your benefits are not subject to New Jersey income tax until you reach age 65.

If you are receiving an Accidental Disability Retirement, or if you are a survivor receiving Accidental Disability or Accidental Death benefits, the NJDPB reports your benefit as exempt from federal income tax.

Ordinary Disability Retirements are subject to federal tax to the same extent as other pensions.

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