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Social Security Benefit Reductions Affecting Government Employees

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In Ohio, state and local government employees generally contribute to a state retirement system, rather than Social Security, for their government service. The state retirement systems provide a number of benefits, including retirement, disability, and survivor benefits. Government employees who have sufficient private sector service, or have a spouse with that service, may also qualify for a Social Security benefit. In most cases, however, federal law causes a reduction in any Social Security benefit as a consequence of receiving a retirement or disability benefit from one of Ohio's state retirement systems.

In Ohio, state and local government employees generally do not participate in Social Security for their government service.

Two provisions of federal law cause a reduction in the Social Security benefit payable to a recipient of a retirement or disability benefit from an Ohio retirement system:

- The **Windfall Elimination Provision** reduces the Social Security benefit that is based on an individual's own earnings record.
- The **Government Pension Offset** reduces, and may eliminate, the Social Security benefit based on a spouse's earnings.

Federal law causes Social Security benefits to be reduced if a recipient also receives a state retirement system benefit for service not covered by Social Security.

Background – Social Security coverage of state and local government employees

To be eligible to receive a Social Security retirement benefit, an individual must meet both of the following requirements:[1]

(1) Have been employed full-time and have contributed to the Social Security system (in the form of a Social Security payroll tax) for at least ten years or have the equivalent of ten years of full-time employment;[2]

(2) Have attained full retirement age.[3]

When it was enacted in 1935, the Social Security Act did not provide coverage for state and local government employees. A number of states and municipalities already had retirement systems for their employees and there was a question of whether the federal government had the authority to impose a tax on state and local governments.[4] As a result, state and local government employees were initially excluded from Social Security and did not pay Social Security taxes imposed by the Federal Insurance Contributions Act (FICA). This continues for Ohio retirement system members, but those hired or rehired after March 31, 1986, are required to pay the Medicare tax.[5]

State election of Social Security coverage

States have been given the option of having their state and local government employees covered by Social Security. Ohio has chosen not to have them covered.

Because some states did not have their own retirement systems, Congress amended the Social Security Act in 1950 to allow a state to elect Social Security coverage for some or all of the state's public employees. Section 218 of the Act permits a state to voluntarily enter into a "218 Agreement" under which the federal government agrees to cover the state's public employees under Social Security and the state and local governments and their employees are subject to FICA taxes.[6] Once made, an agreement to cover a type or group of employees cannot be terminated or modified to exclude those employees in the future.[7]

Ohio's 218 Agreement (negotiated in the late 1950s) exempts members of the state's retirement systems from contributing to Social Security for service for which they contribute to a state retirement system. Seven states – Ohio, California, Colorado, Illinois, Louisiana, Massachusetts, and Texas – together account for nearly 70% of the non-Social Security covered payroll in the U.S. In Ohio, less than 5% of state and local government employees are covered by Social Security.[8]

Since Ohio's state retirement system members and their employers have not contributed to Social Security, members do not receive Social Security benefits for employment covered under a state retirement system. However, a retirement system member may have contributed to Social Security for employment outside of government service. A member also may be eligible for spousal or survivor benefits by reason of a spouse's employment in a position covered by Social Security. If a retirement system member receives a state retirement or disability benefit and is also eligible for a Social Security benefit because of the member's own Social Security covered employment or a spouse's covered employment, it is likely that the federal Windfall Elimination Provision or Government Pension Offset will reduce that Social Security benefit.

Windfall Elimination Provision

Social Security low-income benefits

Social Security is designed to provide proportionally higher benefits to lower paid workers. This is accomplished through the formula used to calculate benefits. Very generally, a two-step process determines Social Security benefits. In the first step, Social Security calculates the average lifetime earnings of the worker, adjusted for average wage growth.[9] In the second, the worker's average lifetime earnings are divided into three earning groups and each earnings group is multiplied by a different percentage, with the highest percentage applied to the lowest earnings. The resulting amounts are combined to determine the monthly Social Security payment. Because a higher rate is applied to lower earnings, lower income workers receive a greater per-dollar return on their earnings than higher income workers.[10]

In determining a benefit for 2016, Social Security multiplied the first $856 of average monthly earnings by 90%, the next $4,301 by 32%, and any over $5,157 by 15%.[11] The result is that a worker with average earnings of $3,000 per month received a benefit that equals nearly 50% of the worker's pre-retirement earnings ($1,456), while a worker with average earnings of $8,000 per month received approximately 30% ($2,573).

According to the Social Security Administration, the Windfall Elimination Provision was enacted to prevent government employees from unfairly benefiting from the provisions aimed at low-income workers.[12] The federal government found that some employees worked both under a state retirement system and part-time or for a period in a position covered by Social Security. In retirement, the former employee would receive a state retirement benefit and also a Social Security benefit that was artificially inflated and did not reflect the employee's actual lifetime earnings. In response, Congress enacted the Windfall Elimination Provision as part of the 1983 Amendments to the Social Security Act.[13]

Reduction in benefits

The Windfall Elimination Provision reduces the Social Security benefit earned through a government employee's *own* employment. The provision may affect an employee eligible to receive a benefit who contributed to Social Security for less than 30 years and is receiving a pension from the employee's own employment for which Social Security taxes were not withheld. Under the provision, a modified benefit formula is used to calculate the retired or disabled employee's Social Security benefit.[14]

Under the modified formula, the first $856 of the employee's earnings is multiplied by a percentage based on the number of years of the employee's Social Security participation. For those who work 20 years or less, 40%, rather than 90%, is used. The percentage rises by 5% per year of participation until it reaches 90% for 30 years of Social Security participation. The employee's Social Security benefit is lowered, but never totally eliminated. The reduction cannot exceed 50% of the pension earned from non-Social Security employment.[15]

As an example, assume an employee participating in a state retirement system also was employed in a position covered by Social Security for 20 years and had average indexed monthly earnings of $1,000. If not for the Windfall Elimination Provision, the employee would be

The Windfall Elimination Provision adjusts for the fact that Social Security benefits intended for low-income workers may be artificially inflated for government employees with part-time or temporary private sector employment.

Social Security provides a greater per-dollar return for low-income workers than for those with higher incomes.

The Windfall Elimination Provision modifies the Social Security benefit formula and lowers the benefit by up to 50% of the pension earned from non-Social Security employment.

eligible for a monthly Social Security benefit of $816 ($856 x 90% = $770 plus $144 x 32% = $46). However, because the employee receives a state pension and contributed to Social Security for less than 30 years, the provision reduces the benefit to $388 ($856 x 40% = $342 plus $144 x 32% = $46).

Refund of contributions

A state retirement system member who ceases to be a public employee due to termination of employment may apply for a refund of the member's contributions to the retirement system. The refund makes the member ineligible for a retirement or disability benefit. The Windfall Elimination Provision does not apply to a retirement system member who receives a refund *before* becoming eligible for retirement under a state retirement system. However, it does apply if the member receives a refund *after* having attained retirement eligibility, even though the refund makes the member ineligible for a retirement or disability benefit. The Social Security Administration considers a retirement system member eligible for a pension "the first month he or she meets all requirements for payment except for stopping work and applying for the payment."[16]

Government Pension Offset

The Government Pension Offset reduces the Social Security benefit received by a Social Security contributor's spouse or surviving spouse who is also receiving a government retirement benefit. The offset reduces the benefit earned by reason of *another* individual's employment in a position covered by Social Security.

"Dependent" benefits paid to an individual who is the spouse or surviving spouse (or in some circumstances, divorced spouse) of a worker were established in the 1930s to compensate those who stayed home to raise a family and were financially dependent on a working spouse.[17] The individual did not need to have made any contributions to Social Security to be eligible for these benefits. However, the Social Security Act has consistently required that an individual's Social Security spousal or survivor's benefit be offset dollar for dollar by the amount of any Social Security benefit earned by reason of the individual's own employment, the so-called "dual-entitlement provision."[18]

As initially enacted, the Social Security Act applied the dual-entitlement restriction only to individuals eligible for two Social Security benefits; it did not apply it to any outside government retirement benefits a spouse or surviving spouse might be eligible to receive. However, in 1977, Congress created the Government Pension Offset to reduce the Social Security benefit of a spouse or surviving spouse receiving a retirement benefit from a government pension.[19]

Reduction in benefits

The Government Pension Offset reduces the Social Security benefit received by the spouse or surviving spouse by two-thirds of the amount of any government retirement benefit for which the spouse or surviving spouse is eligible. For example, assume that a man worked in a position covered by one of the state's retirement systems and is receiving a $600 per month benefit from the retirement system. His wife worked in a position covered by Social Security. The wife dies and the man becomes eligible for a $500 per month survivor's benefit from Social Security. The man's state retirement system benefit *does not change*. However, the Social Security survivor's benefit is reduced to $100 per month. This is because the Social Security benefit is reduced by two-thirds of the retirement system benefit.[20] The offset will entirely eliminate a spouse's or surviving spouse's Social Security benefit if the Social Security benefit is equal to or less than two-thirds of the retirement system benefit.[21]

The offset applies only when the state retirement benefit is based on an individual's own work. A Social Security benefit received as a spouse or surviving spouse is not reduced because of a state retirement system survivor benefit. To alter the above example, assume that the man is eligible to receive a $600 per month Social Security benefit based on his deceased wife's employment and also is eligible for a $500 per month survivor benefit provided by the state retirement system. In this instance, the Social Security benefit is not reduced, so the man receives a total of $1,100 per month.[22]

Refund of contributions

The Government Pension Offset does not apply to a retirement system member who receives a refund of contributions to a state retirement system, as long as the refund is of only the member's contributions and any interest on those contributions and the member forfeits all rights to a future retirement or disability benefit. This is true regardless of whether the member is eligible for retirement under the state retirement system at the time of the refund. The offset does apply if the member receives a refund that consists of both the member's employee and employer contributions.[23] In Ohio, laws governing the Public Employees Retirement System and State Teachers Retirement System provide for "enhanced" refunds under which members with at least five years of service credit receive a refund that includes an amount from employer trust funds in addition to employee contributions and interest.[24] It appears that the enhanced refund would cause the offset to be applied even though the refund would make the member ineligible for a state retirement or disability benefit.

The Government Pension Offset may completely eliminate the Social Security survivor benefit of a state retirement system member.

The offset does not reduce a survivor's benefit that is earned by reason of another person's employment covered by a state retirement system.

Endnotes

1 42 United States Code (U.S.C.) 402(a), 414(a), and 416(l). For a brief explanation of benefit eligibility, see "Your Retirement Benefits," *Retirement Benefits*, Social Security Administration Pub. No. 05-10035, July 2016, www.ssa.gov/pubs/EN-05-10035.pdf.

2 The Social Security system uses "credits" to determine eligibility for retirement benefits, requiring a minimum of 40 credits to receive benefits. An individual earns credits based on yearly earnings, receiving one credit for a specified amount of earnings, up to a maximum of four credits per year. For 2016, the amount is $2,016. (*How You Earn Credits*, Social Security Administration Pub. No. 05-10072, June 2016, www.ssa.gov/pubs/EN-05-10072.pdf.)

3 The "full retirement age" is 65 for people born before 1938. Because of longer life expectancies, the Social Security law was changed to increase gradually the full retirement age until it reaches, for those born in 1960 or later, age 67. (Social Security Administration Publication No. 05-10035, July 2016.)

4 Barbara D. Bovbjerg, U.S. Government Accountability Office, "Social Security: Issues Regarding the Coverage of Public Employees," GAO-08-248T (November 6, 2007).

5 FICA establishes the tax used to fund Social Security programs. FICA taxes consist of a 6.2% Social Security tax and 1.45% Medicare tax imposed on both employees and employers ("Fact Sheet: 2016 Social Security Changes," Social Security Administration, 2016, www.ssa.gov/news/press/factsheets/colafacts2016.pdf).

6 42 U.S.C. 418 and "Social Security and Government Employers," *Federal-State Reference Guide*, IRS Publication 963, November 2014, www.irs.gov/pub/irs-pdf/p963.pdf.

7 "Social Security and Medicare Coverage," *Federal-State Reference Guide*, IRS Publication 963, November 2014.

8 Barbara D. Bovbjerg, U.S. Government Accountability Office, "Social Security: Issues Regarding the Coverage of Public Employees," GAO-08-248T (November 6, 2007).

9 This calculation is known as the average indexed monthly earnings (AIME).

10 "Windfall Elimination Provision," Social Security Administration Pub. No. 05-10045, January 2016, www.ssa.gov/pubs/EN-05-10045.pdf.

11 $856 + $4,301 = $5,157. These amounts are adjusted upward for inflation. (42 U.S.C. 415(a)(1) and Social Security Administration, "Your Retirement Benefit: How It's Figured," Social Security Administration Pub. No. 05-10070, January 2016, www.ssa.gov/pubs/EN-05-10070.pdf.)

12 "Windfall Elimination Provision," Social Security Administration Pub. No. 05-10045, January 2016.

13 42 U.S.C. 415(a)(7).

14 In general, the Windfall Elimination Provision may apply if an employee (1) is 62 or became disabled after 1985, and (2) became eligible for a monthly pension based on work in which Social Security taxes were not paid after 1985.

15 42 U.S.C. 415(a)(7)(B) and (D).

16 Social Security Administration, "RS 00605.364: Determining Pension Applicability, Eligibility Date, and Monthly Amount," Program Operations Manual System (POMS), effective July 8, 2016, https://secure.ssa.gov/apps10/poms.nsf/lnx/0300605364.

[17] 42 U.S.C. 402(b), (c), (e), and (f) and "Government Pension Offset," Social Security Administration Pub. No. 05-10007, July 2015, www.ssa.gov/pubs/EN-05-10007.pdf.

[18] Social Security generally does not permit an individual to receive two Social Security benefits; a survivor will receive only the larger of the benefits. With very few exceptions, an individual cannot simultaneously receive an old-age insurance benefit and a survivor or disability benefit from Social Security. (42 U.S.C. 402(k)(1), (2), (3), and (4).)

[19] Social Security Amendments of 1977. (42 U.S.C. 402(k)(5).)

[20] Two-thirds of $600 is $400; $500 (eligible survivor's benefit) - $400 (offset) = $100.

[21] "Government Pension Offset," Pub. No. 05-10007, July 2015, and Social Security Administration, "GN 02608.100: Government Pension Offset (GPO) Provision," Program Operations Manual System (POMS), effective June 21, 2016, https://secure.ssa.gov/apps10/poms.nsf/lnx/0202608100.

[22] A number of additional individuals are exempt from the Government Pension Offset, including (1) a state or local government employee whose government pension is based on a job for which Social Security taxes were paid on the last day of employment, which was before July 1, 2004, or during the last five years of employment if the last day of employment was July 1, 2004 or later, (2) an employee who received or was eligible to receive a government pension before December 1982 and meets all the requirements for Social Security spouse's benefits in effect in January 1977, or (3) an employee who received or was eligible to receive a federal, state, or local government pension before July 1, 1983, and was receiving one-half of his or her support from the spouse (42 U.S.C. 402 and "Government Pension Offset," Social Security Administration Pub. No. 05-10007, July 2015).

[23] Social Security Administration, "GN 02608.400: Determining Pension Applicability and Pension Amount," Program Operations Manual System (POMS), effective June 21, 2016, https://secure.ssa.gov/apps10/poms.nsf/lnx/0202608400#c2.

[24] R.C. 145.401 and 3307.563.

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