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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 Social Security benefits. In most cases, however, federal law causes a reduction in Social Security benefits as a consequence of receiving retirement or disability benefits from one of Ohio's state retirement systems.

There are two provisions of federal law that cause a reduction in the Social Security benefits payable to a recipient of retirement or disability benefits from an Ohio retirement system: the Windfall Elimination Provision and the Government Pension Offset. The Windfall Elimination Provision reduces the Social Security benefits that are based on a person's own earnings record. The Government Pension Offset reduces, and may eliminate, Social Security benefits based on a spouse's earnings.

Background--Social Security coverage of state and local government employees

When signing the Social Security Act, President Franklin Roosevelt said the "social security measure gives at least some protection to thirty million of our citizens who will reap direct benefits through unemployment compensation, through old-age pensions and through increased services for the protection of children and the prevention of ill health."¹ In August 2007, over 49 million individuals received Social Security old age, survivors, or disability insurance benefits.²

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

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.



Social Security retirement, survivor, and disability benefits are funded through the Old-Age and Survivors Insurance and Disability Insurance Trust Funds (OASDI) and provided to those who meet eligibility requirements.

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.

To be eligible to receive a Social Security retirement benefit, an individual must both:³

(1) Be employed full-time and contribute to the Social Security system (in the form of a Social Security payroll tax) for at least ten years or, for those employed part-time, have the equivalent of ten years of full-time employment;

(2) Have attained full retirement age.⁴

Members of Ohio's state retirement systems are ineligible to receive Social Security benefits for their government service because they do not contribute to the Social Security system for service covered by one of the state retirement systems.

When enacted in 1935, the Social Security Act⁵ did not provide coverage for state and local government employees. The two main reasons for this were that numerous states and municipalities already had retirement systems and there was a concern about whether the federal government had authority to impose a tax on state and local governments.⁶ 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).⁷

State election of Social Security coverage

Because some states did not have their own retirement systems, Congress amended the Act in 1950

to provide a mechanism for a state to elect Social Security coverage for the state's employees.⁸ Provided under Section 218 of the Act, and known as "Section 218 Agreements," a state may voluntarily enter into an agreement under which the federal government agrees to cover the state's employees under Social Security and the state and its employees are subject to FICA taxes.⁹ Once made, an agreement to cover a class or group of employees cannot be terminated or modified to exclude that class of employees in the future.¹⁰

Each state has a Social Security administrator to oversee Social Security programs in the state. According to Ohio Social Security Administrator David Breckenridge, Ohio's Section 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.¹¹ State and local government employees in Ohio, California, Colorado, Illinois, Louisiana, Massachusetts, and Texas together account for 75% of the non-Social Security covered payroll in the United States.¹²

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, retirement system members may have contributed to Social Security for employment outside of government service. Or a



member 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 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 higher rates of return 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 inflation.¹³ In the second, average lifetime earnings are divided into three earning groups, each of which receives a different rate of return. The lower amounts receive a greater return, providing lower-income workers a greater per-dollar return on their earnings than higher-income workers.

In determining the actual benefit for 2007, for example, Social

Security multiplies the first \$680 of average monthly earnings by 90%, the next \$3,420 by 32%, and any average monthly earnings over \$4,100 by 15%.¹⁴ This formula is tilted toward benefiting low-income workers; it results in low-income workers receiving a benefit that equals about 55% of the workers' pre-retirement earnings while the average replacement rate for a typical high-income worker is approximately 25%.¹⁵

According to the Social Security Administration, the Windfall Elimination Provision was enacted to prevent federal and state employees from unfairly benefiting from provisions aimed at low-income workers.¹⁶ 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. The Social Security benefit was artificially inflated and did not reflect actual lifetime earnings. In response, Congress enacted the Windfall Elimination Provision as part of the 1983 Amendments to the Social Security Act.¹⁷

Reduction in benefits

The Windfall Elimination Provision reduces the benefit earned through a government employee's own employment. The provision affects employees eligible to receive Social

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%.

The Social Security "dual entitlement" provision prohibits an individual from receiving any two Social Security benefits at the same time.

Security benefits who contributed to Social Security for less than 30 years and are receiving pensions from their own employment for which Social Security taxes were not withheld. Under the provision, a modified benefit formula is used to calculate the amount of the retired or disabled employee's benefit.¹⁸

Under the modified formula, rather than using 90% of the first \$680 to calculate the benefit, a percentage based on the number of years of Social Security participation is used. 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 Social Security benefit is lowered, but never totally eliminated, under the provision; an employee subject to the provision receives no less than 50% of the Social Security benefit the employee would otherwise receive.¹⁹

As an example, assume an employee participating in a state retirement system is eligible to receive a \$500 per month retirement benefit. This employee also was employed in a position covered by Social Security for 20 years and had average indexed monthly earnings of \$1,000. But for the windfall elimination provision, the employee would be eligible for a monthly Social Security benefit of \$714 ($\$680 \times 90\% = \612 plus $\$320 \times 32\% = \102). However, because the employee receives a state pension, the provision reduces the benefit to \$378 ($\$680 \times 40\% = \272 plus $\$320 \times 32\% = \102).

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 federal or state retirement benefit. The offset reduces the benefit earned by reason of *another* person's employment in a position covered by Social Security.

"Dependent" payments (benefits for a spouse or surviving spouse) were established in the 1930s to compensate spouses or survivors who stayed home to raise a family and were financially dependent on the working spouse.²⁰ The spouse or surviving spouse 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 a person's Social Security benefit as a spouse or survivor be offset dollar for dollar by the amount of any Social Security benefit earned by reason of the spouse's or surviving spouse's own employment, the so-called "dual-entitlement provision."²¹


As initially enacted, the Social Security Act applied the dual entitlement restriction only to those eligible for two Social Security benefits; it did not apply it to any outside federal or state pension benefits a spouse or surviving spouse might be eligible to receive. In 1977, however, 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.²²

The offset causes the Social Security benefit received by the spouse or surviving spouse to be reduced by two-thirds of the amount of any federal or state 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 under 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.²³ Mathematically, if the state

retirement benefit is approximately 125% or more of the Social Security benefit, the Social Security benefit will be entirely eliminated. If a member takes a retirement allowance as a lump-sum annuity, Social Security will still calculate the reduction as if the member had elected to receive a monthly benefit.²⁴

The offset applies only when the state benefit is based on a person's own work. Social Security benefits received as a spouse or surviving spouse are 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 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.²⁵ 

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 Franklin D. Roosevelt, "Presidential Statement Signing the Social Security Act," August 14, 1935. <http://www.ssa.gov/history/fdrstmts.html#signing>, visited November 16, 2007.

² Social Security Administration, "OASDI Monthly Statistics, August 2007 OASDI Benefits in Current Payment Status," Table 1. http://www.ssa.gov/policy/docs/StatComps/oasdi_monthly/2007-08/table01.pdf (released September 2007).

³ 42 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 Publication No. 05-10035, January 2007. <http://ssa.gov/pubs/10035.pdf>.

⁴ The "full retirement age" is 65 for people born prior to 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, January 2007.)



⁵ “The Social Security Act of 1935,” Pub. L. No. 74-271, 49 Stat. 620.

⁶ Barbara D. Bovdjerg, United States General Accounting Office, “Social Security: Issues Relating to Noncoverage of Public Employees,” GAO-03-710T (May 1, 2003).

⁷ 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: 2007 Social Security Changes,” Social Security Administration, 2007. <http://www.ssa.gov/pressoffice/factsheets/colafacts2007.pdf>, visited, October 23, 2007. Ohio retirement system members hired or rehired after March 31, 1986 are required to pay the Medicare tax.

⁸ 42 U.S.C. 418.

“Social Security and Medicare Coverage,” *Federal-State Reference Guide*, IRS Publication 963, revised October 2006. <http://www.irs.gov/pub/irs-pdf/p963.pdf>, visited October 23, 2007.

⁹ “Determining Worker Status,” *Federal-State Reference Guide*, IRS Publication 963, revised October 2006. <http://www.irs.gov/pub/irs-pdf/p963.pdf>, visited October 23, 2007.

¹⁰ “Determining Worker Status,” *Federal-State Reference Guide*, IRS Publication 963, revised October 2006. <http://www.irs.gov/pub/irs-pdf/p963.pdf>, visited October 23, 2007.

¹¹ Ohio Social Security Administrator David Breckenridge, telephone conversation August 8, 2005.

¹² Barbara D. Bovdjerg, United States General Accounting Office, “Social Security: Issues Relating to Noncoverage of Public Employees,” GAO-03-710T (May 1, 2003).

¹³ This calculation is known as the Average Indexed Monthly Earnings (AIME).

¹⁴ $\$680 + \$3,420 = \$4,100$. These amounts are adjusted upward for inflation. Social Security Administration, “Your Retirement Benefit: How it is Figured,” Social Security Administration Pub. No. 05-10070 (January 2007); 42 U.S.C. 415(a)(1).

¹⁵ Social Security Administration, “Windfall Elimination Provision,” Social Security Administration Pub. No. 05-10045 (January 2007).

¹⁶ Social Security Administration, “Windfall Elimination Provision,” Social Security Administration Pub. No. 05-10045 (January 2007).

¹⁷ 42 U.S.C. 415(a)(7).

¹⁸ In general, the Windfall Elimination Provision may apply if an employee (1) is 62 or over after 1985, or became disabled after 1985, and (2) is eligible for a monthly pension based on work in which Social Security taxes were not paid after 1985.

¹⁹ 42 U.S.C. 415(a)(7)(B).

²⁰ 42 U.S.C. 402(b), (c), (e), and (f). Dependent payments are also available to certain divorced spouses.

²¹ Social Security generally does not permit an individual to receive two Social Security benefits; a survivor will receive only the larger of the benefits. 42 United States Code 402(k)(1), (2), (3), and (4) contain restrictions, with very few exceptions, on any individual receiving simultaneously an old-age insurance benefit and a survivor or disability benefit from Social Security.

²² Social Security Amendments of 1977, Pub. Law 95-216 91, Stat. 1509. (42 U.S.C. 402, subsection (k)(5).)

²³ Two-thirds of \$600 is \$400; \$500 (eligible survivor’s benefit) - \$400 (offset) = \$100.



²⁴ Social Security Administration, “Government Pension Offset,” Social Security Administration Pub. No. 05-10007 (2007). www.ssa.gov/pubs/10007.html.

²⁵ 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 Social Security Administration, “Government Pension Offset,” Social Security Administration Pub. No. 05-10007 (2007).

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