TAX TOPIC

IRA Withdrawals

Bulletin GIT-2

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Introduction

An individual retirement account (IRA) is a personal savings plan in which you set aside money for retirement. This bulletin explains the New Jersey gross income tax rules that apply when you contribute money to or withdraw money from a traditional IRA or Roth IRA. It also describes how to use New Jersey's IRA Worksheet to calculate the taxable portion of an IRA withdrawal for your New Jersey income tax return. The portion of your IRA withdrawal which is taxable for New Jersey purposes may differ from the Federal amount.

This publication uses forms and worksheets for tax year 2011 to illustrate return completion. Thus, the forms and amounts used in the examples may not reflect current information for other tax years.

Important

If you converted a traditional IRA to a Roth IRA in 2010, the amount that is taxable for New Jersey purposes must be reported in the same manner as for Federal purposes. See ***page 2****.*

IRA Contributions

Traditional IRA

The New Jersey Gross Income Tax Act does not contain any provisions similar to the Internal Revenue Code which permit an individual to deduct contributions to an IRA. Contributions to an IRA are subject to New Jersey income tax in the year they are made. When you make a withdrawal from an IRA, the amount you contributed is not taxable, since the contributions were taxed at the time they were made.

Any contributions you made to an IRA before you moved to New Jersey are treated in the same way as they would have been treated if you had been living in New Jersey at the time you made the contributions.

Roth IRA

As with any other IRA, contributions to a Roth IRA are not excludable for New Jersey income tax purposes but are subject to New Jersey income tax in the year they are made. When you make a withdrawal from a Roth IRA, the portion of the withdrawal that represents your contributions is not taxable, since the contributions were taxed at the time they were made.

Rollovers. If you qualify under Federal rules to convert an existing IRA to a Roth IRA, you also qualify for New Jersey tax purposes. Conversion eligibility for New Jersey is automatic upon Federal qualification even if your New Jersey taxable income exceeds the Federal limitations.

You can withdraw all or part of the assets from a traditional IRA and reinvest them (within 60 days) in a Roth IRA. In most cases, your contributions to

a traditional IRA were previously taxed and only the earnings are taxable to New Jersey in the year you elect to roll over the funds. However, any amounts you roll over from a traditional IRA to a Roth IRA which were not previously taxed by New Jersey, such as a rollover distribution to an IRA from an employer's 401(k) plan, must be included in New Jersey income in the year withdrawn from the traditional IRA.

If you converted a traditional IRA into a Roth IRA in 2010 and you made a Federal election to report the income in equal installments in 2011 and 2012, you must report one-half of the amount that is taxable for New Jersey purposes on your 2011 New Jersey return.

IRA Withdrawals

Traditional IRA

Your IRA consists of your contributions, earnings, plus amounts, if any, rolled over from other pension plans. In general, the contributions were taxed when they were made. Interest, dividends, and other earnings credited to an IRA are subject to tax upon withdrawal. In addition, any amounts which were rolled over into an IRA tax-free from a pension plan are subject to New Jersey tax when they are withdrawn.

An exception exists with respect to the taxability of an IRA withdrawal when the IRA funds are invested in obligations which are exempt from New Jersey income tax. The Gross Income Tax Act specifically excludes from gross income (1) interest received from obligations of the State of New Jersey or any of New Jersey's political subdivisions, or (2) interest received from direct Federal obligations which are statutorily free from state or local taxation.

Thus, where the interest received by the taxpayer on an IRA distribution is from exempt obligations which are directly owned by the taxpayer in the IRA plan, the interest is exempt from New Jersey income tax.

Likewise, if the IRA is part of a New Jersey "Qualified Investment Fund," the portion of the distribution from the IRA which represents interest or gains from the qualified exempt obligations held by the fund is exempt. However, the portion of a distribution which comes from taxable investments held by the fund is taxable.

If the IRA is part of a mutual fund that is not a Qualified Investment Fund, the distributions paid by the mutual fund are exempt only to the extent the distributions are attributable to interest on Federal obligations.

For more information on tax-exempt interest income and New Jersey Qualified Investment Funds, see Tax Topic Bulletin **GIT-5**, *Exempt Obligations*.

Roth IRA

Qualified Distributions. A qualified distribution from a Roth IRA is excludable and does not have to be included in New Jersey gross income in the year received whether it is a periodic distribution or a lump-sum distribution. A "qualified distribution" means any payment or distribution that is made after the five-taxable-year period beginning with the first taxable year in which a contribution was made to an individual's Roth IRA, **and** is made:

- On or after the date on which the individual reaches age 59½; or
- To a beneficiary (or the individual's estate) after the individual's death; or
- Because the individual becomes disabled; or
- As a qualified first-time home buyer distribution as defined by the Internal Revenue Code.

Nonqualified Distributions. A payment or distribution will not be treated as a qualified distribution if it is not made under one of the four circumstances above **or** is made within the five-taxable-year period which begins with the year the first contribution was

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made to the Roth IRA. Likewise, a payment or distribution of an allowable rollover contribution (or income earned on the amount rolled over) from an IRA other than a Roth IRA, is not a qualified distribution if it is made within the five-taxable-year period which begins with the year in which the rollover contribution was made. Under this "five-year rule," if you established a Roth IRA in 2006, you will not be able to receive a "qualified distribution" before 2011. For information on calculating the taxable portion of a nonqualified distribution, see *Lump-Sum Distributions and Rollovers* below, and ***Periodic Distributions*** on page 4.

Reporting Taxable Amounts

Taxable amounts withdrawn from either a traditional or a Roth IRA are reported on the same line of the New Jersey tax return as taxable pensions and annuities (Line 19, Form NJ-1040 or Line 21, Column A, Form NJ-1040NR). Thus, qualified taxpayers are entitled to apply to their taxable IRA distributions the same income exclusions authorized by the New Jersey Gross Income Tax Act for pensions and annuities.

2010 Conversion to Roth IRA. If you converted a traditional IRA into a Roth IRA in 2010 and elected to report the income in equal installments in 2011 and 2012, you must report one-half of the amount that is taxable for New Jersey purposes on Line 19, Form NJ-1040 or Line 21, Column A, Form NJ-1040NR.

For information on reporting pension and annuity income on your New Jersey income tax return, and using the New Jersey income exclusions, see Tax Topic Bulletin **GIT-1**, *Pensions and Annuities*.

Coverdell Education Savings Account (ESA)

A Coverdell education savings account (ESA), formerly known as an education IRA, is not a retirement account. It is a trust or custodial account created only for the purpose of paying the qualified higher education expenses of the designated beneficiary of the account. New Jersey's treatment of Coverdell ESAs differs from the Federal treatment. Contributions to Coverdell ESAs are subject to New Jersey income tax in the year they are made. When you make a withdrawal from a Coverdell ESA, the amount contributed is not taxable. Earnings credited to a Coverdell ESA are subject to New Jersey tax upon withdrawal. Distributed earnings from a Coverdell ESA are reported on Line 15a, Form NJ-1040 or Line 15, Column A, Form NJ-1040NR. Do not include the earnings portion of a distribution from a Coverdell ESA on Line 19, Form NJ-1040 or Line 21, Column A, Form NJ-1040NR.

For information on the treatment of qualified state tuition program accounts, including the New Jersey Better Educational Savings Trust (NJBEST) accounts, see Tax Topic Bulletin **GIT-5**, *Exempt Obligations.*

Lump-Sum Distributions and Rollovers

When you receive a lump-sum distribution from a traditional IRA or lump-sum nonqualified distribution from a Roth IRA, the amounts you receive which are in excess of your previously taxed contributions to the traditional IRA or Roth IRA are fully taxable and must be included in income in the year you receive them. New Jersey has no provisions for income averaging of lump-sum distributions.

A lump-sum distribution which you roll over (transfer) into a traditional IRA or other eligible plan is excludable from New Jersey income if the rollover qualifies for deferral for Federal income tax purposes. The amount rolled over (minus previously taxed amounts) is taxable later when it is withdrawn. As under Federal law, the rollover must be made within the 60-day period after distribution.

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A distribution from a traditional rollover IRA which is fully taxable for Federal income tax purposes may be treated differently for New Jersey purposes if there are contributions remaining in the IRA which were subject to New Jersey income tax when the contributions were made.

Periodic Distributions

If withdrawals from a traditional IRA or nonqualified withdrawals from a Roth IRA are made over a period of years, the portion of the annual distribution that represents interest and accumulated gains (including amounts rolled over and not previously taxed) must be reported as taxable income each year a withdrawal is made. The amount subject to tax is based on the ratio that the taxable portion bears to the total amount in the account.

The formula to determine the taxable portion of a distribution from a traditional IRA or a nonqualified distribution from a Roth IRA is:

$$\frac{\text{Taxable Portion}}{\text{Total Value}} \times \text{Distribution} = \text{Taxable Amount}$$

Total Value means the value of the IRA on December 31 of the tax year (including contributions made for the tax year from January 1 through April 15 of the following year), plus total IRA distributions during the tax year.

Taxable Portion means the Total Value minus previously taxed contributions.

In the first year a withdrawal is made, *contributions* means the total amount you contributed to the IRA from the time the account was opened through the end of the tax year in which the first withdrawal was made. (It does not include amounts rolled over and not previously taxed.)

After the first year, the formula for calculating the taxable portion of a distribution remains the same, but the base for each item changes to take into account the fact that both taxable and nontaxable amounts have been withdrawn from the account.

IRA Worksheet

The New Jersey IRA Worksheet incorporates the formula above. It enables you to easily calculate the taxable portion of your withdrawal from a traditional IRA or nonqualified withdrawal from a Roth IRA. If you make withdrawals from several IRAs in the same year, you may use a separate worksheet for each IRA and report the total of the taxable amounts from each worksheet on your tax return. Or, you may calculate the taxable portion by combining all the IRAs on one worksheet.

Keep copies of the IRA Worksheets you complete for your records. When you make withdrawals from a traditional IRA or nonqualified withdrawals from a Roth IRA over a period of years, you will use the previous year's worksheet as a basis for determining the taxable portion of a subsequent withdrawal from the IRA. You may use the IRA Worksheet on the next page or the one which appears in the New Jersey income tax return instruction booklet. *Do not file the IRA Worksheet with your New Jersey income tax return.*

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NEW JERSEY IRA WORKSHEET

Tax Year _____

Part I

1. **Value of IRA on 12/31 of tax year.** Include contributions made for the tax year from 1/1–4/15 of the following year ..... 1. _____
2. **Total distributions from IRA during the tax year.** Do not include tax-free rollovers ..... 2. _____
3. **Total value of IRA.** Add lines 1 and 2 ..... 3. _____

Unrecovered Contributions: Complete **either** line 4a or 4b.

4a. **First year of withdrawal from IRA:** Enter the total of IRA contributions that were previously taxed ..... 4a. _____

4b. **After first year of withdrawal from IRA:** Complete Part II. Enter amount of unrecovered contributions from Part II, line (g)* ..... 4b. _____

5. **Accumulated earnings in IRA on 12/31 of tax year.** Subtract either line 4a or 4b from line 3 ..... 5. _____
6. Divide line 5 by line 3 and enter the result as a decimal ..... 6. _____
7. **Taxable portion of this year's withdrawal.** Multiply line 2 by decimal amount on line 6. Enter here and on Line 19, Form NJ-1040 or Line 21, Column A, Form NJ-1040NR ..... 7. _____

Part II—Unrecovered Contributions (For Second and Later Years)

(a) **Last year's unrecovered contributions.** From line 4 of last year's worksheet* ..... (a) _____

(b) **Amount withdrawn last year.** From line 2 of last year's worksheet ..... (b) _____

(c) **Taxable portion of last year's withdrawal.** From line 7 of last year's worksheet ..... (c) _____

(d) **Contributions recovered last year.** Subtract line (c) from line (b) ..... (d) _____

(e) **This year's unrecovered contributions.** Subtract line (d) from line (a) ..... (e) _____

(f) **Contributions to IRA during current tax year.** Do not include tax-free rollovers ..... (f) _____

(g) **Total unrecovered contributions.** Line (e) plus line (f). Enter here and on Part I, line 4b ..... (g) _____

* If you did not complete a worksheet in prior year(s), skip Part II and calculate the amount of unrecovered contributions as follows:

A. Determine the total amount of ***withdrawal(s)*** made from the IRA in previous years.
B. Total the portion(s) of these previous year withdrawal(s) already reported as income on prior New Jersey tax returns.
C. Subtract the amount of previous year withdrawals reported (B) from the total amount of previous year withdrawals (A). This difference is the amount of contributions that have been *recovered* thus far.
D. Subtract the amount of *recovered* contributions (C) from the *total* amount of contributions made to the IRA. This is the amount of ***unrecovered*** contributions to enter on **line 4b** of **Part I.**

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Example A

Herbert Walters started to make withdrawals from his traditional IRA in 2010. He withdrew $1,000 in 2010 and another $1,000 in 2011. The IRA Worksheets that follow show how he calculated the taxable portion of the withdrawals for his 2010 and 2011 New Jersey income tax returns.

NEW JERSEY IRA WORKSHEET

Tax Year 2010

Part I

1. **Value of IRA on 12/31 of tax year.** Include contributions made for the tax year from 1/1–4/15 of the following year 1. 9,210
2. **Total distributions from IRA during the tax year.** Do not include tax-free rollovers 2. 1,000
3. **Total value of IRA.** Add lines 1 and 2 ..... 3. 10,210

Unrecovered Contributions: Complete **either** line 4a or 4b.

4a. **First year of withdrawal from IRA:** Enter the total of IRA contributions that were previously taxed 4a. 7,000

4b. **After first year of withdrawal from IRA:** Complete Part II. Enter amount of unrecovered contributions from Part II, line (g)* ..... 4b. _____

5. **Accumulated earnings in IRA on 12/31 of tax year.** Subtract either line 4a or 4b from line 3 ..... 5. 3,210
6. Divide line 5 by line 3 and enter the result as a decimal ..... 6. .314
7. **Taxable portion of this year's withdrawal.** Multiply line 2 by decimal amount on line 6. Enter here and on Line 19, Form NJ-1040 or Line 21, Column A, Form NJ-1040NR 7. 314

Part II—Unrecovered Contributions (For Second and Later Years)

(a) **Last year's unrecovered contributions.** From line 4 of last year's worksheet* ..... (a) _____

(b) **Amount withdrawn last year.** From line 2 of last year's worksheet ..... (b) _____

(c) **Taxable portion of last year's withdrawal.** From line 7 of last year's worksheet ..... (c) _____

(d) **Contributions recovered last year.** Subtract line (c) from line (b) ..... (d) _____

(e) **This year's unrecovered contributions.** Subtract line (d) from line (a) ..... (e) _____

(f) **Contributions to IRA during current tax year.** Do not include tax-free rollovers ..... (f) _____

(g) **Total unrecovered contributions.** Line (e) plus line (f). Enter here and on Part I, line 4b ..... (g) _____

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Example A, *continued*

NEW JERSEY IRA WORKSHEET

Tax Year 2011

Part I

1. **Value of IRA on 12/31 of tax year.** Include contributions made for the tax year from 1/1–4/15 of the following year 1. 8,622
2. **Total distributions from IRA during the tax year.** Do not include tax-free rollovers 2. 1,000
3. **Total value of IRA.** Add lines 1 and 2 ..... 3. 9,622

Unrecovered Contributions: Complete **either** line 4a or 4b.

4a. **First year of withdrawal from IRA:** Enter the total of IRA contributions that were previously taxed ..... 4a. _____

4b. **After first year of withdrawal from IRA:** Complete Part II. Enter amount of unrecovered contributions from Part II, line (g)* 4b. 6,314

5. **Accumulated earnings in IRA on 12/31 of tax year.** Subtract either line 4a or 4b from line 3 ..... 5. 3,308
6. Divide line 5 by line 3 and enter the result as a decimal ..... 6. .344
7. **Taxable portion of this year's withdrawal.** Multiply line 2 by decimal amount on line 6. Enter here and on Line 19, Form NJ-1040 or Line 21, Column A, Form NJ-1040NR 7. 344

Part II—Unrecovered Contributions (For Second and Later Years)

(a) **Last year's unrecovered contributions.** From line 4 of last year's worksheet* ..... (a) 7,000

(b) **Amount withdrawn last year.** From line 2 of last year's worksheet ..... (b) 1,000

(c) **Taxable portion of last year's withdrawal.** From line 7 of last year's worksheet ..... (c) 314

(d) **Contributions recovered last year.** Subtract line (c) from line (b) ..... (d) 686

(e) **This year's unrecovered contributions.** Subtract line (d) from line (a) ..... (e) 6,314

(f) **Contributions to IRA during current tax year.** Do not include tax-free rollovers ..... (f) _____

(g) **Total unrecovered contributions.** Line (e) plus line (f). Enter here and on Part I, line 4b ..... (g) 6,314

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Recordkeeping

Keeping records will help you prepare a complete and accurate tax return and pay the correct amount of New Jersey tax on income from your IRA.

Contributions. It is very important to keep any statements that show contributions made to your IRA. You will need this information when you start to make withdrawals. You may have to pay more tax than necessary if you cannot determine the amount in your IRA on which New Jersey income tax has already been paid.

Income Statements. Keep all the statements from your IRA showing the amounts you have received from the plan.

Tax Returns and Worksheets. Keep copies of the tax returns you have filed and the income tax instruction booklet as part of your records. You may need information from the return or from the IRA Worksheet or other worksheets in the instruction booklet to prepare future tax returns. This information is also necessary if you file an amended return. Copies of your returns and other records can be helpful to your surviving spouse/civil union partner, or the executor or administrator of your estate.

For More Information

By Phone

- Call the Division of Taxation's Customer Service Center at **609-292-6400.**
- Text Telephone Service (TTY/TDD) for Hard-of-Hearing Users: **1-800-286-6613** (toll-free within NJ, NY, PA, DE, and MD) or **609-984-7300**. These numbers are accessible *only* from TTY devices. Submit a text message on any tax matter and receive a reply through NJ Relay Services (711).

Online

- Division of Taxation Web site: **www.state.nj.us/treasury/taxation/**
- E-mail: **nj.taxation@treas.state.nj.us**
- Subscribe to *NJ Tax E-News,* the Division of Taxation's online information service, at: **www.state.nj.us/treasury/taxation/listservice.shtml**

In Writing

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Forms and Publications

- Visit the Division of Taxation's Web site:
  Forms — **www.state.nj.us/treasury/taxation/forms.shtml**
  Publications — **www.state.nj.us/treasury/taxation/pubs.shtml**
- Call NJ TaxFax at **609-826-4500** from your fax machine's phone.
- Call the Forms Request System at **1-800-323-4400** (within NJ, NY, PA, DE and MD) or **609-826-4400** (Touch-tone phones only) to have printed forms or publications mailed to you.
  Note: Due to budgetary constraints, supplies are limited and only certain forms and publications can be ordered through this System.

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