# PLANNING MAY BE POSSIBLE WITH THE WINDFALL ELIMINATION PROVISION AND THE GOVERNMENT PENSION OFFSET

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## ABSTRACT

The *Social Security Amendments of 1983* made comprehensive changes to the United States' Social Security System. Two changes—the Windfall Elimination Provision and the Government Pension Offset— deal primarily with government employees who, for a substantial part of their working lives, collected compensation for which no Social Security contributions were made. Even though these provisions were passed in 1983, individuals frequently learn about them at or near retirement when it may be too late to plan. This paper describes the effects of these provisions and investigates possible planning opportunities and pitfalls for affected individuals.

## INTRODUCTION

Social Security benefits are determined based on one's earnings that were subject to the old-age and survivors' disability levy during his or her best 35 working years. Instead of being linear in nature, the benefits decline as a percentage--from 90 percent, to 35 percent, to 15 percent--of covered compensation as the amount of the compensation increases. Those government employees who do not contribute on their government compensation, might qualify for Social Security benefits from other employment, either part-time or for other periods of time. Since they often have lower average earnings, they benefit because a higher percentage benefit applies to a larger portion of their earnings. The *Social Security Amendments of 1983* [4] require that in most cases a lower percentage, usually 40 percent, will apply at the lower levels of income to which the 90 percent rate might have applied.

A different provision, the Government Pension Offset, reduces one's spousal or widow(er)s benefit under Social Security. The benefit one is otherwise entitled to is reduced by two-thirds of any government pension he or she receives based on your earnings that were not subject to OASDI.

## EFFECT OF EARNINGS ON SOCIAL SECURITY BENEFITS

There is currently a direct, although not necessarily proportional, relationship between one's reported earnings and the eventual social security benefit she/he receives. The benefit is based on one's last 35 years of reported earnings, adjusted for inflation. The retirement benefit, called the primary insurance amount, is described on the Social Security Administration website (SSA.gov) as follows [8] (This research does not consider the effect of the income tax on the Social Security benefit under § 86):

The "primary insurance amount" (PIA) is the benefit (before rounding down to next lower whole dollar) a person would receive if he/she elects to begin receiving retirement benefits at age-62 (or year of disability or death prior to age-62). The two places where the percentages used to calculate the benefit change are called the PIA formula bend points. The PIA is the sum of the amounts determined after applying three separate percentages on portions of average indexed monthly earnings. The portions depend on the *year* in which a worker attains age 62, becomes disabled before age 62, or dies before attaining age 62. For 2009 these portions are the first $744, the amount between $744 and $4,483, and the amount over $4,483. These dollar amounts, $744 and $4,483, are the "bend points" of the 2009 PIA formula. For annuitants who reached age-62 in a year prior to starting benefits, the PIA is increased for cost of living adjustments in intervening years (for example, if one reached age-62 in 2008 and retires in 2009, the COLA is 5.8 percent).

**PIA Formula**

For an individual who first becomes eligible for old-age insurance benefits or disability insurance benefits in 2009, or who dies in 2009 before becoming eligible for benefits, his/her PIA will be the sum of:

(a) 90 percent of the first $744 of average indexed monthly earnings, plus
(b) 32 percent of average indexed monthly earnings from $744 to $4,483, plus
(c) 15 percent of his/her average indexed monthly earnings over $4,483.
Rounded to the next lower multiple of $0.10.

The following table, extracted directly from SSA.gov, illustrates how the current bend points were derived from those that were set for 1979. The bend points are simply adjusted for inflationary increases in the average wage rates.

**Determination of the PIA bend points for 2009**

| **Amounts in formula** | **Average wage indices** | **Bend points for 1979** |
|---|---|---|
| | For 1977: 9,779.44<br>For 2009: 40,405.48 | First: $180<br>Second: $1,085 |
| **Computation of bend points for 2009** | **First bend point** | **Second bend point** |
| | $180 times $40,405.48 divided by $9,779.44 equals $743.70, which rounds to $744. | $1,085 times $40,405.48 divided by $9,779.44 equals $4,482.87, which rounds to $4,483. |

To determine one's primary insurance amount, i.e., her basic Social Security benefit at normal retirement age (i.e. 66 years of age for those born from 1943 to 1954), one simply finds her average "indexed monthly earnings" (recall that this is the average for the highest 35 years). For a beneficiary whose "indexed monthly earnings" is $5,000, or $60,000 annually, and who reaches age-62 in 2009, the primary insurance amount would be approximately $1,943 per month [$744 x 90% + ($4,483 - $744) x 35% + ($5,000 - $4,483) x 15%], or $23,321 annually.

Although the primary insurance amount is always determined at age-62 (earlier for those dying or becoming disabled before age-62), not everyone retires at age-62. However, if one does retire at age-62, there is a penalty (a benefit reduction). Although generalization is nearly impossible, the following are observations about how the retirement annuity for one turning age-62 in 2009 (i.e., born in 1947) is determined with reference to the primary insurance amount.

- If the annuitant retires (i.e., starts collecting benefits) at exactly age-62, the annuity is discounted 25 percent. For our annuitant, the monthly benefit is $1,457 ($1,943 x 75%). The penalty is reduced for each month that the annuitant waits past age-62 until normal retirement age. Further, if one who retires early has earned income that exceeds $14,160 in 2009, the retirement annuity is decreased by one-half of the excess. A different formula applies in the year the annuitant reaches normal retirement age (for the months prior) and there is no reduction after reaching normal retirement age.
- If one retires exactly at normal retirement age (66 years of age for those born between 1943 and 1954) she gets the full benefit. The benefit is the primary insurance amount adjusted for the wage-based cost of living adjustments (COLAs) for the four years between 2009 and retirement (2010 to 2013). The COLAs are announced annually. Most recently they were 2.3 and 5.8 percent for 2007 and 2008, respectively.
- For those retiring after their full-retirement age (i.e., delayed retirement), the benefit is further adjusted for the COLAs, plus a delayed retirement credit of 8 percent per annum, but there is no delayed retirement credit after age-69.

For those who are older or younger than 62 in 2009, these effects, and others, can be found at www.ssa.gov [4].

Caution must be exercised for married taxpayers. A qualifying person (generally one who is married, or in the case of an ex-spouse one who was married to an annuitant for at least 10 years) whose personal benefit is less, receives a Social Security benefit equal to 50 percent of that spouse's (or ex-spouse's) benefit [4]. Planning can also be more difficult since upon a spouse's death (or in the case of an ex-spouse where the marriage must have lasted 10 years), the surviving spouse or ex-spouse receives the decedent's benefit if it is larger than his own (i.e., benefits are not reduced if there is another spouse or ex-spouse receiving survivor benefits related to the same decedent).

## WINDFALL ELIMINATION PROVISION

Many government and foreign employers provide retirement programs that are substantially equivalent to Social Security. These programs vary as to the amounts of employee contributions and benefits. Since such programs provide base retirement benefits, to allow employees who also have social security participation would represent somewhat of a "windfall." Generalization as to the magnitude of this windfall is difficult or impossible. In a "one size fits all" approach, employees who received compensation that was not covered by social security must replace the 90 percent factor in the PIA with 40 percent. This is referred to as the 'windfall elimination provision [6]."

This windfall elimination provision does not apply to any worker who has substantial social security earnings in 30 years (phased in if earnings are substantial in between 21 and 29 years). Substantial earnings for 2009 were $19,800, which were indexed for inflation each previous year (for 1937 to 1950, for example, the threshold was $900).

This reduction in benefits can be devastating for workers with extremely low benefits from their employers' plans. To protect these individuals, there is a guarantee, in that the reduction in benefits

cannot be more than one-half of the retirement benefit received from the retirement plan based on non-social security earnings.
The windfall elimination provision does not apply to survivors' benefits and certain other individuals. For example, it does not apply to persons reaching age-82 in 2009 or earlier.

## GOVERNMENT PENSION OFFSET

Married persons, and formerly married persons, in many cases may receive social security benefits on their own account or survivors' or widow(er)s' benefits. Essentially, the larger, but not both, is generally claimed. In principal, some argue that the widow(er) or survivors's benefit are offset by the recipients' own benefits.
To allow benefits from a government's social security substitute plan to be received in addition to survivors' or widow(er)s' social security benefits would be a windfall of another kind. To prevent this perceived inequity, the government pension offset was instituted. This provision reduces the survivors' or widow(er)s' benefit by two-thirds of the retirement benefits from his or her federal, state, or local government plan that was not covered by social security [5].

## PLANNING

Planning for the provisions discussed above can be difficult to impossible. It is also even more complicated if the worker is not vested in social security. Generally, vesting requires that one have 40 (less in the case of death or disability) quarters of coverage, also called "credits [7]." For 2010, a credit is earned if one has earnings of $1,120. No more than four credits can be earned in a year [8]. If one is not fully insured, a question arises as to whether they should work to become vested.
The answer is not always readily apparent. If one takes steps to qualify, the benefit may determined using the 40 percent factor instead of the 90 percent factor (below the first bend point). But, one's own benefit is unreduced under the pension offset provision, where a widow(er)'s benefit is reduced.
If one is considering steps to assure being fuly insured, he or she may change jobs or careers before it is too late. Here it is important to weight the gained social security benefit against the amount of the alternate plan benefit that is lost. These estimates may be unreliable and one may never reach the required threshold.
Another possible strategy is to supplement one's income with qualified earnings from a second job or through self-employment income. These may be fruitful, especially if one has the time for the extra activities or can shorten his or her time commitment at the main job.
Assessing these alternative strategies is simply a cost and benefit analysis. One must ask how good the government pension is and how it grows.
Many who have been in the alternate system for extended periods will simply bite the bullet and stay on course. They can, if the government pension is insufficient, use alternate savings programs, including qualified plans in the form of cash or deferred arrangements (CODAs) or IRAs, etc.

## CONCLUSIONS

The windfall elimination provision and the pension offset provisions were responses to perceived "windfalls." They are, in a way, one size fits all provisions. Although they reduce the possible windfalls, they may not be equitable to all who are affected.

Ideally, one considers these provisions when accepting employment under a government plan, but many simply do not consider retirement at early ages and others are unaware of these provisions. Other may not feel that they have alternative employment available. These are sunk costs.

At whatever point in life one is considering his or her options, the relevant costs and benefits should be considered. In some way, the costs should include financial and nonfinancial costs.

## REFERENCES


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[3] Kilgour, John, "Public Sector Retiree Benefits in California: Problems and Solutions," **Compensation and Benefits Review 2009**, 41: 27-32.

[4] ***Social Security Amendments of 1983*** (P.L. 98-21, H.R. 1900, April 20, 1983).

[5] http://www.socialsecurity.gov/pubs/10007.html [Government Pension Offset].

[6] http://www.socialsecurity.gov/pubs/10045.html [Windfall Elimination Provision].

[7] http://www.socialsecurity.gov/OACT/ProgData/insured.html [Fully Insured].

[8] http://www.socialsecurity.gov/OACT/COLA/QC.html